UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

MATTRESS WORLD, INC. CASE NO. 9l-02947

Debtor

APPEARANCES:

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STEPHEN D. GERLING, U.S. Bankruptcy Judge

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

The Court has before it a motion by The National Bank and Trust Company ("NBT") seeking an order pursuant to §362(d) of the Bankruptcy Code (11 U.S.C. §§101-1330) ("Code"), modifying and lifting the automatic stay imposed pursuant to Code §362(a).

NBT seeks to take possession of Debtor's inventory and accounts receivable pursuant to a pre-petition security agreement.

Debtor opposes the motion upon the ground that the loan for which it granted NBT a security interest was paid off pre-petition and the only remaining debt due NBT is unsecured.

The Chapter 7 Trustee ("Trustee") has also filed an affidavit in opposition which simply adopts the position taken by the Debtor.

The motion originally appeared on the Court's Utica, New York calendar on January l4, l992 for a preliminary hearing, and was thereafter scheduled for a final hearing on February l0, l992. Upon consent of the parties, the final hearing was rescheduled for and held on February 27, l992. The parties

have agreed to waive the requirements of Code §362(e).

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this contested matter pursuant to 28 U.S.C. §§1334(b) and l57(a), (b)(l) and (2)(G).

FACTS

On February 28, l990, Debtor executed a security agreement ("February '90 Security Agreement"), which granted NBT a security interest in generally all of the Debtor's inventory and accounts receivable. (See Movant's Exhibit 2, Security Agreement).

Paragraph B of said Security Agreement granted NBT a security interest to secure payment of any current indebtedness, as well as

> ... any and all other obligations of borrower to bank of every kind and description, direct or indirect, absolute or contingent, due or to become due, now existing or hereafter arising, and whether such indebtedness is from time to time reduced and thereafter increased, or entirely extinguished and thereafter reincurred, including without limitation, any sums advanced by the bank for taxes, assessments, insurance and other charges and expenses as hereinafter provided (all hereinafter called "Obligations").

On April 30, l99l, Debtor executed a promissory note ("April '9l note"), which evidenced a loan from NBT to Debtor in the sum of $65,000. (See Debtor's Exhibit A, Promissory Note).

The April '9l note referenced as security two NBT certificates of deposit in respective amounts of $50,000 and $l8,7l8.7l. Further reference in the note was made to a "Security Agreement dated Oct. 4, l990". The April '9l note was stamped as follows: "Paid July l7, l99l NBT".

On or about May l7, l99l, Debtor made application for a loan in the amount of $l5,000 from NBT. The application indicated, among other things, the amount of the loan, the purpose of the loan, the source of repayment and whether it was to be unsecured or secured. From the face of the application, it is apparent that a description of the note as unsecured was originally checked, then

"whited out" and redesignated as secured. (See Movant's Exhibit 3, Commercial Loan Application).

Also on May l7, l99l, Debtor executed a Master Note ("May '9l note"), evidencing a loan from NBT in the sum of $l5,000. The Master Note makes no reference to any specific security agreement or interest given by Debtor to NBT to secure the note. (See Movant's Exhibit l, Master Note).

At the time the May '9l note was executed, Debtor had pending at NBT an application for a United States Small Business Administration ("SBA") loan which loan was subsequently denied.

On or about September l7, l99l, NBT prepared a promissory note ("September '9l note"), evidencing a $l5,000 loan to debtor, which Debtor refused to sign. The September '9l note identifies specific collateral as "all accounts receivable, inventory & equipment" and further makes reference to a specific security agreement dated "Feb. 20, l990". (See Debtor's Exhibit B, Promissory Note).[1]

The May '9l note in the sum of $l5,000 remained unpaid on the date Debtor filed its voluntary petition pursuant to Chapter 7 of the Code, October 22, l99l.

ARGUMENTS

Debtor contends that the May '9l note was an unsecured obligation because it makes no specific reference to any security agreements or interests, and because the loan application of the same date originally designated the loan as unsecured and was thereafter altered by a representative of NBT to indicate that it was to be secured. Debtor also points out that the note form used in May '9l was that used by NBT for unsecured rather than secured loans, that it was the understanding of the parties that the May '9l note would be paid from the proceeds of the anticipated SBA loan, and that NBT sought to require the Debtor to execute a secured note in September '9l when it discovered the fact that the May '9l note was unsecured and the SBA loan was denied.

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[1] Date in Debtor's Exhibit as written appears to be Feb. 20, l990.

NBT asserts that it entered into a series of loan transactions with the Debtor dating back to February l990 and that the February '90 Security Agreement was intended to secure a future line of credit. NBT further alleges that the first advance to Debtor under the line of credit was the April '9l note in the sum of $65,000, with the May '9l note being the second advance under the line.

NBT references the language contained in the February '90 Security Agreement which it contends clearly provides that the security interest created by the Agreement blankets all present and future indebtedness due and owing from the Debtor to NBT. Finally NBT denies that it ever told Debtor that the May '9l note would be repaid from the proceeds of the pending SBA loan.

DISCUSSION

A threshold issue to be considered by the Court herein is the standing of the Debtor to oppose NBT's motion on the basis of the validity of NBT's security interest.

Code §522(h) does permit a debtor to utilize the so-called "strong arm clause" found in Code §544 to attack an alleged secured creditor's lien where the debtor could have exempted the property under Code §522(g)(l) and the trustee fails to attack the transfer. See In re Sullivan, 3l B.R. l25 (Bankr. N.D.N.Y. l983); In re McMahon, 70 B.R. 290 (Bankr. N.D.N.Y. l987).

Here, while at the time the motion was initially filed by NBT, the Trustee had not challenged the validity of its security interest for the May '9l note, the Debtor cannot satisfy the criteria of Code §522(g)(l) because the transfer of the alleged security interest to NBT was voluntary rather than involuntary. In addition, the Debtor is a corporation and cannot utilize the applicable exemption provisions under New York law. See §282 of New York Debtor and Creditor Law and Code §l0l(4l).

It appears, however, that the infirmities of Debtor's position were overcome when the Chapter 7 Trustee decided to join with the Debtor in opposing the motion to lift the stay.

Turning then to the merits, it does not appear that the Debtor

disputes the existence of the NBT security interest created by virtue of the September '90 Security Agreement. Rather, it is Debtor's contention that the security interest created by way of the Security Agreement terminated upon the satisfaction of the April '9l note since it secured only that note. As evidence of the parties' intent, Debtor's president, Colleen Rotondi ("C.Rotondi") testified that at the time of execution of the May '9l note and loan, she was told by an NBT representative that the note would be repaid from the proceeds of the pending SBA loan and that it wasn't until after the SBA loan was disapproved that NBT requested Debtor to sign the September '9l note, which on its face is a secured note.

NBT's loan officer, Kenneth Finegan ("K.Finegan") testified that he never told C.Rotondi that the May '9l note would be paid off with the proceeds of an SBA loan, however, he did tell her that there was no need to execute a new security agreement at that time because NBT had a pre-existing security agreement. Further, he was not aware of who may have altered the loan application executed in connection with the May '9l note, changing it from an unsecured to secured status, though he was certain that application never left NBT's possession.

K.Finegan also testified that he requested Debtor to execute the September '9l note simply because it was a new note form being used by NBT, which specifically identified the collateral security. He conceded, however, that NBT apparently had been using this "new" note form as early as April since the April '9l note was executed using the identical form.

While NBT's actions surrounding the execution of the May '9l note and the subsequent request of Debtor in September '9l that it execute a new note evidencing the same debt, appear to be inconsistent with that of a creditor who is relying upon a so-called "blanket" security interest, the law is well-settled that where such a security interest has been created, it constitutes a continuing interest until revoked by agreement of the parties.

The Second Circuit Court of Appeals in In re Riss Tanning Corp., 468 F.2d l2ll, l2l3 (2d Cir. l972) set the standard to be applied to so-called "future advance or dragnet clause" found in security agreements as provided in §9-204(3) of the New York Uniform Commercial Code ("NYUCC"). The Second Circuit

concluded that agreements which provide that the collateral secures both current and future advances may be liberally construed, but the contractual provisions must be clear and unambiguous.

The February '90 Security Agreement utilized by NBT clearly sets out the fact that it is intended to secure future advances in paragraph B - Indebtedness Secured. Debtor does not dispute the existence of the Agreement or assert that NBT misrepresented the nature of same at the time of its execution.

While the May '9l note did not specifically refer to a particular security agreement, it nevertheless provided that NBT might declare the indebtedness evidenced by the note to be immediately due and payable under "any Security Agreement or other agreement now or hereafter in effect, pursuant to which payment of the indebtedness evidenced by this Note is secured."

Debtor contends that NBT's action following execution of the February '90 Security Agreement constitutes a waiver of the rights created under that Agreement. While the Court does note that the actions of NBT's representative with regard to the May '9l loan application and note, as well as the subsequent September '91 note, raise at least an inference that NBT acted in a manner inconsistent with its rights under the February '90 Security Agreement, they do not rise to the level of a waiver or estoppel.

There is also no evidence before the Court that the Debtor would not have sought the May '9l loan of $l5,000 had it believed that the loan was to be secured.

The contention that Debtor was under the impression that the May '9l note would be paid off with the proceeds of a subsequent SBA loan does not suggest that Debtor was misled as to the secured nature of that note. See Bank of Northern New York v. Shaad, 60 A.D.2d 774, 775, 400 N.Y.S.2d 965 (l977);see also Matter of Lawrence Peska Associates, Inc., 5 BCD 278 (Bankr. S.D.N.Y. l979).

Finally, the Court considers NBT's request for relief from the automatic stay pursuant to Code §362(d). As indicated, there is no contention by Debtor or the Trustee that NBT did not perfect its alleged security interest pre-petition. Additionally, neither the Debtor nor the Trustee suggest that there may be any equity in the accounts receivable and inventory sought by NBT which might be otherwise available to the general unsecured creditors.

The Court notes, however, that NBT admits in its moving papers that "Pursuant to the Petition herein, the fair market value of the inventory at the time of filing exceeds Debtor's debt to movant." (See Affidavit In Support of Motion For Relief From Automatic Stay, ¶5).

Based on the foregoing, it is

ORDERED, that NBT had a valid security interest in all of Debtor's inventory and accounts receivable as of October 22, l99l, and it is further

ORDERED, that said inventory and accounts receivable secured a debt due and owing in the sum of $l5,000, with interest from July l7, l99l; and it is further

ORDERED, that the stay imposed pursuant to Code §362(a) is modified to the extent that NBT may take possession of said inventory and accounts receivable liquidate same in accordance with appropriate state law and to thereafter turn over to the Trustee any surplus for distribution to unsecured creditors.

Dated at Utica, New York
this day of June l992

STEPHEN D. GERLING
U.S. Bankruptcy Judge