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ASK THE PROFESSOR: DID THE 7TH CIRCUIT PROPERLY RULE IN SENTINEL II?

RONALD H. FILLER[1]

The short answer is YES; the long answer is TIME WILL TELL.[2]

On March 19, 2014, the U.S. Court of Appeals for the Seventh Circuit reversed the ruling in the lower federal district court case and ruled that the pre-petition transfers and the post-petition transfers from the estate of Sentinel Management Group ("Sentinel"), a firm registered as both a futures commission merchant ("FCM") with the U.S. Commodity Futures Trading Commission ("CFTC") and as an investment adviser ("IA") with the U.S. Securities and Exchange Commission ("SEC"), were protected from being avoided.[3] As noted in more detail below, the Seventh Circuit based its decision on the interpretation of a plain reading of two specific bankruptcy code provisions (Sections 546(e) for the pre-petition transfer and Section 549 for the post-petition transfer). However, the Seventh Circuit did, without any explanation or analysis, agree with some of the conclusions of law noted in the district court case that did not in any way form the basis for its decision. It is this language in the Seventh Circuit's opinion that might be most concerning for FCMs in the future. However, the 14 FCMs involved in this case should be rejoicing.

Setting of the Federal District Court Case

Sentinel was an unusual FCM in that it did not engage in futures trading activities on behalf of its customers.[4] Sentinel was registered as a FCM solely to receive customer assets held by other FCMs.[5] Each FCM thus opened a customer account on the books of Sentinel, each labeled as "FCM's Customer Omnibus Account". Sentinel then invested the customer assets of these other FCMs in a customer segregated account, with each FCM selecting a different trading strategy as permitted by CFTC Rule 1.25.[6] Sentinel also offered an asset management service for other clients. Sentinel thus provided an asset management investment service primarily for two groups, with each group subject to different regulatory requirements. The first group, namely, the other FCMs, that invested futures customer assets that they held in their respective Customer Segregated Accounts into the Sentinel Customer Segregated Account, were referred to as the "SEG 1 Pool" in this case. The second group of Sentinel customers, namely the other private investors, including hedge funds, corporations and proprietary assets of FCMs, were referred to as the "SEG 3 Pool".[7] The SEG 1 Pool re-

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quired Sentinel to be registered as an FCM. The SEG 3 Pool required Sentinel to be registered as an IA. As a registered FCM and IA, Sentinel was thus required to keep the assets in the SEG 1 Pool and the SEG 3 Pool separate and distinct from each other. It did not.[8] Sentinel pooled the assets of both the SEG 1 Pool and the SEG 3 Pool to purchase securities, including repo transactions. When the credit markets started to contract in 2007, many of Sentinel's repo counterparties ceased doing business with Sentinel or required greater financial protections. In August 2007, Sentinel's house crashed.

On August 20, 2007, Sentinel filed an emergency order with the U.S. Bankruptcy Court for the Northern District of Illinois, seeking an order approving the distribution of the proceeds of the securities sold to Citadel.[9] This Order was supported and approved by both the CFTC and the National Futures Association ("NFA"). On August 21, 2007, approximately $297 million of the assets managed by Sentinel were distributed directly into the Customer Segregated Accounts of the 14 FCMs that had invested their futures customer assets into the SEG 1 Pool. Of this amount, approximately $14,479,000 was distributed directly into the Customer Segregated Account of FCStone. Only a small amount was distributed to customers who had invested their assets in the SEG 3 Pool.

Frederick J. Grede was appointed as the Liquidation Trustee of the Sentinel estate on December 17, 2007, some four months after the proceeds of the Citadel sale were distributed to the Customer Segregated Accounts of the various FCMs that invested their customer assets in the SEG 1 Pool.[10] In September 2008, Mr. Grede brought the action in the federal district court to avoid (e.g., claw back) the transfer of the assets that were distributed to the SEG 1 Pool in August 2007 under the theory that the assets belonged *pro rata* to both the SEG 1 Pool and the SEG 3 Pool.[11]

The Federal District Court Decision

On January 4, 2013, Judge James Zagel ruled that the pre-petition transfer was voidable as a preferential transfer and the post-petition transfer of $14,479,000, that had been distributed to the Customer Segregated Account[12] of FCStone in August 2007, must be returned to the bankrupt estate of Sentinel.[13] As noted above, in August 2007, pursuant to a Court Order,[14] funds had been distributed out of the bankrupt estate of Sentinel[15] directly into Customer Segregated Accounts of several Futures Commission Merchants ("FCMs"), including the afore-mentioned Customer Segregated Account of FC Stone, the Defendant in this case.[16] None of the funds were distributed directly to these FCMs.

Judge Zagel agreed with the Trustee and held, in essence, as follows:

1. As to the pre-petition transfer, the safe harbor provisions of Section 546(e) of the U.S. Bankruptcy Court could not conceivably be applied to this case. To do so would be inequitable, and thus an uneven and arbitrary distribution to Sentinel's various customers (e.g., the SEG 1 and SEG 3 Pools) and that Congress did not intend for this inequitable treatment when it enacted the safe harbor provisions.
2. The custody rule adopted by the SEC pursuant to the IAA, namely SEC Rule 206(4)-2, created a statutory trust protection as robust as those set forth under the Commodity Exchange Act ("CEA") and applicable CFTC regulations. Therefore, the SEG 3 Pool customers have an equally forceful claim to trust protection as the SEG 1 Pool customers.
3. FCStone is subject to common law tracing requirements due to the co-equal claims of the competing trust claimants. The assets distributed to the Customer Segregated Accounts of the various FCMs back in August 2007 are property of the Sentinel bankrupt estate and were not "customer property" as defined by the CEA and applicable CFTC regulations.
4. The August 2007 distribution to the FCStone's Customer Segregated Accounts was not authorized under the Bankruptcy Code or by the bankruptcy court.

Judge Zagel's First Conclusion of Law

Sentinel II is a case of first impression regarding the bankruptcy of a firm registered as both an FCM and as an IA. The issue before Judge Zagel in *Sentinel II* was whether the statutory trust created by Sections 4d(a) and 4d(b) of the CEA was superior to the IA Custody Rule adopted by the SEC. Defendant FCStone made several arguments in support of this theory, namely:

1. The customer protections provided by Congress in Sections 4d(a) and 4d(b) of the Commodity Exchange Act of 1936 were stronger than those resulting from a single SEC regulation requiring funds to be held with a custodian. In fact, Con-

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gress has never enacted any such similar provision in the IAA.

2. Sections 4d(a) and 4d(b) of the CEA emphatically states that the assets held in a Customer Segregated Account must be treated as customer property "belonging to" the customer regardless of their location. In other words, the CEA created a "floating trust" over such customer property[17] whereas the IA Custody Rule merely requires that customer assets be segregated from the IA's own assets. Therefore, Sections 4d(a) and 4d(b) made clear that the statutory trust imposed on customer segregated funds means that the assets in question, e.g., the SEG 1 Pool assets, could never be treated as the property of the depository (e.g., Sentinel). Therefore, unless the SEG 1 Pool assets become property of the Sentinel estate, it could never be clawed back by the Trustee and redistributed to the SEG 3 Pool.
3. The legislative history accompanying Sections 4d(a) and 4d(b) of the CEA clearly demonstrate that segregation violations and improper commingling of customer funds do not destroy the statutory trust created under the CEA.[18]
4. Congress did not intend to protect IA advisory client funds in the same manner as FCM customer funds because no provision under the IAA provides the specific customer protections that Sections 4d(a) and 4d(b) do.
5. The risks unique to the futures markets demand that FCM customer-held property be afforded heightened protections compared to IA customer funds.
6. The CFTC has promulgated a series of detailed regulations regarding how customer assets must be held, reported and maintained whereas the IA Custody Rule merely requires that customer assets be held in one of three types of custodian firms.[19]

Judge Zagel did not accept any of these arguments and held that the IA Custody Rule is also a statutory trust, just like Sections 4d(a) and 4d(b), and that Congress did not intend to elevate protections for customer funds regulated by the CEA and CFTC regulations over customer funds regulated by the IA Custody Rule. He then stated: "there is no basis in law for elevating one federal statutory trust over another absent the tracing of specific property."[20] Judge Zagel basically holds that when two trusts require segregation, without analyzing any other requirement, then the two trusts must be treated equally. He then stated:

> **"Until Congress demonstrates a clear intention to give commodity customers so-called 'super priority' in bankruptcy, I have no basis for elevating the interests of the CEA over IAA-protected customers."[21]**

Judge Zagel's Second Conclusion of Law

Judge Zagel also held that FCStone is subject to common law tracing due to the co-equal claims of the competing trust claimants. He then stated that FCStone failed to meet this tracing standard. In fact, he stated that such tracing was impossible. FCStone's expert did in fact identify the location of the SEG 1 Pool assets but this, according to the court, is indicative of why tracing is not possible in this case. He then stated:

> **"But for tracing purposes, the critical shortcoming of Ms. McCloskey's report is that it fails to adequately account for the fact that none of Sentinel's customers (referring to the FCMs) held specific ownership interests in securities. Rather they own pro rata portions of investment portfolios which Sentinel was free to fill with any of the securities in its pool of assets so long as those securities met the portfolio's investment criteria."**

Judge Zagel believed that the "fungible nature of cash alone makes it impossible to trace specific securities back to the original customer deposits in this case."[22] He then stated:

> **"So, commingling aside, Sentinel's investment model makes tracing essentially impossible because, upon deposit, customer funds were immediately converted into an abstract ownership interest. In other words, Sentinel's pooled investment model renders tracing impracticable because *there is no specific form of converted trust property to trace.*"[23]**

In support of FCStone's position and that of the CFTC, the critical case to analyze is *Begier v. I.R.S.*[24] *Begier* holds, in essence, that trust assets should not be deemed property of the bankrupt estate and that tracing is not required if a nexus can be shown between the assets re-

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ceived by the beneficiary and those held in trust by the debtor. In its Amicus Brief in *Sentinel II* in the 7th Circuit case, the CFTC stated:

> **"The nexus approach requires that the federal trust claimant must establish 'some connection' between the original trust assets defined by the relevant statute and the 'assets sought to be applied' to the trust claim subsequently in circumstances where the original trust assets have been commingled or transferred (citing *Begier, 496 U.S. at 65-66).* The court has flexibility in determining what connection is sufficient in particular circumstances so long as it 'applies reasonable assumptions to govern the tracing of funds…' These reasonable assumptions can include, but are not restricted to, common law tracing."[25]**

Judge Zagel held that, since the FCMs deposited cash with Sentinel, such cash is intangible and cannot be traced.[26] The SEC in its Amicus Brief concurred with Judge Zagel and distinguished *Begier* by stating that *Begier* is inapplicable as *Begier* did not involve competing claims by beneficiaries of two trusts, as applies here.[27]

Judge Zagel's Third Conclusion of Law

Judge Zagel held that the transfer of assets to the Customer Segregated Accounts of FCStone (and all of the other FCMs) was not authorized by the Bankruptcy Code or by the Bankruptcy Court. As noted above, the U.S. Bankruptcy Court for the Northern District of Illinois permitted this distribution on August 20, 2007.[28] Judge Zagel stated that the Bankruptcy Court did issue an Order stating that the assets, less a $15.6 million holdback, could be distributed to the Customer Segregated Accounts of the various FCMs. Judge Zagel then stated that the Order said nothing about whether the proceeds were property of the estate. Approximately, one year later, on August 8, 2008, the Trustee for Sentinel filed a Motion to Clarify or in the Alternative to Vacate or Modify the Court's August 20, 2007 Order. In open court, the judge then explained that the August 20, 2007 Order had not ruled on the "property of the estate" issue.

Appeal of the Federal District Court Decision

The district court case was appealed to the Seventh Circuit. Oral arguments were held in December 2013. On March 19, 2014, the Seventh Circuit reversed Judge Zagel's decision, primarily determining that the pre-petition transfer and the post-petition transfer to FCStone were proper, and should not be avoided (e.g., claw-backed), in accordance with Sections 546(e) and 549 of the U.S. Bankruptcy Code, respectively, and remanded the case back to the district court.[29] [30] This article will now analyze the Seventh Circuit decision and provide some commentary as to whether the Seventh Circuit properly ruled in this case.

The Seventh Circuit Decision

Judge David Hamilton of the Seventh Circuit, in a 3-0 decision,[31] wrote the opinion for the Seventh Circuit and narrowly ruled that the pre-and post-petition transfers should not be avoided (e.g., not subject to being clawed-back) pursuant to Section 546(e)[32] and Section 549[33] of the U.S. Bankruptcy Code. As discussed below, since the Seventh Circuit ruled solely on whether the transfers should or should not be avoided, it elected not to decide on the other legal issues addressed by Judge Zagel. As noted above, its reference to these other conclusions of law posited by Judge Zagel, without any explanation or analysis, is what is most troublesome.

The Pre-Petition Transfer

A bankruptcy trustee may, pursuant to Section 547(b) of the U.S. Bankruptcy Code,[34] avoid a transfer that took place within 90 days of the filing of the bankruptcy petition if certain conditions were met. This provision, as the Seventh Circuit noted, is designed to

> **"prevent a debtor approaching bankruptcy from choosing on its own to favor some creditors at the expense of others in ways that are not consistent with the priorities and preferences of bankruptcy law".[35]**

The Seventh Circuit noted that Congress enacted Section 546(e) to exempt payments in securities transactions from Section 547(b). Section 546(e) exempts transfers, such as a margin payment, if the transfer constituted a "settlement payment" or was made "in connection with a securities contract".[36] The Seventh Circuit then held:

"We agree with FCStone that Sentinel's pre-petition transfer fell within Section 546(e)'s safe harbor. The district court's findings of fact show that the transfer to FCStone was a "settlement payment" and was made "in connection with a securities contract' within the meaning of Section 546(e)."[37]

The Seventh Circuit then stated:

"Section 546(e) states that the trustee may not avoid a pre-petition transfer made to a commodity broker that is either a 'settlement payment' .... or 'in connection with a securities contract'. The parties agree that FCStone is a commodity broker and that the transfer occurred before the commencement of the bankruptcy case. The only disputed issues are whether the transfer was a 'settlement payment' or was made 'in connection with a securities contract' as those terms are defined in the statute. If the answer to either question is yes, the safe harbor applies and the pre-petition transfer may not be avoided. The answer to both questions is yes."[38]

The Seventh Circuit held that both of these terms should be broadly interpreted. With respect to whether the transfer was made "in connection with a securities contract", the Seventh Circuit determined that, even though Sentinel's customers, such as FC Stone, did not have rights to specific securities, they could authorize Sentinel to purchase or sell securities as they saw fit. It then stated:

"The fact that the Segment 1 customers were entitled to cash rather than to the securities themselves does not change the fact that these customers' investment agreements were contracts for the purchase and sale of securities."[39]

The Seventh Circuit concluded that Judge Zagel's decision was not based on the literal text of Section 546(e) but on policy grounds.[40] The Seventh Circuit then stated:

"We understand the district's court powerful and equitable purpose, but its reasoning runs directly contrary to the broad language of Section 546(e). The text of Section 546(e) does not include an exception for preferential transfers."[41]

The Seventh Circuit reasoned that, through Section 5646(e):

"Congress chose finality over equity for most pre-petition transfers in the securities industry.... In other words, Section 546(e) reflects a policy judgment by Congress that allowing some otherwise avoidable pre-petition transfers in the securities industry to stand would probably be a lesser evil than the uncertainty and potential lack of liquidity that would be caused by putting every recipient of settlement payments in the past 90 days at risk of having its transactions unwound in bankruptcy court."[42]

Thus, the Seventh Circuit found "no persuasive reason to depart from the deliberately broad text of Section 546(e)".[43]

The Post-Petition Transfer

Under Section 549 of the U.S. Bankruptcy Code, a post-petition transfer of property of the estate can be avoided unless the transfer was authorized under the bankruptcy code or by the bankruptcy court.[44] In Sentinel II, the bankruptcy court issued an order in August 2007 (the "2007 Order"), shortly after the filing of the bankruptcy petition, permitting a distribution of approximately $300,000,000 directly into the customer segregated accounts of some 14 FCMs, including FC Stone. One year later, the trustee requested the bankruptcy court to clarify the 2007 Order, in particular, that the transfer in 2007 did not affect the trustee's right to avoid this post-petition transfer. Surprisingly, in 2008, the bankruptcy court held that "its order (issued in 2007) had not authorized the transfer within the meaning of Section 549 and thus did not prevent avoidance of the post-petition transfer."[45] Judge Zagel held that the 2007 Order thus did not authorize this transfer within the meaning of Section 549.

The Seventh Circuit disagreed with Judge Zagel's conclusion. It held that the 2007 Order "was clearly authorized by the bankruptcy court" and that its subsequent order, issued in 2008 was an abuse of discretion.[46] It sensibly determined that the so-called

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clarification ran counter to the "plain language of the order".[47]

The Seventh Circuit then held that it is not necessary for a court to decide whether the property being transferred belongs to the estate and that the bankruptcy court need not determine that the transfer involves property of the estate. A court, it held, can simply authorize a transfer whether the property belonged to the estate or not.[48] In this case, the 2007 Order issued by the bankruptcy court "ended any discussion about its original ownership, and the disputed property cannot later be clawed back by the trustee.[49] The 2007 Order thus did not reserve for the Sentinel trustee the right to avoid the transfer that occurred in August 2007.

The Seventh Circuit then focused on the literal language of the 2007 Order, holding that the language being asserted by the Trustee is meritless. The Seventh Circuit's rational approach focused on the events that took place in August 2007, namely that:

1. The various FCMs, including FCStone, needed BONY to release the money within hours of the original Order being issued. Otherwise, FCStone would have been insolvent itself if it could not transfer the money to meet its obligations to its own customers.

2. The district court's views would undermine the ability of involved parties to rely ever on a bankruptcy court order. In this case, the FCMs clearly relied on the original Order and should be allowed to assume that the transfer to their customer segregated accounts were unencumbered.[50]

3. To not allow the transfer that took place in August 2007 would result in losses to its current customers and creditors, and not those that would have been affected in August 2007.[51]

4. The bankruptcy court should have clarified the 2007 Order before any interested party relies on the Order.

This ruling reflects proper yet practical reasoning, emphasizing the reliance test for parties, which receive a post-petition distribution and the fact that the claw-back would have occurred some seven years later.

Other Legal Issues Addressed by Judge Zagel

Had the Seventh Circuit stopped there, one can easily argue that it simply took a narrow but specific interpretation of the language in Sections 546(e) and 549 of the U.S. Bankruptcy Code. Its practical reasoning could easily be justified. In future FCM bankruptcies, interested parties could evaluate whether the safe harbors of Section 546(e) might apply to a pre-petition transfer and whether a post-petition transfer was authorized or not by a bankruptcy court.

However, the Seventh Circuit, for some unknown reason, chose to address some of Judge Zagel's other Conclusions of Law noted above, but provided little or no explanation or analysis of them. In fact, it chose not to base its decision on any of them.

One of these issues involved whether FCStone was an initial transferee or an beneficiary of the transfer as required by Section 550(a)(1) of the U.S. Bankruptcy Code.[52] If so, the transfer could be avoided. The Seventh Circuit did not decide the ultimate issue but did state, in a footnote, that FCStone was "necessarily either an initial transferee or a beneficiary under Section 550(a)(1)".[53] This language in the footnote could have a significant adverse impact on future FCM failures. Historically, when one FCM fails, the CFTC or an exchange, such as the CME, steps in and works together to find a home quickly for futures customers of the failed FCM so that monies used to margin the open positions and the open futures positions themselves of customers at the failed FCM are transferred to another well-capitalized FCM. This language in the footnote could theoretically hold up an immediate transfer unless and until the trustee appointed by the CFTC obtains an Order from the Bankruptcy Court that expressly authorizes these transfers. It can take days, if not weeks, to obtain such an Order from the bankruptcy court. Query, will this case force future trustees appointed by the court to simply take actions quickly to liquidate all open positions on the books of the failed FCM. What about those positions held by bona-fide hedgers, which are clearly protected against any such liquidation by Part 190?[54] Query, will this case be used by future FCM trustees to hold up any transfers of the open positions of hedgers and their margin monies to another FCM until the trustee can obtain a clear bankruptcy court order? This would be quite troubling in my opinion. Prompt immediate action is required when an FCM fails so that its customers can be properly protected.

Also, what is most concerning is that it provided no analysis or explanation as to why an FCM is an initial transferee. No other case has dealt with this issue involving FCMs; all other cases involve an insolvent broker-dealer. The crucial test in determining whether a brokerage firm is an initial transferee is whether the firm exercises dominion and control over the assets/funds of the bankrupt estate. Pursuant to the Securities Exchange Act and applicable SEC regulations, broker-dealers have more control over their customer assets, especially when the customer purchases securities on margin. On the other hand FCMs, in my opinion, merely act as an agent for their customers and provide a mere conduit of the margin amounts paid by their customers to the respective clearinghouse.[55] The dominion and control test was not addressed by the Seventh Circuit as it applies to FCMs. Its silence is deafening.[56]

A second important Conclusion of Law posited by Judge Zagel involved the concept that the statutory trusts that were created by the Commodity Exchange Act and the Investment Advisers Act are equitable and that the underlying customers should be treated equitably. The Seventh Circuit agreed with Judge Zagel that "there is no basis for placing one trust ahead of the other despite FCStone's and the CFTC's attempts to argue otherwise."[57] However, the Seventh Circuit provided no guidance or explanation of its position other than to state that it believed that the *Cunningham* case had more merit than *Begier*.[58] These cases, among other things, involved the property of the estate issue, which the Seventh Circuit said was not relevant. More importantly, the Seventh Circuit did not discuss the equality vs. equity trust elements which were noted in my prior article, that is whether the explicit provisions found in Section 4d of Commodity Exchange Act and the specific CFTC regulations, which together clearly govern how FCMs must handle futures customer property control the issue versus a single SEC rule that simply states that investment advisers must deposit their customer assets in one of three types of custodians.[59]

The Seventh Circuit thus combined these two Conclusions of Law in a very strange way. It should have either not addressed these other legal issues posited by Judge Zagel or explained its interpretation in more detail.

Possible Impact of The 7TH Circuit's Decision on Sentinel I[60]

As noted in my prior article, Frederick Grede as the Liquidation Trustee, filed an earlier case against Bank of New York Mellon ("BONY"), which acted as the custodian for Sentinel's repo and futures customer accounts. Grede sought $312 million from BONY claiming that BONY knew about Sentinel's fraudulent use of its customer assets and thus BONY acted inequitably and unlawfully. On August 12, 2012, Judge Zagel ruled that BONY was not liable for the actions taken by Sentinel with respect to its fraudulent movement of assets from its customer accounts to an account held in the name of Sentinel on BONY's books. Judge Zagel found that Grede had "failed to prove that Sentinel made the Transfers with the actual intent to hinder, delay or defraud its creditors."[61] On November 30, 2012, without any explanation, the 7th Circuit vacated Judge Zagel's decision in Sentinel I and held that this appeal remains under consideration by the panel.[62] On August 26, 2013, the 7th Circuit overturned Judge Zagel's lower court decision regarding Grede's fraudulent transfer and equitable subordination claims and remanded the case back to the district court for further proceedings.

Conclusion

The Trustee has filed a petition before the Seventh Circuit to request that the Seventh Circuit reconsider its decision. This motion had not been decided as of the date of this article. It will be interesting to see whether this motion will be granted or not. It will also be interesting to see whether the Trustee only brings the action in Sentinel I against BONY, given the Seventh Circuit's decision in that prior case to remand that case back to the district court, or seeks to bring both cases (e.g., Sentinel I and II) back simultaneously to the district court. Further, it will be interesting to see whether either of the two Seventh Circuit decisions in Sentinel I and II will reach the U.S. Supreme Court.

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NOTES

1. Ronald Filler is a Professor of Law and the Director of the Financial Services Institute at New York Law School. He is also the Program Director of its award-winning LLM in Financial Services Law Graduate Program, which offers more than 40 courses involving various aspects of the global financial services industry. He is a Public Director and Member of the Executive Committee of the National Futures Association, the futures industry self-regulatory organization, a Public Director and Chair of the Regulatory Oversight Committee (ROC) of SWAP-EX, a swap execution facility, and a Board Member of Global Clearing & Settlement, a company providing insurance to CCPs around the globe. He is a Past Chair of the CFTC Global Markets Advisory Committee and has served on numerous industry boards and advisory committees throughout his professional career. He is the co-author of a new law book entitled "Regulation of Derivative Finan-

cial Instruments (Swaps, Options and Futures)". Prof. Filler served as an expert witness on behalf of FC Stone in the federal district court case.

2. See "Ask the Professor: How Will the Seventh Circuit Rule in Sentinel II, 33 Fut. & Deriv. L. Rep 21 (November 2013), which explained, in more detail, the facts and issues at law that were raised in the federal district court case. This case against FCStone is referred to herein as *Sentinel II*. As noted in my prior article, there is a separate action brought by the Trustee against the Bank of New York (referred to as *Sentinel I*.
3. See Frederick J. Grede, not individually but as Liquidation Trustee of the Sentinel Liquidation Trust v. FCStone, LLC, Nos. 13-1232, 13-1278, 2014 WL 1041736 (7th Circuit)
4. Since Sentinel did not act as a traditional FCM, the bankruptcy provisions under the U.S. Bankruptcy Code did not apply to Sentinel (See page 16 of Judge Zagel's Memorandum Opinion and Order). Therefore, Part 190 of the CFTC Rules, 17 C.F.R. Part 190, also did not apply to this case.
5. See Letter from John L. Manley, Director, CFTC Division of Trading and Markets, to Terry I. Claassen, O'Neal & Claassen, dated May 7, 1981. See also CFTC Interpretation Letter 04-06 from James Carley, Director, CFTC Division of Clearing and Intermediary Oversight, to Eric Bloom, President & CEO, Sentinel Management Group, Inc., dated January 21, 2004.
6. 17 CFR 1.25
7. The SEG 2 Pool involved other assets not at issue in this case.
8. One of its principals, Eric Bloom, was recently found guilty of several counts and is now in jail.
9. *Supra, Note 3.*
10. *Supra*, Note 3 at page 2.
11. *Supra,* Note 3 at page 1.
12. Pursuant to Section 4d(a) of the Commodity Exchange Act, 7 U.S.C. 6d(a), and CFTC Regulation 1.20, 17 C.F.R. 1.20, all futures commission merchants ("FCMs") must hold all futures customer assets in a "customer segregated account".
13. Frederick J. Grede, not individually but as Liquidation Trustee of the Sentinel Liquidation Trust, v. FCStone, LLC, No. 09 C 136 (N.D. Ill). (hereinafter referred to as Sentinel II).
14. See Order issued by the U.S. Bankruptcy Court for the Northern District of Illinois, in *In Re: Sentinel Management Group, Inc., Case No. 07-14987 (August 20, 2007)*
15. Sentinel Management Group, Inc. filed for bankruptcy on August 17, 2007, *supra,* Note 4.
16. 14 FCMs were sued by the Trustee to claw-back the amounts distributed in August 2007, into the Customer Segregated Accounts but these actions were not consolidated. This case is a test case and only involves FC Stone, and none of the other FCMs. The other cases against FCMs, which invested in the SEG 1 Pool have been deferred.
17. See *In Re Bucyrus Grain Co., Inc.,* 127 B.R. 45 (D. Kan 1988)
18. Section 4(d)(a) of the CEA was enacted in 1936 to establish this statutory trust in order to protect futures customers who deposit their margin with their FCMs. Some quotes from Senator Bronson Murray, the sponsor of the CEA amendments, in the legislative reports include: (i) "Surely they thought their margins were regarded as trust funds and would be handled with a reasonable degree of integrity.": (ii) "This section merely provides that the public's money put up for margins shall in fact be treated as belonging to the customer and held in trust."; and (iii) "This mandatory trust fund status was intended to stop the then-common practice in the industry whereby futures commission merchants receiving margin monies in excess of the amounts required by the exchange to be deposited, (then) use these excess margin deposits as their own capital, for any purpose they choose." 80 Cong. Rec. 7858 (May 25, 1936).
19. See CFTC Rules 1.20 through 1.29, 17 C.F.R. 1.20 – 1.29
20. *Supra,* Note 4 at page 24.
21. *Ibid* at page 27.
22. *Supra*, Note 4 at page 37.
23. Ibid
24. 496 U.S. 53 (1990)
25. See CFTC Amicus Brief, at page 13.
26. Supra, Note 4 at page 37.
27. See SEC Amicus Brief, at page 14.
28. Supra, Note 5.
29. Frederick J. Grede, not individually but as Liquidating Trustee of the Sentinel Liquidation Trust, v. FCStone, LLC, 7th Cir, Nos. 13-1232 and 13-1278, March 19, 2014.
30. 11 U.S.C. 546(e) and 11 U.S.C. 549.
31. This case was heard before Judges Hamilton, Manion and Rovner.
32. 11 U.S.C. 546(e)
33. 11 U.S.C. 549
34. 11 U.S.C. 547(b)
35. See page 13 of the Opinion, citing Warsco v. Preferred Technical Group, 258 F.3d 557 (7th Cir. 2001)
36. See page 14 of the Opinion.
37. See page 15 of the Opinion.
38. Ibid.
39. See Pages 16-17 of the Opinion. Note that the Seventh Circuit referred to the two main pools at Sentinel as Segment 1 and Segment 3 whereas the district court referred to them as SEG Pool 1 and SEG Pool3.
40. See Page 17 of the Opinion.
41. See pages 17-18 of the Opinion.
42. See Pages 18-19 of the Opinion.
43. See Page 18 of the Opinion.

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44. See 11 U.S.C. 549
45. See Page 21 of the Opinion.
46. Ibid
47. Ibid.
48. See Page 22 of the Opinion.
49. See Page 23 of the Opinion, citing Vogel v. Russell Transfer, Inc., 852 F.3d 797 (4th Cir. 1988).
50. See Page 27 of the Opinion
51. Ibid
52. 11 U.S.C. 550(a)(1)
53. See Note 5 on Page 20 of the Opinion.
54. 17 C.F.R. Part 190
55. See Note 2, supra, for a more detailed analysis of this issue.
56. See Supra Note 2 for a greater discussion of the Initial Transferee issue.
57. See Page 29 of the Opinion.
58. See Pages 29-30 of the Opinion, stating that there is no floating trust here.
59. See Pages 23 -26 of the article cited in Note 2, supra. The Seventh Circuit did state that this issue needs to be resolved by rule. I believe that it meant by Congress.
60. Frederick Grede, not individually but as Liquidation Trustee for the Sentinel Liquidation Trust v. The Bank of New York Mellon and the Bank of New York Mellon Corp., U.S. District Court for the Northern District of Illinois, Eastern Division (Case No. 08-C-2582, November 3, 2010 (hereinafter referred to as Sentinel I"
61. See page 11 of In Re: Sentinel Management Group Inc., U.S. Court of Appeals for the 7th Circuit (Nos. 10-3787, 10-3990 & 11-1123), dated August 26, 2013.
62. In Re Sentinel Management Group, Inc., Seventh Circuit, Case No. 10-3787, November 30, 2012.

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