
**IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

FREDERICK J. GREDE, not individually)	
but as Liquidation Trustee of the Sentinel)	
Liquidation Trust,)	
)	Appeal from the United States
Plaintiff-Appellant,)	District Court for the Northern
)	District of Illinois
v.)	
)	No. 09 C 1919
THE BANK OF NEW YORK MELLON and)	
THE BANK OF NEW YORK MELLON CORP.,)	Hon. James B. Zagel
)	
Defendants-Appellees.)	

**BRIEF OF DEFENDANTS-APPELLEES THE BANK OF NEW YORK MELLON
AND THE BANK OF NEW YORK MELLON CORP.**

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 09-3121

Short Caption: Frederick Grede v. Bank of New York Mellon, et al

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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[] PLEASE CHECK HERE IF ANY INFORMATION ON THIS FORM IS NEW OR REVISED AND INDICATE WHICH INFORMATION IS NEW OR REVISED.

(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P. 26.1 by completing the item #3):

The Bank of New York Mellon

The Bank of New York Mellon Corp. ("BNYM")

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Mayer Brown LLP

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

BNYM is the parent corporation of The Bank of New York Mellon f/k/a The Bank of New York

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

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JURISDICTIONAL STATEMENT

Appellant's jurisdictional statement is not complete and correct.

In the district court, plaintiff-appellant Frederick J. Grede ("Trustee") asserted both "related to" jurisdiction pursuant to 28 U.S.C. § 1334(b) and diversity jurisdiction pursuant to 28 U.S.C. § 1332. App. 7 ¶¶ 6-7. On appeal, however, the Trustee asserts only diversity jurisdiction. Trustee Br. 1. The only fathomable reason why the Trustee dropped his invocation of "related to" jurisdiction on appeal is to try to camouflage the fact that the Liquidation Trust remains subject to bankruptcy court oversight, which conflicts with his appellate argument that the estate is a dead letter. In any event, for the reasons set forth below, diversity jurisdiction is lacking.

The Trustee contends that he is a citizen of Illinois and that defendants are citizens of New York and Delaware. However, the Trustee brings this action as the assignee of over 100 claimants ("Claimants") listed on Exhibit A to the Trustee's Complaint. App. 52-53. Those Claimants include citizens of New York, such as Dan's Supreme Supermarkets, Inc., a corporation headquartered in Hempstead, New York, Jennie Currie, Neal Stevens, Stanley and Nancy Perelman, and Robert and Leslie Boshnack. In addition, the Claimants include many limited partnerships and limited liability companies, which are citizens of every State of which any member is a citizen. *Belleville Catering Co. v. Champaign Marketplace, L.L.C.*, 350 F.3d 691, 692 (7th Cir. 2003). Many of these LLC and LLP Claimants are headquartered in New York—including One York Property LLC; BC Capital Fund A, LLC; BC Capital Fund B, LLC; and Ancile Global Diversification Fund I, LLC—and include members resident in New York. See Appellee's Docketing Statement for documentation.

The New York citizenship of defendants-appellees The Bank of New York Mellon and The Bank of New York Mellon Corp. (collectively, “BNYM”) and some Claimants defeats diversity jurisdiction. The Claimants are the real parties in interest whose citizenship counts for diversity purposes because they will be the recipients of any recovery. Instead of pursuing their individual claims individually in state court, the Claimants assigned their claims to the Trustee so that he could file them collectively in federal court (and get the estate to subsidize their litigation). The law forbids such an artificial stratagem to obtain diversity jurisdiction. 28 U.S.C. § 1359 states: “A *district court shall not have jurisdiction of a civil action in which any party, **by assignment** or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court*” (emphasis added). That is precisely what occurred here.

The leading case on the application of § 1359 is *Kramer v. Caribbean Mills, Inc.*, 394 U.S. 823 (1969). In *Kramer*, a Panamanian corporation assigned its contract rights against a Haitian corporation to a Texas resident (Kramer) for one dollar. On the same day, Kramer assigned back to the Panamanian corporation 95% of any recovery he might receive on the contract. Kramer sued the Haitian corporation in federal court, alleging diversity jurisdiction. The Supreme Court held that the assignment was improperly or collusively made in violation of § 1359. *Id.* at 827-28. The Court explained:

When the assignment to Kramer is considered together with his total lack of previous connection with the matter and his simultaneous reassignment of a 95% interest back to Panama, there can be little doubt that the assignment was for purposes of collection, with Kramer to retain 5% of the net proceeds for the use of his name and his trouble in collecting.

Id. In other words, Kramer simply served as a collection agent for the real party in interest, and thus Kramer's citizenship could not provide the basis for diversity jurisdiction.

Here, too, the Trustee had no connection to the claims at issue prior to the assignment, and he has no interest in the damages sought from BNYM other than the fees he would earn from litigating the matter. Like the plaintiff in *Kramer*, he is simply a conduit through whom the real parties in interest are bringing their claims against BNYM. Section § 1359 bars federal courts from exercising diversity jurisdiction artificially devised through such an assignment. As this Court has noted,

if getting into federal court was the sole purpose of the assignment, then even if the assignment was supported by consideration and was lawful under state law, one could question in just what sense the assignment was bona fide, and, more to the point, could ask whether it is not the precise purpose of section 1359 to discourage people from using the device of assignment to get access to the federal courts.

Steele v. Hartford Fire Ins. Co., 788 F.2d 441, 444 (7th Cir. 1986).

In distinguishing *Kramer* in *Hartford Accident & Indem. Co. v. Sullivan*, 846 F.2d 377 (7th Cir. 1988), this Court noted that, pursuant to § 1359, “[a]ssignments designed to confer diversity jurisdiction, normally for purposes of facilitating the collection of a debt, are collusive and ineffective.” *Id.* at 382. But there the Court found “no evidence” that at the time of the assignment the assignor anticipated the lawsuit, precluding the application of § 1359. *Id.* Here, in contrast, the sole purpose of the Claimants' assignments to the Trustee was to enable the Trustee to bring suit against parties like BNYM. This is precisely the type of case to which § 1359 applies and bars diversity jurisdiction.

The Trustee argues that there was no collusion with respect to his appointment as Liquidation Trustee. Trustee Br. 50. But that misses the point. It was not his appointment that was collusive but rather the assignment of claims which not only evaded the requirements for diversity jurisdiction but was “only for purposes of bringing suit,” that is, to enable the trustee to attempt “to collect money not owed to the estate.” *Williams v. California 1st Bank*, 859 F.2d 664, 667 (9th Cir. 1988). Indeed, those assignments enabled the New York Claimants to avoid having to finance their own state-court litigation and instead to foist federal court litigation expenses on the Sentinel estate creditors. Such a collusive assignment is barred by § 1359, requiring dismissal of this case for lack of subject matter jurisdiction.

ISSUE PRESENTED FOR REVIEW

Whether a liquidation trustee appointed to be representative of the estate and gather the estate's assets for pro rata distribution to the estate's creditors has standing to pursue litigation against a third party where any recovery will not go to the estate.

STATEMENT OF THE CASE

On August 17, 2007, Sentinel Management Group, Inc. ("Sentinel") filed for Chapter 11 bankruptcy protection. In October 2007, Frederick J. Grede, the appointed trustee of the Sentinel Chapter 11 estate, sued Sentinel's principals for fraud and other wrongdoing. In March 2008, the Trustee filed an adversary proceeding against BNYM for allegedly facilitating the Sentinel principals' alleged fraud, an action currently pending in the district court. On December 15, 2008, the bankruptcy court confirmed a plan that created a Liquidation Trust to liquidate the Sentinel estate and provided for Grede's resignation as Chapter 11 Trustee and his simultaneous appointment as Liquidation Trustee. On March 27, 2009, the Trustee brought this action against BNYM, asserting claims of certain unsecured creditors who had assigned their individual claims against BNYM to the Liquidation Trust. On July 28, 2009, the district court granted BNYM's motion to dismiss that action for lack of standing. On August 25, 2009, the Trustee timely filed a notice of appeal.

STATEMENT OF FACTS

As described below, Grede was appointed Chapter 11 Trustee and then Liquidation Trustee for a specific purpose—to gather the Sentinel bankruptcy estate assets for distribution to Sentinel's creditors in accordance with the provisions of the Bankruptcy Code. He filed this lawsuit for a very different purpose—to obtain damages for a subset of Sentinel's unsecured creditors from a third party, BNYM. Far from

maximizing the value of the estate, this lawsuit forces the estate to subsidize litigation that does not even purport to seek any benefit for the estate as a whole. For this and other reasons, the district court ruled that the Trustee lacks authority to bring this lawsuit.¹

A. The parties and Sentinel’s bankruptcy

Sentinel managed investments for sophisticated clients, including commodity brokers, hedge funds, financial institutions, and pension plans. App. 10-11 ¶ 19. When the credit markets and therefore the value of Sentinel-held securities declined, Sentinel collapsed and filed for Chapter 11 bankruptcy in August 2007. App. 7 ¶ 3. Grede was appointed trustee of Sentinel’s Chapter 11 estate. App. 8 ¶ 10.

For more than ten years, BNYM had provided services to Sentinel, including same-day settlements, secured lending, and other credit arrangements, first through its custodial services division and later through its clearing services division. App. 14-15 ¶¶ 37, 39.

B. The Trustee’s suits on behalf of the Sentinel estate.

In October 2007, the Trustee sued Sentinel’s principals. He alleged that they had defrauded Sentinel and its customers by diverting customer income and trading gains, concealing its leveraging through bank loans, and violating account segregation requirements. See Complaint, *Grede v. Bloom (In re Sentinel Mgmt. Group)*, No. 07-14987 (Bankr. N.D. Ill. Oct. 11, 2007).

In March 2008, the Trustee filed an adversary proceeding against BNYM (the “Trustee Action”), claiming that BNYM had facilitated the Sentinel principals’ alleged

¹ BNYM vigorously denies the facts alleged about its conduct in the Trustee’s complaint and brief. But because they are irrelevant to the standing issue addressed here, BNYM will not attempt to correct the record at this stage.

fraud. See Complaint, *Grede v. Bank of New York*, No. 08-AP-00127 (Bankr. N.D. Ill. Mar. 3, 2008), reference withdrawn, No. 08-C-02582 (N.D. Ill. June 20, 2008). In particular, the Trustee alleged that BNYM established a flawed account structure, which allowed Sentinel to pledge customer assets to secure BNYM's loans, permitted the commingling of customer assets with Sentinel's own assets, and failed to investigate what Sentinel was doing with the loan proceeds. *Id.* ¶¶ 3-4. The Trustee sought to recover for the estate the value of customer assets that were allegedly diverted as a result of BNYM's conduct, which he claimed exceeded \$550 million. *Id.* ¶ 10. The district court granted BNYM's motion to dismiss the Trustee's claims in part. See *Grede v. Bank of New York*, 2009 WL 188460 (N.D. Ill. Jan. 27, 2009). The remaining claims in the Trustee Action are currently pending. If the Trustee prevails in that action, any recovery will be distributed to Sentinel's creditors pursuant to the confirmed liquidation plan.

C. The Sentinel Plan

In December 2008, the bankruptcy court entered an order confirming the Fourth Amended Chapter 11 Plan of Liquidation for Sentinel ("Plan"). App. 8 ¶ 10; App. 417. The Plan's treatment of classes of claims is set forth in Articles II-IV. App. 79-86. The Plan created the Liquidation Trust to liquidate the Sentinel estate pursuant to a Liquidation Trust Agreement. App. 8 ¶ 11; App. 87 § 6.2; App. 117. The Plan also provided for Grede's resignation as Chapter 11 Trustee and his appointment as Liquidation Trustee. App. 8 ¶ 10. According to the Plan, Grede would thereby "become the appointed representative of the Estate in accordance with Section 1123(b)(3) of the Bankruptcy Code." App. 87 § 6.3. As such, he was to be "the sole officer and sole director of the post-Effective Date Debtor until such time as its dissolution." *Id.* The Liquidation Trust Agreement confirmed that "[t]he Liquidation Trustee has been ***

appointed representative of the Estate.” App. 120 § 2.1. In the Bankruptcy Court’s order confirming the Plan, Grede as Liquidation Trustee was given “all powers afforded a trustee under the Bankruptcy Code and Rules.” App. 419 § 4.

The Plan established “a distinct tranche of the Liquidation Trust,” which it designated “Tranche-P,” to hold the “Non-Estate Claims owned by Customers” who assigned those claims to the Liquidation Trust. App. 91 § 6.12; App. 119 § 1.4. These Non-Estate Claims were defined broadly to include potential claims against a variety of persons and entities including BNYM. App. 74-75. The Plan specifies that these Non-Estate Claims “shall not become Property,” which the Plan defines as “all property and interests in property of the Estate.” App. 91 § 6.12; App. 77. The Plan authorizes the Trustee to prosecute the Non-Estate Claims (App. 89 § 6.5(e)), but not on behalf of the estate as a whole. As the Plan expressly provides, Sentinel creditors who did not hold claims assigned to Tranche-P “will not receive any distribution on account of Tranche-P.” App. 91 § 6.12. And the Liquidation Trust Agreement adds that “[a]ny recoveries on account of such Non-Estate Claims held in Tranche-P shall be distributed Pro Rata solely to Tranche-P Electors,” that is, solely to those creditors who assigned their Non-Estate Claims to Tranche-P of the Liquidation Trust. App. 119 § 1.4.

The Plan also established a “Liquidation Trust Expense Fund” from which the Trustee and his retained professionals (such as the law firm representing him in this case) are to be compensated. App. 91-92 § 6.14, 94 § 6.21. The Liquidation Trust Agreement provides that the Trustee shall receive both “hourly-based compensation” and “contingency-based compensation” tied to recoveries obtained for the Liquidation Trust. App. 148. No exception is provided for litigation relating to, or recoveries obtained for, Tranche-P of the Liquidation Trust. Thus, the Trustee’s hourly fees and

expenses incurred in pursuing this lawsuit on behalf of the Tranche-P assignors, as well as the fees and expenses incurred by the counsel he has engaged to represent him, are paid out of estate assets, even though the estate as a whole will not receive any recovery from this lawsuit. Further, the Trustee, if he prevails in this lawsuit, will likely obtain a contingency fee consisting of a portion of the recovery designated for Tranche-P.

D. The Trustee’s suit on behalf of a subset of unsecured creditors

In April 2009, the Trustee brought this action (the “Customer Action”) on behalf of “certain of Sentinel’s customers,” namely, those with claims assigned to Tranche-P of the Sentinel Liquidation Trust. App. 7 ¶ 5. The Trustee raises essentially the same claims that he raised in the Trustee Action, but now on behalf only of the assigning customers instead of the estate creditors as a whole. The Amended Complaint contains three Counts, asserting claims against BNYM for “Aiding and Abetting/Knowing Participation in Breach of Fiduciary Duty by Sentinel to Its Customers,” “Aiding and Abetting Fraud by Sentinel,” and “Negligence.” App. 43-50 ¶¶ 148-68.

E. The decision below

BNYM moved to dismiss the Customer Action, contending that the Trustee lacks standing and that his claims are insufficient as a matter of law. The district court granted BNYM’s motion, holding that the Trustee lacks standing and not reaching BNYM’s additional grounds for dismissal.

The court first addressed the Trustee’s contention that res judicata bars BNYM from seeking dismissal for lack of standing. According to the Trustee, BNYM’s failure to challenge the Trustee’s standing when raising its objections to confirmation of the Plan bars it from doing so now. The court rejected that argument for three reasons. First, the bankruptcy court never ruled on those objections, which were settled. Short App. 4.

Second, standing is a jurisdictional question that cannot be waived. *Id.* Finally, the court explained, a confirmed plan has no preclusive effect with respect to issues that must be raised in a formal adversary proceeding under the Federal Rules of Bankruptcy Procedure. The court concluded that this principle applies with particular force to this action, which could not have been litigated “as part of the less-formal confirmation process before the adversarial action itself was even filed.” *Id.* at 5.

The court next addressed the merits of the standing issue, noting that Supreme Court precedent bars standing for a bankruptcy trustee pursuing claims for money not owed to the estate. Short App. 7. The court refused the Trustee’s request to create an exception where the trustee is an assignee of such claims because the Bankruptcy Code limits the trustee’s authority to acting on behalf of the estate. *Id.* at 9. Moreover, the court explained, allowing a trustee to pursue such non-estate litigation risks diminishing the assets available to the estate’s creditors. *Id.* at 10. As the court put it, bankruptcy law does not permit a trustee “to bring claims for the benefit of the few at the expense of the many.” *Id.* Here, the mere fact that any proceeds would be distributed pursuant to the Plan does not confer authority on the Trustee to pursue such litigation because those proceeds would be available only to the assignors, a subset of the estate’s claimants. *Id.* at 11. Allowing the Trustee to go forward would “essentially circumvent[] the order of priority of claims established by the Code” by distributing the proceeds solely to some holders of unsecured claims. *Id.* at 12. The court also raised “the possibility of inconsistency” with actions brought independently by creditors on their own behalf, noting that at least one such action already has been stayed due to such concerns. *Id.* at 14 n.6, citing *Shatkin v. Bank of New York Mellon Corp.*, 2008 WL 2446837 (S.D.N.Y. June 17, 2008). For these and other reasons, the court concluded, “the estate has no

interest in the claims, and Trustee has no authority under the Code to bring them.” *Id.* at 12.

SUMMARY OF THE ARGUMENT

I.

Almost half-a-century ago, the Supreme Court held that a trustee appointed by a bankruptcy court lacks standing to sue third parties where any recovery would go to select creditors rather than to the bankruptcy estate. That rule, which rests on the fact that a trustee’s sole purpose is to serve the estate, has survived a wholesale revision of the bankruptcy statutes and remains firmly entrenched today. The question of whether a trustee has standing in a particular case has been litigated in a variety of factual and legal contexts. But in each case the answer has depended on whether the recovery would go to the estate. If the answer is yes, the trustee likely has standing; if the answer is no, the trustee does not have standing. Benefit to the estate is the red thread that ties all these cases together and provides the analytical path out of what may seem like a tangle of issues. Here, it is undisputed that any recovery from this lawsuit will not go to the bankruptcy estate for pro rata distribution to the creditors as a whole but instead will go only to a subset of unsecured creditors. Accordingly, the district court correctly ruled that the Trustee lacks standing.

II.

The Trustee’s arguments for why the benefit-to-the-estate rule does not apply here are without merit. First, the Trustee contends that the Supreme Court effectively abrogated that rule in its *Sprint* decision. But *Sprint* does not even address bankruptcy law, much less whether a trustee appointed by a bankruptcy court has standing to bring lawsuits that will not benefit the estate.

Second, the Trustee contends that the confirmed Plan's establishment of a liquidation trust thereby buried both the estate and the benefit-to-the estate standing rule. But the Plan established the Liquidation Trustee as "representative of the Estate" in accordance with Bankruptcy Code provisions that require him to serve the estate. The Liquidation Trust is simply a mechanism to gather the estate's assets for pro rata distribution to the estate's creditors. It would be inconsistent with both that purpose and the Bankruptcy Code to permit the Trustee to use estate assets to subsidize litigation that will not benefit the estate.

Third, the Trustee contends that even if a benefit to the estate were required for standing, this lawsuit does indirectly benefit the estate. But the supposed indirect benefits he postulates are so weak and speculative as to be chimerical. Far from benefiting the estate, the Trustee's actions will cause the estate to suffer an affirmative detriment. Thus, the Trustee's argument is like the robber telling his victim, "Give me your money, it's good for you."

Fourth, the Trustee contends that having the many subsidize this litigation for the few is appropriate in light of Delaware trust law. But even if Delaware trust law could override the federal law standing principles that control this case, nothing in Delaware trust law supports the Trustee's position that he is free to use estate assets to finance litigation that will benefit only select creditors, the Trustee, and his lawyers.

Fifth, the Trustee contends that he must have standing to preserve the required flexibility of bankruptcy courts when liquidating estates. But the ruling below does not affect the establishment of liquidation trusts or in any way hamper bankruptcy courts from liquidating estates. It simply applies established standing rules to liquidation trustees appointed to serve estate creditors through a liquidation trust vehicle.

Finally, the Trustee contends that the confirmed Plan is res judicata with respect to the standing issue in this lawsuit. But the Plan does not address the Trustee's standing, much less whether he would have standing in a particular case. Courts address standing in concrete contexts, not based on speculation about possible future contexts. Because the question of the Trustee's standing in this action could be meaningfully addressed only after the action was filed, confirmation of the Plan is not preclusive as to that issue.

ARGUMENT

Standard of Review. A dismissal for lack of standing is reviewed de novo. *Wisconsin Right to Life, Inc. v. Schober*, 366 F.3d 485, 489 (7th Cir. 2004). Standing “is the threshold question in every federal case, determining the power of the court to entertain the suit.” *Warth v. Seldin*, 422 U.S. 490, 498 (1975).

I. The Trustee Lacks Standing To Bring Claims That Are Not For The Benefit Of The Estate.

A bankruptcy trustee is “the representative of the estate” (11 U.S.C. § 323(a)), charged with “gather[ing] the estate’s assets for pro rata distribution to the estate’s creditors.” *In re Teknek, LLC*, 563 F.3d 639, 645 (7th Cir. 2009). Property of the estate comprises “all legal or equitable interests of the debtor in property as of the commencement of the case” (11 U.S.C. § 541(a)(1)), including causes of action. See *In re Polis*, 217 F.3d 899, 901 (7th Cir. 2000). In short, trustees appointed by bankruptcy courts must act for the benefit of the bankruptcy estate, including when filing lawsuits. That principle has been securely established since the Supreme Court’s decision in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972).

A. The *Caplin* rule

In *Caplin*, the Court held that a Chapter X trustee under the former Bankruptcy Act lacked standing to sue a third party on behalf of debenture-holding creditors. 406 U.S. at 434. The Court explained that a bankruptcy trustee has no authority to bring claims seeking “to increase the assets of the debtor for the benefit of a specific class of creditors,” rather than “for all creditors” other than the defendant. *Id.* at 421 n.12. The Court reached that conclusion by “examining the nature of Chapter X proceedings, the role of the trustee in reorganization, and the way in which standing to sue on behalf of debenture holders would affect or change that role.” *Id.* at 422. In particular, the Court explained, “nowhere in the statutory scheme is there any suggestion that the trustee in reorganization is to assume the responsibility of suing third parties on behalf of debenture holders.” *Id.* at 428. Rather, the statute made his task “simply to ‘collect and reduce to money the property of the estates for which (he is trustee).’” *Id.* at 428-29.

The Court raised additional potential problems with allowing bankruptcy trustees to bring suits against third parties on behalf of only some creditors rather than the estate as a whole. In cases where the trustee alleges that the debtor is “as much at fault” as the defendant, a question would be raised as to whether the defendant “would be entitled to be subrogated” to the claims of the creditors. *Id.* at 430. Moreover, the Court added, such actions “may be inconsistent with any independent actions” filed by such creditors. *Id.* at 431-32. The Court concluded by noting that conferring standing on a trustee for such matters is “a policy decision [that] must be left to Congress and not to the judiciary.” *Id.* at 434.

B. The *Caplin* rule survives statutory revision

From the moment *Caplin* was decided, trustees and their sponsors sought ways to circumvent it. Some thought that the replacement of the Bankruptcy Act by the Bankruptcy Code in 1978 offered a way to relegate *Caplin* to the ash heap of history. But the courts have uniformly held that *Caplin* survived the change in statutes. In *In re Ozark Restaurant Equip. Co., Inc.*, 816 F.2d 1222 (8th Cir. 1987), the Eighth Circuit provided a lengthy analysis on which many other courts have relied.

In *Ozark*, the court held that a bankruptcy trustee lacked standing to bring an alter ego action on behalf of creditors, explaining that the Bankruptcy Code authorizes a trustee to bring causes of action only if they belong to the debtor, not if they “run to the corporate creditors personally.” *Id.* at 1225. The court rejected the trustee’s argument that a provision in the new statutory scheme, 11 U.S.C. § 544(a), conferred standing to bring such suits. The court explained that “nowhere in Sections 544(a) or (b), nor in other relevant provisions of the Code is there any suggestion that the trustee has been given the authority to collect money not owed to the estate.” *Id.* at 1229-30.

The court noted that the Supreme Court in *Caplin* had “expressly invited Congress” to decide that trustees have standing to bring such claims, and that Congress “declined to accept the invitation.” *Id.* at 1227. Although Congress “clarified and expanded the trustee’s role with respect to creditors” when it enacted the new Code six years after *Caplin* was decided, the trustee was **not** authorized “to bring suits on behalf of the estate’s creditors against third parties. In fact, the legislative history suggests just the opposite.” *Id.* That history shows that proposed § 544 initially contained a subsection which “would have applied to both reorganization and liquidation trustees” and was “intended to overrule *Caplin*.” *Id.* at 1227-28. By refusing to enact that

subsection, Congress sent a clear “message” that “no trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee as in the present case, has power under Section 544 of the Code to assert general causes of action, such as the alter ego claim, on behalf of the bankrupt estate’s creditors.” *Id.* at 1228.

C. The *Caplin* rule in this Court

This Court, too, has repeatedly affirmed the *Caplin* principle that a bankruptcy trustee lacks standing to bring claims that do not seek recovery for the estate as a whole. For example, in *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994), the Court rejected a bankruptcy trustee’s standing to sue shareholders of the debtor corporation, explaining that the trustee’s role “is to collect any money that may be owing to the bankrupt entity” and that the trustee “has no authority to enforce claims other than claims of the debtor” and “no right to enforce entitlements of a creditor” against third parties. *Id.* at 891-93. “When a third party has injured not the bankrupt corporation itself but a creditor of that corporation, the trustee in bankruptcy cannot bring suit against the third party. He has no interest in the suit.” *Id.* at 893.

The Court in *Steinberg* relied on principles set forth in this Court’s earlier decision in *Koch Refining v. Farmers Union Central Exch., Inc.*, 831 F.2d 1339 (7th Cir. 1987). *Koch* explained that trustees lack authority to file lawsuits that do not seek recoveries for the estate as a whole. A bankruptcy trustee “has the duty to marshal the debtor’s property **for the benefit of the estate**, and thus the right to sue parties for recovery of all property available under state law. He then distributes the amounts collected on a *pro rata* basis to all creditors in accord with the bankruptcy provisions and theme of ‘equality of distribution.’” *Id.* at 1343 (emphasis added). In contrast, “the trustee has no standing to bring *personal* claims of creditors” but rather “only a general

claim,” one that does not accrue “to *specific* creditors.” *Id.* at 1348-49. That is because “the paramount duty of a trustee [is] the massing of estate assets for a *pro rata* distribution to **all** creditors.” *Id.* at 1352 (emphasis added).

This Court recently reiterated that principle in *Teknek*, holding that a trustee lacked standing to bring claims against the corporate debtor’s shareholders. The Court explained that a bankruptcy trustee may “sue to represent the interests of the creditors as a class” but “has no standing to bring ‘personal’ claims of creditors.” 563 F.3d at 646. Other courts of appeals uniformly agree. *E.g., E.F. Hutton & Co. v. Hadley*, 901 F.2d 979, 987 (11th Cir. 1990) (trustee lacked standing because the “only claims that he is pursuing in this action are those of a particular segment of customers of the [debtor]”); *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991).

D. The *Caplin* rule applied to trustee-assignees

Another way parties sought to avoid the strictures of *Caplin* was by assigning creditor claims against third parties to the trustee. That ploy was rejected by the Ninth Circuit in *Williams v. California 1st Bank*, 859 F.2d 664 (9th Cir. 1988). There the court held that a Chapter 7 trustee lacked standing to sue a bank on behalf of over 100 creditors of the debtor who had assigned their claims to him. *Id.* at 665. The court rejected the trustee’s contention that “the mere fact of assignment in order to allow the Trustee to pursue the claims for the creditors sufficiently distinguishes this case to allow of a different result” than in *Caplin*. *Id.* at 666. The court explained that “the same problems exist” that concerned the Supreme Court in *Caplin*, in particular that, “the assignments notwithstanding, the investors plainly remain the real parties in interest in these actions” because they will “receive the bulk of any recovery.” *Id.* Thus, the assignments were “only for purposes of bringing suit,” and the trustee, as in *Caplin*, was

“attempting to ‘collect money not owed to the estate.’” *Id.* at 667. The court therefore concluded that “**no** trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee,” may assert general causes of action “on behalf of the bankrupt estate’s creditors.” *Id.* (emphasis added).

The Trustee tries to limit the application of *Williams* to Chapter 7 trustees, contending that “no court ha[s] ever held that a liquidation trust or other liquidation vehicle created under a plan could not accept or prosecute non-estate claims assigned to it by creditors.” Trustee Br. 18. In fact, courts **have** rejected standing where a liquidation trustee-assignee pursue litigation not designed to benefit the estate (or liquidation trust) as a whole but only the assignors. In *Mukamal v. Bakes*, 383 B.R. 798 (S.D. Fla. 2007), a trustee of a liquidation trust established under a confirmed Chapter 11 plan, who had been assigned creditor claims (the same scenario as here), sued a third-party accounting firm and others for, *inter alia*, aiding and abetting breaches of fiduciary duties. The court held that he lacked standing. The court explained that, based on *Caplin*, “a trustee (or litigation trust) does not have standing to pursue the direct claims of creditors, but is only empowered to pursue the claims belonging to the debtor.” *Id.* at 811. The court then considered “whether the *Caplin* rule applies if there is an unconditional assignment of creditor claims.” *Id.* (internal quotation marks omitted). After citing authority, including *Williams*, that the *Caplin* rule “holds true even in cases where a creditor has assigned all claims to a trustee or trust,” the court ruled that the trustee lacked standing because he was seeking relief only on behalf of “certain of the Debtors’ creditors,” raising the risk of “inconsistent actions by those who did not assign” their claims to the trustee. *Id.* at 811-13.

Another case rejecting the Trustee’s position is *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff’d sub nom. Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007). There the court held that a litigation trust established pursuant to a confirmed Chapter 11 plan lacked standing to pursue assigned creditor claims that would not benefit the estate. *Id.* at 191. “[E]ven if the Litigation Trust Agreement or plan of reorganization did expressly assign the direct claims of [debtor’s] creditors to the Litigation Trust, federal bankruptcy law is clear that litigation trusts do not have standing to pursue the direct claims of creditors.” *Id.* “The rule articulated in *Caplin* holds true even in cases where a creditor has assigned her claims to a trustee or Trust.” *Id.*²

E. The *Caplin* rule gives trustees standing where they act to benefit the estate

There are cases where trustees do have standing to sue third parties, but those cases involve attempts to recover assets for the estate as a whole. For example, in *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998), where defrauded investors sought to sue the debtor’s third-party accomplices, this Court held that the investors had to “wait their turn behind the trustee, who has the responsibility to recover assets for the estate **on**

² The Trustee may try to rely on *In re Emerald Casino, Inc.*, Order, Nos. 09 C 5514/09 C 5515 (N.D. Ill. Nov. 25, 2009), a case decided after the district court decision in this case. But that case is very different from this one, as Judge Pallmeyer explained. In *Emerald Casino*, Judge Pallmeyer upheld the bankruptcy court’s refusal to dismiss for lack of standing a complaint filed by the Chapter 7 trustee against Emerald’s former officers and directors. Judge Pallmeyer distinguished this case, noting that the *Emerald Casino* defendants sought “to challenge the Trustee’s right to bring claims in her *own* behalf. It is those claims—not those assigned to the Trustee by third parties—that the bankruptcy court refused to dismiss.” *Id.* at 3. In other words, the *Emerald Casino* case is more akin to the Trustee Action, not the Customer Action, against BNYM. Furthermore, the attorneys for the Emerald Casino trustee (the same attorneys who represent the Trustee in this case) told Judge Pallmeyer that “we don’t think that Judge Zagel’s decision in the *Sentinel* case is applicable here for, among other reasons, the fact that the claims that are pending in front of Judge Wedoff are claims that always belonged to the bankruptcy estate.” *Id.*, Transcript of Proceedings, Nov. 24, 2009, at 4.

behalf of the creditors as a whole.” *Id.* at 881 (emphasis added). The Court noted that the trustee had filed claims against the same third-party defendants—just as the Trustee has already done here in the Trustee Action—and was “pursuing them to maximize the debtors’ estates for the benefit of their creditors.” *Id.*

Another such case, this one involving claims assigned to the trustee, is *In re Bogdan*, 414 F.3d 507 (4th Cir. 2005). There the trustee had standing to bring claims assigned to him by mortgage creditors against the debtor’s alleged co-conspirators. The court distinguished *Caplin* and *Williams* on the basis that “[t]he mortgage lenders will recover nothing directly from any recovery attained from the trustee’s adversary proceeding” but rather “will recover, if at all, by sharing from the general assets of the estate on a pro rata basis with all other creditors.” *Id.* at 513. Thus, the estate was “the real party in interest” in the adversary proceeding. *Id.* Consistent with all the above cases, the court drew a clear line in the sand: If the lawsuit seeks recovery for the estate, the trustee has standing to bring it; if not, he lacks standing. Accord *In re Agribiotech, Inc.*, 319 B.R. 207, 214 (D. Nev. 2004) (trustee who was assigned fraud claims against the debtor’s officers and directors by a confirmed Chapter 11 plan would have lacked standing if the proceeds were to be distributed to the assignors but had standing because they instead were “to be distributed to creditors pro rata as set forth in the distribution priorities in the Plan”).

The Trustee relies primarily on *Semi-Tech Litig., LLC v. Bankers Trust Co.*, 272 F. Supp. 2d 319 (S.D.N.Y. 2003), *aff’d*, 450 F.3d 121 (2d Cir. 2006). There the court distinguished *Caplin* based solely on the assignments of claims to the trustee by third-party creditors of the debtor’s estate, and it disagreed with *Williams* on the ground that a trustee-assignee is “no different” from any other assignee “outside the bankruptcy

context.” 272 F. Supp. 2d at 323-24. But the *Semi-Tech* opinion does not even mention (much less consider) the critical distinction on which *Caplin* and all the above cases rest—whether the litigation brought by the trustee will benefit the estate or instead just some portion of the creditors. And the Second Circuit affirmed without discussing that issue (or any other issue involving the trustee’s standing). Moreover, a later Second Circuit case characterized *Semi-Tech* as implicitly holding that “a trustee may assert claims assigned to it by a bankrupt’s creditors **for the benefit of the estate**, because those claims can become property of the estate under § 541(a)(7).” *In re CBI Holding Co., Inc.*, 529 F.3d 432, 459 (2d Cir. 2008) (emphasis added). Accordingly, *Semi-Tech* provides no basis for deviating from *Caplin*, *Williams*, and the many cases from this and other courts rejecting trustee standing where any recovery from a trustee-initiated lawsuit will not go to the estate.

F. Applying the *Caplin* rule, the Trustee lacks standing

Applying the principles set forth in the above cases, the district court properly ruled that the Trustee lacks standing. It is undisputed that any recovery from this lawsuit will go to only a subset of the estate’s unsecured creditors, not to the estate (or to the Litigation Trust) as a whole. It also is undisputed that the Trustee’s fees and expenses incurred in prosecuting this lawsuit, as well as the fees and expenses incurred by his counsel, will be paid out of estate assets. It is further undisputed that (unlike the estate) the Trustee stands to receive a portion of any recovery from this lawsuit. Preying on the estate to serve the interests of himself, his assignors, and his lawyers cannot be reconciled with his duty to serve the estate as a whole.

The Trustee would have the Court take its eye off the ball by highlighting the assignment of claims by a subset of creditors to the Trustee (as well as by a variety of

arguments addressed in Part II, *infra*). But the *Caplin* principle would be a mighty thin reed if it could be so easily circumvented by a mere strategic ploy. By affirming the judgment below, this Court will give effect to the bright line set forth in *Caplin* and its progeny that bars trustee standing unless the estate is to receive any recovery from trustee-initiated litigation against third parties.³

II. The Trustee’s Attempts To Circumvent *Caplin* And Its Progeny Are Unavailing.

The Trustee offers a potpourri of arguments to try to avoid the application of the *Caplin* rule. None has merit.

A. *Sprint* has nothing to say about the standing of bankruptcy or liquidation trustees.

The Trustee argues that the Supreme Court’s decision in *Sprint Commc’ns Co. v. APCC Serv., Inc.*, 128 S. Ct. 2531 (2008), somehow overrides *Caplin* and its progeny and authorizes bankruptcy-court-appointed trustees to file claims for damages that will not go to the estate. That is a remarkable proposition because *Sprint* addresses only assignment law principles, not bankruptcy law principles.

In *Sprint*, the Court simply held that an assignee of a collection claim has standing to sue on that claim even when the assignee has promised to remit the proceeds of the litigation to the assignor. *Id.* at 2542. That holding has no bearing on the question here—whether a trustee appointed to gather the assets of a bankruptcy estate through a liquidation trust vehicle has standing to initiate litigation that will bring

³ The Trustee dismisses two of the concerns raised in *Caplin*—subrogation and inconsistent actions—because he says the facts here make subrogation and inconsistent actions unlikely. Trustee Br. 32-33. But it was enough for the Court in *Caplin* that the subrogation “question” might arise and that a trustee suit “may be inconsistent” with any independent actions. 406 U.S. at 430-31. The Trustee’s charge that Sentinel was at least as responsible for customer losses as BNYM and the filing already of several independent actions against BNYM (see *infra* p. 26 n.4) implicate the same potential questions and concerns here.

no benefit to the estate (or the trust) as a whole. In fact, the Court noted in passing that “[t]rustees bring suits to benefit their trusts [and] assignees in bankruptcy bring suit to benefit bankrupt estates.” *Id.* at 2543. *Sprint* therefore offers not a whit of support for the Trustee’s view that he may file suit on behalf of only some estate creditors and indeed have that suit subsidized by the estate as a whole.

Before leaving *Sprint*, it should be noted that the Trustee egregiously misrepresents the district court’s handling of that case. According to the Trustee, the district court “declined to follow *Sprint*, concluding that it was ‘unpersuasive.’” Trustee Br. 17-18, citing Short App. 8-9. One need but read the cited sentence from the district court opinion to see the inaccuracy of that assertion (one that would be startling in light of a federal court’s duty to follow Supreme Court precedent). The district court in fact said, after reprising the Trustee’s argument based on *Sprint*, “This argument is unpersuasive ***.” Short App. 8. The court plainly found the Trustee’s argument unpersuasive, not the Supreme Court’s holding. There is frankly no excuse for the Trustee’s crossing the line of proper advocacy in this fashion. Moreover, the Trustee further crosses that line with his assertion that “*Sprint* overrules *Williams*.” Trustee Br. 27 (referring to the Ninth Circuit’s *Williams* case, discussed *supra* pp. 17-18). *Sprint* does not even mention *Williams* or indeed any case involving bankruptcy-court-appointed trustees.

B. Establishing a liquidation trust to recover assets for the estate does not avoid the *Caplin* rule on trustee standing.

The Trustee attempts to cast aside *Caplin* and its progeny by contending that the focus of the courts in those cases on benefit to the estate is of no moment because “the Sentinel bankruptcy estate no longer exists.” Trustee Br. 19. Thus, the Trustee claims,

he is not subject to established law that a bankruptcy-court-appointed trustee “can only take actions that benefit an estate,” which he calls “an impossible construct.” *Id.* at 20. He relies on the establishment of the Litigation Trust upon confirmation of the Plan.

As an initial matter, this argument is waived. The Trustee did not argue in the district court that “the estate no longer exists,” his principal argument on appeal. In the standing section of his Opposition to Defendants’ Motion to Dismiss, the Trustee’s three headnotes were as follows:

- A. *Res Judicata* Bars BONY’s Standing Challenge;
- B. *Williams* Flouts Bedrock Principles of Law Concerning Assignment of Claims; and
- C. The “Prudential Considerations” on Which BONY Relies Do Not Warrant Dismissal.

None of the text under those headnotes addressed this issue, barring the Trustee from raising it here. See *Metzger v. Illinois State Police*, 519 F.3d 677, 681-82 (7th Cir. 2008) (“if a party fails to press an argument before the district court, he waives the right to present that argument on appeal”).

Even if the issue is not waived, it fails on the merits. The Litigation Trust remains a creature of the Plan and was established solely to gather assets for the bankruptcy estate creditors and then liquidate the estate. According to the Plan, upon his resignation as Chapter 11 Trustee, Grede would “become the appointed **representative of the Estate** in accordance with Section 1123(b)(3) of the Bankruptcy Code.” App. 87 § 6.3 (emphasis added). As such, he was to be “the sole officer and sole director of the post-Effective Date Debtor until such time as its dissolution.” *Id.* The referenced Code section states that a plan may provide for “(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the

estate; or (B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest.” 11 U.S.C. § 1123(b)(3). In other words, bankruptcy law authorized the Plan to make the Trustee a “representative of the estate” to retain and enforce all claims or interests “belonging to the debtor or to the estate,” not claims belonging to a subset of estate creditors. And the Liquidation Trust Agreement confirms that “[t]he Liquidation Trustee has been *** appointed representative of the Estate.” App. 120 § 2.1.

Cases relied on by the Trustee, including *Pettibone Corp. v. Easley*, 935 F.2d 120, 122 (7th Cir. 1991) (Trustee Br. 19), involve a very different situation, one where a reorganized debtor emerges from bankruptcy and “may go about its business without further supervision or approval [or] protection of the bankruptcy court.” *Id.* Here, in contrast, the Plan provides that, upon establishment of the Liquidation Trust, “the Chapter 11 Case will remain open pending final order of the Bankruptcy Court closing the case and the Bankruptcy Court **shall retain jurisdiction**” for numerous listed purposes, including “[t]o determine on a non-exclusive basis, any and all Causes of Action and Non-Estate Claims that have been transferred to the Litigation Trust on the Transfer Date.” App. 104 § 9.1(b) (emphasis added).

The Trustee’s view that the Liquidation Trust is “emancipated” and that the Trustee should therefore “be allowed to prosecute assigned claims regardless of where the recoveries would go” (Trustee Br. 20) cannot be reconciled with this continued oversight by the bankruptcy court. Indeed, the bankruptcy court’s order confirming the Plan expressly states that the Liquidation Trustee would have “all powers afforded a trustee under the Bankruptcy Code and Rules” (App. 419 § 4), underscoring that his powers are coextensive with those of a bankruptcy trustee, not with those of the

independent plaintiffs' bar as he effectively contends. See *Mukamal*, 383 B.R. at 812 n.9 (rejecting purported “distinction between a bankruptcy trustee and a litigation trustee” where “bankruptcy law governs the question of ability to pursue any assigned claims”). Moreover, the Liquidation Trust was not established as an independent business entity but simply to liquidate the estate. See App. 89 § 6.7; *In re Consolidated Pioneer Mortgage Entities*, 264 F.3d 803, 807-08 (9th Cir. 2001) (rejecting liquidation trust's contention that the estate had “vanished” upon confirmation where the trust was not established as an “independent for-profit corporation” but instead “to distribute proceeds for the benefit of the investors *** under the supervision of the bankruptcy court”).⁴

To be sure, the Plan apparently authorizes the Trustee to pursue Tranche-P claims that would not bring any recoveries to the Estate or Litigation Trust as a whole. App. 89 § 6.5(e). But that provision is flatly inconsistent with the appointment of the Trustee as “representative of the Estate” and hence cannot override established principles of bankruptcy law that deprive a trustee of standing in a particular case when he seeks recoveries that will not go to the Estate.

The Trustee nonetheless complains that applying the *Caplin* standing rule to him would produce an “anomaly”—that “customers could have validly assigned their claims to anyone in the world except the liquidation trust.” Trustee Br. 33. But there would be no need for bankruptcy law if it had to be totally undifferentiated from general commercial law. The Trustee is a creature of bankruptcy law and still subject to the jurisdiction of the bankruptcy court. There is nothing anomalous about recognizing his

⁴ The continued oversight of the bankruptcy court is not merely Plan boilerplate. Since the Plan was confirmed, the Trustee has filed at least 13 actions against various parties in the bankruptcy court, refuting any notion of post-confirmation “emancipation” of the Trust.

obligation to benefit the estate and not divert estate property to benefit select creditors and himself.

Other than *Semi-Tech* and *Pettibone* (addressed *supra*), the Trustee relies on three cases for his “the Estate is dead, long live the Liquidation Trust” argument. Trustee Br. 19, 22. In the first, *In re Fairfield Communities, Inc.*, 142 F.3d 1093 (8th Cir. 1998), the court explained that, notwithstanding a confirmed plan, the estate continues to exist where the bankruptcy court retains jurisdiction over enforcement of the plan. *Id.* at 1095. That is precisely the situation here (see *supra* p. 25), and thus *Fairfield* offers the Trustee no support.

The Trustee fares no better with his second case, *Holywell Corp. v. Smith*, 503 U.S. 47 (1992). There the Court noted that the plan at issue created “a separate and distinct trust holding ***the property of the estate*** and gave the trustee control of this property.” *Id.* at 55 (emphasis added). The court certainly did not authorize the trustee to use that estate property to subsidize litigation that would benefit only part of the estate, as the Trustee here contends he is free to do.

Finally, the Trustee cites *Torch Liquidating Trust v. Stockstill*, 561 F.3d 377 (5th Cir. 2009), for the proposition that the Code contemplates the transfer of estate property to a new liquidating entity. But such a transfer in itself is uncontroversial. The issue here is whether the liquidation trustee may pursue litigation where the estate creditors will not obtain the recoveries pursuant to Bankruptcy Code priorities. In *Torch*, the court authorized a liquidation trustee to “enforce an estate’s claims for breach of fiduciary duties ***owed to the corporation***”—not to particular creditors—and to sue “on behalf of the Trust” and distribute the proceeds “according to the Plan, which allocated the proceeds *** by pro rata share.” *Id.* at 387-88 (emphasis added). This

would be a very different case if the Trustee's litigation appetite were confined within the bounds set by the court in *Torch*.

C. The asserted “benefits” to the estate from this litigation are specious.

The Trustee argues that, even if he were obliged to seek a benefit for the estate, this litigation does so. Trustee Br. 23. This argument too is waived because it was not raised below. In the district court, the Trustee never suggested any of the benefits he asserts here. In any event, the benefits he now suggests are mere chimeras.

First, the Trustee contends that “[a]ll creditors are benefited” by his “ability to maximize the settlement values of what were previously the estate’s claims against BONY and other third parties” and to “offer defendants that settle a broader release.” Trustee Br. 24-25. But there is no evidence that any potential defendant has sought a broader release or was willing to pay more consideration to obtain one, nor that the Trustee would allocate the full amount of any such consideration to the estate as a whole rather than at least in part to Tranche P. In addition, nothing would prevent the Trustee from negotiating on a one-off basis for an assignment of claims from particular creditors or otherwise binding them to the settlement. In any event, all this is merely speculative conjecture, not a showing of actual benefit to the estate. In contrast, the fees and expenses that the Trustee and his counsel are pulling from the estate are actual, concrete, and undeniable.

Second, the Trustee contends that the estate benefits from avoiding “litigation seeking to enjoin creditors from pursuing their independent causes of action at the same time as the Trust is pursuing claims against BONY and others.” Trustee Br. 25. But it is pure speculation that the Trustee would engage in any such litigation or, if he did, that it

would cost the estate more than this litigation. Moreover, in the only three cases where a Sentinel customer did file an independent action, the Trustee did not even appear, much less seek to enjoin the action. See *Shatkin* (*supra* p. 10) (stayed at BNYM's request); *McKinlay v. Bank of New York Mellon Corp.*, No. 07-8765 (S.D.N.Y. filed Oct. 10, 2007, voluntarily dismissed Feb. 26, 2008); *Am. Nat'l Trading Corp. v. Bank of New York*, No. 08-5322, 2008 WL 5163377 (C.D. Cal. filed Oct. 15, 2008) (stayed at BNYM's request). Again, the Trustee points to no benefit to the estate, but only maybes.

Finally, the Trustee suggests that any recoveries from this litigation will “reduce the overall amount of claims asserted against the Trust” and thus provide a “larger recovery” to all creditors from the estate claims that were transferred to the trust. Trustee Br. 25. But nothing in the Plan provides for a dollar-for-dollar reduction of any claim against the estate based on any recovery for the assigned claims tranche. The Trustee's attempt to re-write the Plan to conjure up a supposed benefit simply highlights the lack of any benefit to the estate from this litigation.

Each of the asserted benefits to the estate is thus illusory, much like the illusory benefit described by this Court in *Steinberg*, 40 F.3d at 892:

Suppose a neighbor of the Buczynskis [the debtor's shareholders] had slipped on ice in front of their house. Could the trustee sue the Buczynskis, on the theory that if the suit succeeded the proceeds of the suit would go to the bankrupt estate (though just until claimed by the injured neighbor, the equitable beneficiary of the proceeds)? To ask the question is to answer it.

At least in that hypothetical, the proceeds did make an initial stop at the bankrupt estate. Here, in contrast, any proceeds from this litigation would go straight to Tranche P and thereby bypass the estate creditor body.⁵

The Trustee argues that “benefit to the estate” is not “narrowly defined,” relying on this Court’s decision in *Mellon Bank v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003). There, the Court held that the bankruptcy court’s decision to give prepetition lenders the first \$30 million of any recovered preferences indirectly benefited the estate where it was necessary to obtain post-petition financing that would permit the economically distressed debtor to remain in business until its assets could be sold as a going concern. In other words, the preference decision provided the debtor with the means to stay in business so as to benefit the estate as a whole. That is a far cry from the situation here, where the Trustee seeks to have the estate subsidize litigation that does not even purport to seek any recovery for the estate. Whether defined narrowly or broadly, a benefit to the estate must in fact benefit the creditor body as a whole, not just a select tranche.

The Trustee also tries to suggest, by repeatedly asserting that the claims assigned to the Trust represent “89% in value of all Sentinel customer claims” (Trustee Br. 12; see *id.* at 24-25), that any recovery from this lawsuit will go to most creditors and thus will benefit the estate. But in addition to the fact that his 89% calculation omits BNYM’s large secured claim, the Trustee treats the remaining 11% in value of customer claims as if they are of no moment. That is inconsistent both with *Caplin* and its progeny and with the Trustee’s duty to represent the estate as a whole. See *In re Bradley*, 326 F. App’x 838, 839 (5th Cir. 2009) (rejecting trustee’s attempt to distinguish *Caplin* on the

⁵ Courts repeatedly reject cost applications based on incidental and minimal benefits to the estate. *E.g.*, *In re Flight Transp. Corp. Sec. Litig.*, 874 F.2d 576, 581 (8th Cir. 1989) (alleged benefits were “only marginal or incidental”).

basis that he sought “to remedy an injury to all *** creditors and not merely a subset thereof,” because “[t]he Bankruptcy Code does not authorize the Trustee to collect property or money except that which is owed to the estate”).

D. Delaware trust law does not support having the estate subsidize litigation from which it draws no benefit.

As described *supra* pp. 8-9, the estate is compensating the Trustee and his lawyers for their time and expenses incurred in this litigation. The Trustee also stands to gain additional contingency compensation from any amounts recovered for the creditors whose assigned claims he is prosecuting here. See App. 148. That might be fine if the estate were to receive any recovery from the litigation. But the estate’s forced subsidization of litigation from which it can draw no benefit underscores the impropriety of this litigation and the soundness of the district court’s judgment.

As the district court noted, bankruptcy law does not permit a trustee “to bring claims for the benefit of the few at the expense of the many.” Short App. 10. To do so would be inconsistent both with the duties of bankruptcy-court-appointed trustees and with the “equality of distribution” principle of the Code. See *Koch*, 831 F.2d at 1343.

The Trustee’s only argument in favor of this financing scheme (other than the supposed benefits addressed in the prior section) is that “Delaware trust law” gives a trustee “discretion [to] allocate the litigation costs in an equitable manner.” Trustee Br. 31. Again, the Trustee tries to pretend that the Liquidation Trust is completely emancipated from bankruptcy law. But even assuming Delaware trust law speaks to this issue, the case on which the Trustee relies actually refutes his position that Delaware trust law authorizes the subsidization of litigation by the many to benefit the few. In *In re 14 Realty Corp.*, 2009 Del. Ch. LEXIS 141 (Del. Ch. Aug. 5, 2009) (Trustee Br. 31), the

court rejected a challenge to a trustee's attorney fee allocation after the dissolution of a family corporation because the challenger ignored the deductions from the amounts available for distribution to the family members as a whole caused by her challenge. See *id.* at *29-30. Like the challenger there, the Trustee here seeks to force the estate as a whole to incur the costs imposed by litigation initiated on behalf of (and which can benefit) only some creditors. There is certainly nothing "equitable" about "discretion" exercised in such a tilted manner.

In fact, Delaware trust law imposes fiduciary duties of care and loyalty on the trustee of a trust (see, *e.g.*, *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1113 (Del. Ch. 2008)), duties that cannot be squared with the Trustee's imposition of costs and expenses on the Liquidation Trust for litigation that will not benefit it.

E. The ruling below does not reduce a bankruptcy court's flexibility in liquidating an estate.

The Trustee heralds his "innovative use of a liquidation trust" to pursue this litigation and contends that the district court's holding limits the effective restructuring of debtor-creditor relationships and asset liquidation. Trustee Br. 34-35. In fact, the ruling below does not in any way prevent the establishment of liquidation trusts pursuant to a confirmation plan. It simply holds that established limits on trustee standing are not thereby overthrown.

The Trustee (at 35) relies on § 1123(b)(6) of the Code, which provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." That catch-all provision does not support the Trustee's standing (even if the Plan addressed his standing, which it does not) because allowing him to use

estate assets to pursue litigation that would not benefit the estate **is** “inconsistent with this title.”

The cases on which the Trustee relies likewise provide him with no support. See Trustee Br. 34-35. In *CBI Holding*, the court held that a “disbursing agent” appointed pursuant to a confirmed reorganization plan had standing to assert assigned creditor claims against a third-party account “for the benefit of the estate.” 529 F.3d at 459. Any recovery would go to the estate for pro rata distribution to the creditors as a whole, not, as here, directly to the assigning creditors. *Id.* Thus, far from supporting the Trustee’s position, *CBI* refutes it. The Trustee’s reliance on *In re Specialty Equip. Cos.*, 3 F.3d 1043 (7th Cir. 1993), is baffling because that case says nothing about trustee standing, liquidation trusts, or any other issue bearing on this appeal. The Court simply recognized that “consensual and non-coercive” releases may be warranted in a reorganization plan and then concluded that the appeal was moot. *Id.* at 1047-49.⁶

Again, the district court’s ruling does not affect a bankruptcy court’s general authority to establish liquidation trusts pursuant to a confirmed plan. Instead, it simply affirms longstanding law requiring the threshold establishment of standing before a particular case may proceed. “[S]tanding is an essential and unchanging part of the case-or-controversy requirement of Article III” and “an indispensable part of the plaintiff’s case.” *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). It cannot be cast aside by a mere plea for “flexibility.”

⁶ The Trustee also relies on a district court opinion that discusses only removal jurisdiction and abstention issues in a case that was subsequently dismissed on the pleadings. See *Kirschner v. Bennett*, 2008 WL 1990669 (S.D.N.Y. May 7, 2008); *Kirschner v. Bennett*, 648 F. Supp. 2d 525 (S.D.N.Y. 2009). Indeed, in related litigation, the court dismissed aiding and abetting claims against third parties by the liquidation trustee for lack of standing. *Kirschner v. Grant Thornton LLP*, 2009 WL 1286326 (S.D.N.Y. May 6, 2009).

Furthermore, the Trustee disregards the intolerable incentives that would be generated by allowing trustees to raid the estates they are supposed to represent to finance litigation against third parties on behalf of assigning creditors. Whereas litigation costs generally act to constrain private parties from pursuing unwarranted litigation, under the Trustee's theory a trustee may freely draw on estate assets to pursue what is essentially private litigation. Especially where, as here, a trustee is not only guaranteed his fees and expenses from estate assets but also has a chance to earn a substantial contingency fee if he wins, even the most dutiful of trustees would be hard-pressed to resist being overly litigious. That is not the role of bankruptcy-court-appointed trustees. As this Court vividly expressed the point in *Fisher*, 155 F.3d at 880, a trustee acts "on behalf of the estate or the creditors as a whole" and thus "obviously may not roam around collecting whatever property suits her fancy."

The generation of such intolerable incentives confirms why the district court's judgment should be affirmed. As this Court has observed, unlike managers of a going concern, "the trustee of a defunct business has little to do besides filing claims that if resisted he may decide to sue to enforce. Judges must therefore be vigilant in policing the litigation judgment exercised by trustees in bankruptcy." *Maxwell v. KPMG LLP*, 520 F.3d 713, 718 (7th Cir. 2008). That is even more true with respect to litigation launched by liquidation trustees with personal incentives to bring actions funded by the bankruptcy estate.

F. There is no res judicata bar to BNYM's standing argument.

As the district court ruled, there is no res judicata bar to BNYM's standing argument. The Trustee challenges that conclusion, relying on the many cases holding that a confirmed plan has res judicata effect. Trustee Br. 37. But here the Plan does not

address the Trustee's standing, much less whether he would have standing in a particular case. "Standing requirements guarantee that courts do not decide abstract principles of law but rather concrete cases and controversies." *Sierra Club v. Marita*, 46 F.3d 606, 613 (7th Cir. 1995). This case did not exist when the Plan was confirmed. Thus, the issue of the Trustee's standing in this case had to await his filing of this case and cannot have been preclusively barred by confirmation of the Plan.

It is insufficient to assert that BNYM could have objected to the Plan's provision for assigning creditor claims to the Liquidation Trust. Trustee Br. 38. The issue here is not assignment but standing. During the confirmation process, BNYM did not know whether the Trustee would bring suit and certainly not what claims he would bring. For all BNYM knew, the Trustee would adhere to his responsibility and seek recoveries only for the estate (or Liquidation Trust) as a whole. If he had done so, any standing challenge would be far weaker than in the actual case filed by the Trustee, which expressly disclaims recovery for the estate as a whole. That is why standing must await an actual case. If BNYM had raised the standing issue during the confirmation hearing, the bankruptcy court would have had to address speculative hypotheticals, not a concrete case. See *Holywell*, 503 U.S. at 58 (rejecting contention that the United States, a creditor, "should have objected to the plan if it had wanted a different result" where the obligation of the trustee to file tax returns did not arise until after confirmation of the plan).

Moreover, the Trustee had already brought an aiding and abetting claim against BNYM in the Trustee Action, which was pending at the time the Plan was under consideration. BNYM had no reason to expect the Trustee to file yet another action based on the same allegations. The first time the Trustee ever suggested the possibility

of such a claim was at a discovery conference in February 2009, well after the Plan had been confirmed. See Trustee action Docket No. 86. The Plan's blanket reservation of "Non-Estate Claims" (App. 89 § 6.5(e)) certainly provided no notice that the Trustee would bring this lawsuit on top of the one already pending. See *D & K Props. Crystal Lake v. Mutual Life Ins. Co.*, 112 F.3d 257, 261 (7th Cir. 1997) ("A blanket reservation that seeks to reserve all causes of action reserves nothing"); accord *Browning v. Levy*, 283 F.3d 761, 775 (6th Cir. 2002); *Harstad v. First Am. Bank*, 39 F.3d 898, 903 (8th Cir. 1994).

The Trustee's reliance on *Ernst & Young LLP v. Baker O'Neal Holdings, Inc.*, 304 F.3d 753 (7th Cir. 2002), is misplaced. There a motion to compel arbitration in an adversary proceeding was deemed precluded in light of a confirmed reorganization plan because the adversary proceeding was filed *prior* to the plan. *Id.* at 755. Thus, the movant could and should have raised its motion to compel at that time. In contrast, BNYM could not object to standing prior to any adversary proceeding being filed.

The Trustee again tries to rely on *Semi-Tech*. Trustee Br. 38-39. But the res judicata discussion in *Semi-Tech* does not address standing. It addresses a very different issue—whether the bankruptcy court “had authority to work an assignment of the claims.” 272 F. Supp. 2d at 325. The court simply held that a failure to challenge that assignment in the confirmation proceeding precluded a subsequent collateral challenge to the assignment. *Id.* at 326. Here, in contrast, BNYM's challenge is to the Trustee's standing to bring a particular lawsuit filed after the Plan was confirmed, which it could not have raised prior to that lawsuit being filed. Thus, *Semi-Tech* is off-point.

Furthermore, a “confirmed plan has no preclusive effect on issues that must be brought by an adversary proceeding.” *In re Enewally*, 368 F.3d 1165, 1173 (9th Cir.

2004). The Trustee tries to deny or evade the force of this requirement. Trustee Br. 44. But the case law is replete with affirmations that confirmation of a plan “is *res judicata* only as to issues that can be raised in the less formal procedure for contested matters. *** [I]f an issue must be raised through an adversary proceeding it is not part of the confirmation process and, unless it is actually litigated, confirmation will not have a preclusive effect.” *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 93 (4th Cir. 1995); accord *In re Mersmann*, 505 F.3d 1033, 1050 (10th Cir. 2007).

As the district court explained, “[i]t is difficult to see how the issue of standing in this adversarial action could have been litigated as part of the less-formal confirmation process before the adversarial action itself was even filed.” Short App. 5. Even if it would not have been premature for the Trustee’s standing to have been determined before he had filed an actual lawsuit (which it was, see *supra*), the parties could have litigated the action only by seeking a declaratory judgment on the standing issue. But the bankruptcy rules require the initiation of an adversary proceeding to obtain a declaratory judgment relating to any proceeding to recover money or property. See Fed. R. Bankr. P. 7001(9).

In short, there was neither a case or controversy about the Trustee’s standing at the time of the confirmation hearing nor a means to resolve that issue in that summary proceeding. As this Court has explained, a confirmed plan is *res judicata* only as to issues where a party had “adequate notice” and an actual “opportunity to present their arguments and claims,” not issues involving “an unexpected problem at some point in the future.” *In re Harvey*, 213 F.3d 318, 321, 323 (7th Cir. 2000). It would simply be senseless to require parties to object to a trustee’s standing to bring any and all possible future lawsuits (which might never materialize) during the confirmation proceeding.

Nor should bankruptcy courts have to decide such questions “at a stage when they are not directly in issue and neither party has a full incentive to litigate them.” *Brown v. Felsen*, 442 U.S. 127, 134 (1979). Such a requirement, which the Trustee apparently advocates, would simply hamper the confirmation process and drain even more assets from the debtor’s estate.

CONCLUSION

The district court’s judgment should be affirmed.

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C), the undersigned counsel for Defendants-Appellees certifies that the foregoing brief:

(i) complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i) because it contains 11,626 words including footnotes and excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii); and

(ii) complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type styles requirements of Fed. R. App. P. 32(a)(6) because the brief has been prepared in a proportionally spaced typeface using Microsoft Word 2002 SP3 in 12-point Georgia.

/s/
Seema V. Dargar

CIRCUIT RULE 31(e) CERTIFICATION

Pursuant to Circuit Rule 31(e), the undersigned attorney certifies that a copy of the foregoing Brief in native PDF format was filed electronically with the Court.

/s/
Seema V. Dargar

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that, on January 8, 2009, she caused two copies of the foregoing Brief of Defendants-Appellees to be served by hand delivery, as well as by e-mail, on the following:

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