IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

IN RE: TOWER AIR, INC., Debtor.	)	Chapter 7 Bankruptcy Case No. 00-1280 (RJN)
CHARLES A. STANZIALE, JR., Chapter 7 Trustee of Tower Air, Inc. Appellant, v. FINOVA CAPITAL CORP., Appellee.	)	Civil Case No. 01-cv-792 (GMS) Appeal No. 01-96

MEMORANDUM AND ORDER

I. INTRODUCTION

On February 29, 2000 (the "Petition Date"), Tower Air, Inc. ("Tower Air") filed for chapter 11 bankruptcy protection. On May 5, 2000, the Bankruptcy Court entered an order approving the selection of Charles A. Stanziale, Jr. ("Stanziale") as the chapter 11 trustee for the bankruptcy estate of Tower Air. On December 20, 2000, Tower Air's chapter 11 case was converted to a chapter 7 case. Stanziale was selected to serve as the chapter 7 trustee as well.

On August 27, 2001, the Bankruptcy Court entered judgment in favor of FINOVA Capital Corp. ("FINOVA"), and against Tower Air's bankruptcy estate, with regard to the entitlement to settlement reimbursement proceeds in the amount of $951,503.26, plus interest. Stanziale appealed this decision on September 4, 2001.

II. STANDARD OF REVIEW

In reviewing a case on appeal, the Bankruptcy Court's factual determinations will not be set

aside unless they are clearly erroneous. *See Mellon Bank, N.A. v. Metro Comm., Inc.*, 945 F.2d 635, 641 (3d Cir. 1991), *cert. denied*, 503 U.S. 937, (1992). Conversely, a Bankruptcy Court's conclusions of law are subject to plenary review. *See Metro Comm., Inc.*, 945 F.2d at 641. Mixed questions of law and fact are subject to a "mixed standard of review." *See id.* at 641-42. Under this "mixed standard of review," the appellate court accepts findings of "historical or narrative facts unless clearly erroneous, but exercise[s] plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to historical facts." *Id.*

III. BACKGROUND

Tower Air was the record owner of certain aircraft and aircraft engines. On May 6, 1996, Tower Air and FINOVA entered into an Aircraft Loan And Security Agreement (the "Loan Agreement"). Pursuant to the Loan Agreement, and its related documents, Tower Air financed the purchase of certain aircraft and aircraft engines, including a Pratt & Whitney model JT9D-7q aircraft engine ("the engine").

On September 23, 1997, the engine was damaged as a result of an in-flight failure. Tower Air repaired the engine at a cost of $2,251,747.51. The engine has since been returned to FINOVA as part of its collateral. The Trustee subsequently learned that the damage to the engine might be covered by one of Tower Air's insurance policies. Upon further investigation, the insurance company agreed to pay Tower Air $951,504.26 in full settlement of the insurance claim on the engine. FINOVA opposed this agreement, asserting instead that it was entitled to the $951,503.26, not the Trustee. In response, the Trustee argued that, since FINOVA received the repaired engine, it was not entitled to the insurance proceeds as well.

On August 27, 2001, the Bankruptcy Court issued its "Findings of Fact, Opinion and

Conclusions of Law" (the "Opinion"). In this Opinion, it held that FINOVA was entitled to the insurance proceeds and rendered judgment in favor of FINOVA and against the Trustee in the amount of $951,503.25. Following the Opinion, the Trustee served an emergency motion for a stay pending appeal. Although the Bankruptcy Court found that the Trustee had "even less than a likelihood of success on the merits," it granted the stay and directed the Trustee to post a bond in the amount of $10,000 to cover FINOVA's appeal costs.

The Trustee filed the present appeal on September 4, 2001.

IV. DISCUSSION

The Trustee first argues that FINOVA does not have security interest in the $951,503.25 because the money does not constitute "proceeds" as required by Section 47-9306 of the Arizona Uniform Commercial Code (the "Arizona UCC").[1]

Section 47-9306(b) of the Arizona UCC provides, in relevant part, that:

> . . . a security interest continues in collateral notwithstanding the sale, exchange or other disposition thereof . . . and also continues in any identifiable proceeds including collections received by the debtor.

Section 47-9306(a) further provides that:

> 'Proceeds' includes whatever is received upon the sale, exchange, collection, or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds . . .

Arizona case law recognizes that, "[t]his statute allows a secured party's rights to continue in proceeds from the disposition of collateral. Section 9306 provides that a creditor's interest continues in proceeds received from disposition of collateral including casualty insurance proceeds paid as a result of damage to the collateral." *Flake v. United States*, 1995 WL 735740, *5 (D.

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[1]The parties do not dispute that Arizona law is applicable to the issues on appeal.

Arizona 1995). Finally, Section 9-203(3) of the Arizona UCC provides that, "[u]nless otherwise agreed a security agreement gives the secured party the right to proceeds provided by Section 9-306." Thus, to prevail, FINOVA need only have a perfected security interest in the engine in order to have a perfected security interest in the insurance proceeds.

Section 9-302(b)(3) of the Arizona UCC governs the procedure for perfection of security interests in aircraft. It provides, in pertinent part:

> (3) The filing of a financing statement otherwise required by this article is not necessary or effective to perfect a security interest in property subject to
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> (a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this Article for filing the security interest.

In addition, 49 U.S.C. § 44107 provides:

§ 44107. Recordation of conveyances, leases, and security interests

> (a) ESTABLISHMENT OF SYSTEM - The Administrator of the Federal Aviation Administration shall establish a system for recording -
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> (1) conveyances that affect an interest in civil aircraft of the United States;
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> (2) leases and instruments executed for security purposes, including conditional sales contracts, assignments, and amendments, that affect an interest in -
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> (A) a specifically identified aircraft engine having at least 750 rated takeoff horse power or its equivalent;
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> (B) a specifically identified aircraft propellor capable of absorbing at least 750 rated takeoff shaft horsepower;
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> (C) an aircraft engine, propeller, or appliance maintained for installation or use in an aircraft, aircraft engine, or propeller, by or for an air carrier holding a certificate issued under section 4705 of this title; and
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> (D) spare parts maintained by or for an air carrier

holding a certificate issued under section 44705 of this title.

Accordingly, pursuant to the Arizona UCC and 49 U.S.C. § 44107, a creditor with a security interest in an aircraft engine must perfect its security interest therein by filing its security agreement with the FAA. In the present case, FINOVA perfected its security interest in the engine by filing the N616FF Mortgage with the FAA. Moreover, and as the Bankruptcy Court noted in its decision, the Trustee "acknowledged in a June 9, 2001 stipulation and order that FINOVA has a first priority security interest in the engine." It is also undisputed that the insurance proceeds are being paid as a result of damage to the engine. Thus, under Arizona law, FINOVA has a perfected security interest in the insurance proceeds as well.[2]

With regard to the Trustee's argument that Section 47-9104 makes Article 9 of the Arizona UCC inapplicable to the present case, the court must disagree. As the Bankruptcy Court properly noted, that statute only applies to a "direct security interest in an insurance policy by making the policy itself the immediate collateral securing the transaction." *See* Bankruptcy Court Opinion at 5, *citing PPG Indus. Inc. v. Harford Ins. Co.*, 531 F.2d 58, 60 (2d. Cir. 1976). In the present case, it is clear that the insurance proceeds derived from a secured party's collateral is what is at issue, not the insurance policy itself. Thus, for the reasons the Bankruptcy Court articulated in its Opinion, the court will affirm on this ground.

Finally, the Trustee contends that any right FINOVA may have in the insurance proceeds should be nullified pursuant to 11 U.S.C. § 552(b). Under this Section, a Bankruptcy Court is required to "strike the proper balance between the rights of the secured creditor and the rehabilitative

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[2]It is additionally important to note that Section 5.4(a) of the Loan Agreement entitles FINOVA to determine how the insurance proceeds are to be applied.

goals of the Code." *In re Bennett Funding Group, Inc.*, 255 B.R. 616, 634 (N.D.N.Y. 2000). In reviewing the Bankruptcy Court's exercise of discretion in considering the application of the equity exception, "the district court may only determine whether the [B]ankruptcy [C]ourt did or did not abuse its discretion." *Halvajian v. The Bank of New York*, 216 B.R. 502, 508 (D.N.J. 1998), *aff'd* 168 F.3d 478 (3d Cir. 1998). A court "abuses its discretion if its decision rests upon a clearly erroneous finding of fact, an errant conclusion of law or an improper application of law to fact." *Johntson v. HBO Film Management, Inc.*, 265 F.3d 178, 183 (3d Cir. 2001) (internal citations omitted).

In the present case, the court cannot say that the Bankruptcy Court abused its discretion in declining to apply the equity exception. In making its determination, the Bankruptcy Court considered the following factors: (1) there was no evidence that the assets of the estate, as opposed to pre-petition assets, had been used to enhance the value of the collateral; (2) FINOVA is greatly undersecured; and (3) there had been no showing that the insurance proceeds in question might otherwise have been available to pay Tower Air's unsecured creditors. In light of the Bankruptcy Court's full consideration and weighing of these facts, among others, the court finds that it did not abuse its discretion.

Adopting the Bankruptcy Court's reasoning in full, the court will affirm its decision.[3]

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[3]Notwithstanding the court's affirmance of the Bankruptcy Court's decision, the court wishes to note that it is not unsympathetic to the view on "double dipping" espoused by the Tower Air trustee. Indeed, had the trustee offered any authoritative basis for his view, rather than merely his conclusory statements, the court may have been otherwise persuaded. In light of the dearth of authority supporting the appellant's position, however, the court is not in a position to conclude that the Bankruptcy Court ruled incorrectly.

V. CONCLUSION

For the following reasons, IT IS HEREBY ORDERED that:

1. The August 27, 2001 decision of the Bankruptcy Court for the District of Delaware is AFFIRMED.

Dated: June 16, 2003

Gregory M. Sleet
UNITED STATES DISTRICT JUDGE