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Hearing Date: April 12, 2017 at 10:00 a.m.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: MF GLOBAL HOLDINGS LTD., ET AL., DEBTORS.	CHAPTER 11 CASE NO. 11-15059 (MG) (JOINTLY ADMINISTERED)
MF GLOBAL HOLDINGS USA, INC. BY AND THROUGH MF GLOBAL HOLDINGS, LTD., AS PLAN ADMINISTRATOR, PLAINTIFF, -AGAINST- HEARTLAND CO-OP, DEFENDANT.	ADVERSARY PROCEEDING NO. 17-01000 (MG)

DEFENDANT'S CORRECTED[1] REPLY IN SUPPORT OF
MOTION TO DISMISS ADVERSARY COMPLAINT

[1] The only change is that a case name (*In re Crowley*) inadvertently omitted from a cite on page 5 has been added.

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Heartland, by and through its counsel, Foley & Lardner LLP, hereby submits its reply in support of its motion to dismiss the Adversary Complaint (the "Motion"). In support hereof, Heartland states as follows:[2]

INTRODUCTION

MF Global's claim against Heartland was not preserved under the Plan and should be dismissed under principles of *res judicata.* In its response (the "MF Global Resp."), MF Global does not dispute that the "claim reservation" clauses in the Plan and Disclosure Statement were only general, and did not identify claims against Heartland or even claims against MF Global's derivative counterparties more generally. *See* Opening Brief ("OB") at 4-6, 10. Under well-established law, a blanket reservation of "all claims" under a chapter 11 plan is insufficient to overcome the *res judicata* bar.

MF Global attempts to sidestep this principle in two ways, both of which fail. *First*, MF Global asks this Court to adopt a "general reservation" standard for preserving claims, citing a policy argument that in a large and complicated bankruptcy proceeding like this one, it is impossible for a debtor to specify potential claims it plans to pursue. This Court should reject MF Global's argument. Not only would adopting a "general reservation" standard put this Court in conflict with the overwhelming majority of courts, both in this district and elsewhere, but failing to require a debtor to provide its creditors with notice of potential recovery sources would conflict with the policies underlying disclosures to creditors under the Bankruptcy Code. MF Global goes so far with its "general reservation" argument that it suggests, without citing any statutory or case law authority (because none exists), that Heartland is somehow barred under *res judicata* principles from raising the defense.

[2] Capitalized terms not defined herein shall have the meanings ascribed to them in the Motion.

Second, MF Global argues that the claim against Heartland was adequately set forth in the Disclosure Statement, relying on a single sentence that references the amounts that the Trustee "has recovered" under derivative contracts. Nothing in this sentence (which uses the past tense), or in the rest of the Disclosure Statement, discloses or even suggests that the Debtors possessed litigation claims against derivative counterparties. MF Global cannot rely on this purported "disclosure" to save its claim from being barred under *res judicata*.

Finally, this Court should exclude the affidavit MF Global improperly submitted in opposition to the Motion. This Court should not consider factual matter outside the Complaint in ruling on Heartland's Motion under Fed. R. Civ. P. 12(b)(6).

I. A General Reservation Of Claims Under A Plan Does Not Preserve Those Claims Under Principles Of *Res Judicata*

MF Global first argues that a general reservation of claims under a Plan preserves those claims for *res judicata* purposes. This argument fails.

Pursuant to § 1141(a) of the Bankruptcy Code, an order confirming a chapter 11 plan constitutes a final judgment on the merits under principles of *res judicata* and "bind[s] its debtors and creditors as to *all* the plan's provisions, and all related, property or non-property based claims which could have been litigated in the same cause of action." *Sure-Snap Corp. v. State St. Bank and Trust Co.*, 948 F.2d 869, 873 (2d Cir. 1991); *In re Hooker Invest., Inc.*, 162 B.R. 426, 433 (S.D.N.Y. 1993) ("[A] confirmed plan of reorganization has full preclusive effect and is binding on all parties thereto"). While MF Global suggests that a confirmation order does not have *res judicata* effect on litigation claims against third parties (MF Global Resp. at 18-19), it is incorrect. It is well-established that "the confirmation of a plan of reorganization prevents the subsequent assertion of any claim not preserved in the plan as required by *§ 1123(b)(3)*." *In re I. Appel Corp.*, 300 B.R. 564, 567 (S.D.N.Y. 2003), *aff'd*, 104 F. App'x 199 (2d Cir. 2004); *In re*

Futter Lumber Corp., 473 B.R. 20, 29 (E.D.N.Y. 2012) ("[A] debtor is precluded from asserting any claims post-confirmation that are not preserved in its plan."); *Goldin Assocs., L.L.C. v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 00 Civ. 8688 (WHP), 2004 U.S. Dist. LEXIS 9153, at *11 (S.D.N.Y. May 25, 2004) (same).

As discussed in the OB, while courts agree that a claim must be preserved under a plan or it will be barred by *res judicata*, the degree of specificity required to preserve a claim is subject to a split of authority. *See* OB at 8-10. Despite that split of authority, the overwhelming majority of courts, ***both in this district and elsewhere***, have held that a blanket reservation of "all claims" under a plan fails to properly preserve those claims for *res judicata* purposes. *See, e.g.*, *Hooker*, 162 B.R. at 433-34 ("Each of these decisions either expressly or impliedly recognizes that whereas a blanket reservation would not be enough to escape the *res judicata* bar, an express reservation would."); *Goldin Assocs.*, 2004 U.S. Dist. LEXIS 9153, at *17 (stating that "the reservation clause in the Plan is a blanket one, and thus insufficient alone to preserve the Debtor's claims")[3]; *Rosenshein v. Kleban*, 918 F. Supp. 98, 103 n. 4 (S.D.N.Y. 1996) (stating that the debtor could not "rely on a general retention clause to preserve undisclosed causes of action known to him when he filed for bankruptcy"); *D & K Props. Crystal Lake v. Mutual Life Ins. Co. of New York*, 112 F.3d 257, 261 (7th Cir. 1997) ("A blanket reservation that seeks to reserve all causes of action reserves nothing."); *In re Kelley*, 199 B.R. 698, 704 (9th Cir. B.A.P. 1996) ("Even a blanket reservation by the debtor reserving 'all causes of action which the debtor may choose to institute' has been held insufficient to prevent the application of res judicata to a specific action.") (quoting *Hooker*, 162 B.R. at 433).

[3] The Court in *Goldin Assocs.* held that the claims were nevertheless preserved because, unlike here, the debtor's disclosure statement specifically identified the claims sought to be pursued. *Id.* at *18.

In its response, MF Global argues that Heartland "ignores the weight of authority in the Southern District of New York, which provides that a general reservation of post-confirmation claims suffices to preserve those claims for the bankrupt estate." MF Global Resp. at 14. The alleged "weight of authority" that MF Global relies on consists of two cases: The District Court's decisions in *Appel* and *In re Perry H. Koplik & Sons, Inc.*, 357 B.R. 231 (Bankr. S.D.N.Y. 2006).

Appel provides no support for MF Global's position. While the District Court in *Appel* rejected the majority approach requiring a specific disclosure of every claim to preserve it under a plan, the court did ***not*** rule that a general reservation of claims was sufficient. *Appel*, 300 B.R. at 569-70. Indeed, the debtor's disclosure statement in *Appel* specifically referenced claims against the defendants, a point relied on by the court in finding that the debtor preserved the claims:

> The ***combination*** of the blanket reservation of claims in the Plan ***and the reference to potential claims against the Katzes in the Disclosure Statement*** was sufficient to provide adequate notice to the creditors, the Katzes, the trustee, and the bankruptcy court that the Debtor had potential outstanding claims against the Katzes.

Id. at 570 (emphasis added); *see also I. Appel Corp.*, 104 F. App'x at 201 (noting that the disclosure statement specifically identified "claims by the Debtor against Katz and his son").

With respect to *Koplik*, while the Court there stated that a general reservation was sufficient, unlike in this case, *Koplik* involved protracted pre-petition litigation between the parties that was well known to all interested parties as of confirmation of the plan. *Koplik*, 357 B.R. at 235-39. Thus, *Koplik*'s "general reservation" language is, at best, dictum that is contradicted by the bevy of authority from this district and around the country that has held that general reservation language is insufficient. *Koplik* also misread *Appel* in stating that *Appel*

involved only a general reservation of claims, where that case, as noted above, in fact identified claims against the defendants. *Id.* at 246-47.

Adopting a "general reservation" standard not only would conflict with the weight of authority cited above and in the OB, but it would also be inconsistent with the policies underlying notice to creditors under the Bankruptcy Code, including §§ 1125 and 1123(b)(3). Section 1123(b)(3) "is really intended to give creditors notice of a possible action that the Debtor may pursue in order for a creditor to adjust its vote accordingly." *In re Goodman Bros. Steel Drum Co.*, 247 B.R. 604, 608 (Bankr. E.D.N.Y. 2000); *see also In re United Operating, LLC*, 540 F.3d 351, 355 (5th Cir. 2008) ("Proper notice allows creditors to determine whether a proposed plan resolves matters satisfactorily before they vote to approve it – 'absent 'specific and unequivocal' retention language in the plan, creditors lack sufficient information regarding their benefits and potential liabilities to cast an intelligent vote.'") (quoting *In re Paramount Plastics, Inc.*, 172 B.R. 331, 334 (Bankr. W.D. Wash. 1994)); *see also In re Crowley, Milner and Co.*, 299 B.R. 830, 851 (Bankr. E.D. Mich. 2003) ("Not only is § 1123(b)(3) central to other creditors in their evaluation of likely distributions under a chapter 11 plan, it is also important to creditors who may become defendants in a later post-confirmation action by a debtor.").

A general reservation of claims does nothing to help creditors evaluate a plan and decide whether to vote in favor of it. While MF Global attempts to minimize the disclosure issue by noting that the claim against Heartland is only to recover $2 million,[4] it misses the mark. The general reservation clause here failed to identify any of the 90 derivative counterparty claims held by MFGMS – or the "hundreds" in derivative counterparty claims held by other MF Global

[4] *See* MF Global Resp. at 19.

affiliates[5] – resulting in many millions in undisclosed claims. Importantly, MF Global does not say (because it cannot do so) that its claim against Heartland is the only one that is being pursued against a counterparty to an ISDA Agreement. Creditors in chapter 11 cases have the right to know about these (potential) millions at issue when they vote on whether to accept or reject a plan.

Facing the weight of case law against its position as well as the principles underlying §§ 1123(b)(3) and 1125, MF Global offers its own policy arguments in favor of the "general reservation" standard. First, MF Global argues that it would be "commercially impractical and detrimental" to list every cause of action in a large chapter 11 case. MF Global Resp. at 18; *see also id.* at 15 (making similar argument). This argument fails. MF Global admits that it was well aware of the approximately 90 claims that MFGMS had against derivative counterparties. *Id.* at 16. Listing those entities as potential litigation targets for breach of contract claims would have taken very little effort, particularly given the sophisticated firms representing the plan proponents in this case. Indeed, when it came to listing other targets, such as Jon Corzine and other insiders, the plan proponents had no trouble doing so. D.I. 1382 at Article IV.G (expressly preserving for the Litigation Trustee the "Litigation Trust Claims," which are defined as the claims against Jon S. Corzine *et al*).

Moreover, not only did the plan proponents fail to list the derivative counterparties that were litigation targets, but they failed to even generally identify claims against such parties, despite being well aware of such claims. MF Global has not, and cannot, allege that it would be "impractical" to generally identify claims against derivative counterparties in the Plan.

Second, MF Global argues that it would be "absurd" to potentially reduce creditor recoveries due to the failure to disclose claims against Heartland. This argument is an improper,

[5] *See* MF Global Resp. at 5.

back-door attempt to disregard established precedent that undisclosed claims are barred by *res judicata*. Indeed, courts have applied principles of *res judicata* to preclude the assertion of undisclosed, post-confirmation claims even when the successful prosecution of those claims would have benefitted creditors. *See, e.g.*, *American Preferred Prescription, Inc.*, 266 B.R. 273, 279-80 (E.D.N.Y. 2000) (chapter 11 trustee barred from challenging claim); *Crowley,* 299 B.R. at 851-52 (*res judicata* required dismissal of creditors' committee's adversary proceeding seeking recovery of $25 million for creditors).

Finally, MF Global argues that Heartland should be bound by the Plan provisions that provide for a general reservation of claims and purport to deem that reservation sufficient for *res judicata* purposes. MF Global Resp. at 19-20. This circular, completely unsupported argument also fails. As stated above, because a general reservation "reserves nothing" under principles of *res judicata*, the purported reservation of "any claims, demands, rights and Causes of Action" is of no force and effect. If merely stating that "all claims are reserved" meant that others were bound by the statement that "all claims are reserved," a general reservation would always be deemed sufficient which, of course, is not the law, either under *res judicata* or other matters.[6] *See*, e.g., *D & K Props.*, 112 F.3d at 261; *see also In re Ener1, Inc.*, 558 B.R. 91, 97-98 (Bankr. S.D.N.Y. 2016) (broad plan provision stating that jurisdiction is reserved for virtually all claims does not create jurisdiction over post-confirmation claim).

MF Global does not dispute that the "claim reservation" clauses in the Plan and Disclosure Statement were only general, and did not identify claims against Heartland or even

[6] While not legally relevant because merely stating that "all claims are reserved" does not bind third parties to that statement, MF Global overstates Heartland's participation in its chapter 11 case. MF Global Resp. at 12, 19-20. By its own allegations, Heartland was not a creditor of the Debtors nor did it have any right to vote on the Plan. Thus, MF Global's suggestion that Heartland somehow had an obligation to "object" to the Plan's general reservation clause in order to preserve its *res judicata* arguments has no basis whatsoever.

claims against derivative counterparties generally. *See* OB at 4-6, 10. Thus, the Court should dismiss MF Global's claim against Heartland on the grounds of *re judicata*.

II. The Claim Against Heartland Was Not Adequately Disclosed In The Disclosure Statement

MF Global tries to avoid the *res judicata* bar by arguing that the claim against Heartland was adequately disclosed in the Disclosure Statement.

MF Global points to a single sentence in the Disclosure Statement that describes amounts "recovered" under derivative contracts. To suggest that the sentence demonstrates preservation of similar claims is pure linguistic sophistry. Article V.A of The Disclosure Statement provides under "Other Potential Sources of Recovery":

> **A. Recovery of Trading Close-Out Valuation Under Certain Derivative Transactions.**
>
> The Chapter 11 Trustee ***has recovered*** in excess of $25 million for the Unregulated Debtors from the termination of certain master derivative agreements and the related underlying transactions.

Disclosure Statement, Art. V.A (emphasis added).

Nothing in this sentence provides, or even suggests, that the Debtors possessed litigation claims against derivative counterparties. Indeed, the sentence uses the phrase "has recovered," the past tense, and does ***not*** go on to say "and $_____ million remains to be recovered from derivative counterparties." If anything, this reference only misled creditors into believing that derivative counterparty issues had been resolved through the recovery of $25 million. Moreover, unlike potential avoidance actions, claims against derivative counterparties were not included in the separate section of "Other Potential Sources of Recovery" entitled "Litigation." Disclosure Statement at Art.V.E. The sentence in Article V.A thus falls far short of being an adequate disclosure of claims.

Finally, MF Global attempts to rely on the "disclosure" of amounts owed by derivative counterparties on MFGMS's bankruptcy Schedules. But the Schedules, filed in May 2012, listed amounts owed as of the petition date (October 31, 2011), not what was owed as of confirmation of the Plan in 2013, and nothing in the Plan or Disclosure Statement provides that the Debtors possessed claims against derivative counterparties for the amounts set forth in the Schedules.

The purported "disclosures" in the Disclosure Statement cited by MF Global are nothing like the disclosures deemed sufficient in other cases. *See, e.g.*, *In re Bankvest Capital Corp.*, 375 F.3d 51, 60 (1st Cir. 2004) (holding plan of reorganization's express reservation of right to pursue avoidance actions sufficiently preserved particular avoidance action); *In re Railworks Corp.*, 325 B.R. 709, 717 (Bankr. D. Md. 2005) (same); *In re Felt Mfg. Co., Inc.*, 402 B.R. 502, 517 (Bankr. D.N.H. 2009) (holding that description of potential § 506(c) claims to be pursued sufficiently reserved an action under § 506(c)). Accordingly, unlike in those cases, the claims against Heartland were not adequately disclosed even under a "categorical approach" to claim preservation.

III. This Court Should Exclude The New Affidavit Attached To MF Global's Response

It was improper for MF Global to attach, via affidavit, factual matter outside the Complaint in response to Heartland's Motion under Fed. R. Civ. P. 12(b)(6).[7] If this Court were to consider these extraneous materials, then Heartland's Motion would need to be converted into one for summary judgment and Heartland would need to be afforded the opportunity to present supporting material. Under Fed. R. Civ. P. 12(d), when "matters outside the pleadings are presented to and not excluded by the court," a motion to dismiss "must be treated as one for

[7] Heartland disputes MF Global's characterization of the alleged "facts" set forth in its response, but a 12(b)(6) motion is not the forum for adjudicating such disputes, as they are not relevant to the legal issue governing the Motion.

summary judgment," and "[a]ll parties must be given a reasonable opportunity to present all the material that is pertinent to the motion." Fed. R. Civ. P. 12(d). *See generally Fonte v. Bd. of Managers of Cont'l Towers Condo.*, 848 F.2d 24, 25 (2d Cir. 1988) (vacating district court's grant of 12(b)(6) motion when the plaintiff submitted affidavit in response to motion, and the district court did not specify whether it considered extraneous material; stating further that "it would also have been error for the court to consider the factual allegations contained in the plaintiffs' memorandum of law without converting the motion to one for summary judgment.").

Moreover, a district court errs when it "considers affidavits and exhibits submitted by" defendants, *Kopec v. Coughlin*, 922 F.2d 152, 155 (2d Cir. 1991), or relies on factual allegations contained in legal briefs or memoranda, *see Fonte*, 848 F.2d at 25, in ruling on a 12(b)(6) motion to dismiss. Vacatur is required even where the court's ruling simply "makes a connection not established by the complaint alone" or contains an "unexplained reference" that "raises the possibility that it improperly relied on matters outside the pleading in granting the defendant's Rule 12(b) motion." *Id*.

The rule does not require, however, that the Court convert a motion to dismiss to a motion for summary judgment. Rather, the Court may (and, here, should, due to the governing legal issue in the Motion) exclude the additional material submitted by MF Global and decide the Motion on the Complaint alone. *See Lamont v. Wilson*, 14-cv-5052, 2015 U.S. Dist. LEXIS 110856, at *7 (S.D.N.Y. Aug. 20, 2015) (excluding plaintiff's affidavit and other materials submitted in opposition to 12(b)(6) motion and granting the motion).

CONCLUSION

For the reasons set forth herein and in the OB, Heartland's Motion should be granted in its entirety and the Complaint should be dismissed with prejudice.

Dated: March 28, 2017
New York, NY

FOLEY & LARDNER LLP

BY: */s/ Derek L. Wright*
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CERTIFICATE OF SERVICE

I, Derek L. Wright, hereby certify that on March 28, 2017, I caused a true and correct copy of ***Defendant's Reply in Support of Motion to Dismiss Adversary Complaint***, to be served upon counsel of record using the Court's CM/ECF system.

/s/ Derek L. Wright
DEREK L. WRIGHT