UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC.

Debtors

CASE NO. 96-61376
Chapter 11
Substantively Consolidated

RICHARD C. BREEDEN, Trustee of
THE BENNETT FUNDING GROUP, INC. et al.

Plaintiff

vs.

ADV. PRO. NO. 98-70028A

FIRST NATIONAL BANK OF CARMI, FIRST NATIONAL BANK OF CARMI, AS AGENT FOR JANE ABSHER, FIRST NATIONAL BANK OF CARMI AS AGENT FOR HENRY ABSHER, FIRST NATIONAL BANK OF CARMI AS AGENT FOR RON ABSHER, FIRST NATIONAL BANK OF CARMI, AS AGENT FOR HENRY ABSHER d/b/a ABSHER OIL COMPANY

Defendants

RICHARD C. BREEDEN, Trustee of
THE BENNETT FUNDING GROUP, INC. et al.

Plaintiff

vs.

ADV. PRO. NO. 98-70019A

MINNESOTA VALLEY BANK

Defendant

RICHARD C. BREEDEN, Trustee of
THE BENNETT FUNDING GROUP, INC. et al.

Plaintiff

vs.

ADV. PRO.. NO. 98-70034A

FIRST COMMUNITY BANK, FSB

Defendant

APPEARANCES:

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

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

Presently under consideration by the Court are motions ("Motions"), filed on July 22, 1999, by First National Bank of Carmi ("Carmi"), in its own right and as agent, Minnesota Valley Bank and First Community Bank, FSB (collectively, the "Movants"), requesting dismissal of certain causes of action asserted by Richard C. Breeden ("Breeden" or "Trustee")[1] in the above-referenced adversary proceedings. The Trustee, in his amended complaints, *inter alia*, seeks to avoid as fraudulent certain pre-petition transfers made by the Debtors to the Movants. He also seeks a declaration from the Court, based on Code § 553, that the monies allegedly owed by the Debtors to the Movants in connection with certain transactions and the monies currently on deposit with the Movants, including monies received by or for the benefit of the Movants within

[1] The Trustee was appointed chapter 11 trustee of the consolidated estates of eight related entities, including The Bennett Funding Group, Inc. ("BFG") (collectively, the "Debtors"), which filed for bankruptcy under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"), between March 29, 1996, and July 25, 1997 when the debtor estates were consolidated pursuant to an order of this Court.

90 days prepetition, are not subject to setoff. The Trustee also is seeking, pursuant to Code § 544, to avoid any security interest claimed by the Movants in certain equipment leases and lease payments.

Pursuant to Rule 7012(b) of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P."), the Movants contend that the Trustee fails to state a claim under the fraudulent conveyance provisions of Code § 548(a)(1) and New York's version of the Uniform Fraudulent Transfer Act ("UCFA"), codified as New York Debtor & Creditor Law ("NYD&CL") § 271-276. The Movants also argue that the Trustee's factual allegations set forth in his amended complaints do not comply with the particularity requirements of Fed.R.Bank.P. 7009(b). In addition, the Movants assert that the Trustee's causes of action based on Code § 553 should be denied based on this Court's decision in *In re The Bennett Funding Group, Inc.*, Case No. 96-61376 (Bankr. N.D.N.Y. Nov. 15, 1996), *aff'd sub nom. Official Committee of Unsecured Creditors v. Manufacturers and Traders Trust Co.,* 212 B.R. 206 (BAP 2d Cir. 1997), *aff'd* 146 F.3d 136 (2d Cir. 1998) ("M&T Decision"). Finally, it is the Movants' position that the Trustee's causes of action pursuant to Code § 544, should be dismissed based on this Court's decision in *In re The Bennett Funding Group, Inc.*, Case No. 96-61376 (Bankr. N.D.N.Y. May 6, 1998), *aff'd in part and rev'd in part sub nom. Marine Midland Bank et al. v. Breeden*, 255 B.R. 616 (N.D.N.Y. 2000) ("Carmi Decision").[2]

The Motions were originally scheduled to be heard on August 26, 1999, and were

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[2] On October 27, 1997, the Court approved a stipulation entered into by the Trustee and various similarly-situated banks, including the Movants, which sought to provide joint resolution of certain common issues raised by lift-stay motions filed by the banks pursuant to Code § 362(d). An evidentiary hearing was held on January 28, 1998, with the banks participating as intervenors.

adjourned and carried on the Court's calendar pursuant to a stipulation executed by the Trustee and the Movants, as well as by various other financial institutions, on or about October 11, 1999.[3] Under the terms of the stipulation, all motions to dismiss the Trustee's causes of action to avoid alleged fraudulent conveyances asserted in various adversary proceedings were stayed pending a decision by the former United States Bankruptcy Appellate Panel for the Second Circuit ("BAP") in connection with the appeal of a decision rendered by this Court on February 9, 1999. *See Breeden v. Gloucester Bank and Trust Co. (In re The Bennett Funding Group, Inc.),* Case No. 96-61376, Adv. Pro. No. 98-70037 (Bankr. N.D.N.Y. Feb. 9, 1999) ("February 1999 Decision). In the February 1999 Decision the Court denied Gloucester Bank's motion to dismiss certain causes of action of the Trustee, including those alleging constructive fraudulent conveyances pursuant to NYD&CL §§ 273-275, based on a finding that if the Trustee was able to prove a lack of good faith on the part of the transferor, namely BFG, he would establish that the transactions at issue were not made for fair consideration. *See* February 1999 Decision at 32. On March 17, 1999, the Court issued separate decisions in six other adversary proceedings commenced by similarly situated banks, incorporating and adopting the conclusions of law of the February 1999 Decision in their entirety.

On July 22, 1999, the former BAP granted leave to the seven banks to appeal the above-referenced decisions with respect to the issue of "fair consideration" in a constructive fraud cause of action based on NYD&CL §§ 273-275. The BAP rendered its decision on May 25, 2000 ("BAP Decision"), concluding that only the good faith of the transferee, not that of the transferor, is to be considered when determining fair consideration for purposes of constructive fraudulent

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[3] By Order dated October 25, 1999, the Court approved the stipulation.

transfers.

Following the BAP Decision, the Motions were again placed on the Court's calendar. Opposition to the Motions was filed by the Trustee on August 31, 2000, and a hearing was held in Utica, New York, on September 14, 2000. In accordance with the February 1999 Decision, as well as the BAP Decision, this Court signed an Order in each of the adversary proceedings herein on September 29, 2000, granting the Movants' Motions to the extent that they sought dismissal of the constructive fraudulent conveyance causes of action based on Code § 548(a)(1)(B) and NYD&CL §§ 273-275. The Court reserved on the Movants' Motions to the extent that they sought dismissal of the fraudulent conveyance actions based upon actual fraud pursuant to the NYD&CL § 276 and Code § 548(a)(1)(A). The Court also reserved on the Movants' Motions insofar as they sought to dismiss the Trustee's causes of action based on Code § 544 and Code § 553.

JURISDICTIONAL STATEMENT

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

FACTS

As set forth in his amended complaints, the apparent basis for the Trustee's causes of action alleging fraudulent transfers in the above-referenced adversary proceedings is an allegation

that the Debtors operated an elaborate "Ponzi scheme" whereby the Debtors leased equipment and provided financing to vendors and manufacturers of the equipment. The Trustee alleges that the Debtors financed their capital and cash flow needs by (i) obtaining investments and loans by pledging the same lease multiple times to investors and pledging that same lease to a financial institution and (ii) pledging to investors fictitious leases." Movants are alleged to be financial institutions that claim to have loaned monies to one or more of the Debtors. Because the lease payments from the lessees were insufficient to satisfy the obligations due investors and financial institutions, the Debtors met their obligations by using funds raised from new investors or leases pledged to others. Funds received by the Debtors from a variety of sources were commingled into a single account, referred to as the "Honeypot." Between March 29, 1990 and March 29, 1996, the Debtors made payments to the Movants using funds from the Honeypot. It is those transfers of funds to the Movants which the Trustee now seeks to avoid in addition to the security interests asserted by the Movants in the leases and the lease payments.

DISCUSSION

Motion to Dismiss Causes of Action based on Code § 544, which seek to avoid Security Interests in Leases and Lease Payments/Proceeds

In the Carmi Decision, the Court concluded, *inter alia,* that Carmi possessed valid and perfected security interests in certain leases and their proceeds, and that the Trustee could not avoid Carmi's security interest in the right to receive postpetition lease payments. *See* Carmi Decision at 42, 70. This portion of the Carmi Decision was affirmed by the United States District

Court for the Northern District of New York (Kahn J.) on November 29, 2000, and the matter is currently on appeal with the United States Court of Appeals for the Second Circuit. Until there is a final determination by the Second Circuit, it would be premature for this Court to dismiss the Trustee's causes of action based on Code § 544 seeking to avoid the security interests in leases and lease payments/proceeds. If the Second Circuit were to reverse the decision of the District Court, those causes of action represent the procedural mechanism by which the Trustee is entitled to seek relief within the time constraints provided for in Code § 546(a). Accordingly, the Court will deny the Movants' motions without prejudice insofar as they request that the causes of action based on Code § 544 be dismissed.

Motion to Dismiss Causes of Action seeking a Declaration by the Court based on Code § 553

In his amended complaints, the Trustee seeks a declaration that certain monies on deposit with the Movants pursuant to payment account agreements with BFG are not subject to setoff. The Movants request dismissal of those causes of action based on the M&T Decision in which the Court concluded that to the extent that the balance in the Debtors' payment account with the bank exceeded the Collateral,[4] mutuality of debt existed between BFG and the bank. *See* M&T Decision at 10. With respect to each lease portfolio assigned to the bank, the Court allowed the bank to exercise its right of setoff to that portion of the payment account in excess of the Collateral.

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[4] For purposes of the M&T Decision, "Collateral" referred to the amount initially deposited into each payment account, which was equivalent to the first month's payment to be made by BFG to the bank upon receipt of the lease payments in the bank's portfolio of leases. *See* M&T Decision at 6-7.

The Trustee argues that the causes of action should not be dismissed to the extent that they relate to the collateral portion of the payment accounts because the Court found in the M&T Decision that there was no mutuality of debt for that portion. The Court will grant the Movants' motion and dismiss the Trustee's causes of action only to the extent that they seek a declaration that mutuality of debt does not exist with respect to the non-collateral portion of the payment accounts.

Motion to Dismiss for Failure to Plead Fraud with Particularity pursuant to Fed.R.Bankr.P 7009(b)

Having previously granted the Movants' Motions to dismiss the causes of action based on constructive fraud by virtue of the Court's Order, dated September 29, 2000, the Court need only address the Movants' Motions pursuant to Fed.R.Bankr.P. 7009(b) as they apply to the Trustee's causes of action based on actual fraud pursuant to Code § 548(a)(1)(A) and NYD&CL § 276.

> Under the actual fraudulent transfer provision of Code § 548(a)(1), a prepetition transfer will be avoidable if the debtor "made such transfer . . . with the actual intent to hinder, delay, or defraud" a present or future creditor. Similarly, NYD&CL § 276 provides that "[e]very conveyance made . . . with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." Under either statute, the fraud which must be pleaded with particularity is that of the debtor-transferor; knowledge of the fraud or other misconduct on the part of the transferee is not an element of the plaintiff's proof.

Breeden v. Walnut Street Securities (*In re The Bennett Funding Group, Inc.),* Case No. 96-61376, Adv. Pro. No. 98-70256, slip op. at 6-7 (Bankr. N.D.N.Y. Nov. 24, 1998) (citations omitted).

In *Walnut Street* the Trustee alleged that the defendants were brokers who sold fraudulent interests in the Debtors' Ponzi operation and that every commission that they received had the indirect effect of prolonging the scheme. The Court concluded that the Trustee had provided sufficient information to the defendants to allow for effective litigation and denied their motion to dismiss pursuant to Fed.R.Bankr.P. 7009(b). *Id.* at 7-8.

In *Breeden v. First Nationwide (In re The Bennett Funding Group, Inc.)*, Case No. 96-61376, Adv. Pro. No. 98-70528 (Bankr. N.D.N.Y. Nov. 25, 1998), the Court found that the Trustee's complaint against the defendant, seeking to avoid certain transfers pursuant to the actual and constructive fraudulent conveyance provisions of Code § 548(a)(1) and NYD&CL §§ 271-278, did not comply with Fed.R.Civ.P. 9(b) and Fed.R.Bankr.P. 7009. The complaint in *Nationwide* merely alleged that "[o]ne or more Debtors made payments to Defendant in the amounts and on or about the dates set forth on Exhibit A hereto . . . . The transfers were paid to Defendant from the Honeypot." (*Nationwide* Complaint at ¶ 14). The Court found that the Trustee had not indicated why the money was paid, what services or property were provided by the defendants in exchange or how the transaction operated to defraud creditors of the Debtors. *Id.* at 5. The Court noted that "mere invocation of the phrase 'Ponzi scheme' does not by itself satisfy the requirement of Fed.R.Civ.P. 9(b)." *Id.* The Court noted that "[m]issing from the complaint is any factual allegation that even remotely suggests a nexus between this fraud and the alleged payments to Defendants. Without a more precise description of this nexus, Defendant cannot fairly be expected to prepare a coherent answer to the Trustee's allegations of fraud . . ." *Id.* at 6.

Unlike the complaint in *Nationwide*, the Trustee's amended complaints in the above-

referenced adversary proceedings identify the Movants/Defendants as financial institutions that claimed to have loaned monies to one or more of the Debtors in connection with certain transactions identified in the complaints. The Trustee identifies the amount of the payments made by the Debtors in connection with the loan transactions. In connection with the causes of action alleging fraudulent conveyances, the Trustee asserts that the Debtors were insolvent as early as 1990 and remained insolvent continuously until they filed their bankruptcy petitions because the payments from the lessees of the equipment were inadequate to pay all the obligations due to investors and financial institutions. The Trustee also alleges that the payments to the Movants were made with the actual intent to hinder, delay or defraud creditors. These allegations, as discussed in *Walnut Street*, are sufficiently pled with particularity to meet the standards set forth in Fed.R.Bankr.P. 7009.

Motion to Dismiss pursuant to Fed.R.Bankr.P. 7012

Movants acknowledge that the claims asserted against them are identical to those considered by the Court in the February 1999 Decision in which the Court declined to dismiss the Trustee's cause of action based on Code § 548(a)(1)(A). They are also identical to those considered by the Court in a decision issued subsequent to the filing of the Motions. *See Breeden v. Gloucester Bank and Trust Co. et al. (In re The Bennett Funding Group, Inc.)*, Case No. 96-61376 (Bankr. N.D.N.Y. Feb. 21, 2001) ("February 2001 Decision") (addressing motions seeking dismissal of the Trustee's causes of action/counterclaims for actual fraud based on NYD&CL § 276).

The Movants, relying on *In re Independent Clearinghouse Co.*, 77 B.R. 843 (D.Utah

1987) and *Stratton v. Equitable Bank*, 104 B.R. 713 (D.Md. 1989), *aff'd* 912 F.2d 464 (4th Cir. 1990), argue that the Court in its February 1999 Decision did not consider the fact that if the banks were not involved in the Ponzi scheme as perpetrators of the fraud or as victims who received an exorbitant profit, then they did not receive fraudulent conveyances. *See* Movants' Memoranda of Law, filed June 1, 1999, at 15. Movants contend that the Trustee's complaints are defective because they do not allege that the banks were any of the financial institutions that received multiply-pledged leases or fictitious leases or that they were investors. *Id.* at 16.

These arguments, however, are more appropriately addressed in the context of motions for summary judgment, which was the case in both *Independent Clearinghouse* and *Stratton*. As this Court discussed in its February 1999 Decision,

> [i]n considering a motion brought under Fed.R.Civ.P. 12(b)(6), which is made applicable to this proceeding by Fed.R.Bankr.P. 7012(b), this Court must accept all of the non-movant's allegations as true, and will grant the motion to dismiss "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." (citation omitted). Because a pre-answer order of dismissal deprives the plaintiff of an opportunity to present any evidence on the merits of the case, motions under Fed.R.Civ.P. 12(b)(6) are treated with disfavor, and are granted only with extreme caution. (citations omitted).

February 1999 Decision at 18.

Upon review of the issues raised by the Movants, the Court determines that they are factually and legally identical to those addressed by the Court in the February 1999 Decision (*see* February 1999 Decision at 20-22) with respect to the Trustee's causes of action pursuant to Code § 548(a)(1)(A) and in the February 2001 Decision with respect to NYD&CL § 276. Accordingly, the findings of fact and conclusions of law in those Decisions are incorporated in the present

decision by reference, except with respect to the specific transaction dates and amounts identified in the amended complaints.

Based on the foregoing, it is hereby

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking to avoid the Movants' alleged security interest in certain leases and lease payments pursuant to Code § 544 are denied without prejudice; it is further

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking declaratory relief pursuant to Code § 553 are granted to the extent that they seek a declaration that no mutuality of debt exists with respect to the non-collateral portion of the monies on deposit with the Movants in certain payment accounts, and is denied with respect to the collateral portion of the monies on deposit in certain payment accounts; it is further

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking to avoid certain prepetition transfers based on Code § 548(a)(1)(A) and NYD&CL § 276 pursuant to Fed.R.Bankr.P. 7009(b) are denied, and it is finally

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking to avoid certain prepetition transfers based on Code § 548(a)(1)(A) and NYD&CL § 276 pursuant to Fed.R.Bankr.P. 7012(b) are denied.

Dated at Utica, New York

this 18th day of May 2001

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STEPHEN D. GERLING

Chief U.S. Bankruptcy Judge