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ATTORNEYS FOR DEFENDANT, HEARTLAND CO-OP

Hearing Date: March 7, 2017 at 2:00 p.m.
Objection Deadline: February 28, 2017

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 MEMORANDUM OF LAW IN
SUPPORT OF MOTION TO DISMISS ADVERSARY COMPLAINT

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Heartland Co-Op ("Heartland" or the "Defendant"), by and through its counsel, Foley & Lardner LLP, hereby moves (the "Motion"), pursuant to Federal Rules of Civil Procedure 12(b)(1) and (6), as made applicable to this Adversary Case by Federal Rule of Bankruptcy Procedure 7012, and the doctrine of *res judicata*, to dismiss the Adversary Complaint (the "Complaint") for failure to state a claim upon which relief may be granted and, alternatively, for lack of standing. In support of the Motion, the Defendant submits the following Memorandum of Law and states as follows:

INTRODUCTION

The Complaint is based on a contract that terminated more than five years ago, prior to MF Global Market Services, LLC's ("MFGMS") filing of its chapter 11 bankruptcy petition on December 19, 2011. MFGMS and Heartland were parties to an ISDA Master Agreement under which they engaged in various derivatives transactions. When MF Global Holdings Ltd. ("MF Global"), a credit support provider under the ISDA agreement, filed for bankruptcy protection on October 31, 2011 ("Event of Default"), Heartland exercised its rights to terminate the ISDA agreement. Almost four years after MFGMS filed chapter 11 and more than two years after MFGMS confirmed its chapter 11 plan, MFGMS contacted Heartland and demanded that Heartland pay MFGMS almost $2.7 million, an amount that MFGMS calculated as *its* Loss under the ISDA agreement, including almost $1 million in interest. The Complaint now raises the claim initially asserted against Heartland in 2015.

For the reasons set forth below, the Complaint should be dismissed because the plaintiff's claims against Heartland are barred by the doctrine of *res judicata*. It is well established that, under the doctrine of *res judicata*, a debtor is precluded from asserting any claims post-confirmation that are not preserved properly in its chapter 11 plan. Here, despite being well

aware of the claims against Heartland since 2011, the Debtors did not list any claims specifically against Heartland in their plan and disclosure statement, nor did they even enumerate breach of contract claims against counterparties to ISDA agreements more generally. Instead, other than certain specified claims – which have no connection to those asserted in the Complaint – the Debtors' plan and disclosure statement merely contained a general "blanket" reservation of claims, which is insufficient to preserve the claims under applicable law. Accordingly, *res judicata* bars the plaintiff's claim against Heartland and this Court should dismiss the Complaint with prejudice.[1]

BACKGROUND

I. The Parties' Pre-Petition Relationship

On April 9, 2010, MFGMS and Heartland entered into a standard-form 1992 ISDA Master Agreement (the "ISDA Agreement"). Complaint, ¶ 15.[2] Pursuant to the ISDA Agreement, Heartland and MFGMS engaged in a number of derivatives transactions between April 9, 2010 and October 31, 2011. Complaint, ¶ 19. MF Global Holdings Ltd. ("MF Global") was a "Credit Support Provider" under the ISDA Agreement. Complaint, ¶ 16; ISDA Agreement, Sch. Part 4(g) (p. 26). Pursuant to Section 5(a)(vii) of the ISDA Agreement, an "Event of Default" occurs when, among other things, a party to the ISDA Agreement or a "Credit Support Provider" files bankruptcy. Complaint, ¶ 16; ISDA Agreement § 5(a)(vii).

On October 31, 2011, MF Global filed chapter 11, causing an Event of Default under the ISDA Agreement. Complaint, ¶ 30. On November 8, 2011, pursuant to its rights under the ISDA Agreement and 11 U.S.C. §§ 556, 560, 362(b)(6) and (17), Heartland terminated the ISDA Agreement. Complaint, Ex. C (the "Termination Letter"). Pursuant to Section 6(a) of the ISDA

[1] As discussed below, under the same analysis, the plaintiff lacks standing to pursue claims against Heartland.

[2] The ISDA Agreement is attached as Exhibit A to the Complaint.

Agreement, the Termination Letter also designated November 8, 2011, as the "Early Termination Date." Complaint, ¶ 31 & Ex. C; ISDA § 6(a).

Under the ISDA Agreement, the parties selected the "Loss" and "Second Method" for determining the amount payable to either party in the event of an "Early Termination Date." ISDA Agreement, § 6(e), Sch. Part 1(f) (p. 21). The ISDA Agreement defines "Loss" as the amount that the non-defaulting party "***reasonably determines in good faith*** to be its total losses and costs (or gain…) in connection with this Agreement . . . including any loss of bargain, cost of funding or . . . loss or cost incurred as a result of its . . . reestablishing any hedge or related trading position." ISDA Agreement, §§ 6(e)(i)(4), 14 (emphasis added). The determination of the "Loss" by the non-defaulting party thus governs unless such determination was "unreasonable" or in "bad faith."

II. The Debtors' Bankruptcy Petitions and Schedules

As noted above, on October 31, 2011, MF Global filed a voluntary petition pursuant to chapter 11 of the Bankruptcy Code. On December 19, 2011 (the "Petition Date"), MFGMS filed its voluntary chapter 11 petition, and on March 2, 2012, MFGMS's affiliate, MF Global Holdings USA Inc., filed its chapter 11 petition.

On November 28, 2011, this Court entered an order appointing a chapter 11 trustee pursuant to 11 U.S.C. § 1104(d). On May 18, 2012, MFGMS filed its bankruptcy schedules and Statement of Financial Affairs ("SOFA"). *See* D.I. 695, 700.[3] On June 15, 2012, MFGMS filed its only amendments to its schedules and SOFA. D.I. 727, 728. In the schedules and SOFA, MFGMS scheduled the ISDA Agreement as an executory contract and identified Heartland as the contract counterparty (D.I. 700 at 30 of 34), scheduled an account receivable from Heartland

[3] Unless otherwise specified, all references to "D.I." in this Motion refer to docket items on the Lead Bankruptcy Case docket (Case No. 11-15059-mg (Bankr. S.D.N.Y.)).

in the amount of $306,288.54 (*Id.* at 19 of 34), and disclosed payments totaling approximately $17.9 million made to Heartland within the 90 days prior to the Petition Date (D.I. at 23 of 31).

III. The Debtors' Plan and Disclosure Statement

On January 10, 2013, the Debtors (as defined in the Complaint) filed their Chapter 11 Plan of Liquidation [D.I. 996] (which was later amended at D.I. 1094, 1382 (as amended, the "Plan")), Disclosure Statement [D.I. 995] (which was later amended at D.I. 1111 (as amended, the "Disclosure Statement")), and motion to approve, *inter alia*, their Disclosure Statement [D.I. 997]. As set forth below, the Plan and Disclosure Statement did not identify and did not preserve any causes of action against Heartland for prosecution in the post-confirmation period. The Disclosure Statement contained only the following blanket reservation of causes of action at Article VII.G:

> **Preservation of Causes of Action.**
>
> Except as provided in the Plan, the Confirmation Order, or in any contract, instrument, release or other agreement or document entered into or delivered in connection with the Plan, in accordance with § 1123(b)(3)(B) of the Bankruptcy Code, the Plan Administrator, on behalf of each Debtor, shall have and retain and may enforce any claims, demands, rights and Causes of Action[4] that any Debtor or Estate may hold against any Person or Entity to the extent not released otherwise, all of which are included within the Property of the Estate. The Plan Administrator may pursue such claims, demands, rights or Causes of Action, as appropriate,

[4] "Causes of Action" is defined in Article I.A.18 of the Plan to mean the following: "without limitation, any and all actions, causes of action, controversies, liabilities, obligations, rights, suits, damages, judgments, claims, and demands whatsoever, whether known or unknown, reduced to judgment, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, secured or unsecured, assertable directly or derivatively, existing or hereafter arising, in law, equity, or otherwise, based in whole or in part upon any act or omission or other event occurring prior to the Effective Date, including without limitation: (a) claims and causes of action under §§ 502(d), 510, 542-545, and 547-553 of the Bankruptcy Code, (b) any other avoidance or similar claims or actions under the Bankruptcy Code or under similar or related state or federal statutes or common law, and the proceeds thereof, whether received by judgment, settlement or otherwise, (c) any claims arising out of the Debtors' entitlement to distributions from MFGI on account of the Held Open Chapter 11 Claims as defined in the MFGI-Debtors Letter Agreement, (d) any claims against or entitlements to distributions from any Debtor, any Non-debtor U.S. Subsidiary or any Non-debtor Foreign Subsidiary, (e) any claims against any of the Debtors' former officers, directors or employees, and (f) any other litigation claims."

> in accordance with the best interests of the beneficiaries of the Estates. A nonexclusive schedule of currently pending actions and claims brought by one or more Debtors or the Chapter 11 Trustee, as applicable, is attached as Exhibit IV.G to the Plan. In accordance with and subject to any applicable law, the Plan Proponents' inclusion or failure to include any right of action or claim on Exhibit IV.G to the Plan shall not be deemed an admission, denial or waiver of any claims, demands, rights or Causes of Action that any Debtor or Estate may hold against any Person or Entity. The Plan Proponents intend to preserve all such claims, demands, rights or Causes of Action (except to the extent any such claim is specifically released herein).

Nothing in this reservation references either Heartland specifically or even generally breach of contract claims against counterparties to ISDA agreements, even though other causes of action are specified. In addition, Exhibit IV.G to the Plan [D.I. 1283 at 107-108 of 199], which lists claims that are specifically preserved under the above provision, lists five domestic actions and four foreign actions or claims. None of those, however, involve Heartland specifically or breaches of contract claims more generally.[5]

The Plan also contains a similar blanket reservation at Article IV.G:

> Except as provided in this Plan, the Confirmation Order, or in any contract, instrument, release or other agreement or document entered into or delivered in connection with this Plan, in accordance with § 1123(b)(3)(B) of the Bankruptcy Code, the Plan Administrator, on behalf of each Debtor, shall have and retain and may enforce any claims, demands, rights and Causes of Action that any Debtor or Estate may hold against any Person or Entity to the extent not released otherwise, all of which are included within the Property of the Estate, provided, however, that the Litigation Trustee shall have the exclusive authority to pursue the Litigation Trust Claims, consistent with the terms of the Litigation Trust Agreement, and under no circumstances may the Plan Administrator pursue the Litigation Trust Claims. The Plan Administrator may pursue such claims, demands, rights or Causes

[5] The domestic causes of action listed on Exhibit IV.G to the Plan are adversary proceedings asserted by Louis J. French, as Chapter 11 Trustee in 2012 against the following defendants: W.H. Davis Family Limited Partnership (Adv. Proc. No. 12-01852), Central Coffee Corporation (Adv. Proc. No. 12-01853), World Financial Desk LLC (Adv. Proc. No. 12-01854), Chopper Trading LLC (Adv. Proc. No. 12-01858), and Commercial de Marterias Primas S.A. (Adv. Proc. No. 12-01859). *See* D.I. 1283 at 107-108 of 199. The foreign actions or claims listed on Exhibit IV.G to the Plan are all asserted against MF Global UK Limited. *Id.*

> of Action (other than the Litigation Trust Claims), as appropriate, in accordance with the best interests of the beneficiaries of the Estates. A nonexclusive schedule of currently pending actions and claims brought by one or more Debtors or the Chapter 11 Trustee, as applicable, is attached as Exhibit IV.G. In accordance with and subject to any applicable law, the Plan Proponents' inclusion or failure to include any right of action or claim on Exhibit IV.G shall not be deemed an admission, denial or waiver of any claims, demands, rights or Causes of Action that any Debtor or Estate may hold against any Person or Entity. The Plan Proponents intend to preserve all such claims, demands, rights or Causes of Action (except to the extent any such claim is specifically released herein).

The above provision is similar to the reservation provision in the Disclosure Statement, except it also refers to "Litigation Trust Claims," which are defined in the Plan as:

> the claims set forth in the complaint entitled '*Louis J. Freeh, as Chapter 11 Trustee of MF Global Holdings Ltd., et al. v. Jon S. Corzine, et al.*', Adversary Proceeding Number 13-01333 (Bankr. S.D.N.Y.), as it may be subsequently modified, amended, or supplemented, and any claims arising out of or related to the facts or circumstances alleged in the complaint or set forth in the Report of Louis J. Freeh, as Chapter 11 Trustee of MF Global Holdings Ltd., et al., dated April 3, 2013 [Docket No. 1279].

Again, such claims relate not to Heartland or even to breach of contract claims against ISDA counterparties more generally. Instead, they relate to alleged "risky business strategy engineered and executed by [John] Corzine and other officers and their failure to improve the Company's inadequate systems and procedures." *See* D.I. 1279 at 7. Accordingly, nowhere do the Plan and Disclosure Statement expressly preserve the specific cause of action against Heartland asserted in the Complaint or even the type of claim (i.e., a breach of contract claim) contained in the Complaint.

This Court entered an order confirming the Plan on April 5, 2013. D.I. 1288. On May 2, 2013, this Court entered an order approving "non-material" modifications of the Plan. D.I. 1376.

IV. The Complaint Against Heartland

On October 28, 2015, almost four years after the Early Termination Date and more than two years after confirmation of the Plan, MF Global for the first time sent a demand to collect from Heartland under the ISDA Agreement, alleging that Heartland owed $1,734,098.25, plus interest. Complaint, Ex. D. On November 19, 2015, in response, Heartland provided its good faith calculation of "Loss" to MF Global, demonstrating that Heartland's "Loss" was [-$47,614.96].[6] Complaint, ¶ 39.

On January 3, 2017, MF Global filed the Complaint, commencing this adversary proceeding.

ANALYSIS

This Court should dismiss the Complaint for failure to state a claim upon which relief can be granted under Federal Rules of Civil Procedure 12(b)(1) and (6), made applicable by Bankruptcy Rule 7012. MFGMS (and MF Global) failed to preserve the claim against Heartland under the Plan, resulting in (a) the claim being barred under the doctrine of *res judicata*, and (b) MF Global lacking standing to pursue the claim.

I. Claims That Are Not Properly Preserved Under A Chapter 11 Plan Are Barred By *Res Judicata*, And Plaintiff Lacks Standing To Pursue The Claim

It is well established that a bankruptcy court's order confirming a reorganization plan constitutes a final judgment on the merits and is to be given preclusive effect under *res judicata*. 11 U.S.C § 1141(a); *Sure-Snap Corp. v. State Street Bank and Trust Co.*, 948 F.2d 869, 873 (2d Cir. 1991); *see also In re Amer. Preferred Prescription, Inc.*, 266 B.R. 273, 277 (E.D.N.Y.

[6] The "Loss" expressed as a negative number meant that, through valuation of the terminated trades (the method MF Global suggested), Heartland calculated that it had realized a small gain as a result of terminating the ISDA Agreement, and offered to pay this amount to the Plaintiff. Under the ISDA Agreement, Heartland's calculation controls as long as it is reasonable and in good faith. ISDA Agreement § 6(e)(i)(4) (defining payments on "Second Method and Loss") and ISDA Agreement § 14 (defining "Loss"). Heartland does not admit that it owes anything to MF Global. If this action is not dismissed, as it should be, Heartland will demonstrate through a reasonable, good faith calculation that the Loss it suffered as a result of the Event of Default was a positive number.

2000); *In re Hooker Invest., Inc.*, 162 B.R. 426, 433 (S.D.N.Y. 1993) (collecting cases). *Res judicata* applies to all claims that could have and should have been asserted prior to confirmation. *Sure-Snap Corp.*, 948 F.2d at 873 (stating that *res judicata* "bars re-litigation not just of those claims which were brought in a prior proceeding, but of 'any other admissible matter' which could have been brought, but wasn't'") (citations omitted); *see also Browning v. Levy*, 283 F.3d 761, 773 (6th Cir. 2002).

Accordingly, under *res judicata*, "a debtor is precluded from asserting any claims post-confirmation that are not preserved in its plan." *In re Futter Lumber Corp.*, 473 B.R. 20, 29 (E.D.N.Y. 2012); *In re I. Appel Corp.*, 300 B.R. 564, 567 (S.D.N.Y. 2003) ("[T]he confirmation of a plan of reorganization prevents the subsequent assertion of any claim not preserved in the plan as required by *§ 1123(b)(3)*."), *aff'd*, 104 F. App'x 199 (2d Cir. 2004). Courts around the country agree on this general principle, but have required varying degrees of specificity to preserve a claim properly in order to avoid the bar under *res judicata*.

"The majority of courts that have examined this issue have held that for this exception to apply, the plan must expressly reserve the right to pursue ***that particular claim*** post-confirmation and that a blanket reservation allowing for an objection to ***any claim*** is insufficient." *See, e.g., Amer. Preferred Prescription*, 266 B.R. at 277 (emphasis in original); *citing In re Kelley*, 199 B.R. 698, 704 (9th Cir. B.A.P. 1996); *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."); *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"); *In re Hooker Invs., Inc.*, 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.").

While a minority of courts have held that a general reservation of claims can avoid the *res judicata* bar, *see, e.g.*, *In re Ampace Corp.*, 279 B.R. 145, 156-62 (Bankr. D. Del. 2002); *In re Perry H. Koplik & Sons, Inc.*, 357 B.R. 231, 246-47 (Bankr. S.D.N.Y. 2006),[7] many of the ***courts*** employing the minority approach ***require***, at the very least, a categorical ***reservation of the type of claims*** being pursued in the complaint or ***language sufficient to provide adequate notice*** to creditors that the debtor had outstanding claims against third parties. *See, e.g.*, *In re Felt Mfg. Co., Inc.*, 402 B.R. 502, 517 (Bankr. D. N.H. 2009) (holding that "categorical reservations are sufficient, so long as the language used identifies the categories with enough detail to put creditors on notice."); *Appel Corp.*, 300 B.R. 564 at 570 ("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."), *aff'd In re I. Appel Corp.*, 104 F. App'x 199 (2d Cir. 2004)[8]; *In re Ampace Corp.*, 279 B.R. at 160 (stating, "a general reservation in a plan of reorganization ***indicating the type or category of claims to be preserved*** should be sufficiently specific to provide creditors with notice that their claims may be challenged post-confirmation.") (emphasis added) (citations omitted); *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

[7] *Koplik* involved protracted pre-petition litigation between the parties that has no application to the case at bar, which involved none.

[8] The Second Circuit in *I. Appel* did not adopt any of the differing standards applied by courts in deciding whether a claim has been preserved because, in that case, the plan specifically disclosed and preserved claims against the defendants. *See 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").

avoidance action) (collecting cases); *In re Railworks Corp.*, 325 B.R. 709, 717 (Bankr. D. Md. 2005) ("A reservation is sufficient ***if it reserves a category or type of claim***, and it is not required that individual claims and specific defendants be specified.") (emphasis added).

Some courts have evaluated the issue of claim preservation on the basis of a plaintiff's standing, finding that the plaintiff lacks standing to sue third parties when a claim is not preserved in the plan confirmation process. *See, e.g., In re United Operating, LLC*, 540 F.3d 351, 355 (5th Cir. 2008) ("If the debtor has not made an effective reservation, the debtor has no standing to pursue a claim that the estate owned before it was dissolved."); *see also In re Gulf States Long Term Acute Care of Covington, L.L.C.*, 614 F. App'x 714, 719 (5th Cir. 2015) ("Because the Plan does not set forth the legal basis of [plaintiff's] claims against [defendants], [plaintiff] lacks standing to pursue them.").

II. The Complaint Was Not Preserved In The Plan Or Disclosure Statement And It Should Be Dismissed

Whether analyzed under *res judicata* grounds or on standing grounds, the Complaint should be dismissed. Neither the Disclosure Statement nor the Plan preserves the type of cause of action asserted in the Complaint (breach of contract against counterparties to ISDA Agreements) or any other causes of action against the specific defendant, Heartland. Instead, the only claims specifically preserved therein were (i) certain adversary proceedings filed in 2012 against contract counterparties other than Heartland, (ii) certain foreign actions and claims against MF Global UK Limited, and (iii) certain claims against John Corzine. Under the majority approach requiring a specific preservation, the Plan and Disclosure Statement fail to preserve the claims against Heartland, requiring a dismissal of the Complaint.

Even under the less exacting "categorical approach" followed by a minority of courts, the Plan and Disclosure Statement still fail to adequately preserve the claims against Heartland.

While categories of claims such as avoidance actions are identified on a general basis, the Plan and Disclosure Statement fail to contain any mention of potential breach of contract claims against Heartland or any other party, despite the Debtors being fully aware of the existence of such claims under ISDA agreements.

Accordingly, the only way that the Complaint can survive is if this Court adopts the sub-set of the minority approach whereby a general "blanket" reservation of claims somehow suffices. This Court should not do so. Not only is this approach a distinct minority position, but it would run afoul of the notice requirements under the Bankruptcy Code, including § 1125. Indeed, the requirement of preserving specific causes of action is designed in part to make creditors and other parties-in-interest aware of what claims exist when they vote on a plan. "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.'" *United Operating*, 540 F.3d at 355 (quoting *In re Paramount Plastics, Inc.*, 172 B.R. 331, 334 (Bankr. W.D. Wash. 1994)).

The Debtors are in a situation of their own making. Notwithstanding MFMGS's (and MF Global's) full knowledge of the facts underlying the Complaint back in 2011, the Debtors failed to identify the claim in the Plan or in the Disclosure Statement, either specifically or generally. Under *res judicata* and the doctrine of standing, MF Global cannot bring claims against Heartland many years after the facts giving rise to the Complaint took place and well over three years after the Plan was confirmed. This Court should dismiss the Complaint with prejudice.

CONCLUSION

For all of the foregoing reasons, this Motion should be granted in its entirety and the Complaint should be dismissed with prejudice.

Dated: February 20, 2017
New York, NY

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BY: */s/ Derek L. Wright*
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