No. 17-1086

In The
Supreme Court of the United States

FREDERICK J. GREDE, NOT INDIVIDUALLY
BUT AS LIQUIDATION TRUSTEE OF THE
SENTINEL LIQUIDATION TRUST,

Petitioner,

v.

FCSTONE, LLC,

Respondent.

**On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Seventh Circuit**

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STEPHEN P. BEDELL
Counsel of Record
DAVID B. GOROFF
THOMAS P. KREBS
FOLEY & LARDNER LLP
321 N. Clark Street, Suite 2800
Chicago, Illinois 60654-5313
(312) 832-4500
sbedell@foley.com
dgoroff@foley.com
tkrebs@foley.com

Counsel for Respondent
March 20, 2018

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTIONS PRESENTED

1. Whether the United States Court of Appeals for the Seventh Circuit correctly held that funds held in reserves pursuant to the confirmed chapter 11 Plan of Liquidation of Sentinel Management Group, Inc. ("Sentinel") are statutory trust funds protected by the statutory trust imposed by § 4d(b) of the Commodity Exchange Act, 7 U.S.C. § 6d(b), and belonging solely to FCStone, LLC and other SEG 1 customers of Sentinel who had preserved their trust rights under the Plan and actually traced the reserve funds from their original deposits to the reserve account based on unrebutted expert testimony, and, thus, cannot, in accordance with § 541(d) of the Bankruptcy Code, 11 U.S.C. § 541(d), and *Begier v. IRS*, 496 U.S. 53 (1990), be deemed property of Sentinel's estate to be shared with unsecured creditors.

2. Whether the United States Court of Appeals for the Seventh Circuit correctly held, consistent with every other Circuit Court that has addressed the issue, that the Bankruptcy Code preempts state law claims for unjust enrichment.

PARTIES TO THE PROCEEDINGS BELOW AND RULE 29.6 STATEMENT

Petitioner Frederick J. Grede is the appointed trustee of the Sentinel Liquidation Trust, the successor to the chapter 11 debtor, Sentinel Management Group, Inc. No parent or publicly held entity owns 10% or more of the stock of Sentinel Management Group, Inc.

Respondent FCStone, LLC, following a merger with INTL FCStone Financial Inc., is now the FCM Division of INTL FCStone Financial Inc., which is 100% owned by INTL FCStone Inc. INTL FCStone Inc. is a public company listed on NASDAQ under the symbol 'INTL'.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDINGS BELOW AND RULE 29.6 STATEMENT	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	vi
STATEMENT OF THE CASE	1
I. Introduction	1
II. Facts Material To The Questions Presented	6
A. FCStone's Business	6
B. Sentinel's Business	7
C. Sentinel's Collapse And Bankruptcy	9
D. Pursuant To Court Order, Sentinel Distributed Additional Citadel Proceeds	10
E. Pursuant To The Plan, The SEG 1 Objectors Preserved Their Trust Rights While Sentinel's SEG 3 Customers Waived Theirs	10
III. Procedural Background	14
A. The Trustee Sued FCStone And The SEG 1 Objectors Because They Objected To The Plan	14
B. The District Court Initially Ruled Against FCStone On All Counts Except The Unjust Enrichment Claim	15

TABLE OF CONTENTS – Continued

Page

C. The Seventh Circuit Ruled In Favor Of FCStone On All Counts 16

D. On Remand, The District Court Entered Judgment Against FCStone On Count III 18

E. The Seventh Circuit Reversed The District Court On Count III 18

REASONS FOR DENYING THE PETITION...... 21

I. This Court Should Deny The Trustee's Petition As It Relates To The Reserves Holding 21

A. The Reserves Holding Does Not Conflict With *Cunningham* Or The Trustee's Other Circuit Court Decisions 21

B. There Is No Conflict Regarding The Seventh Circuit's Actual Tracing Decision 27

C. This Reserves Holding Is Not Of Great Precedential Value And A Similar Case Is Highly Unlikely To Recur................ 30

II. This Court Should Deny The Trustee's Petition As It Relates To The Unjust Enrichment Holding 32

A. Every Circuit That Has Considered The Issue Has Agreed With The Seventh Circuit That The Bankruptcy Code Preempts State Law Unjust Enrichment Claims 32

TABLE OF CONTENTS – Continued

Page

B. The Preemption Issue Is Moot Because The Trustee Cannot Establish His Unjust Enrichment Claim 40

CONCLUSION.. 41

TABLE OF AUTHORITIES

Page

CASES

Ass'n Ben. Servs. v. Caremark RX, Inc., 493 F.3d 841 (7th Cir. 2007)..40

B.E.L.T. v. Wachovia Corp., 403 F.3d 474 (7th Cir. 2005) 40

Begier v. IRS, 496 U.S. 53 (1990)........................*passim*

Bessette v. Avco Fin. Servs., Inc., 230 F.3d 439 (1st Cir. 2000) 32, 34, 39

CFTC v. Walsh, 712 F.3d 735 (2d Cir. 2013)..............26

Contemporary Indus. Corp. v. Frost, 564 F.3d 981 (8th Cir. 2009)....................................... 17, 32, 33, 35

Cunningham v. Brown, 265 U.S. 1 (1924) ....*passim*

El Camino Res., Ltd. v. Huntington Nat'l Bank, 722 F. Supp. 2d 875 (W.D. Mich. 2009) 40

Ernst & Young LLP v. Baker O'Neal Holdings, Inc., 304 F.3d 753 (7th Cir. 2002)...........................24

First Federal of Mich. v. Barrow, 878 F.2d 912 (6th Cir. 1989)..26

Freightliner Corp. v. Myrick, 514 U.S. 280 (1995) 33, 35

Hill v. Kinzler (In re Foster), 275 F.3d 924 (10th Cir. 2001) 26

In re Sentinel Mgmt. Grp., Inc., 809 F.3d 958 (7th Cir. 2016) 13

Merit Management Group, LP v. FTI Consulting, Inc., No. 16-784, ___ U.S. ___, 2018 U.S. LEXIS 1514 (Feb. 27, 2018) 33

TABLE OF AUTHORITIES – Continued

Page

Mik v. Federal Home Loan Mortgage Corp., 743 F.3d 149 (6th Cir. 2014).....35, 36

Miles v. Okun, 430 F.3d 1083 (9th Cir. 2005).....35, 36

Pertuso v. Ford Motor Credit Co., 233 F.3d 417 (6th Cir. 2000)..... 17, 32, 33, 34, 35

Rosenberg v. Collins, 624 F.2d 659 (5th Cir. 1980) 26

Rosenberg v. DVI Receivables XVII, LLC, 835 F.3d 414 (3d Cir. 2016) 35, 36

SEC v. Credit Bancorp, Ltd., 290 F.3d 80 (2d Cir. 2002) 26, 27, 28

SEC v. Elliott, 953 F.2d 1560 (11th Cir. 1992) ...26, 27, 28

SEC v. Wealth Mgmt. LLC, 628 F.3d 323 (7th Cir. 2010) 28

U.S. v. Ron Pair Enters., 489 U.S. 235 (1989).....16

United States v. Durham, 86 F.3d 70 (5th Cir. 2002) 27, 28

United States v. Real Property Located at 13328 and 13324 State Highway 75 North, 89 F.3d 551 (9th Cir. 1996).....26

STATUTES

Commodity Exchange Act, 7 U.S.C. § 6d(b) .....*passim*

Investment Advisors Act of 1940 3

Protecting Tenants at Foreclosure Act of 2009, Pub.L. No. 111-22, § 702, 123 Stat. 1632 (codified at 12 U.S.C. § 5220 note).....36

TABLE OF AUTHORITIES – Continued

Page

United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq*. ....*passim*

11 U.S.C. § 101(6) 31

11 U.S.C. § 541...2, 22, 38

11 U.S.C. § 541(d) ....*passim*

11 U.S.C. § 546...37

11 U.S.C. § 546(e) ....*passim*

11 U.S.C. § 547...36, 37

11 U.S.C. § 547(b) 14

11 U.S.C. § 549(a) 14, 17

11 U.S.C. § 549(a)(2)(B).............................15, 38, 39

11 U.S.C. § 550...14

11 U.S.C. § 761(4) 30, 31

11 U.S.C. § 761(9)(A) 31

11 U.S.C. § 1141(a) 24

RULES AND REGULATIONS

Commodity Futures Trading Commission Part 190 Rules, 17 C.F.R. §§ 190.01 *et seq*. 5

OTHER AUTHORITIES

H.R. Rep. No. 97-420 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 583..37

H.R. Rep. No. 101-484 (1990), *as reprinted in* 1990 U.S.C.C.A.N. 5785..37

STATEMENT OF THE CASE

I. Introduction

Frederick J. Grede, not individually but as Liquidation Trustee of the Sentinel Liquidation Trust ("Trustee") seeks this Court's review of two holdings of the Seventh Circuit. In the first holding ("Reserves Holding"), the Seventh Circuit ruled that property held in reserves ("Reserves") pursuant to the confirmed chapter 11 Plan of Liquidation ("Plan") of Sentinel Management Group, Inc. ("Sentinel") is not property of Sentinel's bankruptcy estate but rather consists of statutory trust assets belonging to a group of Sentinel customers, including Respondent FCStone, LLC[1] ("FCStone"), that had objected to the Plan ("SEG 1 Objectors"). In the second holding ("Unjust Enrichment Holding"), the Seventh Circuit ruled that the Trustee's unjust enrichment claim is preempted by the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq*. ("Bankruptcy Code"). According to the Trustee, these holdings conflict with this Court's precedent, the holdings of other Circuits, or both.

The Trustee's Petition is utterly baseless. There is not the slightest conflict arising from either holding.

To the contrary, the Seventh Circuit's Reserves Holding is entirely consistent with – indeed dictated by – § 541(d) of the Bankruptcy Code and this Court's holding in *Begier v. IRS*, 496 U.S. 53 (1990). Under

[1] FCStone, LLC is now the FCM Division of INTL FCStone Financial Inc.

§ 541(d) and *Begier*, property that a debtor holds in trust for a third party, such as the Reserves, cannot be property of the debtor's bankruptcy estate. *See* 11 U.S.C. § 541(d); *Begier*, 496 U.S. at 59. Because the Reserves consisted of statutory trust assets that were protected by a trust imposed by the Commodity Exchange Act ("CEA") and the regulations promulgated thereunder ("CEA Trust"), the Seventh Circuit properly followed the dictates of § 541(d) and *Begier* and held that the Reserves were not property of Sentinel's estate. Disturbingly, the Trustee does not even mention *Begier* or discuss the impact of § 541 in his Petition, even though both are controlling here.

Instead, the Trustee contends that the Seventh Circuit's Reserves Holding conflicts with this Court's holding in *Cunningham v. Brown*, 265 U.S. 1 (1924), the original Ponzi scheme case, and various decisions from the Second, Fifth, Sixth, Ninth, Tenth and Eleventh Circuits, which the Trustee cites for his argument that similarly situated trust beneficiaries in receivership and bankruptcy cases involving financial fraud should share *pro rata* with all of the failed entity's unsecured creditors. None of these cases, however, address *Begier* or the fact that property which a debtor holds pursuant to a statutory trust, such as the Reserves, cannot become property of the estate. For this reason alone, these cases are inapposite and, thus, do not conflict with the Reserves Holding.

These cases also do not conflict with the Reserves Holding for the additional reason that they all involve similarly situated trust beneficiaries. That is not the case here. As the Seventh Circuit explained, there were two groups of potential trust beneficiaries with respect to the Reserves: (1) the SEG 1 Objectors, whose assets were *always* protected by the CEA Trust; and (2) Sentinel's SEG 3 customers, whose assets were *initially* protected by a trust imposed by the regulations ("SEC Regulations") promulgated under the Investment Advisors Act of 1940 ("IAA"). By the Plan's express and binding terms, however, only FCStone and the SEG 1 Objectors *preserved* their statutory trust rights with respect to the Reserves while Sentinel's SEG 3 customers expressly *waived* theirs and agreed to be treated as general unsecured creditors. As a result of the Plan, the SEG 1 Objectors and Sentinel's SEG 3 customers, by agreement, were *not* similarly situated.

Based on this highly specific fact pattern, the Seventh Circuit correctly found that *Cunningham* was not applicable and allowed FCStone, as a statutory trust beneficiary, to rely on tracing conventions to demonstrate its ownership of the trust assets in the Reserves. There is no Circuit Court case that holds otherwise. That is why none of the cases cited by the Trustee involve trust claimants – statutory or otherwise – that had voluntarily waived their trust rights under a confirmed chapter 11 bankruptcy plan. There simply is no conflict here arising from the Seventh Circuit's use of tracing conventions under these highly case-specific circumstances.

The Trustee fares no better with his challenge of the Seventh Circuit's decision to allow FCStone to engage in *actual* tracing of its customer assets.[2] Once again, none of the cases cited by the Trustee involve dissimilar groups of statutory trust claimants, one of which had expressly waived its trust rights pursuant to a confirmed chapter 11 bankruptcy plan. For this reason alone, there is no conflict.

Moreover, the Seventh Circuit's holding is entirely consistent with *Cunningham*, which expressly held that, as a general matter, any trust beneficiary is entitled to rely on actual tracing even in the extreme case of a Ponzi scheme.[3]

In any event, the Trustee's cases are inapposite because they are all receivership cases. A court in a receivership case has very broad discretion to approve a receiver's proposed distribution plan, unconstrained by any statutory framework. In this case, however, the Seventh Circuit was confronted with the chapter 11 bankruptcy of a Futures Commission Merchant ("FCM") whose customer assets are regulated under the CEA. Therefore, the Seventh Circuit was constrained by the trust framework imposed by the CEA (per § 4d(b), 7 U.S.C. § 6d(b)) and the Bankruptcy Code (per *Begier*). For this reason as well, there is no conflict.

The Trustee also argues that review of the Seventh Circuit's Reserves Holding is appropriate because, according to the Trustee, the issue is of great

---

[2] That FCStone actually traced makes the issue regarding the use of tracing conventions moot and provides another reason for this Court to deny the Trustee's Petition.

[3] As explained below, Sentinel was not a Ponzi scheme.

importance and is "likely to recur." (Tr.Pet.22.) That is a gross misstatement.

The Seventh Circuit's Reserves Holding was highly fact-specific and dictated by the specific and unique terms of the Plan, pursuant to which one group of trust beneficiaries retained their trust rights while another group of statutory trust beneficiaries waived theirs. This highly fact-specific situation is exceedingly unlikely to recur in any setting, but especially in the context of an FCM, such as Sentinel. FCM liquidations are normally dictated by the specific distribution scheme set forth in subchapter IV of chapter 7 of the Bankruptcy Code and the Commodity Futures Trading Commission ("CFTC") Part 190 Rules, 17 C.F.R. §§ 190.01 *et seq*. There is ordinarily no chapter 11 plan of liquidation in FCM bankruptcies. The one exception on record is Sentinel because it did not execute futures contracts for its customers, as required for subchapter IV and the Part 190 Rules to apply. Accordingly, Sentinel's distribution scheme was carried out pursuant to a highly unusual Plan, whose scheme differed from the Part 190 Rules in significant respects.

There is no conflict with the Seventh Circuit's Unjust Enrichment Holding either. Every Circuit Court that has considered this issue has held that the Bankruptcy Code preempts state law unjust enrichment claims. This should end this Court's inquiry.

Attempting to avoid this result, the Trustee turns creative, arguing that the Seventh Circuit supposedly relied on an unconventional form of preemption that he mislabels "end run" preemption, which according to the Trustee, conflicts with recent opinions from the Third and Sixth Circuits that have rejected "end run" preemption. The Seventh Circuit, however, did nothing of the sort. In finding preemption, the Seventh Circuit merely observed that it would frustrate the administration of Sentinel's estate under federal bankruptcy law "[t]o allow an unjust enrichment claim in this context." (Pet.App.102a.) This is simply a restatement of conflict preemption – one of the three well-established forms of preemption. Presumably that is why the Trustee does not include the quote in his Petition.

Equally troubling, none of the cases cited by the Trustee involve unjust enrichment claims, and only one of them even uses the phrase "end run," albeit in an entirely different context. There simply is no conflict here.

Finally, even if there were a "conflict" (and there is not), the Trustee's unjust enrichment claim is moot because FCStone traced its assets.

This Court should deny the Trustee's Petition.

II. Facts Material To The Questions Presented.

A. FCStone's Business

FCStone is an FCM. (Pet.App.4a.) FCMs act as financial intermediaries between investors and futures markets by providing clearing and execution services to their customers. (Pet.App.4a, 106a.) FCStone was a customer of Sentinel. (Pet.App.109a.)

B. Sentinel's Business

Sentinel was a non-clearing FCM manager and custodian that managed clearing FCMs' futures customer funds. (Pet.App.4a.) As an FCM, Sentinel's business was regulated by the CFTC and governed by the CEA and the regulations promulgated thereunder ("CFTC Regulations"). (Pet.App.5a.)

Sentinel also acted as a securities investment advisor for hedge funds and other sophisticated investors. (Pet.App.109a.) As a securities investment advisor, Sentinel was bound by the IAA and the SEC Regulations. (Pet.App.5a.)

Sentinel separated its futures and securities customers into different tranches called "SEGs". (Pet.App.5a.) Within each SEG, Sentinel further divided its customers into groups based on detailed financial guidelines. (Pet.App.52a, 108-109a.) SEG 1 consisted solely of FCM customer assets. (Pet.App.5a.) FCStone's customer assets, which were invested in low-risk government securities, corporate bonds and cash, were in Group 7 of SEG 1. (Pet.App.5a, 108a.) The futures customer funds that clearing FCMs deposited with Sentinel were protected by the CEA Trust. (Pet.App.24a, 76a.)

SEG 3 was comprised of "assets belonging to hedge funds and other sophisticated investors, as well as FCM proprietary or 'house' funds." (Pet.App.5a.) These funds were protected by a trust imposed by the SEC Regulations. (Pet.App.26-27a, 75-76a.)

The Seventh Circuit accurately described the investment process as follows:

> When customers invested funds with Sentinel, those funds were exchanged for securities and interest-bearing cash through a process that Sentinel called 'allocation.' Customers did not own securities outright but instead held indirect pro rata interests in the securities allocated to their group portfolios, as determined by their level of investment.

(Pet.App.5a.)

Sentinel maintained detailed and meticulous accounting records that made it easy to trace the customer assets deposited at Sentinel through their various forms from the time of their deposit to their eventual withdrawal. (Pet.App.34-37a.) The fact that each SEG 1 security bore a unique CUSIP number simplified the tracing process. (Pet.App.34a.) There were "no instances of missing, fictitious, or double-allocated securities." (Pet.App.35a.) And Sentinel's customer statements reflected to the penny the economic exchange, which represented a real economic transaction, "that occurred between the customers and Sentinel for an interest in a pool of securities valued at market for that day." (Pet.App.35a.)

Unbeknownst to its customers, Sentinel engaged "in a leveraged trading strategy for its own benefit" that failed to "honor the statutory trusts and comply with the segregation rules under the" CEA and the IAA. (Pet.App.6a.) Specifically, Sentinel used customer securities as collateral for an overnight loan from the Bank of New York ("BNY"), which loan was used to cover haircuts associated with repo transactions that it had entered into with counterparties such as FIMAT USA and Cantor Fitzgerald & Co. (Pet.App.77a, 119a.) SEG 1 securities were rarely used as collateral by Sentinel. Indeed, they were out of segregation for "no more than two brief periods" and were easily traceable, as established by FCStone's expert in unrebutted testimony. (Pet.App.33-37a.)

C. Sentinel's Collapse And Bankruptcy

Sentinel's leveraged trading strategy collapsed during the summer of 2007, when the market value of many of Sentinel's borrowed assets dropped significantly due to tightening credit markets and lack of liquidity caused by the financial crisis of the late 2000s. (Pet.App.6a.) Sentinel ceased customer redemptions on August 13, 2007. (Pet.App.123a.)

Three days later, on August 16, 2007, Sentinel sold most of its securities in the SEG 1, Group 7 portfolio to Citadel for approximately $384 million and deposited the proceeds ("Citadel Proceeds") in a SEG 1 segregated cash account at the BNY. (Pet.App.124a.)

On August 17, 2007, Sentinel partially settled FCStone's account by wiring $1,097,925 to FCStone's customer segregated account. (Pet.App.124a.)

Sentinel filed for bankruptcy later that day. (Pet.App.124a.)

D. Pursuant To Court Order, Sentinel Distributed Additional Citadel Proceeds.

On August 20, 2007, Sentinel filed an emergency motion seeking an order authorizing the distribution of the Citadel Proceeds to the customer segregated accounts of Sentinel's SEG 1 customers, including FCStone. On the same day, the Bankruptcy Court entered an unambiguous order authorizing the distribution of the Citadel Proceeds subject to a 5% holdback pending further order of the Bankruptcy Court. (Pet.App.7a, 80-81a, 100a.) The funds held back, which equaled $15.6 million, along with proceeds from a late-settling security totaling $4.9 million and certain proceeds of subsequent liquidations, remained in reserve in a SEG 1 account at BNY (*i.e.*, the Reserves). (Pet.App.21a.)

E. Pursuant To The Plan, The SEG 1 Objectors Preserved Their Trust Rights While Sentinel's SEG 3 Customers Waived Theirs.

Soon after Sentinel filed for bankruptcy, the Trustee started working on the Plan. (Pet.App.8a.) The early drafts treated all of Sentinel's customers merely as unsecured creditors. (Pet.App.21a.) FCStone and the other SEG 1 Objectors objected to these drafts and insisted on the inclusion of Reserves to account for the likelihood that the SEG 1 Objectors would be able to prove that the disputed SEG 1 customer assets were, in fact, CEA Trust property and not property of the estate. (Pet.App.21a.) After multiple contested hearings, the Trustee eventually agreed to include these reserves in the Plan, which the Trustee confirmed in a memorandum filed shortly after the Plan's Confirmation Hearing:

> [T]he Plan Proponents have established reserves to address the Seg 1 Objectors' contention that certain funds are not property of the estate. . . . Customers will share pro rata with Holders of General Unsecured Claims, only in property that the Court determines is property of the estate.

(Pet.App.29a.) The Plan does not have similar provisions for Sentinel's SEG 3 customers. (Pet.App.29a.)

The first SEG 1 Reserve is addressed in Plan § 7.20(a):

> (i) *Seg 1 Property Of The Estate Reserve*. On the Effective Date, the Liquidation Trustee shall establish a reserve equal to the amount of all funds held in any bank account denominates as a Seg 1 account, multiplied by a fraction, the numerator of which is the amount of Citadel Beneficiary Class 3 Customer Claims attributable to Seg 1 accounts (the principal amount of such claims calculated consistent with Section 4.4 of this Plan) which voted against the Plan and/or lodged objections thereto, and the denominator of which is the

> total aggregate amount of Class 3 Customer Claims attributable to Seg 1 accounts.

(SA.472.)[4]

The second SEG 1 Reserve is addressed in § 7.20(b), which provides for a reserve for when the Trustee makes a distribution of assets other than "Customer Property" (litigation recoveries) to SEG 3 customers or other unsecured creditors. In that instance, he must reserve for the amount any SEG 1 customer would be entitled to receive as a claimant pending a determination of the property of the estate issue. (SA.472-473.)

Thus, the Reserves were created at the insistence of the SEG 1 Objectors, who had voted against the Plan, to protect their statutory trust property rights. Sentinel's SEG 3 customers who voted for the Plan were deemed to have accepted the "plan settlement," which required releasing any claim for statutory trust property. (Pet.App.27-30a; CA.82, 351.)

Plan § 7.20(c)(i) addresses what happens if the Reserves are adjudicated to be trust property (*not* property of the estate). It provides that if the SEG 1 Objectors prevail on this issue, the Reserves will not be considered "Customer Property" to be shared with

[4] Citations to "SA._" are to the Trustee's separate appendix to his Opening Brief in the second consolidated appeal in this case, Nos. 16-1916, 16-1896. Citations to "CA._" are to FCStone's separate appendix to its Combined Response/Opening Brief in the same consolidated appeal.

unsecured creditors but, instead, will be returned to their "rightful owners," *i.e.*, the SEG 1 Objectors:

> In the event the Court determines that the property in any of the Property Of the Estate Reserves is not property of the estate, Sections 4.4 and 4.5 of the Plan shall be deemed modified to provide that Customer Property shall be distributed to the rightful owners of such property or to the Estate, as determined by the Court.

(SA.473.)

During the confirmation process, Sentinel's SEG 3 customers neither requested nor received any equivalent reserve, and the Plan does not provide for one. The Plan treats Sentinel's SEG 3 customers solely as unsecured creditors. (Pet.App.22a, 27a.) The Plan thus: (1) reserves the right of the SEG 1 Objectors, including FCStone, to advance their ownership claim on the disputed putative trust assets (Pet.App.28-30a.); and (2) removes the rights of Sentinel's SEG 3 customers to do so. (Pet.App.22a, 27a.)

Plan § 4.5 provides that holders of "Customer Claims" (Sentinel's customers) and "General Unsecured Claims" (all other unsecured creditors of Sentinel) share *pro rata* in all estate property. (SA.440, 456.) The Plan's "unsecured creditor" class includes non-trust beneficiaries, including Sentinel's utilities, landlord and, most significantly, BNY, Sentinel's largest creditor and a complicit wrongdoer in Sentinel's collapse. *In re Sentinel Mgmt. Grp., Inc.*, 809 F.3d 958, 966

(7th Cir. 2016). If the Seventh Circuit had held that SEG 1 customer assets held in the Reserves were estate property, all of these unsecured creditors, including BNY, would have shared in these assets on a *pro rata* basis.

III. Procedural Background

A. The Trustee Sued FCStone And The SEG 1 Objectors Because They Objected To The Plan.

Because FCStone and the other SEG 1 Objectors objected to the Plan and insisted on preserving the right to recover their customer trust property, the Trustee brought adversary actions against them. The Trustee alleged five counts: Count I – avoidance and recovery of the post-petition transfer under 11 U.S.C. §§ 549(a) and 550; Count II – avoidance and recovery of the prepetition transfer under 11 U.S.C. §§ 547(b) and 550; Count III – declaratory judgment that assets held in the Reserves were estate property; Count IV – unjust enrichment; and Count V – disallowance of claims, which is irrelevant here and will not be addressed. (Pet.App.105a.) The Trustee's action against FCStone was chosen as a test case. (Pet.App.9a, 50a.) The parties held an eleven-day bench trial during October 2012. (Pet.App.105a.)

B. The District Court Initially Ruled Against FCStone On All Counts Except The Unjust Enrichment Claim.

On January 4, 2013, the District Court issued its first opinion. Regarding Count I (post-petition avoidance claim), the District Court rejected FCStone's defense under 11 U.S.C. § 549(a)(2)(B) that the post-petition transfer had been "authorized" by the Bankruptcy Court and was thus immune from challenge despite the fact that the relevant order contained numerous express references to court "authorization." (Pet.App.156-157a.) The District Court also held that the funds at issue were "property of [Sentinel's] estate." (Pet.App.155a.) Relying on the statement in *Cunningham* that "equality is equity," the District Court concluded it was improper to employ any tracing conventions because the SEG 1 Objectors and Sentinel's SEG 3 customers were similarly-situated trust claimants whose assets should be shared *pro rata* with all of Sentinel's creditors, including unsecured ones, absent a successful tracing exercise. (Pet.App.146a, 150-151a.) The District Court then concluded that FCStone could not trace. (Pet.App.154a.)

The District Court emphasized that, despite its tracing conclusions, it would have ruled otherwise if it believed it were not dealing with similarly situated trust claimants:

> To be clear: if I was merely dealing with competing claims of SEG 1 customers and unsecured creditors not protected by statutory trust, I believe the law would require me to

> apply every reasonable tracing fiction available to preserve the CEA trust. But because the claimants are similarly situated, equity prevents the application of any fiction.

(Pet.App.151a.) The District Court, however, failed to address that, at least with respect to the Reserves, Sentinel's SEG 3 customers had waived their trust rights while the SEG 1 Objectors had retained theirs. (Pet.App.104-175a.)

Regarding Count II (prepetition preference claim), the District Court rejected FCStone's "securities contract" and "settlement payment" defenses under § 546(e). The District Court felt that enforcing the section as written "would produce a result demonstrably at odds with the intentions of its drafters." (Pet.App.165a.) (citing *U.S. v. Ron Pair Enters.*, 489 U.S. 235, 242 (1989)).

The District Court ruled in favor of FCStone on Count IV, holding that the Trustee's unjust enrichment claim is "preempted by the bankruptcy laws, regardless of on whose behalf the Trustee brings the claim." (Pet.App.172-173a.)

Both parties appealed.

C. The Seventh Circuit Ruled In Favor Of FCStone On All Counts.

On March 19, 2014, the Seventh Circuit reversed in its entirety the District Court's judgment for the

Trustee on Counts I, II and III and affirmed the District Court's judgment for FCStone on Count IV.

As for Count I, the Seventh Circuit held that the Trustee could not bring his post-petition avoidance claim, as a matter of law, because the Bankruptcy Court had unambiguously authorized the post-petition transfer within the meaning of § 549 of the Bankruptcy Code. Regarding Count II, the Seventh Circuit held that the plain language of the "securities contract" and "settlement payment" defenses in § 546(e) barred the Trustee's prepetition transfer claim.

The Seventh Circuit did not specifically rule on the disposition of the Reserves because it thought that its ruling on Count I (post-petition avoidance claim) also disposed of Count III (declaratory action concerning the Reserves). (Pet.App.101-102a.)

Addressing Count IV, the Seventh Circuit, like the District Court, held that the Bankruptcy Code preempted the Trustee's unjust enrichment claim:

> To allow an unjust enrichment claim in this context would allow the trustee or a creditor to make an end run around the bankruptcy code's allocation of assets and losses, frustrating the administration of the bankruptcy estate under federal bankruptcy law. See *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 988 (8th Cir. 2009); *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417, 426 (6th Cir. 2000).

(Pet.App.102a.)

The Trustee petitioned the Seventh Circuit for rehearing and rehearing *en banc*, but the petition was denied. (Pet.App.179a.)

D. On Remand, The District Court Entered Judgment Against FCStone On Count III.

On remand, both parties moved for judgment on Count III. (Pet.App.11a.) On March 28, 2016, the District Court ruled for the Trustee. (Pet.App.50a.) The District Court misread the Plan's plain language, which clearly established that Sentinel's SEG 3 customers had waived their trust rights, and found that FCStone did not trace. (Pet.App.68-69a) The District Court then used its own sense of "fairness" to construct the result it believed to be the most equitable – that the assets in the Reserves should be treated as estate property to be shared *pro rata* with all of Sentinel's unsecured creditors, including BNY, Sentinel's largest unsecured creditor whose wrongdoing contributed to creditors' losses and Sentinel's bankruptcy. (Pet.App.61-70a.) The District Court commented that the facts of the case were too "messy" to rule otherwise. (Pet.App.68a.) FCStone appealed the judgment against it on Count III. (Pet.App.1a.)

E. The Seventh Circuit Reversed The District Court On Count III.

On August 14, 2017, the Seventh Circuit reversed the District Court's judgment on Count III. The

Seventh Circuit held that the assets in the Reserves were not property of Sentinel's estate but rather statutory trust property belonging solely to FCStone and the other SEG 1 Objectors, which should be distributed *pro rata* among them only. (Pet.App.46a.) Citing to § 541(d) of the Bankruptcy Code and *Begier*, the Seventh Circuit began its analysis by rejecting the District Court's holding that the assets in the Reserves were estate property. The Seventh Circuit explained that trust property, such as the customer assets of FCStone and the other SEG 1 Objectors, is not property of the estate as a matter of law and that it does not "lose its character simply because, as in this case, the debtor misappropriated it or commingled it with the debtor's own property." (Pet.App.23a.)

The Seventh Circuit then turned to addressing the rights of the SEG 1 Objectors and Sentinel's SEG 3 customers with respect to the Reserves. The Seventh Circuit carefully analyzed the Plan's relevant sections and found that FCStone and the other SEG 1 Objectors had preserved their trust rights while Sentinel's SEG 3 customers had expressly waived theirs:

> Reading all these provisions together, as we must, we find that . . . the SEG 1 Objectors alone preserved their right to recover trust property held in reserve, and the plan specifically contemplates that such property may be restored to those customers. SEG 3 customers simply did not preserve a comparable right.

(Pet.App.30a.)

In light of their radically different treatment under the Plan, the Seventh Circuit found that the SEG 1 Objectors (including FCStone) and Sentinel's SEG 3 customers were *not* similarly situated, thus making *Cunningham* inapplicable:

> Although there are understandable reasons for wanting to treat SEG 3 customers similarly based on their similar statutory protections, we conclude that the SEG 3 customers surrendered those protections by agreeing to be treated as unsecured creditors under the confirmed Chapter 11 plan.
>
> * * *
>
> Since only the SEG 1 Objectors preserved their status as trust claimants with respect to the SEG 1 reserve funds, the problem of co-equal trust claimants addressed in *Cunningham v. Brown*, 265 U.S. 1 (1924), the key case on which the district court relied, is absent here.

(Pet.App.22a, 31a.)

Citing to the "powerful policy reasons for according robust protection to investors whose trust property is covered by the" CEA, the Seventh Circuit then found that FCStone should be permitted to use reasonable tracing conventions. (Pet.App.32a.) Relying on the convention proposed by the CFTC that assets in SEG 1 accounts and portfolios at Sentinel at the time of bankruptcy should be presumed to be CEA Trust assets, the Seventh Circuit found that the Reserves were CEA

Trust property belonging solely to the SEG 1 Objectors. (Pet.App.24a, 32-33a.)

The Seventh Circuit, however, made clear that its holding was not dependent on the use of a tracing convention. It found that FCStone could actually trace the funds in the Reserves, which provided an independent and additional basis for the Reserves Holding:

> [E]ven apart from those conventions or presumptions, FCStone has shown an independent basis for its claim to a share of the SEG 1 reserves. It can actually trace . . . FCStone has done so through the essentially unrebutted report and testimony of its key expert. . . .

(Pet.App.33-34a.)

The Trustee again petitioned the Seventh Circuit for rehearing and rehearing *en banc*, but the petition was denied. (Pet.App.179a.)

REASONS FOR DENYING THE PETITION

I. This Court Should Deny The Trustee's Petition As It Relates To The Reserves Holding.

A. The Reserves Holding Does Not Conflict With *Cunningham* Or The Trustee's Other Circuit Court Decisions.

The Trustee contends that the Reserves Holding conflicts with *Cunningham* and various decisions from the Second, Fifth, Sixth, Ninth, Tenth and Eleventh Circuits. The Trustee is incorrect. There is no conflict.

Throughout this litigation, the Trustee has contended that the Reserves were estate property that should be distributed *pro rata* to all of Sentinel's creditors, including its unsecured creditors. The Seventh Circuit properly rejected the Trustee's argument and held that the Reserves were CEA Trust property and not estate property, as dictated by § 541 of the Bankruptcy Code and this Court's holding in *Begier*.

Under § 541 and *Begier*, property that a debtor holds in trust for a third party, such as the Reserves, is not property of the debtor's bankruptcy estate as a matter of law. *See* 11 U.S.C. § 541(d) ("Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."); *Begier*, 496 U.S. at 59 ("Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not 'property of the estate.' ").

As the Seventh Circuit rightly explained, there are powerful policy reasons for following *Begier* and enforcing the CEA Trust:

> The ability of participants in futures markets to rely on the protections provided by section 6d when an FCM becomes insolvent is critical to the functioning of these markets. . . . In

> futures transactions there is no equivalent of federal deposit insurance for bank depositors or the Securities Investor Protection Corporation Fund to protect securities investors. . . . Instead, the requirements of section 6d are the principal legal protection for commodity customer funds against wrongdoing or insolvency by FCMs and their depositories. . . . Participants in the futures market rely on this protection . . . and customers' ability to rely on this protection when an FCM faces insolvency contributes to the stability of markets in times of stress.

(Pet.App.23-25a.)

Notably, none of the cases cited by the Trustee in support of his assertion of conflicting precedent even address *Begier*, the CEA Trust or the fact that statutory trust property held by a bankrupt debtor cannot become property of the estate. This renders these cases inapposite and provides the first basis for the conclusion that there is no conflict of authority.

The second basis is that the SEG 1 Objectors and Sentinel's SEG 3 customers, unlike the trust claimants in the other cases cited by the Trustee, are not similarly situated. A brief review of the Seventh Circuit's opinion confirms this.

After determining that the Reserves were not estate property, the Seventh Circuit turned to analyzing what it described as the difficult question of how to treat the SEG 1 Objectors and Sentinel's SEG 3 customers with respect to the Reserves, recognizing that, at least initially, the groups were protected by different, but equal, statutory trusts. After thoroughly analyzing the Plan, the Seventh Circuit correctly found that the SEG 1 Objectors had preserved their statutory trust rights under the Plan while Sentinel's SEG 3 customers had waived theirs and become merely unsecured creditors. (Pet.App.22a, 30-31a.)

As the Seventh Circuit rightly noted, that waiver was binding on Sentinel's SEG 3 customers. *See Ernst & Young LLP v. Baker O'Neal Holdings, Inc*., 304 F.3d 753, 755 (7th Cir. 2002) ("A confirmed plan of reorganization is in effect a contract between the parties and the terms of the plan describe their rights and obligations."); *see also* 11 U.S.C. § 1141(a).

This difference in status is significant. In *Cunningham*, this Court addressed whether a common law trust beneficiary could rely on tracing conventions to establish a constructive trust where there were other similarly-situated common law trust beneficiaries. This Court held that the trust beneficiary could not do so under those circumstances and explained that similarly situated trust beneficiaries should be treated equally. *Cunningham*, 265 U.S. at 12-14.

As the Seventh Circuit correctly explained, however, the SEG 1 Objectors and Sentinel's SEG 3 customers were no longer similarly situated as a result of the Plan, which made *Cunningham* inapplicable:

> Since only the SEG 1 Objectors preserved their status as trust claimants with respect to the SEG 1 reserve funds, the problem of

> co-equal trust claimants addressed in *Cunningham v. Brown*, 265 U.S. 1 (1924), the key case on which the district court relied, is absent here.

(Pet.App.31a.)

There simply cannot be a conflict between the Reserves Holding and *Cunningham* when *Cunningham* is not even applicable.

The differences between *Cunningham* and this case do not end there. The business that was the subject of *Cunningham* was a complete sham operating as a Ponzi scheme, which relied on deposits from new investors to pay the returns and redemptions of earlier ones. Sentinel, on the other hand, managed legitimate customer investments and there were "no instances of missing, fictitious, or double-allocated securities." (Pet.App.35a.) The practical and policy reasons militating against the use of tracing conventions, thus, are not present here regardless of whether the SEG 1 Objectors and Sentinel's SEG 3 customers are similarly situated. For this reason as well, there is no conflict between the Reserves Holding and *Cunningham*.

As for the Second, Fifth, Sixth, Ninth, Tenth and Eleventh Circuit decisions cited by the Trustee, the Reserves Holding does not conflict with them for the same reasons. Those decisions, like *Cunningham*, do not: (a) address *Begier*, the impact of a CEA Trust, or the fact that property held by a debtor pursuant to a statutory trust cannot become property of the estate; or (b) involve a situation where a trust beneficiary expressly waived its rights as a statutory trust beneficiary under a confirmed chapter 11 bankruptcy plan and, thus, became merely an unsecured creditor that was not similarly situated to federal statutory trust beneficiaries.

Moreover, they all involved Ponzi or similar fraudulent investment schemes. *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2d Cir. 2002) (Ponzi scheme); *CFTC v. Walsh*, 712 F.3d 735 (2d Cir. 2013) (Ponzi scheme); *Rosenberg v. Collins*, 624 F.2d 659 (5th Cir. 1980) (fraudulent financial scheme); *First Federal of Mich. v. Barrow*, 878 F.2d 912 (6th Cir. 1989) (fraudulent mortgage investment scheme); *United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d 551 (9th Cir. 1996) (fraudulent loan brokerage scheme); *Hill v. Kinzler (In re Foster)*, 275 F.3d 924 (10th Cir. 2001) (Ponzi scheme); *SEC v. Elliott*, 953 F.2d 1560 (11th Cir. 1992) (Ponzi-type scheme). That also distinguishes them from this case, where, as explained above, Sentinel ran a legitimate business managing actual customer investments.[5]

[5] The Trustee contends that the Reserves Holding "breaks irreconcilably" with these cases because the Seventh Circuit did not focus on whether Sentinel's "victims" were similarly situated in relation to the fraud. Again, the Trustee forgets that Sentinel's SEG 3 customers explicitly waived their trust rights under the Plan, making them unsecured creditors who were not similarly-situated to the SEG 1 Objectors. As the Seventh Circuit correctly noted, this waiver had significant consequences. At bottom, the Trustee is attempting to grab statutory trust assets from a statutory trust beneficiary (*i.e.*, another fraud victim) and distribute them to Sentinel's unsecured creditors, including BNY, a

Finally, this Court should also decline to review this issue because it is moot. As explained below, FCStone actually traced its assets without using tracing conventions.

For all these reasons, there is no conflict between the Reserves Holding and the cases cited by the Trustee. This Court, therefore, should deny the Trustee's Petition as it relates to the Reserves.

B. There Is No Conflict Regarding The Seventh Circuit's Actual Tracing Decision.

The Trustee contends that this Court should also grant his Petition because the Reserves Holding conflicts with decisions from the Second (*Credit Bancorp*, 290 F.3d 80), Fifth (*United States v. Durham*, 86 F.3d 70 (5th Cir. 2002)), and Eleventh (*Elliott*, 953 F.2d 1560) Circuits that do not permit actual tracing "when there is a limited pool of assets and competing trust claimants." Once again, the Trustee is incorrect. There is no conflict.

As an initial matter, these cases do not conflict with the Reserves Holding because they all involve similarly situated and "competing trust claimants," as the Trustee concedes. (Tr.Pet.20.) As explained above, the SEG 1 Objectors and Sentinel's SEG 3 customers are neither similarly situated nor both trust claimants

---

significant contributor to Sentinel's collapse. This result would turn § 541(d), *Begier* and the Plan all on their heads.

because the SEG 1 Objectors specifically preserved their trust rights pursuant to the Plan while the Sentinel's SEG 3 customers waived theirs. The Trustee conspicuously ignores this inconvenient fact, which is dispositive of the issue.

Moreover, *Credit Bancorp*, *Elliott* and *Durham* are either SEC or equitable receivership cases. In the receivership context, the receiver and court have very broad discretion to formulate a plan to distribute property in the hands of the receiver, unconstrained by any statutory framework such as the CEA or the Bankruptcy Code. *See, e.g.*, *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 333 (7th Cir. 2010). Here, in contrast, the Bankruptcy Code and applicable non-bankruptcy law impose mandatory rules for distribution of assets, and more fundamentally, require that the property available for distribution to creditors is limited to estate property. The situations are completely different. For this reason as well, there is no conflict.

And perhaps most importantly, the Reserves Holding is consistent with *Cunningham*. In *Cunningham*, this Court held that tracing is permissible when there are "competing trust claimants" even in the extreme case of a Ponzi scheme (which Sentinel was not):

> They could have followed the money wherever they could trace it and have asserted possession of it on the ground that there was a resulting trust in their favor. . . . These things they could do without violating any statutory rule against preference in bankruptcy, because they then would have been endeavoring

> to get their own money, and not money in the estate of the bankrupt. But to succeed they must trace the money, and therein they have failed.

Cunningham, 265 U.S. at 11. The Seventh Circuit merely followed this Court's precedent in allowing actual tracing. The Court should deny the Trustee's Petition for this reason as well.

The Trustee criticizes the Seventh Circuit's actual tracing analysis because, according to him, the Seventh Circuit dispensed with the requirement that FCStone "prove that the cash it invested at Sentinel was converted into the securities and cash in the" Reserves. (Tr.Pet.14.) The Trustee further contends that this will result in the SEG 1 creditors receiving "distributions the SEG3 creditors will not receive solely because Sentinel's wrongdoers placed the SEG1 name on the" relevant account. (Tr.Pet.21.) The Trustee is incorrect on all counts. The Seventh Circuit found that FCStone could and did "actually trace its initial investment to the proceeds of the Citadel security sale (both those proceeds disbursed in the August 2007 post-petition transfer and those remaining in reserve)" without the use of any tracing conventions.[6] (Pet.App.33a.) Indeed, the Seventh Circuit spent six pages discussing FCStone's detailed and unrebutted actual tracing analysis. (Pet.App.40-46a.) As the Seventh Circuit

---

[6] This holding also completely refutes the notion that Sentinel treated its assets under management as a single undifferentiated pool.

explained, FCStone's ability to actually trace its assets provided "an independent basis for its claim to" the Reserves. (Pet.App.33a.)

C. This Reserves Holding Is Not Of Great Precedential Value And A Similar Case Is Highly Unlikely To Recur.

The Trustee contends that this Court should grant his Petition because cases similar to this one are highly likely to recur. The Trustee is wildly incorrect.

The Seventh Circuit's decision to allow FCStone to use tracing conventions was based on the fact that the SEG 1 Objectors and Sentinel's SEG 3 customers were not similarly situated because Sentinel's SEG 3 customers had waived their trust rights under Sentinel's unique chapter 11 bankruptcy plan while the SEG 1 Objectors had specifically retained theirs. This scenario is completely unique. That likely is why the Trustee did not cite to any cases that conflict with the Seventh Circuit's reading of the Plan.

Moreover, Sentinel, itself, was a very unique investment vehicle – it was an FCM that acted as an investments advisor for other FCMs and hedge funds, but did not execute futures contracts for its customers.[7] Indeed, it was the *only* entity of its kind in the marketplace.

---

[7] Futures contracts are defined as "commodity contracts." *See* 11 U.S.C. § 761(4).

The *sui generis* nature of Sentinel is illustrated by the differences between Sentinel and the two FCM bankruptcy cases referenced by the Trustee – MF Global Inc. ("MFGI") and Peregrine Financial Group, Inc. ("PFG"). Unlike Sentinel, both MFGI and PFG were FCMs that executed futures contracts for their customers. As such, both MFGI and PFG were liquidated as "commodity brokers" under subchapter IV of chapter 7 of the Bankruptcy Code and the CFTC's Part 190 Rules. Subchapter IV and the Part 190 Rules dictate in great detail the distribution scheme for customers and other creditors in FCM bankruptcy cases, including the MFGI and PFG cases.

The one exception to this rule is the Sentinel case: because Sentinel executed no futures contracts for its customers, subchapter IV and the Part 190 Rules did not apply.[8] Because the precedent in Sentinel will not apply to other FCM bankruptcy cases, the parade of horribles forecasted by the Trustee has no basis in reality. Moreover, the Seventh Circuit's holding that Sentinel's SEG 3 customers waived their trust claims under Sentinel's *chapter 11* plan cannot possibly apply in FCM bankruptcies under *chapter 7* and the Part 190 Rules because there is no chapter 11 plan in these bankruptcies.

[8] Only "commodity brokers" are liquidated under subchapter IV. To be a "commodity broker," an FCM must have a "customer," which Sentinel did not because it did not enter into "commodity contracts." *See* 11 U.S.C. §§ 101(6), 761(9)(A), 761(4).

II. This Court Should Deny The Trustee's Petition As It Relates To The Unjust Enrichment Holding.

A. Every Circuit That Has Considered The Issue Has Agreed With The Seventh Circuit That The Bankruptcy Code Preempts State Law Unjust Enrichment Claims.

The Trustee contends that this Court should review the Unjust Enrichment Holding because there is a split between the Circuits that should to be resolved. That, too, is incorrect. Only three other Circuits have addressed this issue – the First, the Sixth and the Eighth – and all three, like the Seventh Circuit, have held that the Bankruptcy Code preempts state law claims for unjust enrichment. *See Contemporary Indus. Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); *Petruso v. Ford Motor Credit Co.*, 233 F.3d 417, 426 (6th Cir. 2000); *Bessette v. Avco Fin. Servs., Inc.*, 230 F.3d 439 (1st Cir. 2000).

In *Contemporary Industries*, the plaintiff brought a claim for unjust enrichment seeking to recover allegedly excessive payments that were made to the defendant in the context of a leveraged buyout of a corporation that later filed for bankruptcy. 546 F.3d at 984-85. The Fifth Circuit addressed whether plaintiff's claim was preempted by § 546(e) of the Bankruptcy Code under the theory of conflict preemption, which among other things, provides that state law is preempted "where it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995) (citations omitted). The Fifth Circuit held that the unjust enrichment claim was preempted:

> Through its state law claims, [plaintiff] seeks to recover the same payments we have already held are unavoidable under §546(e). Allowing recovery on these claims would render the §546(e) exemption meaningless and would wholly frustrate the purpose behind that section. Thus, [plaintiff's] state law claims must fail.

Contemp. Indus., 546 F.3d at 984-85 (citations omitted).[9]

In *Petruso*, the Sixth Circuit analyzed whether an unjust enrichment claim for damages arising from a creditor's alleged violation of the Bankruptcy Code's automatic stay provisions was preempted under either conflict or field preemption (which occurs where the federal scheme is so pervasive as to make reasonable the inference that Congress left no room to supplement it). *Freightliner Corp.*, 514 U.S. at 287. After noting the pervasive nature of Congress' regulation of bankruptcy, the Sixth Circuit held that plaintiff's unjust

---

[9] This Court in *Merit Management Group, LP v. FTI Consulting, Inc.*, No. 16-784, ___ U.S. ___, 2018 U.S. LEXIS 1514 (Feb. 27, 2018), recently rejected the analysis in *Contemporary Indus.* relating to § 546(e)'s applicability to transactions in which a protected party was only a "pass through" entity. *Merit*, however, did not abrogate or otherwise address the preemption analysis in *Contemporary Indus.*, which is directly on point here.

enrichment claim was preempted by both conflict and field preemption. *Petruso*, 233 F.3d at 426. The Sixth Circuit observed that permitting such a claim would "undermine the uniformity the Code endeavors to preserve and would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id*. (internal quotation omitted).

Similarly, in *Bessette*, the First Circuit held that plaintiffs' state law class action claim for unjust enrichment, which arose from defendant's wrongful practice of coercing inexperienced debtors into reaffirming debt that had been properly discharged in bankruptcy, was preempted by the Bankruptcy Code under field preemption. 230 F.3d at 442, 447-48. In analyzing the issue, the First Circuit found that Congress' intent in enacting the remedial provisions of the Bankruptcy Code left no room for plaintiffs' state-law unjust enrichment claim. *Id*. at 447-48.

Notably, the Trustee does not even address any of these cases. He also does not cite any Circuit Court authority to the contrary. That is because he cannot. As explained above, all four circuits that have addressed the issue, including the Seventh Circuit, have held that the Bankruptcy Code preempts state law unjust enrichment claims. This should end the inquiry and this Court should deny the Trustee's Petition.

Because there is no actual conflict, the Trustee attempts to manufacture one. He contends that the Seventh Circuit supposedly relied on a form of preemption called "end run" preemption that supposedly was first enunciated by the Ninth Circuit in *Miles v. Okun*, 430 F.3d 1083 (9th Cir. 2005). According to the Trustee, this theory allegedly conflicts with more recent opinions from the Third Circuit (*Rosenberg v. DVI Receivables XVII*, *LLC*, 835 F.3d 414 (3d Cir. 2016)) and the Sixth Circuit (*Mik v. Federal Home Loan Mortgage Corp.*, 743 F.3d 149 (6th Cir. 2014)), both of which supposedly rejected "end run" preemption.

The Seventh Circuit, however, did no such thing. In finding that the Bankruptcy Code preempted the Trustee's unjust enrichment claim, the Seventh Circuit correctly observed that permitting such a claim in "this context would allow a trustee or a creditor to make an end-run around the bankruptcy code's allocation of assets and losses, frustrating the administration of the bankruptcy estate under federal bankruptcy law." (Pet.App.102a.) This sentence merely is a restatement of the standard for conflict preemption, which, as explained above, provides for preemption of a state law claim "where it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Freightliner Corp.*, 514 U.S. at 287. That the Seventh Circuit cited to *Contemporary Industries* and *Petruso* – two cases applying conflict preemption in holding that the Bankruptcy Code preempts state law unjust enrichment claims – only confirms this.

Notably, not even the cases cited by the Trustee help him. As an initial matter, none of them even address the issue of whether the Bankruptcy Code preempts state law unjust enrichment claims. For this reason alone, they are inapposite.

Moreover, *Miles* and *DVI Receivables*, two decisions that, according to the Trustee, conflict on the use of "end run" preemption, do not even contain the phrase "end run." As the opinions make clear, they are field preemption cases. *Miles*, 430 F.3d at 1090-91; *DVI Receivables*, 835 F.3d at 419.

Finally, although *Mik* does contain the words "end run," the Sixth Circuit used the phrase in a different context. In *Mik*, plaintiffs argued that they could use violations of the Protecting Tenants at Foreclosure Act of 2009 ("PTFA"), Pub.L. No. 111-22, § 702, 123 Stat. 1632, 1661 (codified at 12 U.S.C. § 5220 note), offensively to establish the elements of various state law causes of action. *Mik*, 743 F.3d at 165. Defendant contended that plaintiffs were making an "end run" around the fact that the PTFA does not expressly provide for a private right of action. *Id*. The Sixth Circuit held that plaintiffs could use PTFA violations to establish the elements of its various state law claims because the PTFA would be rendered "virtually meaningless" if they were unable to do so. *Id*. at 167. This is not the issue that the Seventh Circuit addressed. The Seventh Circuit merely held that the Trustee's unjust enrichment claim was preempted because it conflicted with the Bankruptcy Code.

The Seventh Circuit was correct. The Trustee brought his prepetition preferential transfer claim under § 547 of the Bankruptcy Code. Section 546(e) of the

Bankruptcy Code provides several complete defenses to, or "safe harbors" from, actions brought by a trustee under § 547 to avoid prepetition preferential transfers (a) made to a commodity broker in connection with a "securities contract," or (b) that qualify as a "settlement payment" as defined in §§ 741(7) and (8), respectively. The purpose of these complete defenses or "safe harbors" is to "minimize the displacement caused in commodities and securities markets in the event of a major bankruptcy affecting those injuries." H.R. Rep. No. 97-420, at 1 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 583; *see also* H.R. Rep. No. 101-484, 2 (1990), *as reprinted in* 1990 U.S.C.C.A.N. 5785, 5794 (explaining that Congress enacted 11 U.S.C. § 546 to promote speed, certainty, and finality in "resolving complex financial transactions").

As the Seventh Circuit explained:

> Congress enacted § 546(e) to prevent a large bankruptcy from triggering a wave of bankruptcies among securities businesses. Section 546(e) applies only to the securities sector of the economy, where large amounts of money must change hands very quickly to settle transactions. Those dealing in securities have an interest in knowing that a deal, once completed, is indeed final so that they need not routinely hold reserves to cover the possibility of unwinding the deal if a counterparty files for bankruptcy in the next 90 days. Also, even a short term lack of liquidity can prove fatal to a commodity broker or other securities business.

> By enacting § 546(e), Congress chose finality over equity for most pre-petition transfers in the securities industry – *i.e.*, those not involving actual fraud. In other words, § 546(e) reflects a policy judgment by Congress that allowing some otherwise avoidable pre-petition transfers in the securities industry to stand would probably be a lesser evil than the uncertainty and potential lack of liquidity that would be caused by putting every recipient of settlement payments in the past 90 days at risk of having its transactions unwound in bankruptcy court.

(Pet.App.89-90a.)

The Seventh Circuit correctly determined that permitting the Trustee to avoid a prepetition preferential transfer under the guise of an unjust enrichment claim would frustrate the administration of Sentinel's estate under the Bankruptcy Code (*i.e.*, would stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"). Indeed, allowing such a claim to proceed would render § 546(e)'s safe harbors meaningless and wholly frustrate the purpose of that section because a plaintiff could circumvent it merely by bringing an unjust enrichment claim seeking to avoid the same transfer. It also would frustrate the purposes of § 541, which requires a trustee to establish that transfers sought to be avoided consist of property of the estate.[10] Contrary

[10] With respect to the post-petition transfer, allowing such a claim would frustrate the purposes of § 549(a)(2)(B), which permits a trustee to avoid a post-petition transfer of estate property

to Congress' clear intent, this untenable result would sow doubt, uncertainty and instability in the markets rather than promote finality, certainty, stability and speed.[11]

The Trustee also cites to the petition filed in *Deutsche Bank Trust Company Americas v. Robert R. McCormick Foundation*, Case No. 16-317, to argue that this Court should grant his Petition. The petition in *Deutsche Bank*, however, has not even been granted and its issues are far afield from this case. *Deutsche Bank* is a fraudulent transfer case that analyzes whether § 546(e) of the Bankruptcy Code preempts state law fraudulent transfer claims held by individual creditors of the debtor when the trustee has failed to pursue such claims. The *Deutsche Bank* case does not involve unjust enrichment or preference claims. Moreover, as explained above, the Seventh Circuit in this case did not base its preemption analysis solely on § 546(e). Rather, it affirmed the District Court's ruling that unjust enrichment claims are preempted because an individual creditor (or the Trustee as assignee) cannot avoid proving the elements of a Bankruptcy Code preference claim by repackaging it as "unjust enrichment" because such a result would conflict with the Bankruptcy Code.

---

only if the transfer was not authorized. 11 U.S.C. § 549(a)(2)(B). Here, as explained above, the post-petition transfer clearly was authorized.

[11] For the reasons stated in *Bessette*, the Trustee's unjust enrichment claim also is preempted under field preemption.

For all these reasons, this Court should deny the Trustee's Petition as it relates to the Trustee's unjust enrichment claim.

B. The Preemption Issue Is Moot Because The Trustee Cannot Establish His Unjust Enrichment Claim.

This Court should deny the Trustee's Petition for the additional reason that the issue of whether the Bankruptcy Code preempts state law unjust enrichment claims is moot here. Because the prepetition transfer was neither by mistake nor a result of wrongful conduct, the only way the Trustee could have established unjust enrichment under Illinois law was to show that Sentinel's other creditors had a better or superior claim to these transfers. *Ass'n Ben. Servs. v. Caremark RX, Inc.*, 493 F.3d 841, 854 (7th Cir. 2007). The Trustee could not do this.

Because the Seventh Circuit held that the SEG 1 Objectors' customer property is *not* property of Sentinel's estate due to the fact that, among other things, FCStone could actually trace, it would be impossible for any other creditor of Sentinel to have a better or superior claim to the transfers. Moreover, outside bankruptcy, "a creditor who receives payment from a debtor is not unjustly enriched merely because other creditors went unpaid." *El Camino Res., Ltd. v. Huntington Nat'l Bank*, 722 F. Supp. 2d 875, 932 (W.D. Mich. 2009); *B.E.L.T. v. Wachovia Corp.*, 403 F.3d 474, 477 (7th Cir. 2005) ("[R]epayment of a loan is not 'unjust' enrichment").

CONCLUSION

For the foregoing reasons, the Trustee's Petition should be denied.

Respectfully submitted,

STEPHEN P. BEDELL
Counsel of Record
DAVID B. GOROFF
THOMAS P. KREBS
FOLEY & LARDNER LLP
321 N. Clark Street, Suite 2800
Chicago, Illinois 60654-5313
(312) 832-4500
sbedell@foley.com
dgoroff@foley.com
tkrebs@foley.com

Counsel for Respondent