

Square Mile Structured Debt (One) LLC v Swig

2010 NY Slip Op 32937(U)

October 15, 2010

Sup Ct, NY County

Docket Number: 603825/08

Judge: Bernard J. Fried

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. BERNARD J. FRIED

E-FILE

PART 60

Index Number : 600613/2010

FIRST REPUBLIC BANK

VS.

BIENSTOCK, MARTIN

SEQUENCE NUMBER : 001

TURNOVER PROCEEDING



INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

on this motion to/for _____

PAPERS NUMBERED

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

This motion is decided in accordance with the attached memorandum decision.

SO ORDERED

Dated: 10/15/2010
~~10/14/2010~~

HON. BERNARD J. FRIED J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 60

-----X
SQUARE MILE STRUCTURED DEBT (ONE) LLC and :
SQUARE MILE STRUCTURED DEBT (THREE) LLC, :

Petitioners, :

-against- :

Index No. 603825/08

KENT M. SWIG; SWIG EQUITIES, LLC; SWIG :
BURRIS EQUITIES, LLC; HALSTEAD PROPERTY, :
LLC; HALSTEAD BROOKLYN, LLC; HALSTEAD :
PROPERTY RIVERDALE, LLC; HALSTEAD :
PROPERTY DEVELOPMENT MARKETING, LLC; :
HALSTEAD PROPERTY HUDSON VALLEY, LLC; :
SE WEST 57 MANAGEMENT, LLC; SE WEST 57 :
OWNERSHIP LLC; SE WEST 57 DIRECTOR, LLC; :
SE WEST 57 CAPITAL, LLC; SE WEST 57 :
PROPERTY, LLC; KMS HOLDINGS, LLC; SBE 110 :
WILLIAM PROPERTY, LLC; SBE 110 WILLIAM :
MANAGEMENT, LLC; SBE 44 WALL, LLC; SBE 44 :
WALL MANAGEMENT, LLC; SE 90 BROAD :
MANAGEMENT, LLC; SE 90 BROAD CAPITAL, :
LLC; SE 90 BROAD OWNERSHIP, LLC; SE 5 :
HANOVER MANAGEMENT, LLC; SE 5 HANOVER :
CAPITAL, LLC; SE 5 HANOVER OWNERSHIP, LLC; :
KMS 5 HANOVER, LLC; SE 450 SANSOME :
PRINCIPAL, LLC; SE 450 SANSOME :
MANAGEMENT, LLC; SE 450 SANSOME :
OWNERSHIP, LLC; SE 450 SANSOME CAPITAL :
LLC; SE 80 BROAD MANAGEMENT, LLC; SE 80 :
BROAD CAPITAL, LLC; SE 80 BROAD :
OWNERSHIP, LLC; 140 WILLIAM MANAGEMENT, :
LLC; 140 WILLIAM CAPITAL, LLC; SBE 48 :
MANAGEMENT, LLC; SBE 48 WALL, LLC; BROWN :
HARRIS STEVENS, LLC; HELMSLEY SPEAR, LLC; :
FALCON PACIFIC CONSTRUCTION, LLC; :
FORTRESS INVESTMENT GROUP, LLC; SBE 110 :
WILLIAM OWNERSHIP, LLC; SBE 44 WALL- :
OWNERSHIP, LLC; 770 LEXINGTON ASSOCIATES, :
LLC; SBE 770 REALTY, LLC; FIRST 89, LLC; SBE :
89, LLC; SBE 63, LLC; BHS REALTY COMPANY, :

LLC; KMS-BHS, LLC; SBE WEST 92 :
 MANAGEMENT, LLC; CHELSEA 21ST STREET :
 CORP.; 110 WILLIAM, LLC; 140 WILLIAM, LLC; :
 MERCER SQUARE, LLC; SBE 44 CAPITAL, LLC; :
 BROWN HARRIS STEVENS PROJECT :
 MARKETING, LLC; BROWN HARRIS STEVENS :
 RESIDENTIAL SALES, LLC; BROWN HARRIS :
 STEVENS BROOKLYN, LLC; BROWN HARRIS :
 STEVENS WESTHAMPTON, LLC; BROWN HARRIS :
 STEVENS RESIDENTIAL MANAGEMENT, LLC; :
 BROWN HARRIS STEVENS SELECT, LLC; :
 FEATHERED NEST RESIDENTIAL, LLC; ZZSB :
 MANAGEMENT, LLC; JACOB MEYERS ELEVATOR :
 COMPANY, LLC; 770 REALTY ASSOCIATES, LLC; :
 ZILNEK, LLC; SBE PARKING 89, LLC; SHB :
 CAPITAL, LLC; ALLIED HOLDINGS COMPANY II; :
 80 BROAD MEZZ PARENT, LLC; KMS PARK, LLC; :
 5 HANOVER MEZZ, LLC; SWIG EQUITIES WEST, :
 INC.; KMS 80 BROAD, LLC; 90 BROAD STREET :
 REALTY COMPANY, LLC; 5 HANOVER REALTY :
 COMPANY, LLC; AZ-48 WALL, LLC; WLZ-48 :
 WALL, LLC; and FOUR HUNDRED AND SIX :
 OWNER'S CORP. :

Respondents. :

-----X

FIRST REPUBLIC BANK, a Division of :
 Bank of America, N.A., a National Bank, :

Petitioner, :

-against- :

Index No. 600613/10

MARTIN BIENSTOCK, New York City Marshal; :
 SQUARE MILE STRUCTURED DEBT (ONE) LLC; :
 SQUARE MILE STRUCTURED DEBT (THREE) :
 LLC, :

Respondents. :

-----X

Appearances:**For Square Mile:**

Law Offices of Ira S. Sacks LLP
 575 Madison Avenue, 10th Floor
 New York, NY 10022
 Ira S. Sacks, Esq.

For First Republic:

LeClairRyan
 830 Third Avenue, Fifth Floor
 New York, NY 10022
 Michael T. Conway, Esq.

Fried, J.:

These are two special proceedings to determine adverse claims under Article 52 of the CPLR being considered together for disposition. The first proceeding (Index No. 603825/08) is brought by the petitioners Square Mile Structured Debt (One) LLC and Square Mile Structured Debt (Three) LLC (together, "Square Mile"), in which they seek to compel the respondents to turn over any proceeds they owe to the respondent Kent M. Swig, in light of Square Mile's lien on Swig's property (the "Square Mile petition"). Intervener First Republic Bank, a Division of Bank of America, N.A., a national banking association ("First Republic") opposes and asserts a defensive verified petition to the effect that it has a superior claim to the funds in question (the "First Republic petition").

The second proceeding (Index No. 600613/10) is brought by First Republic in which it seeks to compel the respondent New York City Marshal Martin Bienstock to turn over any proceeds obtained in connection with an execution served by Square Mile (the "Bienstock petition").

My findings below are in accordance with the attached time line that sets forth relevant, undisputed facts.

The following three groups of funds are at issue in these proceedings:

The dispute centers on funds, or distributions, owed to Swig by virtue of his ownership interests in the various respondent entities (collectively, the "Companies"), all of which are limited

liability companies or LLCs (7/20/10 Tr, at 24). Such funds are typically distributed to Swig by these entities based upon his percentage of ownership in each respective entity. However, in light of the recent judgments that have been entered against him by creditors, including Square Mile and First Republic, in addition to the executions subsequently served on the various respondent entities, many of the funds at issue are being held in escrow accounts of the respective entities' attorneys (the "Escrow Funds").

Pursuant to the writs of execution Square Mile caused to be levied by the New York City Marshal, Reed Smith LLP and other attorneys for the various Companies have turned over certain funds to Marshal Bienstock, some of which have subsequently been disbursed to Square Mile (the "Square Mile Funds").

Certain of the funds that have been turned over to Marshal Bienstock continue to remain in his possession (the "Bienstock Funds"), in accordance with the stipulation entered into in court on June 23, 2010. (6/23/10 Tr, at 42-43).

As such, in order to determine whether Square Mile or First Republic has a superior claim to the funds at issue, an examination into their security interests is necessary.

"In order for a security interest to be valid and enforceable against the debtor and third parties, the debtor must sign a document describing the collateral, the security interest must attach and must be perfected." (*Lashua v LaDuke*, 272 AD2d 750, 751 [3d Dep't 2000]; *see also* UCC § 9-203).

On November 30, 2005, concurrent with First Republic extending the Term Loan to Swig and Swig Equities, LLC, the same parties entered into an agreement wherein First Republic was granted a security interest in the collateral described (the "Security Agreement"). The collateral as

described in the Security Agreement includes the ownership interests Swig holds in certain entities. (See Security Agmt, Exh A).

An interest in an LLC or a corporation, such as the individual Companies, is defined in the Uniform Commercial Code (“UCC”) as either a security, a general intangible or investment property. (UCC §§ 8-103[c], 9-102[a][15], 9-102[a][42] & 9-102[a][49]). A security interest in general intangibles and in investment property can be perfected by the filing of a UCC financing statement. (UCC §§ 9-310 & 9-312[a]). Priority among conflicting security interests in the same collateral is based upon the time of filing or perfection. (UCC § 9-322[b]). On December 6, 2005, First Republic filed financing statements related to the Security Agreement. Accordingly, in 2005, First Republic acquired a valid and enforceable security interest in the ownership interests Swig held in the Companies, prior to Square Mile.¹

Under the UCC, distributions are defined as proceeds. Specifically, UCC section 9-102(a)(64)(B) defines the term ‘proceeds’ as meaning “whatever is collected on, or distributed on account of, collateral.” As such, because the funds at issue are typically distributed to Swig on account of his ownership interests in the various respondent Companies (i.e., the collateral), they are considered proceeds.² Further, because First Republic has acquired a perfected security interest in Swig’s assets (the original collateral) by filing the relevant UCC financing statements, it also has a

1

Indeed, Square Mile acquired its security interest in Swig’s assets in 2008, subsequent to making several loans to Swig and filing a related UCC financing statement, as outlined in the attached time line.

2

See generally UCC § 9-102(a)(64), Official Comment 13(a) (“The phrase ‘whatever is collected on, or distributed on account of, collateral,’ in subparagraph (B), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral.”).

perfected security interest in the distributions from the Companies, or proceeds, pursuant to UCC section 9-315(c), which provides that “[a] security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.”

However, Square Mile argues that any security interest First Republic may have had in the proceeds at issue in these proceedings became unperfected 21 days after they were created from the original collateral, pursuant to UCC section 9-315(d), which provides:

Continuation of perfection. A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless:

...

(2) the proceeds are identifiable cash proceeds[.]

Square Mile bases its argument on the theory that the funds at issue are no longer identifiable because they have been transferred from the various Companies and commingled with other funds in the respective attorney escrow accounts. (UCC § 9-315[b] [“When commingled proceeds identifiable. Proceeds that are commingled with other property are identifiable proceeds: . . . (2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.”]). Square Mile further argues that First Republic has failed to meet its burden of establishing that any of the proceeds located in the attorney escrow accounts are identifiable cash proceeds. (*See General Motors Acceptance Corp. [GMAC] v Norstar Bank, N.A.*, 141 Misc 2d 349 [Sup Ct Erie County 1988] [discussing the continuation of a security interest in proceeds that required the use of a tracing method after the proceeds were commingled in the debtor’s account]).

Therefore, the threshold issue to be determined is whether the funds at issue in these

proceedings are ‘identifiable cash proceeds’. For the reasons that follow, I find that the Escrow Funds and the Bienstock Funds are identifiable cash proceeds, but the Square Mile Funds are not.

The UCC neither defines the phrase “identifiable cash proceeds” nor the term “identifiable” (*Conagra, Inc. v Farmers State Bank*, 237 Mich App 109 [1999]), and case law on the subject is scarce at best. However, the *Conagra* case from the Court of Appeals of Michigan, contains a useful discussion:

Because the UCC does not define ‘identifiable cash proceeds,’ we turn to the widely quoted UCC treatise, Uniform Commercial Code Series by William D. Hawkland, Richard A. Lord, and Charles C. Lewis, for a discussion of the meaning of this term: The proceeds in which the security interest continues under subsection 9-306(2) [now section 9-315(d)] are not, however, just any proceeds, but rather identifiable proceeds including collections received by the debtor. The term ‘identifiable’ is not defined in the Code, but it presumably requires that the secured party show that the cash or noncash items were actually received upon the sale, exchange, collection or other disposition of the collateral or proceeds. [Hawkland, Lord, & Lewis, UCC Series, § 9-306:3, pp. 39-41 (1997).] . . . The requirement of identifiable proceeds is, of course, particularly troublesome when the proceeds are cash proceeds which have been commingled with other cash held by the debtor. [Hawkland, § 9-306:3, p. 41.] . . . It suffices to say that cash proceeds do not lose their identity merely because the cash proceeds have been commingled with other cash, provided that there is some basis for the court to connect a specified amount of the commingled cash to the original collateral.

(*Conagra*, 237 Mich App at 127 [finding proceeds identifiable after determining there was a “sufficient basis for connecting” the proceeds to the collateral]). This suggests that such proceeds are identifiable so long as there is a reasonable connection between the proceeds and the collateral secured by the security interest.

With respect to commingling, it is instructive to note that Official Comment 3 of UCC section 9-315, in discussing the new subsection b, directs the reader to Restatement of Trusts (Second), Section 202. This section addresses the rights of a beneficiary where trust funds have

either been wrongfully disposed of or mingled with the trustee's personal property, a situation which also often occurs with funds held by a debtor. As quoted above, Hawkland also discusses commingling in this discrete context applicable to a debtor. Similar to the *GMAC* case cited by Square Mile, the case law cited in section 202 illustrates such instances of debtor commingling that require the use of a tracing method.

From a reasonable reading of the collective information contained in section 9-315, the official comments to that section, the related treatise discussions and very limited case law, a logical inference is that the term 'other property,' referred to in Subsection (b) with which proceeds may have been commingled, is personal property of the debtor. Such is not the case here. Rather, the funds at issue are being held in trust in escrow accounts by the attorneys for the various Companies (i.e., the Escrow Funds) or by Marshal Bienstock (i.e., the Bienstock Funds).

In that vein, a "trustee has a duty to see that trust property is designated or identifiable as property of the trust, and also a duty to keep the trust property separate from the trustee's own property and, so far as practical, separate from other property not subject to the trust." (Restatement [Third] of Trusts § 84). Here, there is no indication or reason to believe that the funds at issue have been commingled by the attorneys of the various Companies or the Marshal or that they have neglected their obligations to keep these funds in such a way that they remain easily identifiable.

In any event, it is undisputed that the funds at issue in these proceedings are distributions owed to Swig by the various Companies and that they fall into either of the three groups discussed above: the Escrow, Square Mile or Bienstock Funds. Referring back to the discussion of the term 'identifiable' in the *Conagra* case, wherein Hawkins is quoted as stating that the UCC "presumably requires that the secured party show that the cash or noncash items were actually received upon the

sale, exchange, collection or other disposition of the collateral or proceeds,” or simply put, that a “sufficient basis [is found] for connecting” (*Conagra*, 237 Mich App at 129) the funds to the secured collateral; by logical inference, a sufficient basis can also be found for connecting the distributions of an entity, such as an LLC, to the funds being held in the attorney escrow account of that entity. Similarly, with respect to the Bienstock Funds that have been turned over to the Marshal from those Companies, a clear and logical connection can be found linking the distributions owed to Swig by the respective Companies and the Bienstock Funds because there is no dispute as to the origin of those funds.

Indeed, with respect to these two groups of funds, there is no indication that the proceeds have been commingled. Rather, Square Mile suggests that simply because certain funds are being held in attorney escrow accounts or by the Marshal, it is clear evidence of commingling. However, this is not a reasonable conclusion.

With respect to the Square Mile Funds, unlike the attorneys of the Companies and Marshal Bienstock, Square Mile takes these funds for its own benefit and, as such, has no obligation to keep the proceeds received from the Marshal in such a way that they remain identifiable. In any event, as a transferee in the context of UCC section 9-332, Square Mile takes these cash proceeds free of any security interest. (UCC § 9-322[a] [“Transferee of money. A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.”]). There is no evidence in the record that Square Mile has acted “in collusion” with Swig.

In light of the foregoing, I find that First Republic has a superior claim over Square Mile to the Escrow Funds and the Bienstock Funds, followed by other of Swig’s creditors whose claim of

priority to the funds at issue is not in dispute, but that Square Mile has a superior claim to the Square Mile Funds.

Accordingly,

The First Republic petition (Index No. 603825/08) is granted to the extent that the various respondent entities are directed to turn over any distributions owed to the respondent Kent M. Swig to First Republic, then Square Mile and then Swig's other creditors in satisfaction of the judgments entered by them against Swig; and

The Bienstock petition (Index No. 600613/10) is granted to the extent that the respondent Marshal Martin Bienstock is directed to turn over any funds remaining in his possession that have been transferred to him by the various respondent entities to First Republic, then Square Mile then Swig's other creditors in satisfaction of the judgments entered by them against Swig; and

The Square Mile petition (Index No. 603825/08) is granted to the extent that Square Mile is entitled to retain the Square Mile Funds; and it is

ORDERED that the parties are directed to settle order and judgment in accordance with the foregoing.

Dated: October 15, 2010

ENTER:



J.S.C.

HON. BERNARD J. FRIED

TIME LINE

Square Mile v. Swig, et al. - 603825/2008 and First Republic v. Bienstock - 600613/2010

The following facts are undisputed and are derived from the 19-a statements of material facts submitted by the parties.

- 11/30/05 First Republic made loan no. 21-408357-2 (the "Term Loan") to Swig and Swig Equities, LLC ("Swig Equities") in the principal amount of \$3,000,000.
- In connection with the Term Loan, Swig and Swig Equities executed various loan documents including, without limitation, a promissory note, security agreements and UCC financing statements.
- 12/06/05 First Republic recorded the UCC financing statements given in connection with the Term Loan.
- 3/22/06 First Republic entered into loan no. 85-409719-2 (the "Line of Credit") with Swig and Swig Equities.
- 4/14/08 Square Mile filed a UCC financing statement related to Swig's ownership interests in the various respondent entities.
- 10/06/08 First Republic entered into loan no. 21-446444-2 (the "Term Commitment") with Swig Equities, guaranteed by Swig, in the principal amount of \$4,200,000.
- 12/22/08 Swig was liable to Square Mile in the total sum of \$28,382,796.83 pursuant to a promissory note (the "Promissory Note") and loan agreement (the "Loan Agreement"), each dated as of July 13, 2007, and thereafter amended by the parties on September 7, 2007, November 12, 2007, November 19, 2007 and December 3, 2007 and restructured by the parties on December 26, 2007 and April 9, 2008 (as amended and restructured, the "Loan").
- 7/17/09 This Court granted Square Mile's motion for summary judgment in lieu of complaint and directed the clerk to enter judgment in favor of Square Mile and against Swig in the amount of \$28,382,796.83 as of December 22, 2008, plus unpaid interest thereon at the rate of 24% to the date of entry of judgment.
- 7/27/09 The New York County Clerk entered a money-judgment against Swig and in favor of Square Mile in the amount of \$32,432,288.87 (the "Square Mile Judgment").

- 8/19/09 Square Mile delivered to the NYC Marshal a writ of execution directing the Marshal to satisfy the judgment out of Swig's property.
- 9/23/09-12/15/09 NYC Marshal served property execution upon various respondents concerning interests Swig held in each.
- 9/09 Terra Holdings LLC ("Terra") withheld money owed to Property Asset Management Services, LLC ("PAMS") pursuant to an asset management agreement between Terra and PAMS, and then to Swig pursuant to his ownership interest in PAMS and transferred those funds to Reed Smith LLP (the "PAMS Funds").
- 9/24/09 Swig filed a petition to request a determination that the PAMS Funds were exempt from execution under CPLR 5205(d) (Index No. 602492/2009).
- 10/15/09 Square Mile filed a petition seeking an order directing Swig, PAMS and Terra to turn over to Square Mile the PAMS Funds and directing PAMS and Terra to turn over to Square Mile any obligation to make future distributions to Swig and Swig's entitlement to receive such future distributions (Index No. 114519/2009).
- 12/16/09 Square Mile delivered to the NYC Marshal a new writ of execution directing the Marshal to satisfy the judgment out of Swig's property.
- 12/17/09 Square Mile delivered to the Albany County Marshal a writ of execution directing the Marshal to satisfy the judgment out of Swig's property.
- 12/18/09 Albany County Marshal served property execution upon various respondents concerning interests Swig held in each.
- 12/18/09-12/22/09 NYC Marshal served property executions upon various other respondents concerning interests Swig held in each.
- 12/22/09 Square Mile filed its petition in the instant proceeding (Index No. 603825/2008).
- 2/26/10 This Court granted Square Mile's petition, filed 10/15/09, and determined that the PAMS Funds were not exempt (the "PAMS Order").
- 2/26/10 First Republic obtained a default judgment against Swig in the United States District Court, Northern District of California in the principal sum of \$8,798,102.42, with prejudgment interest in the amount of \$200,268.93, together with attorneys' fees of \$113,515.37 and costs of suit of \$723.66, amounting to a total judgment of \$9,112,610.38 (the "First Republic Judgment").

- 3/10/10 First Republic filed its petition in the instant proceeding (Index No. 600613/2010).
- 3/3/10 Pursuant to the PAMS Order, judgment was entered and Square Mile caused the New York City Marshal to levy a writ of execution on Reed Smith LLP for the PAMS Funds.
- 3/8/10 Pursuant to the writ of execution, Reed Smith LLP turned over to Bienstock funds in the amount of \$520,157.62.
- 3/11/10 Funds in the amount of \$494,149.78 (the PAMS Funds after deduction of poundage) were disbursed by Bienstock to Square Mile.