UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

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

CITRUS BANK, N.A.

Movant

vs.

RICHARD BREEDEN, TRUSTEE and the
OFFICIAL COMMITTEE OF UNSECURED
CREDITORS

APPEARANCES:

MELVIN & MELVIN Attorneys for Citrus Bank, N.A. 217 S. Salina St. Syracuse, New York 13202	LOUIS LEVINE, ESQ. Of Counsel
SIMPSON, THACHER & BARTLETT Attorneys for Trustee 425 Lexington Avenue New York, New York 13202	WILLIAM RUSSELL, ESQ. Of Counsel JAMES GAMBLE, ESQ. Of Counsel

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

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

Presently before the Court is a motion filed by Citrus Bank, N.A. ("Citrus" or the "Bank") on April 19, 1996, seeking an order pursuant to section 554(b) of the Bankruptcy Code (11 U.S.C. §§ 101-1330) ("Code") requiring the trustee, Richard C. Breeden ("Trustee"), to abandon

the interest of the estate of The Bennett Funding Group, Inc. ("Debtor" or "BFG")[1] in certain equipment leases, lease payments, and underlying equipment; and pursuant to Code § 362(d) to terminate the automatic stay as against that property; and pursuant to Code § 363(c) for immediate segregation and accounting of certain property in which the Bank claims an interest ("Motion for Relief").

JURISDICTIONAL STATEMENT

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

BACKGROUND

The Bank's motion was preliminarily scheduled to be heard on May 5, 1996, and was adjourned several times thereafter. In the interim, on April 26, 1996, the Court *sua sponte* issued an Omnibus Order pursuant to Code § 362(e) deferring the final hearings on various lift stay

[1] On March 29, 1996 ("Petition Date"), the Debtor and three related corporate entities, namely Bennett Receivables Corporation, Bennett Receivables Corporation II, and Bennett Management and Development Corporation filed petitions for relief under chapter 11 of the Bankruptcy Code (jointly "Bennett debtors"). On April 18, 1996, the Trustee was appointed by the U.S. Trustee pursuant to Code § 1104 and the appointment was approved by the Court that same day.

motions, including the Bank's, until August 15, 1996.[2] That Order has been extended *sua sponte* from time to time without objection from any party in interest.

On May 20, 1996, the Court signed an Order granting the Bank provisional relief which required the Trustee to deposit into an account all monies received or collected on lease contracts in which the Bank claims an interest, and further enjoined the Trustee from using, spending, encumbering, selling, leasing, disposing of, or transferring any of those monies ("Segregation Order"). The Segregation Order required the Trustee to provide the Bank with an accounting of the monies collected both pre- and postpetition, and also granted the Bank interim adequate protection in the form of a "lien to the extent that it had a lien prepetition in and upon all Citrus Cash Collateral owed or earned or arising or coming into existence on or after March 29, 1996, and in and upon all monies in the Account consisting of Citrus Cash Collateral whenever acquired or deposited."

On July 15, 1996, the Trustee filed opposition to the Bank's Motion for Relief. In addition, pursuant to the Court's Memorandum-Decision, Findings of Fact, Conclusions of Law and Order, entered October 22, 1996, *see In re Bennett Funding Group, Inc.*, 203 B.R. 30 (Bankr. N.D.N.Y. 1996) ("October Decision"), the Trustee filed particularized responses to the Bank's motion on December 9, 1996.

On February 12, 1997, the Court issued an Order Scheduling Evidentiary Hearing and

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[2] In its 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 Trustee at this stage of the case . . ." which justified extending the time for the final hearing.

Requiring Presentation of Evidence by Declarations/Depositions in connection with the Bank's motion, which was later amended on February 25, 1997 ("Amended Scheduling Order"). The Amended Scheduling Order required each party to present the testimony of its witnesses through declarations/depositions, under penalty of perjury and otherwise admissible under the Federal Rules of Evidence, which would constitute the direct testimony of the offering party. As a condition of admissibility of such testimony, the declarant/deponent was required to be present at the hearing and subject to cross-examination. Each party was also afforded an opportunity to file evidentiary objections in connection with the declarations/depositions, as well as a pre-hearing memorandum of law.

The evidentiary hearing ("Hearing") on the Bank's motion was held in Utica, New York, on April 21, 1997. The matter was submitted for decision at the close of evidence that day.[3]

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[3] On April 23, 1997, the Court *sua sponte* entered an Order extending the date by which it was required to issue a decision on the Motion for Relief to sixty (60) days following the conclusion of the Hearing. Prior to June 21, 1997, the date on which a decision on Citrus' Motion for Relief was due pursuant to the foregoing Order, Marine Midland Bank ("Marine") filed a motion seeking reconsideration of a decision of this Court addressing many of the same factual and legal issues present in Citrus' Motion for Relief. By Order to Show Cause on *sua sponte* application of the Court, dated June 16, 1997, the Court ordered that the stay imposed pursuant to Code § 362(a) be continued in effect for Citrus' Code § 362(d) motion until fifteen days after the Court had an opportunity to hear Marine's motion for reconsideration. On June 26, 1997, the Court heard argument on Marine's motion, and on July 1, 1997, the Court entered a formal Order extending the date for written decision on Citrus' Motion for Relief to one not less than fifteen days following the hearing on Marine's motion.

On August 11, 1997, the Court issued a decision granting Marine's request for reconsideration. *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) ("Reconsideration Decision"), and on August 21, 1997 the Trustee filed a motion seeking to stay the issuance of any further decisions pending the appeal of the Reconsideration Decision. At a hearing held on August 26, 1997, the Court denied the Trustee's motion. The Court is now addressing Citrus' Motion for Relief.

FACTS

Prior to filing, the Debtor was in the business of originating, purchasing and selling commercial leases of copy machines and other office equipment. The Debtor financed its operations in part by compiling these leases into portfolios which were then sold or assigned to banks as collateral for loans. The Debtor sold[4] or collaterally assigned one lease portfolio to the Bank in connection with one financing transaction in which the Bank advanced to the Debtor the principal amount of $599,960.70. According to the Trustee, the outstanding loan amount as of the Petition Date totaled approximately $317,629. *See* Trustee's Exhibit K (Arcy Declaration), at exhibit F.

In connection with the transaction, the Debtor executed and delivered to the Bank, *inter alia*, a Promissory Note in the amount advanced, as well as an Assignment of Contracts pursuant to which the Debtor assigned to the Bank all of its right, title and interest in and to certain specified leases ("Leases"), together with "the equipment and the rent and payments provided therein . . . ." *See* Citrus' Exhibits 4, 6. "Schedule A" attached to the Assignment of Contracts lists each assigned Lease by lease number, lessee, original term and monthly payment. A portion of the monthly payments was earmarked to be paid to the Bank according to the amortization

[4] The Court has previously indicated in connection with other bank motions in this case that it is not addressing the issue of whether the Debtor actually sold the leases to banks. Instead, this Decision addresses whether the Bank has a valid security interest in the leases in its portfolio, without prejudice to the parties to further address the issue of ownership at a later time if necessary.

schedule attached to the Promissory Note ("Schedule A Payments").[5] In addition, UCC-1 financing statements ("UCC-1's") were filed with the New York Department of State ("Secretary of State") and the Onondaga County Clerk's Office as to

> [a]ll of debtor's right, title and interest in and to the contracts set forth in Schedule "A" hereto annexed, and all substitutions and replacements thereto and all proceeds from the same exchange, collection or disposition thereof.

See Citrus' Exhibits 17, 18. Each UCC-1 identifies the "debtor" as "Aloha Leasing, A Div. of The Bennett Funding Group, Inc., Two Clinton Square, Syracuse, NY 13202." The UCC-1's are signed by representatives of both entities and include an attached schedule of leases identical to that attached to the Assignment of Contracts.

The Trustee has continued to collect the Lease Payments postpetition, and pursuant to the Court's Order of May 20, 1996, has segregated those monies and provided the Bank with various reports concerning the collections.

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[5] In connection with the transaction, the Debtor and the Bank entered into a Servicing Agreement under which the Debtor was to invoice the lessees on a monthly basis and collect the amounts due and owing under the contracts. *See* Citrus' Exhibit 9. Debtor was to remit all payments received from the lessees and due the Bank in accordance with the underlying documents. *See id.* at ¶1. The Debtor was to pay all taxes, assessments and other charges levied or assessed against the lease contracts or the collateral or equipment. *See id.* at ¶9. As has been previously indicated in connection with other bank motions in this case, the Court shall treat the Bank's Motion for Relief as seeking relief to enforce its interest only in what the Court has defined as the Schedule A Payments (hereinafter "Lease Payments"), and without prejudice to either party, will not at this time render a decision with respect to the balance of the monies received by the Debtor from the lessees on a monthly basis under the terms of the Leases (the difference between the amounts listed in the Amortization Schedule attached to the Promissory Note and the amounts listed in Schedule A attached to the Assignment of Contracts), including, *inter alia*, late charges and payments earmarked for third parties. The Court does note, however, that the Bank has indicated that it has "waived any interest it might otherwise claim in the 'pass-throughs' consisting of taxes and maintenance charges." *See* Citrus' Trial Memorandum of Law, at 6. The Court also will not address at this time the Bank's claim of a security interest in the equipment subject to the Leases.

ARGUMENTS

The Bank asserts that it is the owner of the Leases and the money paid pursuant thereto, and that it has succeeded to the Debtor's interest in the underlying equipment. Based on this, the Bank asserts that neither the Debtor nor the estate has any interest in the property at issue. Accordingly, the Bank requests pursuant to its motion for abandonment under Code § 554(b) that the Court direct the Trustee to abandon such property.

The Bank also maintains that it is entitled to relief under Code § 362(d) because its interest in the property at issue is not adequately protected, there is no equity cushion protecting its claim, and because the property in which the Bank asserts an interest is not necessary to a reorganization of the Debtor. *See* 11 U.S.C. §§ 362(d)(1), (d)(2).

The Bank argues that it has perfected its security interest in the Leases based on its possession of the ink-signed originals and by virtue of having filed financing statements in the Onondaga County Clerk's Office and with the Secretary of State. The Bank asserts a perfected security interest in the Lease Payments based on the filed financing statements and because the Lease Payments are identifiable cash proceeds. In the alternative, the Bank argues that even if there are no properly filed financing statements, its security interest in the Lease Payments was perfected pursuant to Code § 546(b) when it "seized" the Lease Payments by giving notice to the Debtor in the form of its Motion for Relief from the automatic stay.[6]

The Trustee and the Official Committee of Unsecured Creditors ("Committee") dispute

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[6] As a third alternative, the Bank asserts that Code § 361 authorizes the Court to grant an additional or replacement lien on postpetition proceeds of collateral in which a creditor has a prepetition perfected security interest.

the Bank's contentions, and more significantly, argue that since the Bank improperly filed its UCC-1 financing statements 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.," it is not entitled to relief because it has not perfected its security interest in the Leases/Lease Payments.[7] The Trustee further asserts that Code § 546(b) may not be used by the Bank to effectuate postpetition perfection of its interest in Lease Payments.

In the event that the Court determines that there is a basis to lift or modify the stay, the Trustee requests that the Court use its discretionary power to limit the scope of the Bank's security interest pursuant to Code § 552 based upon the "equities of the case." The Trustee asserts that this is warranted because (1) the Bank failed to act in a reasonably prudent manner in commencing and monitoring the transaction with the Debtor, and (2) in collecting the Lease Payments for the benefit of the Bank, the estate has incurred costs which should be reimbursed in the event that the Court determines that the Bank has a valid security interest in them.

DISCUSSION

Code § 362(e) requires an expedited hearing on a motion to lift the stay in the absence of compelling circumstances. At the same time, "[i]n reorganization cases, the stay is particularly

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[7] The Committee filed a trial memorandum of law on April 18, 1997. The objections of the Committee and the Trustee to the Bank's motion are substantially similar, and, except to the extent discussed herein, the Committee does not raise objections not also substantially raised by the Trustee. *See generally* Memorandum of Law Submitted by the Official Committee of Secured Creditors in Opposition to the Motion Filed by Citrus Bank for Relief from the Automatic Stay, filed April 18, 1997.

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, ed., 15th ed. 1997). The Bank's Motion for Relief pursuant to Code §§ 554(b), 362(d) and 363(c) was filed approximately three weeks after commencement of Debtor's case. The Court granted interim relief on May 20, 1996, in order to allow the Trustee an opportunity to establish some order from the initial chaos. This included the employment of Coopers & Lybrand, L.L.P., to perform forensic accounting work and to assist in the stabilization of the Debtor's operations. In the Court's view, to have granted any of the motions filed by more than ninety banks for stay relief in a piecemeal fashion early on in the case would have caused further disruption to the Debtor's operations to the detriment of all of the thousands of Debtor's creditors. Based on 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 Motion for Relief.

I. Motion for Abandonment

Pursuant to its motion for abandonment under Code § 554(b), the Bank asserts that it is the sole and exclusive owner of the Leases, all monies paid or owed pursuant thereto, and that it has succeeded absolutely to Debtor's interest in the equipment. The Bank therefore claims that neither the Debtor nor the estate has any interest in the Leases or the equipment. Based on this argument, the Bank requests that the Court issue an order requiring the Trustee to abandon the interest of the estate in the aforementioned property.

Under Code § 554(b), on the request of a party in interest and after notice and a hearing,

the court may order a trustee to abandon property of the estate that is burdensome or that is of inconsequential value and benefit to the estate. "Accordingly, abandonment may be ordered where the bankruptcy court finds either that: 1) the property is burdensome to the estate or 2) the property is both of inconsequential value *and* inconsequential benefit to the estate." *In re Beaudoin*, 160 B.R. 25, 31 (Bankr. N.D.N.Y. 1993) (citing *In re K.C. Machine & Tool Co.*, 816 F.2d 238, 245 (6th Cir. 1987). Code § 554(b) operates to divest control of certain property interests from the trustee if one of the above factors is found, and the interest then reverts to the debtor as though no bankruptcy had occurred. *See Dewsnup v. Timm (In re Dewsnup),* 908 F.2d 588, 590 (10th Cir. 1990), *aff'd*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992); *In re Manchester Heights Assocs., L.P.*, 165 B.R. 42, 44 (Bankr. W.D.Mo. 1994); *White v. Coon (In re Purco)*, 76 B.R. 523, 532 (Bankr. W.D.Pa. 1987). After abandonment the property again becomes subject to any party who can claim a possessory right to it. *See Manchester Heights,* 165 B.R. at 44.

Importantly, however, a motion for abandonment cannot be used to determine issues of ownership of property. As stated by Bankruptcy Judge William L. Norton, Jr.,

> [w]hile the Senate Report to § 554 (SRep. No. 95-989, 95th Congl, [sic] 2d Sess 92 (1978), U.S.Code Cong. & Admin.News 1978, p. 5787) indicates the abandoned property may be to a particular creditor, such notion conflicts with the limited purpose of § 554 and the requirement of Rule 7001(2) that requires adversary proceeding procedure, i.e.: plaintiff's complaint and defendant's answer, to determine the validity, extent and priority of a lien. Section 554 abandonment procedure is not intended to determine issues of ownership and possession of property. Thus the procedure of § 554 and Rule 6007 cannot be used to effect turnover, recovery or legal title or possession to any particular creditor.

First Carolina Fin. Corp. v. Trustee of Estate of Caron (In re Caron), 50 B.R. 27, 31-32 (Bankr.

N.D.Ga. 1984) (footnote omitted); *see Manchester Heights*, 165 B.R. at 44-45 (adopting *Caron* analysis); *In re R-B-Co., Inc.*, 59 B.R. 43, 45 (Bankr. W.D.La. 1986) (same). The Debtor disputes the Bank's claim that it owns the Leases, the proceeds and the equipment, and therefore to the extent that the Bank's motion for abandonment requires this Court to make determinations as to issues of ownership, the Court has already noted that this Decision shall not address such issues. *See In re Pepper Ridge Blueberry Farms*, 33 B.R. 696, 698 (Bankr. W.D.Mich. 1983) (indicating that Code § 554(b) abandonment proceeding may be used where there are no questions of law or fact implicated and when continued possession of the property by trustee would be unconscionable; otherwise, creditor should file motion for relief from stay or adversary complaint under Fed.R.Bankr.P. 7001).[8]

II. Analysis of Security Interest in the Leases and Lease Payments [9]

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[8] Over the course of this case, various banks have asserted an interest in personal property, whether it be a security interest or an ownership interest, including not only the leases and the income derived therefrom, but in some cases the equipment subject to the leases as well. In the matter *sub judice*, the Bank asserts that it is "the sole and exclusive owner of the [Leases], and all monies owed or paid pursuant thereto, and the Bank has succeeded absolutely to [D]ebtor's interest in the Equipment." *See* Citrus' Motion for Relief, filed April 19, 1996, at ¶11. The Bank argues as an alternative that it holds valid security interests in the Leases and the Lease Payments. *See generally* Citrus' Trial Memorandum of Law, filed April 11, 1997. In light of the Court's finding regarding abandonment and issues of ownership, this Decision shall focus on whether and to what extent Citrus has a security interest in the above-mentioned property.

[9] The Bank is domiciled in Florida, and 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, 496, 61 S.Ct. 1020, 1021-22, 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 the state in which it sits. *See, e.g., Compliance Marine, Inc. v. Campbell (In re Merritt Dredging Co., Inc.)*, 839 F.2d 203, 206 (4th Cir.), *cert. denied*, 487 U.S. 1236, 108 S.Ct. 2904,

A creditor generally is 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). The Bank asserts that it has a perfected security interest in the Leases and in the Lease Payments, which, as the Court indicated in an earlier decision in this case, are two separate types of collateral. *See In re Bennett Funding Group, Inc.*, 203 B.R. at 38.[10]

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101 L.Ed.2d 936 (1988). Other courts hold that a bankruptcy court must apply federal common law choice-of-law rules. *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) (stating that "[i]n federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the court should apply federal, not forum state, choice of law rules.") (citations omitted). The Court of Appeals for the Second Circuit found it unnecessary to resolve this issue in a case in which there was no difference between applicable federal and New York choice of law rules, both of which apply 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). This Court need not resolve the issue either, because it finds that under federal choice-of-law rules, New York would had a more significant interest in this matter than would Florida, given the fact that the Debtor is located in New York, the UCC-1's 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). Therefore, the Court shall apply New York law in determining the Bank's Motion for Relief.

The Court notes that section 1-105(1) of the New York Uniform Commercial Code ("NYUCC") allows parties to agree to the state law which will govern their rights and duties as long as the transaction at issue bears a reasonable relation to that state. Here, the Promissory Note and Assignment of Contracts provide that they are to be interpreted and enforced under Florida law. The issues before the Court, however, do not involve contract interpretation, but rather perfection of contractually created security interests. Under NYUCC § 1-105(2), parties are not free to choose a law of perfection, which is governed by NYUCC § 9-103. *See* NYUCC § 1-105(2); *Phillips v. Ball and Hunt Enters., Inc.*, 933 F.Supp. 1290, 1294 n.9 (W.D.Va. 1996) (indicating that choice of law provisions do not pertain to issues of perfection or nonperfection and stating that "UCC § 9-103 cannot be abrogated by agreement as it exists to protect the interests of third parties.") .

[10] In that decision, the Court set forth certain criteria with respect to perfection of a security interest in leases. For purposes of this Decision, the Court will assume the reader's familiarity with that discussion.

The parties do not appear to dispute that a majority of 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 National Westminster Bancorp v. ICS Cybernetics, Inc. (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 does assert that sixteen of the Leases in the Bank's portfolios are not for "specific goods" since they do not contain model and serial numbers identifying the goods/equipment. *See* Trustee's Particularized Response in Further Opposition to Citrus' Bank's Motion for Relief from the Automatic Stay ("Particularized Response"), filed December 9, 1996, at 3. The Bank disputes the Trustee's position, arguing that the equipment is identified by model and serial number on the leases and/or in the back-up material which the Debtor sent to the Bank. *See* Citrus' Trial Memorandum of Law, filed April 11, 1997, at 40; Citrus' Exhibit A (Declaration of Randy J. Riley), at ¶34.

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 itself is chattel paper, there is a requirement that there be evidence of *specific* goods. *See* NYUCC §9-105(b). Admittedly, goods/equipment that are "non-serialized" by definition cannot be identified by a serial number. Instead, there must be consideration given to the nature of the collateral and its description set forth in the leases on a case-by-case basis.

> "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, ... When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

See id. This Court has previously found that certain equipment schedules containing, *inter alia*, the amount and number of monthly rental payments for leased equipment constituted chattel paper. *See ICS Cybernetics*, *Inc.,*123 B.R. at 475-76. A determination of whether a lease transaction is evidenced by chattel paper is not necessarily limited to a review of equipment schedules, instruments or the lease itself, however, and it may include consideration of 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*, 111 B.R. at 515-516. 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 the challenged Leases and supporting documentation sufficiently identify the leased equipment or goods and are chattel paper.

NYUCC § 9-203(1) provides that a "security interest is not enforceable against the debtor or third parties . . . 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(3). At the Hearing, the Bank produced ink-signed originals

of all of the Leases. The Bank has also satisfied the second prong in that it has presented the Court with the Promissory Note executed by the Debtor which acknowledges the value given by the Bank in connection with the transaction. The parties do not appear to dispute that the Debtor had rights as lessor under the Leases at the time of the respective assignments. Therefore, the Bank has established that its security interest in the Leases has attached.[11]

A. Perfection in the Leases

A security interest in chattel paper may be perfected either by filing a financing statement, *see* NYUCC § 9-304, or by the secured party's taking possession of the chattel paper. *See* NYUCC § 9-305; s*ee also In re Keneco Financial Group*, 131 B.R. 90, 96 (Bankr. N.D.Ill. 1991).

1. *Perfection by Filing*[12]

With respect to perfecting by filing a financing statement, the evidence in the record indicates that BFG has a place of business in New York only in Onondaga County. Thus, if the Bank is to establish that it has a perfected security interest in the Leases by filing, it must show that it filed proper UCC-1's in both the Onondaga County Clerk's Office and with the Secretary

[11] There is no evidence that there were any substituted leases involved in the Bank's transaction, and therefore a discussion of whether a security interest can attach to such leases is unnecessary.

[12] NYUCC § 9-103(4) and § 9-103(3)(b) provide that with respect to a multistate transaction involving a non-possessory security interest in chattel paper, the law of the state where the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest. In this case the Debtor is located in New York, and therefore New York law governs with respect to the Bank's claim that it has a perfected security interest in the Leases by filing.

of State. *See* NYUCC § 9-401(c)*; John Deere Co. v. Pahl Constr. Co.*, 34 A.D.2d 85, 86, 310 N.Y.S.2d 945, 946 (4th Dep't 1970). The Trustee asserts that the Bank has not perfected its security interest in the Leases because the UCC-1 filed in Onondaga County identifies the "debtor" as "Aloha Leasing, a Div. of The Bennett Funding Group, Inc.," rather than as "The Bennett Funding Group, Inc." Although the UCC-1 filed with the Secretary of State also identifies BFG in this fashion, the Trustee focuses exclusively on the validity of the UCC-1 filed in Onondaga County, arguing that, as a result of the indexing system utilized by the Onondaga County Clerk, the UCC-1 does not sufficiently apprise the public of the Bank's security interest.

In the October Decision the Court included a lengthy discussion concerning whether a financing statement identifying the Debtor by its trade name "Aloha Leasing" and its corporate name "The Bennett Funding Group, Inc," was effective to perfect a security interest in the equipment 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." *Bennett Funding Group*, 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 those UCC-1's filed under the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc.," since both the corporate name and the Debtor's trade name should have been indexed as a single entry. In rendering its decision, however, the Court did not have the benefit of the testimony provided at the subsequent evidentiary hearing to the effect that the computer system utilized by the Onondaga County Clerk's office did not permit a full search of the text as it appeared in the "debtor box" on the financing statement. Instead, the indexing is purely alphabetical and requires exactness on a letter by letter basis. If one requests a search for UCC-1's filed in the

name of "Bennett Funding Group, Inc." at the Onondaga County Clerk's Office, the list which is generated only includes those financing statements which correctly spell out "Bennett Funding Group, Inc.," letter by letter. *See* Trustee's Exhibit I (Dacey Declaration), at exhibit H. If one wished a debtor's name to be cross-indexed so that it appeared in the list of "debtors" whose names begin with "B" as well as in the list of "debtors" whose names begin with "A," it was necessary to pay an additional fee in the Onondaga County Clerk's Office. No evidence was provided to the Court that a fee had been paid to have the Bank's financing statement cross-indexed under both the name of "Bennett Funding Group, Inc." and "Aloha Leasing."

It is now clear to the Court that a reasonably diligent search by a creditor in the corporate name of the Debtor would not have revealed the Bank's filed UCC-1 in the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." There has been no suggestion that this was the result of an error by the filing officer in the indexing of the UCC-1, nor has there been any suggestion that the Debtor conducted business solely under its trade name. In fact, all of the transactional documents offered by the Bank, including the Promissory Note and Assignments of Contracts, identified BFG by its legal name, The Bennett Funding Group, Inc. As a hypothetical lien creditor, the Trustee is deemed to have no knowledge regarding the Debtor's use of a trade name even though he may have actual notice as a result of his involvement in the management and operation of the Debtor. *See Northern Comm'l Corp. v. Friedman (In re Leichter),* 471 F.2d 785, 787 (2d Cir. 1972). As a result, the Trustee cannot be imputed with notice such that he would be expected to perform a UCC-1 search in the Onondaga County Clerk's Office under the name of "Aloha Leasing" rather than or in addition to a search under the name "Bennett Funding Group, Inc."

Therefore, 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 its October 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 the county in which BFG does business in this State. If Onondaga County 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 BFG's trade name would have had merit. Confronted with the actual operative facts, the Court must re-examine its position. Accordingly, the Court concludes that the UCC-1 filed by the Bank in the Onondaga County Clerk's Office under the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." was ineffective in that it 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 that "[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 the debtor's true name would uncover the filing."). A reasonable search for financing statements filed in the name of "Bennett Funding Group, Inc." would not have revealed financing statements filed under the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." Because the Bank did not file a proper UCC-1 in Onondaga County, it failed to perfect its security interest in the Leases by filing.

2. *Perfection by Possession*[13]

As noted earlier, as an alternative to filing a financing statement a secured party may perfect its security interest in chattel paper by taking possession of it. *See* Fla. Stat. ch. 679.305; *see also Keneco Financial Group*, 131 B.R. at 96. The Bank is in possession of the ink-signed original Leases and produced such leases at the Hearing. *See also* Citrus' Exhibit A (Declaration of Randy J. Riley), at ¶13. Based on the evidence presented, although the Bank has failed to file a proper financing statement, it has nonetheless perfected its security interest in the Leases by possession.

B. Perfection in Lease Payments[14]

Having concluded that the Bank perfected its security interest in the Leases solely by possession of the ink-signed originals, the Court must now consider whether the Bank also holds a security interest in the proceeds of those Leases which continues postpetition. The Lease Payments are "proceeds" of the Leases within the meaning of NYUCC § 9-306. *See* NYUCC § 9-306; *see also In re Funding Systems Asset Management Corp.*, 111 B.R. 500, 519 (Bankr. W.D.Pa. 1990) (citing *Feldman v. Philadelphia Nat'l Bank*, 408 F.Supp. 24, 37 (E.D.Pa. 1976)

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[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 § 9-104(4) and § 9-103(1)(b). Thus, Florida law governs with respect to the Bank's assertion that it perfected its security interest in the Leases by possession based on the Bank's continuous possession of the original Leases in its offices in Florida.

[14] NYUCC § 9-103 and § 9-104 make no reference to the choice of law applicable to the perfection of proceeds *per se*. In this case, the Debtor is located in New York and the Trustee has actual possession of the Lease Payments in New York. Furthermore, the Bank filed its Motion for Relief in this Court in New York State notifying the Trustee of its intent to pursue the Lease Payments. Therefore, the Court shall continue to apply New York law regarding the perfection of Lease Payments.

(rental 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 or the security interest in proceeds must be separately perfected as if the proceeds were the original collateral. *See* NYUCC § 9-306(3). As discussed above, the Bank failed to properly file a financing statement in the Onondaga County Clerk's Office in this case.

As an alternative to perfection of the Lease Payments by filing, however, the Bank expressly argues that it perfected its security interest in Lease Payments by taking constructive possession of them pursuant to Code § 546(b). Initially, the Bank asserts that the automatic stay does not apply to any action to perfect or continue the perfection of a security interest in property of the estate to the extent permitted by Code § 546(b). The Bank also claims that if such action requires a seizure of property which did not occur prior to bankruptcy, then seizure can be accomplished by "giving notice." It is the Bank's position that the filing on April 19, 1996, of its Motion for Relief from the automatic stay and the order requiring the Trustee to segregate and account for all proceeds of the lease contracts constituted the giving of notice to the Debtor such that it continued or maintained a perfected security interest in the Lease Payments.

The Court recently rendered a comprehensive analysis of this issue in ruling on a motion for reconsideration involving Marine Midland Bank. *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) (hereinafter "Reconsideration Decision") The Court will therefore incorporate that analysis into this Decision, and in so doing, will make reference to

arguments made by Marine and the Trustee regarding the application of Code § 546(b).[15] *Cf. Gins v. Mauser Plumbing Supply Co.*, 148 F.2d 974, 976 (2d Cir. 1945) (stating that "particular legal theories of counsel yield to the court's duty to grant the relief to which the prevailing party is entitled, whether demanded or not.").

1. *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 § 552(b)(1), which validates a postpetition security interest in, *inter alia*, proceeds, if the security agreement entered into prepetition extends to proceeds. Code § 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 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

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[15] For purposes of determining this issue, the Court notes that Citrus does not raise arguments relating to the application of Code § 546(b) that are significantly different from those made before the Court for Marine's motion for reconsideration.

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). Code § 546(b) 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. § 546(b). 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.

Marine maintained that "applicable law" within the meaning of Code § 546(b) includes NYUCC § 9-306, which, in the absence of bankruptcy, would allow Marine to perfect its interest in certain of the lease proceeds through possession.[16] Marine asserted that because it would have

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[16] 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 permits perfection either by seizure or by filing, and, therefore, that notice cannot be used to maintain perfection of a bank's security interest in lease payments. The Court rejected that argument. NYUCC § 9-305, as incorporated by NYUCC § 9-306(3)(c), clearly requires seizure in this instance.

been allowed to perfect its security interest in lease payments by seizure under state law, Code § 546(b) allows it to perfect its interest in the Lease Payments postpetition by giving notice to the Trustee. Marine, like Citrus, contended that the filing of its motion for relief pursuant to Code § 362(d) and § 363(e) constitutes 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 Reconsideration Decision, the Court found that because Marine did not perfect its security interest in its leases or lease payments by filing, it could perfect its security interest in the 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). The lease payments are cash proceeds in the form of money, an interest in which 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.

In the Reconsideration Decision, 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 therefore asserted that it has a perfected security interest in the lease proceeds dating from the time it perfected its security interest in the Leases by possession of the originals, which 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); *see also* Trustee's Trial Memorandum of Law, filed April 18, 1997, at footnote 29 (addressing Citrus' Motion for Relief and the Code § 546(b) argument). 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).

The Court found that it did not need to address the question of whether NYUCC § 9-306 allows for perfection to relate back. For the reasons set forth herein, resolution of that issue is not necessary in order to determine whether the Trustee is able to avoid Citrus' security interest in the Lease Payments.

Code § 546(b) has not been uniformly interpreted by the courts. A majority of the caselaw surrounding Code § 546(b) 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 decision of the United States Court of Appeals for the Second Circuit 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.").

2. *Lease 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* Amelia H. Boss, *Lease Chattel Paper: Unitary Treatment of a "Special" Kind of Commercial Specialty,* 1983 Duke L.J.

69 (1983). 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 . . .
>
> * * *
>
> [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 stemming from those Leases which are chattel paper 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 those Lease Payments.[17]

3. *Continuation of a 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 in 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

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[17] Pursuant to NYUCC § 9-306(2), the security interest in the Leases continues notwithstanding the conversion of the Leases into Lease Payments periodically. As one court has described the process, "the path from various forms of collateral to cash proceeds is a 'continuous and uninterrupted metamorphosis, through which the security interest remains intact.'" *See In re Barkley*, 31 B.R. 924, 927 (Bankr. W.D.Mich. 1983) (quoting *Klinger v. Pocono Internat'l Raceway,* Inc., 289 Pa. Super. 484, 433 A.2d 1357, 31 UCC Rep. 1223 (1981)).

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.) (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 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 Proceeds.'" *See In re The Bennett Funding Group, Inc.,* No. 96-61376, Adv. Pro. 96-70061, slip op. at 46 (Bankr. N.D.N.Y. Aug. 11, 1997) (quoting Affidavit in Support of Marine's Motion to Modify the Automatic Stay). Upon review of Citrus' Motion for Relief, the Court finds clear language indicating the intent to pursue recovery of the proceeds of the Leases, *see* Affidavit of Louis Levine, Esq., in support of Citrus' Motion for Relief, dated April 15, 1996, and the Court concludes that the Motion for Relief provided notice under Code § 546(b) to the Debtor of the Bank's intent to enforce its security interest in the Lease Payments generated and/or received subsequent to the filing of the Motion for Relief. This notice was effective to take possession of any *identifiable* Lease Payments received by the Debtor within ten days prior to

the date the Motion for Relief was filed on April 19, 1996, because the Lease Payments received during that period remained subject to the Bank's perfected security interest pursuant to NYUCC § 9-306(3).

The Trustee contended in the Reconsideration Decision 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. Thus, 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 the lease payments exist. Further, 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.

The Trustee's arguments might have had 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 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, Code § 546(b) is utilized here 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 Motion for Relief served as notice of the Bank's intent to seize all Lease Payments generated and/or received subsequent to its 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). The Bank asserts that BFG "kept records of all monies received on each individual [Lease] account . . . ." *See* Citrus' Trial Memorandum of Law, at 32. Furthermore, the Bank argues that pursuant to UCC § 9-205, a debtor's commingling of proceeds is permitted, and that cash proceeds remain

identifiable within the meaning of UCC § 9-306 even if commingled in a bank account with other monies. If secured proceeds have been spent, the Bank claims that a creditor will still have a perfected interest in the balance or a proportional part of the balance. *See id.* The Bank also refers to UCC § 9-306(4)(d) as recognizing that commingling does not destroy the secured character or identifiability of specific proceeds. The Bank asserts that this section of the UCC only affects a security interest in commingled funds which are actually present in the account at the time the petition was filed. *See id.*

In the Reconsideration Decision, the Court found that while lease payments were not rendered identifiable by virtue of the filing of Marine's motion for relief, certain lease payments were identifiable as a result of having been segregated by the Trustee pursuant to a segregation order. The Trustee argued, however, that the segregation order could not serve to render lease payments identifiable because the segregation order is a product of bankruptcy and cannot be construed to give a bank any greater rights than would exist under state law. The Trustee asserted that lease payments had been deposited into a "honeypot" of funds from various sources and, citing GILMORE, 2 SECURITY INTERESTS IN PERSONAL PROPERTY, §27.4 at 735-36 (1965), argued that once commingled in a debtor's bank account, proceeds lose their identifiability.

In the Reconsideration Decision, the Court found the Trustee's arguments concerning the identifiability of the lease payments unavailing. Likewise, those same arguments do not have any more force in the context of the instant Motion for Relief. The Trustee acknowledged that he does not dispute "the satisfaction of the identifiable cash proceeds portion of [§ 9-306(3)], which is satisfied by the Trustee's compliance with 11 U.S.C. § 363(c)(4) and the interim cash collateral orders entered by this Court." *See* Trustee's Objection to Citrus Bank's Motion for Relief from

the Automatic Stay, filed July 15, 1996, at 20. Furthermore, the Segregation Order did not give the Bank any right which did not exist under state law, because, in the absence of bankruptcy, and upon default, Citrus had the right to require direct payments from the lessees to it as a form of segregation. Presumably the Bank could have obtained a state court order of segregation.

Therefore, as the Court concluded earlier, the mere filing of Citrus' Motion for Relief on April 19, 1996, functioned to give notice to the Debtor of the Bank's intent to seize the Lease Payments. Filing of the Motion for Relief did not, however, render the Lease Payments *identifiable*. To conclude otherwise, if, as the Trustee has suggested, the Lease Payments were previously commingled with other funds, might allow the Bank to obtain funds in which it did not have a perfected security interest, to the prejudice of other parties in interest. At the same time, contrary to the Trustee's argument in reliance on Professor Gilmore's position, New York law provides that proceeds do not *ipso facto* lose their identifiability when commingled with other funds. As one New York court has stated,

> The courts that have heretofore considered this issue have rejected the opinion of Professor Gilmore in that . . . [his] statement was made in 1965 prior to the 1972 amendment to section 9-306(1) which included deposit accounts within the definition of proceeds to which a security interest would continue and that [his] statement is against the spirit of section 9-205.

General Motors Acceptance Corp. v. Norstar Bank, N.A., 141 Misc.2d 349, 352, 532 N.Y.S.2d 685, 687 (citation and footnote omitted) (N.Y.Sup.Ct. 1988). Thus, the court in *General Motors Acceptance Corp. v. Norstar Bank, N.A.* ultimately concluded that, "under New York law, proceeds, as defined in section 9-306, are identifiable in spite of commingling when they can be traced under principles of trust accounting," and indicated that the "lowest intermediate balance" method of accounting is appropriate to trace proceeds. *Id*. at 355, 689. In this case, however, the

Bank failed to provide sufficient evidence that Lease Payments received prior to May 20, 1996, the date the Court signed the Segregation Order, are identifiable.[18] While the Trustee alleges he has complied with Code § 363(c)(4) in segregating the Lease Payments, thereby making them identifiable, there was no evidence presented at the Hearing to indicate when that occurred. Therefore, based on the evidence before it, the Court finds that the Bank is entitled to Lease Payments received by the Debtor/Trustee from May 20, 1996, going forward.

4. *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.[19] 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 the NYUCC to mean "a

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[18] In the event bankruptcy proceedings are commenced by a debtor, 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." 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* §§ 9-306(4)(b) and (d). NYUCC § 9-306 "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. *In re Bumper Sales, Inc.*, 907 F.2d at 1438.

[19] "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 and rights are." *See In re Kors, Inc.*, 819 F.2d 19, 22-23 (2d Cir. 1987) (citations omitted). The Lease Payments are in the Trustee's possession in New York, and New York's choice of law principles dictate that questions relating to the validity of an interest in personal property are governed by the law of the state where the property is located. *Cf. Kunstsammlungen Zu Weimar v. Elicofon*, 536 F.Supp. 829, 845-46 (E.D.N.Y. 1981), *aff'd*, 678 F.2d 1150 (2d Cir. 1982).

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 . . . . " NYUCC 9-301(3) (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 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---
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> (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 (3rd 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.

In New York, a judgment creditor generally acquires a lien on personal property by delivering execution to the sheriff. *See In re Marceca*, 129 B.R. 369, 370 (Bankr. S.D.N.Y. 1991); New York Civil Practice Law and Rules ("CPLR") § 5230 (McKinney 1978 & Supp. 1997). The methods of effecting execution on personal property is summarized by a New York State Bar Association publication:

> [I]t is recognized that the execution can be levied on personal property in two different ways. If the property is capable of delivery, the sheriff levies upon it by taking it into his/her custody. This is a levy by seizure under CPLR sec. 5232(b)
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> * * *
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> On the other hand, if the property is not capable of delivery, the sheriff is to serve a copy of the execution on the party in possession of the property (garnishee) in the same manner as a summons. See CPLR sec. 5232(a).

JACK L. GETMAN, ET. AL, COLLECTIONS AND THE ENFORCEMENT OF MONEY JUDGMENTS, 243-44 (New York State Bar Association) (1986 & Supp. 1995).

Regardless of whether execution is directed to the judgment debtor or to a garnishee,

property subject to such execution is limited to (a) "any debt, which is past due or which is yet to become due, certainly or upon demand of the judgment debtor . . ." and (b) "any property which could be assigned or transferred, whether it consists of a present or future right or interest and whether or not it is vested . . . ." *See* CPLR §§ 5201(a) and (b).[20] Clearly, the Trustee can be deemed to have the rights of a lien creditor with respect to Lease Payments in existence on or before the Petition Date. However, the law does not allow a lien creditor to obtain, on the Petition Date, a lien on Lease Payments not yet in existence and coming due postpetition. At most, a lien creditor could only obtain on the petition date a lien on either a "debt" within the meaning of CPLR § 5201(a), or on property capable of assignment or transfer, pursuant to CPLR § 5201(b).[21] *Compare Reibor Int'l Ltd. v. Cargo Carriers (KACZ Co.) Ltd.*, 759 F.2d 262 (2d

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[20] In *Glassman v. Hyder*, 23 N.Y.2d 354, 296 N.Y.S.2d 783, 244 N.E.2d 259 (1968), the New York Court of Appeals held that rents to become due under a real property lease were too contingent to withstand attachment pursuant to CPLR §5201(a). Rights to payments to become due under existing contracts appear to be leviable as "property which could be assigned or transferred" within the meaning of CPLR §5201(b). *See Abkco Industries, Inc. v. Apple Films, Inc.*, 39 N.Y.2d 670, 385 N.Y.S.2d 511, 350 N.E.2d 899 (1976).

[21] 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). 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 §5202(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*

Cir. 1985) (discussing New York caselaw holding attachment effective against property acquired within hours after of service of levy). This lien would be subordinate to the Bank's previously perfected security interest in the Leases, which by definition includes the right to payment of the monetary obligation embodied in each Lease, pursuant to CPLR § 5202(a)(1).

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 Debtor. 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 which are chattel paper would have been potentially meaningless if the Bank had not taken steps to continue its perfected security interest in the Lease Payments within ten days after their receipt by BFG.

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,

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284 N.Y. 593 (1940), *cert. denied* 312 U.S. 690 (1941); *Stathos v. Murphy*, 26 A.D.2d at 500)). *Cf. Field v. City of New York*, 6 N.Y. at 186 ("It is contended . . . that the assignment . . . did not pass any interest which was the subject of the assignment, for the reason, that there was no contract, at the time, between [assignor] and the corporation of the city, by which the latter was under any binding obligation to furnish the former with job-printing, or to purchase of him paper or stationery; and that, therefore, the interest was of too uncertain and fleeting a character to pass by assignment."); *see also Don King Prod., Inc. v. Thomas*, 945 F.2d 529, 534 (2d Cir. 1991) (interpreting New York law).

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 [New York] 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).

> 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). In the present situation, while the debt owing under the Leases is encumbered by the Bank's perfected security interest as of the Petition Date, realization of the value of that security interest is dependent upon the Bank taking steps to continue its perfected security interest 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 will be unable pursuant to Code § 544 to avoid the Bank's security interest in those Lease Payments received within ten days prior to April 19, 1996, or in those received thereafter, to the extent that they are identifiable.

IV. Relief from the Automatic Stay

A. Code § 362(d)

Based on the Court's conclusion that the Bank has a perfected security interest in the Lease Payments to the extent discussed herein, the Court must also 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. Code § 362(d) provides for 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" pursuant to § 362(d)(1), other than indicating 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 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. At the Hearing, 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. His main focus at the evidentiary hearing was on the servicing and collection operations of The Processing Center ("TPC"), a related chapter 11 debtor. 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. He 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. 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.

Because there was no proof that the Trustee intends to reorganize BFG utilizing the Lease Payments, a Code § 362(d)(2) analysis is unnecessary. 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. 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 entitle the Bank to interest should it be determined that the Bank is oversecured, to the 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.[22]

Nevertheless, the Court has serious concerns about the potentially adverse impact on the Debtor's operations if the Court were to modify the stay 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. Casey testified that several lessees have multiple leases which have been assigned to a number of different banks and/or private investors. *See* Trustee's Exhibit I (Casey Declaration), at ¶45. 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. 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

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[22] As he has in connection with previous bank motions in this case, the Trustee has argued 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 as, *inter alia*, a preferential transfer pursuant to Code §§ 547 and 550. *See* 11 U.S.C. § 502(d). On April 18, 1997, the Trustee filed an adversary complaint against the Bank in which he has allegedly presented a *prima facie* case of specific preferential transfers from the Debtor to the Bank in the aggregate amount of $ 53,074.17 said to be avoidable and recoverable pursuant to Code §§ 547 and 550 (the "Adversary Proceeding"). Rather than make a determination concerning the merits of the Trustee's Adversary Proceeding in this case, the Court will allow the Trustee to continue to hold and segregate these monies alleged to be recoverable in the Adversary Proceeding, pending entry of a final order in said Adversary Proceeding.

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.

Allowing the Bank to service its portfolios not only would put at risk the collection of servicing payments and tax payments, 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 Citrus.

V. Equities of the Case

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" even if the Court determines that the Bank is perfected in the Lease Payments. *See* Trustee's Trial Memorandum of Law, at 57. The Trustee argues that the Bank effectively helped the Debtor in perpetrating what has been characterized as the largest Ponzi scheme in United States history by allowing the Debtor unfettered and unmonitored control of the cash advanced in connection with the transactions at issue.

The Court was presented with extensive declaration testimony by the Trustee's expert, George L. Davis ("Davis"), concerning what the Bank failed to do which may in some way have prevented the alleged fraud. Davis' testimony focused on what he considered to be prudent

lending practices to achieve risk minimization, and upon review of the procedures employed by Citrus, Davis concluded that the Bank did not act prudently regarding its loans with the Debtor. The Trustee, however, does not allege that the Bank's conduct was in any way fraudulent, merely less than prudent.

The Bank asserts that the "equities of the case" language in the statute applies in instances where the postpetition conversion of collateral into proceeds results in an expenditure by the estate and a corresponding windfall to the secured creditor, and notes that the Trustee's allegations do not relate to such an expenditure. Instead, the Bank also argues that the Trustee is seeking to invoke the "equities of the case" to limit the Bank's security interest based on actions taken by it prior to the commencement of the case. The Bank also argues, *inter alia*, that the decision to police or monitor what the Debtor was doing with prepetition proceeds is not an obligation on the part of the Bank to prevent injury to unsecured creditors, but rather is solely a business decision for the benefit of the Bank. Furthermore, the Bank argues that although the Court has equitable powers, it does not have the jurisdiction to create new rights and remedies and to redistribute rights in accordance with the Court's views of justice and fairness.

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 <u>appreciated</u> 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)). There is no evidence that the 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 Order. Furthermore, these additional monies result from the conversion of the Bank's right to receive Lease Payments into actual Lease Payments. Thus, with each conversion into actual Lease Payments there is a resultant decrease in the number of payments remaining under each Lease, and the value of each Lease is reduced accordingly. This conversion therefore cannot be viewed as a "windfall" to the Bank. Based upon the foregoing, the Court will not limit the scope of the Bank's security interest in the Lease Payments on the basis that the Bank may have been less than prudent in connection with the advancement of funds to the Debtor.

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 cover the costs incurred by the Trustee in collecting the Lease Payments. The Trustee maintains that such costs amount to $6.37 per lease per month, plus outside professional fees which bring the total cost to over $12.00 per lease, per month.

Admittedly, the generation of the Lease Payments has involved the use of assets of the estate to collect and service the lease portfolios of the Bank. However, "[a]s 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." *Id.* (citing H.R. Rep. 103-834, 103d Cong., 2d Sess. 27-29; 140 Cong. Rec. H 10768 (Oct. 4, 1994), *as reported in Norton Bankr. Law & Practice* 2d, p. 671 (1995-96 ed.).

Rather than rely on Code § 552(b), the Court will consider allowing 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 are generally 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 . . . disposing of such property to the extent of any benefit to the holder of such claim." *See General Electric Credit Corp. v. Levin & Weintraub (In re Flagstaff Foodservice Corp.),* 739 F.2d 73, 76 (2d Cir. 1984). As discussed in the October Decision, the Lease Payments arose as a result of the disposition of the underlying collateral, namely the Leases. Arguably, the Bank would have incurred certain costs and expenses if it had been permitted to handle the collection process itself. However, in the view of the Court, by allowing the Trustee to continue the process, the Bank, as well as other secured and unsecured creditors, has benefitted by the minimization of disruption and chaos which would have occurred if the banks attempted to redirect the lease payments and begin the collection process on their own. The Court concludes that $6.37 per lease per month is a reasonable charge that should be borne by the Bank in connection with the collection of the Lease Payments in which the Court has

determined it has a valid security interest.[23]

V. Setoff

Unlike other banks in this case, the Bank's Motion for Relief contains no request to effectuate a setoff of certain funds pursuant to Code § 553(a) allegedly held in a payment account ("Payment Account") established pursuant to the terms of a Payment Account Agreement entered into between the parties. *See* Citrus' Exhibit 8. Although the issue of setoff is addressed by the Trustee and the Committee in their respective trial memorandums of law, the Committee observes that the Bank does not specifically request such relief, but only that it appears that the Bank may be seeking this relief under Code § 362(d).

In the absence of a request for such relief or any information regarding amounts sought to be set off by the Bank, the Court shall make no determination of this issue at this time. The Court notes here that the issue is also raised in the pending Adversary Proceeding commenced by the Trustee on April 18, 1997 alleging preferential transfers to the Bank. *See* footnote 19, *supra,* in which the Trustee alleges that the Payment Account contains in excess of $252.60.

Based on the foregoing, it is

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

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[23] According to the declaration of Manny Alas, a partner in Coopers & Lybrand, L.L.P. ("Coopers & Lybrand"), the accounting firm retained by the Trustee, the per lease cost to the estate is $6.37 or approximately $1,164 per month for the collection on the 97 leases in Citrus' portfolio. *See* Defendant's Exhibit D (Declaration of Manny Alas), at ¶22 and exhibit C.

account that represents Schedule A payments collected on the Leases since May 20, 1996, 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.[24] Said payments shall not exceed, however, the principal amount of the Bank's claims as of March 29, 1996; it is further

ORDERED that the Trustee, utilizing The Processing Center, 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 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 Schedule A 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 monthly collection on any single lease is not sufficient to pay the Bank the full amount of its Schedule A

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[24] Because the Court 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 such testimony 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 pursuant to Code § 506(b) at the confirmation or such time as the Court deems appropriate.

payment, the rate for servicing that particular lease will be reduced proportionately;[25] it is further

ORDERED that the Trustee shall 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, subject to further Order of this Court, the Trustee shall withhold from the Schedule A payments collected on behalf of the Bank the sum of $ 53,074.17, which he alleges in his Complaint filed on April 18, 1997 is the total of preference payments received by the Bank; and it is finally

ORDERED that with regard to any monies currently being collected by the Trustee on the Leases 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.

Dated at Utica, New York

this 8th day of October 1997

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

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