FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re: **MANTIFF ALTOONA HOSPITALITY, LLC,** Debtor.	Case No.: 10-34608 (JKS) Judge: Hon. John K. Sherwood

OPINION

APPEARANCES:

The Chartwell Law Offices, LLP
John J. Winter, Esq.
970 Rittenhouse Road, Suite 300
Eagleville, Pennsylvania 19403
Counsel for HSBC Bank USA, National Association, as Indenture Trustee for the Benefit of the Noteholders and the Certificateholders of Business Loan Express Business Loan Trust 2005-A, c/o Ciena Capital Funding, LLC f/k/a BLX Capital, LLC, as Servicer

Greenbaum Rowe Smith & Davis
Thomas A. Waldman, Esq.
Nancy J. Isaacson, Esq.
75 Livingston Avenue
Roseland, New Jersey 07068
Counsel for Nancy J. Isaacson, Chapter 7 Trustee

THE HONORABLE JOHN K. SHERWOOD, BANKRUPTCY JUDGE

Before the Court is the motion (the "Motion") of HSBC Bank USA, National Association, as Indenture Trustee for the Benefit of the Noteholders and the Certificateholders of Business Loan Express Business Loan Trust 2005-A, c/o Ciena Capital Funding, LLC f/k/a BLX Capital, LLC, as Servicer ("HSBC") for an order directing Nancy Isaacson, chapter 7 trustee (the "Trustee") for the bankruptcy estate of Mantiff Altoona Hospitality, LLC (the "Debtor") to abandon and turn over earnest money deposited with the Trustee in connection with a failed sale of the Debtor's real property. The Court must determine whether the earnest money deposit of $93,000 (the "Deposit") is subject to HSBC's liens on the Debtor's real and personal property or whether it is unencumbered property of the Debtor's estate. Applying 11 U.S.C. § 552, the Court concludes that HSBC's pre-petition security interests attach to the Deposit received by the Trustee and will grant the Motion.

The Court has jurisdiction over the Motion pursuant to 28 U.S.C. §§ 1334(b), 157(a), and the Standing Order of Reference from the United States District Court for the District of New Jersey dated July 23, 1984 as amended September 18, 2012. This matter is a core proceeding pursuant to 28 U.S.C. §§ 157(K) and (O). Venue is proper under 28 U.S.C. §§ 1408 and 1409(a). The following shall constitute the Court's findings of fact and conclusions of law as required by Federal Rule of Bankruptcy Procedure 7052.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

On February 23, 2005, the Debtor borrowed the principal amount of $2,050,000 (the "Loan") from HSBC's predecessor-in-interest, BLX Capital, LLC, to purchase real property located at 2915 Pleasant Valley Boulevard, Altoona, Pennsylvania 16602 (the "Property"). The

Loan was secured by a first mortgage against the Property (the "Mortgage"), an assignment of rents (the "Assignment of Rents"), and a security agreement (the "Security Agreement") with respect to the Debtor's personal property. The terms of these agreements are not in dispute and there is no doubt that, taken together, they are designed to give the secured party a lien on virtually all (if not all) of the Debtor's assets and the proceeds thereof.

For example, the Mortgage grants all of the Debtor's rights and interests in "any and all revenues, income, rents, issues, and profits from and of any of the Mortgaged Premises" and "all proceeds of the conversion, voluntary or involuntary, of any of the [Property] into cash or liquidated claims" as security. (Cert. of Kirk W. Horsley in Supp. of Mot. ("Horsley Cert."), ECF No. 228, Ex. C). The Assignment of Rents assigns all of the Debtor's rights and interests in "rents, issues, profits, revenues, royalties, rights and benefits." (*Id.*, Ex. D at ¶ 1). The Security Agreement grants all of the Debtor's rights and interests in all then-owned or thereafter acquired "equipment and machinery . . . all accounts receivable now outstanding or hereafter arising, all contract rights and general intangibles now in force or hereafter acquired (as all such terms are defined in the Uniform Commercial Code)." (*Id.*, Ex. E).

The Debtor defaulted on the Loan and HSBC filed a Complaint against the Debtor in the Court of Common Pleas of Blair County, Pennsylvania, on September 30, 2009. (*Id.* at ¶ 8). HSBC obtained a judgment against the Debtor and scheduled a sheriff's sale of the Property. On August 10, 2010, the Debtor filed a chapter 11 petition to stay the sheriff's sale. (*Id.* at ¶ 9). On November 4, 2010, HSBC filed a secured claim in the amount of $2,069,029.59 in the Debtor's bankruptcy case. (*See* Claim No. 9). An order confirming the Debtor's chapter 11 plan of reorganization was entered on February 1, 2011 and the case was closed. (Horsley Cert. at ¶ 9). Approximately six months later, the Debtor defaulted under the confirmed plan and HSBC

moved to reopen the case and convert it to chapter 7. (*See* ECF No. 135). HSBC's motion was granted and the Court approved the appointment of the Trustee on September 7, 2011. (Horsely Cert. at ¶ 10).

On August 23, 2012, the Trustee entered into an agreement to sell the Property to GCDS, LLC ("GCDS") for $1,000,000 (the "GCDS Sale Agreement"). (*Id*., Ex. H). The GCDS Sale Agreement provided that the Trustee would retain any deposit monies paid by GCDS as liquidated damages if GCDS defaulted on its obligations under the contract. (*Id.* at ¶ 20(F) ("Seller may elect to retain those sums paid by Buyer, including deposit monies . . . [a]s liquidated damages for [the Buyer's] default."). On November 13, 2012, the Court entered an order granting the Trustee's motion to approve the GCDS Sale Agreement pursuant to section 363 of the Bankruptcy Code. (*See In re Mantiff-Jahnavi Zanesville Hospitality, LLC*, No. 08-26040, ECF No. 286).[1] Although the sale order provided for closing within ten days of entry, the sale was delayed significantly while various addenda to the agreement were executed. (Horsley Cert. at ¶ 12). On January 25, 2014, the Trustee, as Seller, and GCDS, as Buyer, executed the Seventh Addendum to the GCDS Sale Agreement, which provided, in pertinent part:

> Paragraph 3(A) of the Agreement of Sale is hereby amended to provide that on or before January 24, 2014, an additional, non-refundable, earnest money deposit shall be paid by Buyer to Seller concurrently with Buyer's execution of this Seventh Addendum, in the amount of $5,000.00 (thereby increasing the total earnest money deposit to $93,000.00), and if closing does not occur by no later than February 10, 2014, based upon the default of Buyer as set forth in the Agreement of Sale, as modified by the First Addendum, Second Addendum, Third Addendum, Fourth Addendum, Fifth Addendum, Sixth Addendum, and this Seventh Addendum, the parties agree that there will be no further

[1] The Debtor's bankruptcy case was, for a period, jointly administered with the chapter 11 case of an affiliate, Mantiff-Jahnavi Zanesville Hospitality, LLC. *See In re Mantiff-Jahnavi Zanesville Hospitality, LLC*, No. 08-26040, ECF No. 302. The GCDS sale order was entered in this case.

> extensions of the time to close thereunder, and, on ninety-six (96) hours' notice from Seller to Buyer (the "Default Notice"), the Buyer will be deemed to be in default of its obligations under the Agreement of Sale, as modified, without further notice or demand, and the total of all earnest money deposits made as aforesaid shall be immediately forfeited to Seller as liquidated damages to the Seller as set forth in Paragraph 20(G) of the Agreement of Sale.

(*Id.*, Ex. I) (emphasis added). GCDS failed to close by the agreed-upon deadline, and the $93,000 Deposit was forfeited when the Trustee terminated the sale agreement on March 28, 2014. (*Id.* at ¶ 14).

On July 10, 2014, the Trustee agreed to sell the Property to a new purchaser, City Line Hospitality, LP ("City Line"), for the same purchase price. (*Id.* at ¶ 15; *see also* ECF No. 219-2). An order approving the sale was entered on July 22, 2014 and the sale closed on February 19, 2015. (*See* ECF No. 224).[2] Despite the fact that the sale resulted in HSBC recovering less than one third of its $2,069,029.59 secured claim, HSBC agreed to set aside $45,000 of the sale proceeds as a carve-out for the Trustee under the sale agreement. (*See* ECF No. 219-2, Ex. A, ¶ 33(B)(6)). The carve-out included an agreed, projected distribution to unsecured creditors in the amount of $26,815.83 and the sum of $18,184.17 to cover the Trustee's anticipated administrative expenses. (Horsley Cert. at ¶ 17). After providing for the payment of significant tax liens on the Property and the carve-out, HSBC received $603,599.05 of the $1,000,000 purchase price. (*See* HUD-1 Settlement Statement, Horsley Cert., Ex. K).

On July 14, 2015, HSBC filed the instant Motion seeking turnover of the Deposit. (ECF No. 228). HSBC asserts that its perfected pre-petition security interest in all of the Debtor's real and personal property extends to the Deposit. The Trustee argues the Deposit is not subject to HSBC's liens, but is an unencumbered, post-petition asset of the Debtor's chapter 7 estate.

[2] The order approving the sale to City Line inadvertently named GCDS as Buyer instead of City Line. A corrective order was entered on August 25, 2014. (*See* ECF No. 226).

DISCUSSION

It is pretty clear that liquidated damages under an agreement to sell the Property would be within the scope of HSBC's vast pre-petition security interest if the liquidated damages claim existed as of the date the bankruptcy was filed.[3] Here, however, the estate's right to liquidated damages against GCDS arose post-petition. Thus, § 552 of the Bankruptcy Code is implicated.

Section 552(a) governs the effect of a pre-petition security interest on property acquired after the filing of the petition, providing:

> Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

11 U.S.C. § 552(a). Thus, the general rule is that property acquired by the estate following the commencement of the case is not subject to pre-petition liens. It appears that the purpose of this rule is to expand the estate so that more value can be distributed to creditors other than pre-petition lienholders. *See In re Bering Trader, Inc.*, 944 F.2d 500, 502 (9th Cir. 1991) ("Section 552(a) is intended to allow a debtor to gather into the estate as much money as possible to satisfy the claims of all creditors."); *In re Tracy Broadcasting Corp.*, 438 B.R. 323, 329 (Bankr. D. Colo. 2010) ("The primary purpose of § 552's invalidation of after-acquired property clauses is to facilitate the debtor's fresh start, rehabilitation, and reorganization.").

The exception to § 552(a) is found in § 552(b), which provides, in relevant part:

> Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to

[3] *See In re Allegheny Imaging Institute*, 69 B.R. 932, 937 (Bankr. W.D. Pa. 1987).

> proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, products, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 552(b)(1). Thus, while the general rule is that after-acquired property is not subject to pre-petition liens, the exception provides that a secured party's lien continues to encumber the "proceeds, product, offspring, rents, or profits" generated from pre-petition collateral. *Id.* A creditor bears the burden of proving that a pre-petition security interest survives into the post-petition period. *See In re Ne.Copy Servs., Inc.*, 175 B.R. 580, 582-83 (Bankr. E.D. Pa. 1994); *In re Lease–A–Fleet, Inc.*, 152 B.R. 431, 434–35 (Bankr. E.D. Pa. 1993). For a security interest to attach to post-petition assets, a creditor must demonstrate that the security agreement extends to proceeds of collateral and that the asset in question is proceeds of pre-petition collateral. *See In re Ne. Copy*, 175 B.R. at 582-83. The legislative history of section 552 suggests that what constitutes "proceeds" of collateral should be construed broadly. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 376-77 (1977) ("The term 'proceeds' is not limited to the technical definition of that term in the U.C.C., but covers any property into which the property subject to the security interest is converted.").

HSBC argues that its liens extend to the Deposit because courts have held that an earnest money deposit paid pursuant to a proposed sale of pre-petition property constitutes "proceeds" of the property. *See, e.g., Old Stone Bank v. Tycon I Bldg. Ltd. P'ship,* 946 F.2d 271 (4th Cir. 1991); *In re Aldersgate Found., Inc.,* 878 F.2d 1326 (11th Cir. 1989). Whether the Deposit is "proceeds" of the Property under 552(b) involves a two-part analysis. First, the Court must determine whether proceeds of the Property are covered under the language of the security

instruments and applicable Pennsylvania law. *See* 11 U.S.C. § 552(b) (a lien extends to after-acquired property "only to the extent provided by such security agreement and by applicable nonbankruptcy law"); *In re Ne. Copy*, 175 B.R. at 582-83 (the first step of the analysis under § 552(b) is that that the security agreement "must extend to after-acquired property of the designated categories"). Here, the Mortgage grants a security interest in "all revenues, income, rents, issues, and profits" of the Property and "all proceeds of the conversion, voluntary or involuntary, of any of the [Property] into cash or liquidated claims." (Horsely Cert., Ex. C at 2). The Security Agreement grants a security interest in the Property and all fixtures, equipment, personal property, contract rights, and general intangibles of the Debtor and all "[p]roceeds and products" thereof. (*Id.*, Ex. E) Given the broad construction of "proceeds" under § 552, the Mortgage and Security Agreement clearly establish a lien on proceeds of the Property.[4]

The second question is whether the Deposit constitutes proceeds of the Property. *In re Ne. Copy*, 175 B.R. at 582-83 (second step of analysis under § 552(b) requires creditor to demonstrate that after-acquired property "fit[s] within the five enumerated categories of § 552(b)."). In *Old Stone Bank v. Tycon I Building Limited Partnership*, 946 F.2d 271 (4th Cir. 1991), the Fourth Circuit held that an earnest money deposit forfeited upon a failed sale of real property was proceeds of collateral under a deed of trust. Similar to the security agreements here, the deed of trust in *Old Stone* granted the secured creditor an interest in "all rents, issues, and profits arising from" the property.[5] *Id.* at 272. After the bankruptcy court and district court found that the deposit was not a proceed of the property, the Fourth Circuit reversed. Looking to

[4] *See also* 13 Pa. C.S.A. § 9203(f) ("The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by section 9315."); *Id.* at § 9315(a)(2)("[A] security interest attaches to any identifiable proceeds of collateral.").

[5] Although the deed of trust did not explicitly extend to "proceeds" of the collateral, the court noted that a "security interest in collateral extends to the proceeds of the collateral even if they were not explicitly mentioned in the governing security agreement" because "[a]ny contrary rule would allow a debtor to defeat a security interest simply by selling the collateral out from under the creditor and retaining possession of the proceeds." *Old Stone*, 946 F.2d at 273.

Virginia's adoption of the Uniform Commercial Code (the "UCC"),[6] which defined "proceeds" as "whatever is received upon the sale, exchange, collection, or other disposition of collateral or proceeds" the court held that the deposit constituted proceeds because "[s]elling [the] right to purchase the property at a given price was a disposition of the collateral." *Old Stone*, 946 F.2d at 273 (quoting *In re Aldersgate Found., Inc.*, 878 F.2d 1326, 1328 (11th Cir. 1989)). The court rejected the debtor's argument that there was no "sale, exchange, collection, or other disposition of collateral" simply because the sale was never consummated. *Id.* at 275. The court held that the execution of the sale agreement resulted in a disposition of the property because valuable rights arising out of the property were conveyed in exchange for the deposit. The Debtor conveyed not only the exclusive right to purchase the property, but, under Virginia law, equitable title to the property was transferred to the purchaser. *Id.* at 274 ("[T]he deposit was received in substitution for part of the collateral—the equitable title to the property.").

Pennsylvania's codification of Revised Article 9 of the UCC adopts an even broader definition of proceeds. 13 Pa. Cons. Stat. Ann. § 9102 defines "proceeds" to include, among other things, the following property:

> (1) Whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral.
>
> (2) Whatever is collected on or distributed on account of collateral.
>
> (3) Rights arising out of collateral.

13 Pa. Cons. Stat. Ann. § 9102 (West). Although the UCC does not govern the proposed sale of the Property to GCDS, courts often look to its definition of proceeds in determining whether after-acquired property constitutes proceeds of collateral. *See Old Stone*, 946 F.2d at 273; *In re*

[6] *See* Va. Code Ann. § 8.9-306(2). Although Virginia's enactment of the UCC did not govern the transaction since it involved a sale of real property, the Fourth Circuit nonetheless considered it instructive in interpreting whether the earnest money deposit constituted proceeds of the deed of trust.

Ne. Copy, 175 B.R. at 583 ("In interpreting § 552(b), the term 'proceeds' must not be separated from its state law, Uniform Commercial Code meaning."). Under this definition, the Deposit constitutes proceeds "acquired upon the sale, lease, license, exchange, or other disposition of collateral" because the execution of the GCDS Sale Agreement resulted in the granting of valuable rights in the Property to GCDS. As in *Old Stone*, there was a disposition of the property because Pennsylvania law provides that a contract for the sale of real estate results in the transfer of equitable title to the purchaser. *McCannon v. Marston*, 679 F.2d 13, 15 (3d Cir. 1982) ("The law of Pennsylvania considers a purchaser under a written agreement for the sale of real property to be the equitable owner of that property."); *Dubin Paper Co. v. Ins. Co. of N. Am.*, 361 Pa. 68, 76 (1949). Because the Debtor conveyed equitable title to GCDS in exchange for the Deposit, the Deposit is a proceed of the Property.[7] Thus, HSBC's lien on proceeds of the Property and other pre-petition collateral pursuant to the Mortgage and Security Agreement extends to the Deposit.

The reasoning of the majority in *Old Stone* has been advanced by numerous courts addressing similar factual scenarios, including the Eleventh Circuit. *See, e.g., In re Aldersgate Found., Inc.*, 878 F.2d 1326 (11th Cir. 1989) ("When the would-be purchasers deposited the earnest money on the properties . . . a valuable right to the property was conveyed. Selling that right to purchase the property at a given price was a disposition of the collateral, and the forfeited deposits thus fall within the statutory definition of proceeds."); *In re Vandevender*, 87 B.R. 59, 61 (Bankr. S.D. Ill. 1988) (forfeited earnest money was proceeds from sale of real property to which valid liens could attach because "but for the sale of the encumbered property, the earnest

[7] Also, the Deposit arguably constitutes proceeds of the Property under the third category enumerated in 13 Pa. Cons. Stat. Ann. § 9102 because the right to liquidated damages was a "right[ ] arising out of collateral" since the right to keep the Deposit upon the purchaser's default clearly arose from and could not have existed without the Property.

money deposits would never have been forfeited to the trustee."); *In re Clancy & Co. Constr.*, 214 B.R. 387 (Bankr. D. Colo. 1997) (forfeited deposit was derived from a sale of the land and constituted proceeds). These cases provide further support for the relief requested by HSBC.

Finally, although § 552(b) gives the Court authority to disallow a lien on proceeds to extend into the post-petition period "based on the equities of the case," equitable considerations also favor HSBC. 11 U.S.C. § 552(b). Disregarding HSBC's lien would not promote any of the purposes of § 552(a) because the Trustee was simply seeking to liquidate the estate's primary asset under chapter 7 at the time of the GCDS Sale Agreement. There was no business to reorganize or rehabilitate. While § 552(a) is designed to create a greater recovery for all creditors by freeing up newly created assets brought into the estate during the post-petition period, the equities of this case do not compel disallowance of HSBC's lien against the Deposit. As of November 4, 2010, HSBC's secured claim was $2,069,029.59. Thus, the sale to City Line resulted in a less than one-third recovery upon HSBC's secured claim based on the original loan amount. Nevertheless, HSBC agreed to a meaningful carve-out from the proceeds of the sale to City Line for the benefit of the Trustee and unsecured creditors. In light of these considerations, the equities of the case favor enforcement of HSBC's lien, and the Court will grant HSBC's Motion.[8]

Although the Motion is granted, the Court agrees that the Trustee is entitled to the reasonable expenses of preserving and disposing of the Property pursuant to 11 U.S.C. § 506(c). Accordingly, to the extent the Trustee's reasonable expenses exceed the amount of administrative expenses provided for in the carve-out, the Trustee may retain (or set aside) such amounts from the Deposit. The parties should meet and confer to see if an agreement can be

[8] For the sake of completeness, this was not an easy decision for the Court. The Trustee's side of the argument was very compelling and was put forth in a good faith effort to maximize the distribution in this case for unsecured creditors.

reached as to the reasonable amount of the Trustee's fees and expenses. To the extent an agreement cannot be reached, the Trustee can submit a motion for allowance of fees and expenses under § 506(c) of the Bankruptcy Code.

CONCLUSION

For the above reasons, HSBC's Motion is granted. An Order in conformance with this Opinion will be entered.

Very truly yours,

s/ John K. Sherwood

JOHN K. SHERWOOD
UNITED STATES BANKRUPTCY JUDGE