

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

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**In Re:**

**TWIN PARCELS, INC., d/b/a  
PITTSFORD FLORIST,**

**Debtor.**

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**BK. NO. 92-20400**

**DECISION & ORDER**

**BACKGROUND**

**I. Case Overview**

On February 14, 1992, Twin Parcels, Inc., d/b/a Pittsford Florist (the “Debtor”), filed a petition initiating a Chapter 11 case. On March 11, 1993, an Order was entered approving the Debtor’s Amended March 4, 1993 Disclosure Statement (the “Disclosure Statement”), and on September 16, 1993, an Order was entered (the “Confirmation Order”) confirming the Debtor’s August 24, 1993 First Amended Plan of Reorganization, as further orally amended at a July 29, 1993 adjourned confirmation hearing (the “Plan”).

On November 1, 1994, after it had become clear that the Debtor was no longer able to continue in business and make all of the payments required by the confirmed Plan, the Debtor filed a Motion to Modify Plan and to Sell All the Assets of the Business Free & Clear of Liens (the “Plan Modification and Sale Motion”) for a sale price of \$60,000.00, which included a \$5,000.00 payment for a covenant not to compete to be executed by Ms. Carpenter (“Carpenter”), the Debtor’s principal. On December 7, 1994, the Court granted the Plan Modification and Sale Motion, however, it was not until May 24, 1995 that an Order was entered (the “Sale Order”).

On October 20, 1995, after the sale of the business for \$60,000.00 fell through, the Debtor

made a further Motion to Amend the Plan and to Sell Assets of the Business (the “Second Plan Modification and Sale Motion”). On December 11, 1995, an Order was entered (the “Second Sale Order”) granting the Second Plan Modification and Sale Motion. The Second Sale Order provided for a sale price of \$46,500.00 and further provided that from the proceeds of the sale there were to be paid the ordinary and necessary closing costs and a balance due to the landlord, TPDS, Inc., with the remaining sale proceeds to be held in escrow by the attorneys for the Debtor subject to a further order of the Court determining a distribution of the proceeds among the various competing creditors.

On January 10, 1996, the Debtor filed a Notice of Motion and Motion for Hearing on Amount, Validity and Priority of Claims to Sale Proceeds (the “Sale Proceeds Motion”) which was initially heard on February 7, 1996 and finally heard on March 6, 1996 after the parties had an opportunity to make further written submissions.

## **II. General Background**

On its schedules, the Debtor listed personal property with an aggregate value of \$16,950.00, including office equipment, furnishings and supplies valued at \$750.00, and inventory, in the nature of flowers, containers and giftware, valued at \$15,000.00. The schedules also listed secured claims of \$100,000.00, consisting of the claim of Norstar Bank (“Norstar”), unsecured priority claims of \$59,416.52, representing unpaid taxes due to the Internal Revenue Service (the “IRS”) and the State of New York (“New York State”), and unsecured nonpriority claims of \$137,902.01.

The Court’s records indicate that the following secured and priority claims were filed: (1) IRS - March 24, 1993 amended claim for \$37,784.16 as secured; \$5,300.51 as priority; and \$911.99

as general unsecured; (2) New York State - April 5, 1993 amended claim for \$23,717.94 as priority; and April 5, 1993 claim for \$2,491.34 as a Chapter 11 administrative expense; and (3) Charles S. Wehle (“Wehle”), as the assignee of Norstar - \$103,859.68 as secured (the “Wehle Secured Claim”).

The Wehle Secured Claim included: (1) an assignment of claim from Norstar, even though Norstar had never filed a proof of claim with the Bankruptcy Court; (2) a copy of a UCC-1 Financing Statement filed on November 4, 1991 with the New York Secretary of State which showed the secured party as Wehle, and in Box 5 for the property covered by the Financing Statement, it read “See Schedule A attached”, however, no Schedule A was attached; and (3) a copy of a UCC-3 Financing Statement Change Form, which assigned Norstar’s March 21, 1988 UCC Financing Statement filing with the New York Secretary of State and the secured party’s rights in the property described to Wehle, however, no property was described, and the copy of the form did not indicate that it was ever filed with the New York Secretary of State.

The Debtor’s December 30, 1992 Plan and the First Amended Plan, dated August 24, 1993, each provided at Article VII that:

“Charles S. Wehle, as assignee of Fleet Bank, a/k/a Norstar Bank of the claim of all claims, shall continue to retain its first security interest in all Debtor’s inventory and the proceeds therefore and shall be paid its note as follows: The principal amount of \$50,000.00 with interest at the rate of 6% per annum, amortized and payable in 10 years, in equal monthly installments commencing of \$555.10 until principal and accrued interest are paid in full.”

The Debtor’s Disclosure Statement filed December 31, 1992 and Amended Disclosure Statement filed March 4, 1993 each stated that:

“the Plan provides that Debtor’s bank lender, Norstar (assigned to Charles Wehle) designated as Class 4, shall continue to retain its note and its security on all of Debtor’s inventory and the proceeds therefrom and shall receive monthly principal payments of \$555.10 plus interest. The current principal balance on the indebtedness is approximately \$50,000.00.”

Wehle filed a ballot with the Court on June 18, 1993 accepting the Plan.

The Confirmation Order memorialized various oral modifications to the Plan concerning the treatment of the claims of the IRS and New York State which had each initially objected to confirmation, but then accepted the Plan as orally modified. Neither the oral modifications nor the Confirmation Order affected the proposed treatment of the Wehle Secured Claim, but the Order specifically provided that, “with respect to the Federal Tax liens, if any, they will remain on pre-petition property subsequent to confirmation”.

The Plan Modification and Sale Motion in November, 1994 indicated that the Debtor had valued its inventory at the time of the proposed sale of the business at approximately \$13,000.00, and proposed to apply the sale proceeds of \$60,000.00 first to payment of the taxing authority claims, then \$10,000.00 was to be paid on the Wehle Secured Claim and last any balance was to be paid to unsecured creditors. The Court’s docket sheet from the December 7, 1994 hearing on the Plan Modification and Sale Motion indicated that the proceeds of the sale as approved by the Court were to be distributed as follows:

“Ms. Carpenter is to be paid \$5,000.00, IRS taxes are to be paid, the New York State administrative claim is to be paid, the landlord’s administrative claim is to be paid and Mr. Wehle is to be paid \$10,000.00. The balance of the proceeds are to be held

in escrow subject to a determination by the Court as to whether Mr. Wehle or the unsecured creditors are entitled to the money. The Order is to specify what taxes are being paid. Order to be submitted.”

As set forth above, the Sale Order, when submitted to the Court for signature, provided only for the payment from the sale proceeds of the claim of the landlord, TPDS, Inc., with the balance of the proceeds to be held in escrow subject to a further order of the Court. The Sale Order was approved as to form by the attorneys for the IRS, New York State and the landlord, as well as by the attorney for Wehle, who indicated in a transmittal letter that his approval of the Order, “in no manner impairs the claim of Charles S. Wehle that he is the first secured creditor in the above bankruptcy case.”

The Second Plan Modification and Sale Motion in October, 1995 indicated that the Debtor’s inventory still had a value of approximately \$13,000.00, and stated that, “[t]o the extent that monies are available, it is proposed that they be applied to administrative claims, if any, the next to the taxing authority priority claims and then finally the balance, if any, would be paid to the unsecured creditors.”

The Second Sale Order, approved by the attorney for Wehle, provided for the payment of the then outstanding balance to the landlord, TPDS, Inc., with the balance of the sale proceeds to be held in escrow subject to further Court order.

**III. Sale Proceeds Motion**

The Sale Proceeds Motion in January, 1996 indicated that the Debtor’s attorney was holding \$11,085.00 in escrow and that, pursuant to the Purchase and Sale Agreement, the purchaser had

executed a Note in the principal amount of \$26,500.00, to be paid over time.

On January 25, 1996, Wehle filed an Application for Payment of Entire Proceeds from Sale (the "Wehle Application"). The Application: (1) acknowledged that the confirmed Plan provided, with respect to the Wehle Secured Claim that "Charles S. Wehle, as assignee of Fleet Bank, a/k/a Norstar Bank of the claim of all claims, shall continue to retain its first security interest in all Debtor's inventory and the proceeds therefore"; (2) acknowledged that the Plan capped the allowed secured claim of Wehle at \$50,000.00, and that no payments had been received on the allowed secured claim; and (3) requested that the entire net cash proceeds in trust and the promissory note be delivered to Wehle in payment towards his secured claim.

On January 23, 1996, the IRS filed a Response to the Sale Proceeds Motion which asserted that the secured claim of the IRS, which was not subject to avoidance, remained at \$37,784.16 and that its unsecured priority claim remained at \$5,300.51.

On February 6, 1996, the IRS filed a response to the Wehle Application (the "IRS Wehle Response"), which asserted that Wehle was not entitled to any of the sale proceeds because the March 21, 1988 UCC-1 Financing Statement filed by Norstar with the New York Secretary of State had not been continued and, therefore, his filing and perfected security interest under New York State law had lapsed. The Response asserted that, pursuant to New York Uniform Commercial Code Section 9-403(2)<sup>1</sup>, the filing would have had to have been continued by February 14, 1994, a date

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<sup>1</sup> Section 9-403(2) provides:

Except as provided in subsection (6) a filed financing statement is effective for a period of five years from the date of filing. The

sixty days after December 15, 1993 when an Order was entered closing the Debtor's Chapter 11 case. However, the IRS also asserted in its Response that in a Chapter 11 case the sixty-day window commenced with the entry of an order of confirmation, which in this case was September 16, 1993. The IRS Wehle Response also contended that the UCC-1 filed by Wehle with the New York Secretary of State was ineffective as a continuation statement, and no other information was available as to whether Wehle or Norstar had ever filed a financing statement with the Monroe County Clerk's Office, the county in which the Debtor's business was located.

On February 27, 1996, after the Court had adjourned an initial hearing on the Sale Proceeds Motion to afford the parties an opportunity to make further submissions, New York State filed a response to the Sale Proceeds Motion (the "New York State Response"). The New York State Response asserted that: (1) in accordance with Section 1141(c)<sup>2</sup> and relevant case law, the only assets

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effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

<sup>2</sup> Section 1141(c) provides:

Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

of the Debtor in which Wehle retained a perfected security interest after confirmation of the Plan was inventory and the proceeds of inventory, as specifically provided for in the Plan; and (2) Wehle should be treated as an unsecured creditor with respect to the proceeds of the sale of the Debtor's business held in escrow, since Wehle's perfected security interest had lapsed between the date of confirmation and the date of the closing of the sale and the pending Sale Proceeds Motion.

On February 27, 1996, the IRS filed a further response to the Wehle Proceeds Application, which expanded on its prior position with respect to the lapse of the Wehle perfected security interest, and contended that Wehle's security interest in the proceeds, if any, should be limited to the value of the inventory sold.

## **DISCUSSION**

### **I. The Wehle Security Interest**

The Court still does not know for certain what assets the Debtor had granted Norstar, a security interest in, because the Wehle Secured Claim is completely deficient and no other pleadings or proceedings in this case have supplied the Court with that information. Notwithstanding this, it appears that at the time of confirmation the Debtor agreed and acknowledged in its Disclosure Statements and Plans that Wehle, as the assignee of Norstar, had a perfected and continuing security interest in the Debtor's inventory and the proceeds of inventory.

In view of the amounts of the secured and priority claims held by the IRS and New York State, when the two Plan Modification and Sale Motions were made the only parties with an actual



interest in the net sale proceeds (the sale proceeds after the payment of the necessary closing costs, the landlord and the amounts due Carpenter) were Wehle, the IRS and New York State.

During the confirmation process, Wehle filed a ballot accepting the Debtor's Plan. The Plan clearly provided that he would retain a lien only on inventory and the proceeds of inventory, and the IRS and New York State also accepted the Plan which contained that specific provision.<sup>3</sup>

By reason of the foregoing, upon confirmation of the Debtor's Plan, which specifically provided that Wehle would retain a lien only on inventory and proceeds, any other lien which Wehle may have held pre-confirmation was extinguished by the confirmation of the Chapter 11 Plan. *See* 11 U.S.C. Section 1141(c) and *Matter of Penrod*, 50 F.3d 459 (7th Cir. 1995).

## **II. Lapse of Wehle's Perfected Security Interest**

The Court believes that the IRS and New York State by their actions in connection with the Plan Modification and Sale Motion, which occurred after the Norstar/Wehle New York State filings had arguably lapsed, waived the right to later assert such a lapse. At the time of that Motion, all of the interested parties specifically requested that the Court assist them in selling the assets of the Debtor's business as a going concern so that a maximum return could be obtained for those parties,

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<sup>3</sup> At the adjourned hearing on the Sale Proceeds Motion, the attorney for Wehle asserted that the provision in the Plan, "inventory and the proceeds therefore" clearly meant, and should be interpreted by the Court as meaning, inventory and the proceeds of all other assets of the Debtor, including equipment, furnishings and fixtures, goodwill and other intangibles. The Court rejected any such interpretation as being absolutely unsupportable based upon the specific language of the Plan, the requirements for describing collateral with specificity contained in the New York State Uniform Commercial Code Sections 9-306 (Proceeds) and 9-402, the requirements of Rule 3001(a), (c) and (d) regarding the filing of proofs of claim, and the specific treatment of the Wehle Secured Claim set out in the Debtor's Disclosure Statements.

including the IRS and New York State. Therefore, I do not believe that I need to decide the question of the affect of the lapse of the Norstar/Wehle New York State filings.

At the time of the hearing on the Plan Modification and Sale Motion in December, 1994, the Court clearly pointed out to the parties that since substantial consummation had occurred, Section 1127(b) prevented a plan modification as proposed. The parties, including the Debtor, Wehle, the IRS and New York State, specifically requested that, notwithstanding Section 1127(b), the Court cooperate with them in allowing a sale of the business as a going concern so that a maximum return could be obtained for Wehle and the taxing authorities. In their request for the approval and cooperation of the Court, the IRS and New York State acknowledged Wehle's continuing security interest in the Debtor's inventory, and the Court at the hearing on the Motion, with their consent and acknowledgment, approved a distribution to Wehle of \$10,000.00 by reason of his continuing security interest in inventory. Although the Sale Order when submitted provided only for the payment of necessary closing costs and the landlord, it now appears that was because Wehle's attorney was continuing to assert that Wehle had a right to the proceeds of the sale other than the proceeds of inventory, an assertion that was made in an application filed on behalf of Wehle on November 29, 1994. That application contended, without a detailed explanation or justification, that after the payment of the administrative claim of New York State and the \$5,000.00 payment to Carpenter, the balance of the proceeds, including the purchaser's promissory note, should be paid to Wehle as a secured creditor.

By reason of the foregoing, the Court believes that it would be inequitable now, in connection

with the sale of the business as a going concern, for the IRS and New York State to assert the lapse of the Norstar/Wehle New York State filings as a basis for him not to receive the proceeds of the sale of inventory pursuant to a security interest which they had previously acknowledged after the lapse. Had the IRS and New York State asserted the lapse issue at the time of the Plan Modification and Sale Motion, the Court would have refused to grant the Motion, because of Section 1127(b), and the parties would have been left to their respective State Court rights as defined by the confirmed Plan or the prospect of a subsequent bankruptcy petition, both with their added delays and costs.

**CONCLUSION**

From the sale proceeds held in escrow, there shall be paid the following: (1) \$8,000.00 to Charles S. Wehle, representing the value of the inventory sold, an amount set forth between the purchaser and the Debtor in a bulk sale notice sent out in connection with the sale; (2) \$1,077.50 to Gates & Adams, Michael J. Townsend, Esq., of counsel, for the actual legal expenses incurred in connection with the purchase and sale closing; (3) the claims of the Internal Revenue Service; (4) the claims of New York State; and (5) the balance, if any, to the unsecured creditors on a pro rata basis.

**IT IS SO ORDERED.**

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**HON. JOHN C. NINFO, II**  
**U.S. BANKRUPTCY JUDGE**

**Dated: April 18, 1996**