

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In Re:

Eastway Lincoln-Mercury, Inc.,

Debtor.

CASE #96-22201

DECISION & ORDER

BACKGROUND

On August 1, 1996, Eastway Lincoln-Mercury, Inc. (the “Debtor”), a Lincoln-Mercury and Saab franchisee, filed a petition initiating a Chapter 11 case. On December 12, 1996, an Order was entered authorizing the Debtor to sell substantially all of its assets. At this time, the Debtor is collecting certain accounts receivable and preparing a liquidation plan.

On May 7, 1997, Key Bank of New York (“Key Bank”) filed a request, pursuant to Section 503(a), for the allowance and payment of an administrative expense, which alleged that: (1) prior to the filing of the petition, the Debtor, in the ordinary course of its business and in connection with two purchase and sale transactions, took in trade a 1992 Lincoln (the “Lincoln”) and a 1995 Mercury (the “Mercury”); (2) at the time the Debtor took ownership and possession of the Lincoln and Mercury, Key Bank had properly perfected purchase money security interests in them; (3) on July 31, 1996, the day prior to the filing of its petition, the Debtor drew two checks on its Marine Midland operating account (the “Marine Account”) payable to Key Bank to pay off the balance due on the retail installment contracts secured by the Key Bank liens on the Lincoln and Mercury; (4) the Debtor’s \$14,969.00 check to pay off the balance due on the Lincoln and its \$13,209.30 check to pay off the balance due on the Mercury were forwarded to Key Bank sometime subsequent to July 31,

1996 along with requests for releases of the Key Bank liens on the vehicles; (5) when Key Bank received the Debtor's checks and requests for lien releases on August 15, 1996, it was unaware that the Debtor had filed a Chapter 11 petition; (6) after depositing the Debtor's checks for collection in the ordinary course of its business, Key Bank issued the requested lien releases to the Debtor; (7) both of the Debtor's checks were thereafter returned for insufficient funds; and (8) Key Bank believed that pursuant to Section 503(b)(1)(A) it was entitled to the allowance and payment of an administrative expense in the amount of the checks plus interest since paying these amounts to obtain the lien releases would be actual, necessary costs of preserving the estate.

On the May 14, 1997 return date of Key Bank's request for the allowance and payment of an administrative expense, the matter was adjourned to May 21, 1997 so that the parties could provide the Court with the additional information it requested regarding the status of the Lincoln and the Mercury on the date of the filing of the Debtor's petition.

On May 21, 1997, the Debtor, by its attorney, filed a statement which indicated that: (1) the Debtor had re-sold the Lincoln on July 13, 1996 and the Mercury on July 20, 1996; and (2) since the vehicles were sold before the date of the filing of the petition, even though Key Bank had a perfected lien on the vehicles at the time, the vehicles did not become property of the estate and, therefore, as against the Debtor, Key Bank's claims were pre-petition unsecured claims and were not entitled to be paid as administrative expenses.

DISCUSSION

Pursuant to Section 541(a)(1), an estate was created on the date the Debtor filed its petition

on August 1, 1996 consisting of all legal and equitable interests which the Debtor had in property (the "Estate"). Since the Lincoln and the Mercury had been re-sold by the Debtor and delivered to the new buyers well before August 1, 1996, these vehicles did not become part of the Estate.

Furthermore, there have been no facts and circumstances presented to the Court from which it could conclude that the Estate included any of the proceeds of the Debtor's resale of the Lincoln or the Mercury. The schedules filed by the Debtor on September 6, 1996 include a copy of a July 26, 1996 Ford Motor Company Dealer Financial Statement (the "Dealer Statement") for the Debtor. This Dealer Statement indicated that the Debtor had a \$43,242.00 overdraft in the Marine Account, and its only other bank account was a special purpose tax account which had a deposit balance of \$33,660.00. Therefore, the Dealer Statement indicated that on July 26, 1996, five days before it issued its checks to Key Bank, the Debtor had an overall negative cash balance of approximately \$12,000.00. As a result, the Court must conclude that any actual proceeds received by the Debtor from the resale of the Lincoln and the Mercury had been commingled in the Debtor's bank accounts rather than segregated, and were expended before and did not become a part of the Estate on the August 1, 1996 filing date.

In addition, the resale dates for the vehicles, which are also the presumed dates of the receipt by the Debtor of the resale proceeds, were more than ten days prior to both the check issue date of July 31, 1996 and the date of the filing of the Debtor's petition on August 1, 1996. This indicates that any perfected security interest which Key Bank may have had in the cash proceeds pursuant to Section 9-306 of the New York Uniform Commercial Code had expired prior to these dates.

Since the evidence before the Court indicates that neither the vehicles in which Key Bank

had a perfected security interest nor their resale proceeds ever became property of the Estate, the release of the those liens did not in any way enhance or benefit the Estate. Both on July 31, 1996, when the checks were drawn, and on August 1, 1996, the date of the filing of the petition, someone had unsecured claims against the Debtor because of the failure of the Debtor to pay off the Key Bank liens. If post-petition the Debtor had not been able to obtain the Key Bank releases of lien, after Key Bank pursued them for the payment of the amounts due on its unreleased liens or repossessed the vehicles, the resale purchasers would have had unsecured claims against the Debtor for its breach of the warranty that it had sold the vehicles free and clear of liens. Having released the lien, Key Bank cannot look to the innocent resale purchasers, so it holds the unsecured claims against the Debtor.

The Court is aware, as are all of the parties, that criminal violations may have been committed, and it certainly does not in any way endorse the actions of the Debtor in connection with these matters. However, there is nothing before the Court which would permit it to find that the allowance and payment of an administrative expense to Key Bank would in any way enhance, preserve, or benefit the Estate. As set forth above, neither the vehicles in question nor their proceeds were ever property of the Estate, and the allowance and payment of an administrative expense would not further the underlying policy of Section 503, which is to grant an administrative priority to post-petition expenses so that third parties will be moved to provide the goods and services necessary for a successful reorganization.

CONCLUSION

