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

APPEARANCES:

MC GRATH & ASSOCIATES, P.C. Attorneys for Deposit Bank 1500 Union Bank Building 306 Fourth Avenue Pittsburgh, PA 15222-2102	JOSEPH R. LAWRENCE, ESQ. Of Counsel
SIMPSON THACHER & BARTLETT Attorneys for § 1104 Trustee 425 Lexington Avenue New York, New York 10017	M.O. SIGAL, JR., ESQ. Of Counsel KENNETH G. CROWLEY, ESQ. Of Counsel
WASSERMAN, JURISTA & STOLZ Attorneys for Official Committee of Unsecured Creditors 225 Millburn Drive Millburn, NJ 07041	HARRY GUTFLEISH, ESQ. Of Counsel

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

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

On August 17, 2000, the Court heard oral argument on the motion of Deposit Bank "to compel distribution pursuant to stipulation regarding lift-stay litigation regarding transaction with Aloha Capital Corporation." The motion was opposed by Richard C. Breeden, chapter 11 trustee ("Trustee") of The Bennett Funding Group, Inc. and other substantively consolidated debtors, including Aloha Capital Corporation ("Debtors"). At the hearing, Deposit Bank took issue with the fact that the Trustee refused to make provisional payments to it in connection with lease

payments he collected prior to November 11, 1996. The Trustee also deducted $80,714.91 from the provisional payments he did make, claiming that this amount represents alleged preference payments.[1] Deposit Bank points out that in his adversary proceeding commenced against it (Adv.Pro. 98-70558A), the Trustee sought to recover only $18,471.58 in preference payments. Finally, the Trustee has deducted $29,991.93, the amount Deposit Bank allegedly received directly from the lessees "as the exclusive result of pre-petition demand for collection of the rents upon the Debtor's default." *See* ¶ 22 of Deposit Bank's motion.[2]

The Court adjourned the motion to September 14, 2000, to consider the positions of both parties. In lieu of further oral argument, the Court apprized both parties that it would take the matter under submission as of that date and render a written decision.

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).

---

[1] The Trustee acknowledges that the amount is actually approximately $72,281.52 given that apparently one of the payments made to Deposit Bank by the Debtor was returned for insufficient funds.

[2] At the hearing, counsel for Deposit Bank indicated that it would withdraw its request regarding the approximate $30,000 it received directly from the lessees, which the Trustee deducted from the provisional payment to be made to Deposit Bank on the basis that receipt of those monies by Deposit Bank violated the automatic stay.

FACTS

Deposit Bank is one of a number of banks which entered into financing transactions with the Debtors for which the banks received an assignment of an interest in certain equipment leases ("Leases"), including the payments due under the Leases ("Lease Payments"). On November 18, 1996, Deposit filed a motion seeking relief from the automatic stay in order to contact the lessees and collect all amounts due under the Leases. Deposit Bank also requested that the Court order the Trustee to account for and turnover to it all of the Lease Payments collected by the Trustee. In opposing Deposit's motion, the Trustee argued that the Bank failed to perfect its security interest in the Leases/Lease Payments and, therefore, was not entitled to the relief requested. On February 5, 1997, the Court signed an Order granting the "so-called 'standard' provisions of relief awarded to other similarly situated banks. The Trustee was also required to segregate the Lease Payments and to provide Deposit Bank with an accounting with respect to each Lease and all Lease Payments.

On January 28, 1998, an evidentiary hearing was conducted pursuant to a stipulation dated September 25, 1997, and approved by the Court on October 17, 1997 ("Carmi Stipulation"), in which it was agreed that certain banks that had filed motions for relief from the automatic stay, including Deposit Bank, would participate as intervenors and would be bound by the decision of the Court with respect to certain common issues.

On May 6, 1998, the Court rendered its decision ("Carmi Decision") in which it found

that the leases in the possession of the banks for the most part were chattel paper pursuant to § 9-105(b) of the Uniform Commercial Code ("UCC"). Pursuant to UCC §§ 9-304 and 9-305, respectively, a security interest in chattel paper may be perfected either by possession of the collateral or by filing a financing statement. The Court further found that a security interest in the lease payments or proceeds was continuous if the security interest in the original collateral (the leases) had been perfected but ceased to be a perfected security interest and became unperfected ten days after receipt of the proceeds by the debtor unless the financing statement covered the original collateral (the leases) and the proceeds (the lease payments) were identifiable cash (UCC § 9-306(3)(b)) or in the case of perfection by means of possession of the original collateral, the security interest in the proceeds was separately perfected by possession given that the lease payments were cash (UCC § 9-306(3)(c)).

Subsequent to the Carmi Decision, Deposit Bank, along with several other banks, entered into a second stipulation on or about November 23, 1998, asking the Court to address three common issues involving Aloha Capital Corporation, f/k/a Bennett Leasing Corporation ("Aloha Stipulation"). Those issues included:

1. Whether a UCC-1 financing statement filed under the name "Bennett Leasing Corporation" prior to the date the Corporation filed a Certificate of Amendment in Delaware [changing its name to Aloha Capital Corporation] is effective to perfect a security interest in [the bank's] Leases and Proceeds ("Issue #1");
2. Whether a UCC-1 financing statement filed under the name "Bennett Leasing Corporation" after the date the Corporation filed a Certificate of Amendment in Delaware [changing its name to Aloha Capital Corporation] is effective to perfect a security interest

in [the bank's] Leases and Proceeds ("Issue #2), and

3. Whether 11 U.S.C. § 546(b) applies such that [the bank] has a perfected security interest in the Proceeds as a result of its possession of original signed chattel paper under the stipulated facts ("Issue #3").

DISCUSSION

On November 16, 1999, the Court rendered a decision resolving the three issues ("Aloha Decision"). Based on that decision, Deposit Bank takes the position that it is entitled to receive all Lease Payments, less servicing fees, from the time the involuntary petition was filed against Aloha Capital Corporation. According to Deposit Bank, "[i]t is abundantly clear that this Honorable Court concluded that the resolution of the first common issue was that the financing statement filed before the Debtor filed its Certificate of Amendment in Delaware were effective to perfect [the bank's] security interest in the lease payment." In response, the Trustee directs the Court to its finding in the Aloha Decision in connection with Issue #1 that "the fact that [the bank] did not file a new or amended financing statement with respect to the Proceeds does not render its security interest therein unperfected with respect to those received by the Trustee . . . . Whether its security interest in those Proceeds was perfected based on [the bank's] filing of its financing statements [ ], depends on whether the Proceeds are identifiable pursuant to NYUCC § 9-306(3)(b)." *See* Aloha Decision at 19.[3]

Deposit Bank's counsel appears to ignore the fact that the Court expressly found that

[3] At the hearing on August 17, 2000, in connection with its motion, Deposit represented to the Court that its transaction with Aloha Capital Corporation fell within the scenario identified as Issue #1.

despite the fact that a bank might have a perfected security interest in the leases based on the filing of a financing statement in the name of Bennett Leasing Corporation prior to the amendment of the company's Certificate of Incorporation , it was still necessary for the bank to establish that the lease payments were identifiable. This was not a "common issue" addressed by the Court pursuant to the Aloha Stipulation, and the Court has not made a specific determination concerning when the Lease Payments in which Deposit Bank asserts a security interest became identifiable.

Pursuant to ¶ 7(d) of the Aloha Stipulation, the Trustee proposes to make provisional payments to Deposit Bank based not on the validity of its financing statements but on the fact that it has possession of the Leases. Under that scenario, UCC § 9-306(3)(c) requires that the proceeds be perfected within ten days. As the proceeds are cash payments, perfection of a security interest in the Lease Payments must also be by possession. Under Code § 546(b), the Court in its Carmi Decision found that possession or seizure of the proceeds or lease payments could be accomplished by giving notice to the Trustee either by filing a motion for relief from the automatic stay or for a segregation order. The fact that a bank provided the Trustee with notice of its intent to seize the lease payments is ineffective in perfecting the payments, however, unless they are identifiable. The Trustee could only segregate the lease payments which were not commingled in the "honeypot."[4] The Trustee had argued that until there were actual

[4] According to the Trustee, "'[c]ash [received by the Bennett Companies] would flow into the Honeypot . . . from numerous sources on a daily basis, and disbursements were made to the various [Bennett Companies] and other affiliated companies based on their respective cash needs and irrespective of the source of such funds.'" Trustee's Code § 1106 Report, filed Dec. 31, 1998, at 20-21, quoting Affidavit of Sean O'Neill, the former Assistant Controller and Accounting Manager of BFG, dated Oct. 29, 1996.

payments made they could not exist and be identifiable and, therefore, no security interest could attach until the payments came into existence. The Court found that the security interest in proceeds is continuously perfected from at the earliest, the time the security interest in such proceeds attached. *See* Carmi Decision at 63. Based on the evidence before it, the Court found that only the lease payments received by the Trustee on and since the date of the segregation order were identifiable. *See id.* at 77.

No such evidence has been presented on behalf of Deposit Bank in that regard because of the pending appeal of the Carmi Decision. However, according to the terms of the Aloha Stipulation, the Trustee agreed to make provisional payment of lease payments received as of November 11, 1996.[5]

At the hearing, Deposit Bank's counsel indicated that if the provisional payments it was to receive were to be based on its possession of the Leases and its having filed a motion for relief from the automatic stay or for a segregation order, then it was a waste of time for it to have entered into the Aloha Stipulation seeking a determination of the validity of its rights based on having filed appropriate financing statements.

Pursuant to the Carmi Stipulation, Deposit Bank, along with other intervening banks, agreed to participate in a single evidentiary hearing addressing transactions with The Bennett Funding Group, Inc. ("BFG") and/or Aloha Leasing, a Division of BFG. In entering into the Aloha Stipulation, the parties were seeking to extend the holdings in the Carmi Decision to

---

[5] Deposit Bank filed a motion on November 18, 1996, seeking, *inter alia*, an order compelling the Trustee to account for and turnover to it all of the lease payments the Trustee had collected. The Trustee acknowledges that he incorrectly used the date that Deposit Bank's motion was signed, namely November 11, 1996, rather than November 18, 1996, when its motion was filed, to calculate the amount of the provisional payment.

transactions involving Aloha Capital Corporation, f/k/a Bennett Leasing Corporation. Under the terms of the Aloha Stipulation, the Trustee agreed to make provisional payments to the banks much as he had following the Carmi Decision. Obviously, once the Court determined that Code § 546(b) was applicable to the banks' transactions with Aloha Capital Corporation, as addressed by Issue #3, the Trustee was free to make provisional payments based on Deposit Bank's possession of the Leases.

From the Court's perspective, it appears that those banks which entered into the Aloha Stipulation requesting a determination on all three issues did so as a precautionary measure in the event that the Court's conclusions in its Carmi Decision with respect to its interpretation of Code § 546(b) as a means to allow for notice to the Trustee of the banks' intent to seize/possess the Lease Payments under UCC § 9-306(3)(c) were reversed on appeal. If they could not succeed in perfecting an interest in the lease payments based on their possession of the leases, then they would have to rely on properly filed financing statements and the identifiability of the lease payments pursuant to UCC § 9-306(3)(b). The Court's determination that, at least with respect to Issue #1, the banks had a valid security interest in the leases by filing financing statements in the name of Bennett Leasing Corporation simply provided them with an alternate argument should the need arise. Whether this constituted a waste of their time is not for the Court to determine.

Nevertheless, the Court must agree with the Trustee that because there has been no determination concerning the identifiability of the Lease Payments, the provisional payments being made to Deposit Bank are appropriately calculated from the date Deposit Bank filed its motion seeking relief from the automatic stay, namely November 18, 1996.

Deposit Bank also takes issue with the Trustee's indication that he intends to withhold approximately $72,281.52 from the payments earmarked for Deposit Bank based on allegations in his complaint that Deposit Bank received certain preferential payments prior to the commencement of the case. It is Deposit Bank's position that because the complaint only identifies $18,471.58 in alleged preferences the Trustee should not be able to withhold more than that amount.

At the hearing, the Trustee asserted that the defensive use of Code § 502(d) would permit him to withhold the amount of alleged preferences without having to commence an adversary proceeding. Indeed, the Court previously acknowledged the Trustee's right to use Code § 502(d) defensively "to disallow a claim of a creditor even though the trustee lacked a judgment imposing liability for a preferential transfer." *In re The Bennett Funding Group*, Case No. 96-61376-79, slip op. At 4 (Bankr. N.D.N.Y. Jan. 8, 1997). However, the Court also pointed out that "there must be some sort of judicial determination that the creditor received a preference (and has failed to repay it) before invocation of Code § 502(d) is proper (citations omitted)." *Id.* at 5. Here there has been no determination of Deposit Bank's liability insofar as the alleged preferential transfers are concerned which would permit the Trustee to assert Code § 502(d) defensively.

However, in its January 1997 decision, the Court indicated that it would give consideration to any amounts alleged by the Trustee to be preferential transfers when making a determination regarding the banks' motions seeking relief from the automatic stay. Indeed, following a number of evidentiary hearings, including the one held pursuant to the Carmi Stipulation, the Court allowed the Trustee to withhold the amounts alleged in his complaints against the banks or in his counterclaims in adversary proceedings commenced by the banks to

be preferential payments in making distributions to the banks without making any determination as to the validity of the Trustee's allegations.

In his complaint against Deposit Bank, the Trustee identified $18,471.58 in alleged preferential transfers. The Trustee seeks recovery of alleged preferential transfers "in an amount equal to or greater than" the $18,471.58 stated therein. Since the filing of his complaint in March 1998, apparently the Trustee conducted further investigation and now estimates that the actual amount of preferential transfers made to Deposit Bank totals $72,281.52.

Under Rule 15(c) of the Federal Rules of Civil Procedure, as incorporated by reference in Rule 7015 of the Federal Rules of Bankruptcy Procedure, leave to amend is to be freely given to "'enable a party to assert matters that were overlooked or unknown to him at the time he interposed his original complaint or answer.'" *In re Gerardo Leasing, Inc.*, 173 B.R. 379, 388 (Bankr. N.D.Ill. 1994) (citations omitted). Of course, in the case of avoidance actions, Code § 546(b) imposes a time limitation on the Trustee of two years after the entry of the order for relief, which in this case occurred in May of 1996. Therefore, any amendment which the Trustee sought to make would have to relate back to the date of the original filing if it were to be allowed. *See id.*

> It has thus been well established that an amended complaint will relate back, not withstanding the bar of the statute of limitations, if it merely adds a new legal ground for relief, changes only the date and location of the transaction originally alleged, or even increases the *ad damnum* clause of the original complaint.

Id. at 389 (citations omitted) (emphasis added). Under this analysis, the Court believes that the Trustee should be given an opportunity to amend his complaint to increase the amount of damages being sought to be avoided to approximately $72,281.52. If the Trustee amends his

complaint, then the Court believes he should be permitted to withhold that amount from the provisional payments being made to Deposit Bank.

Based on the foregoing, it is hereby

ORDERED that the Trustee make provisional payment to Deposit Bank of the Lease Payments received as of November 18, 1996; and it is further

ORDERED that in the event that the Trustee files an amended complaint in Adversary Proceeding 98-70558A within twenty (20) days of the date of this Order, increasing the amount he seeks to avoid pursuant to Code § 547, he shall be entitled to deduct that amount from the provisional payments to be made to Deposit Bank pursuant to the Aloha Stipulation.

Dated at Utica, New York

this 2nd day of October 2000

_____

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge