IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FREDERICK J. GREDE, not individually but as Liquidation Trustee of the Sentinel Liquidation Trust,	)	
Plaintiff,	)	Honorable Rebecca R. Pallmeyer
v.	)	Case No. 09-cv-00120
FARR FINANCIAL, INC.,	)	
Defendant.	)	

FARR FINANCIAL, INC.'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR ENTRY OF JUDGMENT ON COUNTS I THROUGH V OF THE TRUSTEE'S SECOND AMENDED COMPLAINT

Defendant, Farr Financial, Inc. ("Farr"), submits this Memorandum of Law in Support of its Motion for Entry of Judgment on Counts I through V of the Trustee's Second Amended Complaint ("Complaint").[1]

INTRODUCTION

This case is one of 11 closely related adversary proceedings brought by the Trustee against former SEG 1 customers (collectively, the "SEG 1 Cases") of Sentinel Management Group, Inc. ("Sentinel"). The defendants in the SEG 1 Cases are FCStone LLC ("FCStone") IFX Markets, Inc., IPGL Ltd., Farr Financial, Inc., Cadent Financial Services, Rand Financial Services, Country Hedging Inc., Velocity Futures, LLC, American National Trading Corp., ABN AMRO Clearing Chicago LLC, Penson Financial Futures, Inc., Penson Futures f/k/a Penson GHCO, Farr Financial, Inc. and Crossland LLC (collectively, the "SEG 1 Defendants").

[1] The Trustee is Frederick J. Grede as Liquidation Trustee for the Sentinel Liquidation Trust.

The Complaints in all the SEG 1 Cases contain identical counts, allege the same core facts and transactions, raise the same issues, and make the same claims. These counts are: (1) Count I for avoidance and recovery of post-petition transfer under § 549 of the of Title 11 of the United States Bankruptcy Code ("Bankruptcy Code"); (2) Count II for avoidance and recovery of prepetition preferential transfer under § 547 of the Bankruptcy Code; (3) Count III for declaratory judgment regarding the ownership interest in the reserve funds held by the Trustee (the "Reserves"); (4) Count IV for unjust enrichment; and (5) Count V for reduction or disallowance of claims. All the SEG 1 Defendants have raised the same core defenses.

Because of identical claims and common factual and legal issues, then-presiding Judge James B. Zagel concluded that the Sentinel SEG 1 litigation could best be resolved by using the "test case" approach. Judge Zagel approved *Grede v. FCStone*, Case No. 09-cv-136, as the test case for all the SEG 1 Cases.

After more than nine years of litigation, the Seventh Circuit has rendered rulings that effectively dispose of the SEG 1 Cases. As explained below, the Seventh Circuit's two opinions in the FCStone test case—*Grede v. FCStone*, LLC ("*FCStone I*"), 734 F.3d 244, 246-47, 251-260 (7th Cir. 2014) and *Grede v. FCStone, LLC* ("*FCStone II*"), 867 F.3d 767 (7th Cir. 2017)—have decided all of the Trustee's claims against the Trustee and in favor of FCStone and the other SEG 1 Defendants. These two opinions are legally binding on the Trustee in all of the SEG 1 Cases.

The Court, therefore, should enter judgment in favor of Farr and against the Trustee on Counts I through V of the Complaint, and order the Trustee to pay Farr its *pro rata* share of the SEG 1 Reserve, the Section 7.20(b) Disputed Claims Reserve, and the SEG 3/4 Reserve within seven days of the Court's entry of judgment on Count III.

BACKGROUND

A. The Bench Trial in the FCStone Test Case

During the Fall of 2012, Judge Zagel held a lengthy bench trial in the FCStone test case. On January 4, 2013, Judge Zagel entered final judgment in favor of the Trustee on Count I (post-petition transfer), Count II (pre-petition preferential transfer), Count III (declaratory judgment for reserve funds) and Count V (disallowance of claims), and for FCStone on Count IV (unjust enrichment). FCStone appealed those counts decided against it and the Trustee cross-appealed the finding as to Count IV.

B. *FCStone I*: The Seventh Circuit Rules Against the Trustee on Counts I-V.

On March 19, 2014, the Seventh Circuit found in favor of FCStone and reversed Judge Zagel's judgment on Counts I, II, III and V. *FCStone I*, 734 F.3d at 246-47, 251-260. The Seventh Circuit held that the post-petition transfer[2] (Count I) was authorized by the Bankruptcy Court (*id.* at 246-47, 254-58)—and therefore that no avoidance action could be brought by the Trustee under 11 U.S.C § 549(a). *Id.* at 246-47 The Seventh Circuit also held that the pre-petition preferential transfer (Count II) fell within both the "settlement payment" and "securities contract" safe harbor exceptions to claw back in § 546(e) of the Bankruptcy Code. *Id.* at 251-54. The Seventh Circuit also denied the Trustee's cross-appeal for reinstatement of his unjust enrichment claim (Count IV), affirming Judge Zagel's holding that the Trustee's unjust enrichment claim is preempted by federal bankruptcy law. *Id.* at 259-60. While the Seventh Circuit reversed Judge Zagel's judgment for the Trustee on Count III, the Seventh Circuit did not specifically rule on the disposition of the Reserves.

[2] The transfer at issue in Count I (in the FCStone test case and in the SEG 1 Cases) was the August 21, 2007 transfer of funds to the SEG 1 Defendants constituting the proceeds of Sentinel's sale of SEG 1 securities to Citadel minus a holdback amount (the "Post-Petition Transfer").

C. The SEG 1 Proceedings Before Judge Zagel Following *FCStone I*

On remand, both FCStone and the SEG 1 Defendants filed motions for entry of judgment on Counts I, II, IV and V of the Trustee's Complaints.[3] (*See* FCStone Dkt. No. 276; Farr Dkt. No. 116). The Trustee and the SEG 1 Defendants (including FCStone) also filed competing motions for summary judgment on Count III (the Reserves).

On March 28, 2016, Judge Zagel entered judgment for FCStone on Counts I, II, IV and V, but for the Trustee on Count III. [FCStone Dkt. Nos. 289-90].

As for the SEG 1 Defendants' related motions for judgment on Counts I, II, IV and V, and for summary judgment on Count III, Judge Zagel denied them "with leave to reinstate after common issues of law and fact have been fully resolved in the SEG 1 'test case,' *Grede v. FC Stone LLC*, 9-cv-136. (Dkt. No. 154). Expanding further on the subject, Judge Zagel ordered that the "[p]arties should not refile until my March 28, 2016 Memorandum Opinion and Order in FCStone has been appealed and decided, or the time to appeal it has expired." *Id.*

D. *FCStone II*: The Seventh Circuit Rules Against the Trustee.

The Trustee then appealed Judge Zagel's judgment on Count I (but not Counts II and IV). FCStone appealed Judge Zagel's judgment on Count III. On August 14, 2017, the Seventh Circuit ruled in favor of FCStone and against the Trustee on all the arguments presented by the parties on appeal. *FCStone II*, 867 F.3d at 767.

[3] On January 11, 2013, Penson Financial Futures, Inc. and Penson GHCO filed petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware and did not file motions for entry of judgment or competing motions for summary judgment when filed thereafter by the other SEG 1 Defendants.

With respect to Count I, the Seventh Circuit rejected the Trustee's collateral estoppel argument and affirmed Judge Zagel's judgment against the Trustee on the Trustee's Post-Petition Transfer claim (Count I). *FCStone II*, 867 F.3d at 770-71.

With respect to Count III, the Seventh Circuit reversed Judge Zagel's judgment in favor of the Trustee and ruled in favor of FCStone and the other SEG 1 Defendants. The Seventh Circuit held that: (a) the money maintained by the Trustee in the SEG 1 Reserve[4] was customer property (as opposed to property of Sentinel's estate); (b) as a result, FCStone and the other SEG 1 Defendants are entitled to the funds in the SEG 1 Reserve and the funds in the Section 7.20(b) Disputed Claims Reserve[5]; and (c) the SEG 1 Reserve funds and the funds in the Section 7.20(b) Disputed Claims Reserve must be distributed *pro rata* to FCStone and the other SEG 1 Defendants:

> The question concerns the proper distribution of nearly $25 million held in reserve under the confirmed bankruptcy plan. FCStone argues that these funds are trust property belonging to it and other creditors in its customer class who are protected by statutory trusts under the Commodity Exchange Act. The district court disagreed, treating the funds instead as property of the bankruptcy estate subject to *pro rata* distribution among all Sentinel customers and other unsecured creditors. On this cross-appeal, we reverse. Under the Bankruptcy Code, property held by the debtor in trust for

[4] The SEG 1 Reserve was created by Section 7.20(a) of Sentinel's bankruptcy plan. It consists of a hold-back of $15.6 million (about five percent of the Citadel sale proceeds), $4.9 million in proceeds from a late-settling security and certain proceeds of subsequent liquidations, and interest accrued. *FCStone II*, 867 F.3d at 778–79.

[5] The Section 7.20(b) Disputed Claims Reserve was created by Section 7.20(b) of Sentinel's bankruptcy plan. It "consists of funds that 'any Citadel–Beneficiary Customer Claim which voted against the Plan and/or lodged objections thereto [ ] would be entitled to receive' but for language in Section 4.5(a) that requires SEG 1 Citadel sale beneficiaries to wait on further distributions until other customers catch up to their level of recovery. The 7.20(b) Disputed Claims Reserve was designed to capture the *pro rata* portions of litigation recoveries and similar distributions that SEG 1 Objectors would have received had the parties agreed up front that the Citadel sale proceeds were SEG 1 trust property (and therefore should not count against the SEG 1 Objectors' *pro rata* share in the property of the estate)." *FCStone II*, 867 F.3d at 790.

> others is by definition not property of the bankruptcy estate. Pursuant to the confirmed bankruptcy plan, FCStone and similarly situated customers preserved their right to re-cover their trust property. These creditors are entitled to the benefit of reasonable tracing conventions. Moreover, FCStone introduced essentially unrebutted evidence at trial showing that it can trace a portion of the reserve funds back to its investment.
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> FCStone is therefore entitled to judgment on Count III, and ***FCStone and the other SEG 1 objectors are entitled to share pro rata in the SEG 1 reserve***.
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> In light of these provisions [of Sentinel's bankruptcy plan] and our conclusions about the post-petition transfer and SEG 1 reserve funds, ***the Section 7.20(b) Disputed Claims Reserve should be liquidated and the funds disbursed to the SEG 1 Objectors who would have received these funds but for the property of the estate dispute***.[6]

Id. at 771, 790-91 (emphasis added).[7]

ARGUMENT

The sole reason why Judge Zagel chose the FCStone case as a test case was to allow that case to resolve all the SEG 1 Cases without having to hold repetitive and wasteful trials on common issues and facts. Indeed, that is why Judge Zagel vacated the parties' cross-motions for summary judgment in March 2016 and directed the parties not to refile them until the Seventh Circuit had issued an opinion in *FCStone II*. That has now happened.

The Seventh Circuit has ruled against the Trustee in the FCStone test case on Counts I, II, III, IV and V of the Trustee's Complaint and ordered the Trustee to disburse the funds held in the SEG 1 Reserve and the Section 7.20(b) Disputed Claims Reserve to FCStone ***and the other SEG***

[6] The "SEG 1 Objectors" include all of the SEG 1 Defendants.

[7] On October 2, 2017, the Seventh Circuit denied the Trustee's petition for rehearing and rehearing *en banc*. It issued its mandate in the FCStone case (09-cv-136) on October 10, 2017.

1 Defendants. *FCStone II*, 867 F.3d at 771, 790-91. These rulings are binding on the Trustee in all the other SEG 1 Cases. *See Ank v. Koppers Co.*, No. 89-165759, 1991 U.S. App. LEXIS 5381, *6 (9th Cir. 1991) ("the situations that are most likely to create an implied agreement to be bound involve a shared understanding that a single action is to serve as a test case that will resolve the claims or defenses of nonparties as well as parties."); *Grubbs v. United Mine Workers*, 723 F. Supp. 123 (W.D. Ark. 1989) (holding that test case collaterally estopped losing party from re-ligating same issue).

The rulings in *FCStone II* also bind the Trustee with respect to the funds held by the Trustee for Farr in the SEG 3/4 Reserve. The SEG 3/4 Reserve was created by Section 7.20(a)(iii) of Sentinel's bankruptcy plan to address the objections of Farr and other SEG 1 Defendants that also held SEG 3/4 claims arising from the fact that, in addition to depositing customer trust funds with Sentinel for investment, they separately invested house funds in SEG 3/4 accounts at Sentinel that were entitled to distributions *pro rata* with other SEG 3/4 customers. The SEG 3/4 Reserve enabled objecting SEG 1 customers to receive their *pro rata* share of distributions on account of their SEG 3 claims in the event these SEG 1 customers prevailed on the "property of the estate" issue. (*See* Sentinel's Bankruptcy Plan, Section 7.20(c)(i), Ex. A). The reasoning was that if the SEG 1 customers holding SEG 3/4 claims merely received their own property back on account of their SEG 1 claims (as the Seventh Circuit ruled in *FCStone II*), such customers were entitled to share *pro rata* with all other SEG 3/4 customers in any distributions to holders of SEG 3/4 claims.[8]

[8] The Trustee has never suggested that the SEG 1 Defendants need to trace the funds in the SEG 3/4 Reserve to receive them. That is because, as explained above, tracing is irrelevant to the SEG 1 Defendants' right to recover their *pro rata* share of the funds in the SEG 3/4 Reserve.

Thus, the SEG 1 Defendants' right to recover their *pro rata* share of the funds in the SEG 3/4 Reserve is entirely derivative of their ability to recover their *pro rata* share of the SEG 1 Reserve. Because the Seventh Circuit held in *FCStone II* that the SEG 1 Defendants are entitled to their *pro rata* share of the funds in the SEG 1 Reserve (*i.e.*, that those funds are not property of Sentinel's estate), the SEG 1 Defendants (including Farr) also are entitled under *FCStone II* to their *pro rata* share of the funds in the SEG 3/4 Reserve. Based on the Trustee's latest quarterly report sent to all customers (including the SEG 1 Defendants), the Trustee has made distributions of approximately 59% to SEG 3 customers and other unsecured creditors. (*See* Report of Frederick J. Grede, Liquidating Trustee of the Sentinel Liquidation Trust, Dated July17, 2017, Ex. B). The SEG 1 Defendants holding SEG 3/4 claims are therefore entitled to a distribution of approximately 59% on account of their claims.

For all these reasons, the Court should: (a) enter judgment in Farr's favor and against the Trustee on Counts I through V of the Trustee's Complaint; and (b) direct the Trustee to pay Farr its *pro rata* share of the SEG 1 Reserve, the Section 7.20(b) Disputed Claims Reserve, and the SEG 3/4 Reserve within seven days of the Court's entry of judgment on Count III.

The Court should note that Farr's total *pro rata* share of these Reserves is readily ascertainable. According to a reserve account summary that the Trustee recently provided to the SEG 1 Defendants, Farr's *pro rata* share of the funds in the SEG 1 Reserve was $1,249,235 as of July 31, 2017.[9] (*See* Trustee's Reserve Account Summary, Ex. C). The SEG 1 Defendants

[9] Although the Reserve Account Summary from the Trustee includes a header referencing Fed. R. Evid. 408, the document summarizes reserve account balances, along with supporting facts and numbers that are otherwise discoverable and not subject to Fed. R. Evid. 408's protections. (Trustee's Reserve Account Summary, Ex. A). The Trustee has the fiduciary duty and is required to provide the SEG 1 Defendants with the information set forth in the Reserve Account Summary (*i.e.*, the amount of funds being held in reserve), and the information contained in Exhibit A is obviously otherwise discoverable, and thus not subject to protection under Rule 408. *See* Rule 408, Advisory Committee's note to 2006

do not dispute this calculation. Indeed, the reserve account summary is a statement of account that the Trustee, as the fiduciary of Sentinel's Liquidating Trust, is required to provide to the SEG I Defendants.

Moreover, according to the calculations of the SEG 1 Defendants, Farr's *pro rata* share of the: (a) Section 7.20(b) Disputed Claims Reserve was $151,869 as of June 30, 2017; and (b) SEG 3/4 Reserve was $1,390,649 as of July 31, 2017. (Goodman Aff. ¶16, Ex. D) Each SEG 1 Defendant's *pro rata* share of the Section 7.20(b) Disputed Claims Reserve is based on such customer's SEG 1 (and SEG 2, if applicable) balances as of the petition date divided by the aggregate SEG 1 and SEG 2 balances of the SEG 1 Defendants as of the petition date. The *pro rata* share of a SEG 1 Defendant (that holds SEG 3/4 claims) in the SEG 3/4 Reserve is based on such SEG 1 Defendant receiving a 59% distribution on account of such SEG 1 Defendant's SEG 3/4 balance. (*Id*. at ¶6)

Thus, based on these calculations, the Trustee owes Farr a total of $2,791,753, plus interest accruing from the date of the calculations.

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amendment ("[t]he sentence of the Rule referring to evidence 'otherwise discoverable' has been deleted as superfluous"); *see also Ramada Dev. Co. v. Rauch*, 644 F.2d 1097, 1107 (5th Cir. 1981) (the sentence regarding otherwise discoverable information in the pre-2006 iteration of Rule 408 "was intended to prevent one from being able to immunize from admissibility documents otherwise discoverable merely by offering them in a compromise negotiation"); *Bamber v. Elkhart Cmty. Sch.*, No. 2005 WL 957331, *2 (N.D. Ind. Mar. 28, 2005) (finding that Rule 408 did not bar the court from considering a computerized printout of time entries offered with a settlement letter where the entries were not discounted or changed for settlement). Farr has redacted two footnotes from the Summary because those footnotes arguably refer to the Trustee's settlement proposals related to other SEG 1 Objectors.

CONCLUSION

For the foregoing reasons, the Court should: (a) enter judgment in Farr's favor and against the Trustee on Counts I through V of the Trustee's Second Amended Complaint; (b) direct the Trustee to pay Farr its *pro rata* share of the SEG 1 Reserve, the Section 7.20(b) Disputed Claims Reserve, and the SEG 3/4 Reserve within seven days of the Court's entry of judgment on Count III; and (c) grant all other just relief.

Dated: October 16, 2017

Respectfully submitted,

FARR FINANCIAL, INC.

By: /s/ Henry K. Becker
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CERTIFICATE OF SERVICE

I, Henry K. Becker, an attorney, hereby certify that on October 16, 2017, I electronically filed the foregoing FARR FINANCIAL, INC. MOTION FOR ENTRY OF JUDGMENT ON COUNTS I THROUGH V with the Clerk of the Court using the CM/ECF system, and further caused the same to be served on all counsel of record via ECF filing.

By: /s/ Henry K. Becker