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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: MF GLOBAL INC., Debtor.	Case No. 11-2790 (MG) SIPA
KOCH SUPPLY & TRADING, LP, Plaintiff, v. JAMES W. GIDDENS, Trustee for the SIPA Liquidation of MF Global Inc., Defendant.	Adv. Pro. No. 12-01754 (MG)

MEMORANDUM OF LAW IN SUPPORT OF
MOTION OF KOCH SUPPLY & TRADING, LP FOR SUMMARY JUDGMENT

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PRELIMINARY STATEMENT

Before the Court is the motion of Koch Supply & Trading, LP ("**KS&T**") for summary judgment on both its complaint and the counterclaim filed by James W. Giddens (the "**Trustee**"), the Trustee for the liquidation of MF Global, Inc. (the "**Debtor**"). The issue underlying the parties' claims is the same: Did the Trustee transfer $20 million of customer property to KS&T when a letter of credit expired by its terms on December 31, 2011? No material facts are in dispute, so the only question is whether KS&T is entitled to judgment as a matter of law. It is. The plain language of the authorities that the Trustee relies upon is fatal to his position. Regulation 17 C.F.R. § 190.08(a)(1)(i)(E) governs letters of credit and specifically provides that only "[t]he full **proceeds** of a letter of credit" constitute customer property. (Emphasis added). The interpretive guidance to this regulation further clarifies that a trustee "is required to **draw**" on a letter of credit "and treat the **funds received** as customer property." Supplementary Information, 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983) (emphases added). Here, it is undisputed the Trustee did not draw on the letter of credit before it expired, did not receive $20 million of funds as customer property, and did not pay any funds whatsoever to KS&T. Thus, KS&T is entitled to judgment as a matter of law, and its motion for summary judgment should be granted.

FACTUAL BACKGROUND[1]

A. The Customer Relationship and the Letter of Credit

1. Before it was placed into liquidation on October 31, 2011 (the "**Filing Date**"), the Debtor was a registered futures commission merchant. (SUF, ¶ 1.)

2. KS&T is a former customer of the Debtor, which is the successor to Man Financial Inc. (SUF, ¶¶ 2, 3.)

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[1] KS&T relies herein on the Statement of Undisputed Facts in Support of Motion of Koch Supply & Trading, LP for Summary Judgment ("**SUF**") filed on the date hereof.

3. KS&T and the Debtor were parties to a certain Customer Agreement, dated January 1, 2002. (SUF, ¶ 4.)

4. The Debtor was a beneficiary under Irrevocable Standby Letter of Credit No. TPTS-303934, which was issued by JPMorgan Chase Bank, N.A. (the "**Issuing Bank**"), in an amount (as amended) of $20 million and an expiration date of December 31, 2011 (as amended, the "**Letter of Credit**"). (SUF, ¶ 5.)

5. The Debtor was required to present the Letter of Credit to the Issuing Bank in accordance with its terms and conditions:

> WE [THE ISSUING BANK] HEREBY AGREE WITH THE BENEFICIARY THAT DOCUMENTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS LETTER OF CREDIT SHALL BE DULY HONORED **UPON PRESENTATION AS SPECIFIED**.

(SUF, ¶ 7.) (emphasis added).)

6. One condition to payment was that the Debtor was required to provide to the Issuing Bank a signed claim for payment and a written statement that KS&T was in default under an agreement with the Debtor:[2]

> THIS CREDIT IS AVAILABLE FOR PAYMENT TO BENEFICIARY AT SIGHT UPON DEMAND AT OUR COUNTERS AT 10420 HIGHLAND MANOR DRIVE, 4TH FLOOR, TAMPA, FLORIDA 33610, ATTN: STANDBY LETTER OF CREDIT DEPARTMENT ON OR BEFORE THE EXPIRATION HEREOF AGAINST PRESENTATION TO USE OF ONE OR MORE OF THE FOLLOWING STATEMENTS, DATED AND SIGNED BY A REPRESENTATIVE OF THE BENEFICIARY REQUESTING PAYMENT:

[2] *See generally Brenntag Int'l Chems., Inc. v. Bank of India*, 175 F.3d 245, 251 (2d Cir. 1999) ("A stand-by letter of credit is meant to be drawn upon only in the event that its applicant fails to make a direct payment to the beneficiary . . . . For this reason, to collect upon a stand-by LOC, the beneficiary . . . must present to the issuing bank a 'default letter' stating that the debt had not been satisfied as of a specified date.").

> **YOUR SIGNED CLAIM FOR PAYMENT AND YOUR WRITTEN STATEMENT THAT KOCH SUPPLY & TRADING IS IN BREACH OF, OR HAS FAILED TO PAY ANY AMOUNTS DUE IN ACCORDANCE WITH THE TERMS OF ANY AGREEMENT WITH YOU**.[3]

(SUF, ¶ 8 (emphasis added).)

7. Another condition for payment was that the Debtor was required to present the Letter of Credit to the Issuing Bank on or before its expiration date:

> THIS CREDIT IS AVAILABLE FOR PAYMENT TO BENEFICIARY AT SIGHT UPON DEMAND AT OUR COUNTERS AT 10420 HIGHLAND MANOR DRIVE, 4TH FLOOR, TAMPA, FLORIDA 33610, ATTN: STANDBY LETTER OF CREDIT DEPARTMENT **ON OR BEFORE THE EXPIRATION HEREOF** . . . .[4]

(SUF, ¶ 9 (emphasis added).) The final expiration date was December 31, 2011. (SUF, ¶ 10.)

8. KS&T did not breach, nor fail to pay any amounts due in accordance with, the Customer Agreement, and neither the Debtor nor the Trustee declared a default.[5] (SUF, ¶ 11.)

9. As of the Filing Date, the Debtor had not presented the Letter of Credit to the Issuing Bank for payment. (SUF, ¶ 12.)

B. The Trustee Takes No Action and the Letter of Credit Expires By Its Terms

10. On the Filing Date, the United States District Court for the Southern District of New York (the "**District Court**") entered an order appointing the Trustee. (SUF, ¶ 13.)

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[3] The Letter of Credit also incorporated by reference International Chamber of Commerce, The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500 ("**UCP**"), Article 14.b., which states: "If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, [the issuing bank] may refuse to take up the documents." (SUF, ¶ 6.)

[4] The Letter of Credit also incorporates by reference UCP, Article 42.b, which states: "[D]ocuments must be presented on or before such expiry date." (SUF, ¶ 6.)

[5] On June 22, 2012, the Trustee sent to KS&T a certain Notice of Trustee's Determination of Claim, in which the Trustee alleged that KS&T owed a "debit balance" of $1,551,682 in various trading fees to the Debtor's estate. (SUF, ¶ 23.) On August 1, 2012, KS&T paid to the Debtor's estate the full amount allegedly due—$1,551,682—but reserved its rights to dispute that amount. (SUF, ¶ 24.)

11. As of December 31, 2011, the Debtor's books and records reflected that the Debtor was a beneficiary under the Letter of Credit. (SUF, ¶ 17.)

12. As early as December 9, 2011, the Trustee was aware that the Debtor was also a beneficiary under other letters of credit. (SUF, ¶ 15.)

13. The Trustee could not, absent committing material fraud, certify that KS&T was in default under any agreement with the Debtor. Accordingly, the Trustee did not present the Letter of Credit to the Issuing Bank for payment. (SUF, ¶ 18.)

14. The Trustee has not received any funds or other property from the Issuing Bank on account of the Letter of Credit.[6] (SUF, ¶ 19.)

15. At the end of December 31, 2011, the Letter of Credit expired by its own terms without any action by the Trustee. (SUF, ¶ 20.)

16. KS&T is not a party to any agreement that purports to preserve the Debtor's or the Trustee's rights as beneficiary upon the expiration of the Letter of Credit.[7] (SUF, ¶ 21.)

17. The Trustee did not pay any funds to KS&T upon the expiration of the Letter of Credit. (SUF, ¶ 22.)

18. KS&T has not received any funds from the Trustee or the Debtor's estate at any other time since the Filing Date either. (*Id*.)

19. On June 22, 2012, the Trustee sent to KS&T a certain Notice of Trustee's Determination of Claim (the "**Notice**"). (SUF, ¶ 23.)

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[6] As of the Filing Date, the Debtor was a beneficiary under a total of nine letters of credit. (SUF, ¶ 14.) To date, the Trustee has not presented any letters of credit for payment. (SUF, ¶ 16.)

[7] *Cf. ConocoPhillips Co. v. Giddens (In re MF Global, Inc.)*, No. 12 Civ. 6014, 2012 WL 4757866, at *1 (S.D.N.Y. Oct. 4, 2012) ("Prior to the Domestic LOCs' expiration and subsequent to MFGI's bankruptcy, the Trustee and ConocoPhillips entered into an interim agreement by which the Domestic LOCs would be returned to ConocoPhillips—but frozen—pending a determination by a court on how to treat the proceeds of those LOCs.").

20. In the Notice, the Trustee alleged that KS&T "received an **unauthorized transfer** or distribution of not less than [$20 million] of property in the [Debtor's] estate **by virtue of the expiration** on December 31, 2011 of [the Letter of Credit]."[8] (*Id.* (emphases added).)

21. Shortly thereafter, the Trustee also filed a letter with the Court that alleged that "the [Letter of Credit] . . . is property of the estate, and KS&T's retention of such property constitutes a violation of the Automatic Stay." (SUF, ¶ 26.)

22. On July 19, 2012, KS&T filed a complaint against the Trustee, as Trustee for the liquidation of the Debtor, a former commodity broker. As amended, KS&T's complaint asserts two claims requesting declaratory judgments that the expiration of the Letter of Credit does not give rise to any liability from KS&T to the Trustee under sections 362, 542, 549, 550, or 764 of the Bankruptcy Code (together, "**KS&T's Declaratory Judgments**"). (ECF No. 24.)

23. The Trustee then asserted a counterclaim against KS&T (the "**Counterclaim**") (ECF No. 25). In response to KS&T's motion for a more definitive statement (ECF No. 26), the Trustee modified his Counterclaim, at the Court's direction, in an email dated October 18, 2012 (ECF No. 32, Ex. A).

24. As modified, the Trustee's Counterclaim includes two requests for relief. The first request is for a declaratory judgment "that the face value of the [Letter of Credit], $20 million, with interest, constitutes customer property" pursuant to sections 761 through 767 of the Bankruptcy Code and 17 C.F.R. §§ 190.01 and 190.08, which regulations were promulgated by

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[8] The Trustee has likewise alleged that "the Trustee's determination concluded that KS&T owed the Trustee $20 million on the basis that the [Letter of Credit] constitutes customer property . . . and that expiration of the [Letter of Credit] constituted a transfer or distribution of that property to KS&T" (SUF, ¶ 26), and that "this case is about whether the Trustee is correct in his determination of [KS&T's] claim when he includes the full amount of the [Letter of Credit] as customer property in KS&T's net equity, and concludes that the return or expiration of the [Letter of Credit] acted as a transfer of that property to KS&T" (SUF, ¶ 25).

the Commodity Futures Trading Commission ("**CFTC**") (the "**Trustee's First Requested Declaratory Judgment**"). The second request is for a declaratory judgment "that KS&T must immediately pay to the Debtor the face value of the [Letter of Credit], $20 million, with interest," pursuant to sections 362, 542, 549, 551, and 764 of the Bankruptcy Code and 17 C.F.R §§ 190.01 and 190.08, (the "**Trustee's Second Requested Declaratory Judgment**").

25. On the date hereof, KS&T filed a motion for summary judgment with respect to the Trustee's Counterclaim and both of the claims in KS&T's complaint (the "**Motion**") and respectfully submits this memorandum of law in support of that Motion.[9]

STANDARD OF REVIEW

Rule 56(a) of the Federal Rules of Civil Procedure states that the Court must grant summary judgment if (i) there is no genuine issue as to any material fact, and (ii) the movant is entitled to judgment as a matter of law. Here, there is no genuine issue as to any material fact. Thus, the Court need only consider the second prong of Rule 56(a). As to that prong, a movant is entitled to judgment as a matter of law if the other party cannot "make a showing sufficient on an essential element of the case with respect to which [the other party] has the burden of proof," *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986), or if "the record taken as a whole could not lead a rational trier of fact to find for the [other] party" on an element for which the movant has the burden of proof, *Matsushita Elec. Inds. Co. v. Zenith Radio Corp.*, 475 U.S. 547, 587 (1986).

[9] Pursuant to the Joint Briefing Schedule in this case (ECF No. 23), any hearing on the Motion will be held after the District Court rules on KS&T's motion to withdraw the reference (ECF No. 4). By filing the Motion in this Court, KS&T is not waiving any rights in connection with its motion to withdraw the reference, nor is it consenting to the final adjudication of this proceeding by this Court.

ARGUMENT

The Trustee's Counterclaim boils down to this: KS&T must, as a matter of law, pay $20 million to the Debtor's estate on account of the expiration of the Letter of Credit. KS&T's complaint asserts the opposite—that KS&T has no liability. Thus, a ruling by the Court against the Trustee on his Counterclaim will, necessarily, result in a ruling in KS&T's favor on its complaint.[10] For this reason, and to streamline the Court's consideration of the legal issues, KS&T focuses herein on the Trustee's Counterclaim, which, as explained below, lacks merit.

I. KS&T IS ENTITLED TO SUMMARY JUDGMENT ON THE TRUSTEE'S REQUEST FOR A DECLARATORY JUDGMENT THAT THE "FACE VALUE" OF THE LETTER OF CREDIT CONSTITUTES CUSTOMER PROPERTY.

To support the Trustee's First Requested Declaratory Judgment—that the "face value" of the Letter of Credit constitutes "customer property"—the Trustee relies on a broad array of authorities, namely sections 761 through 767 of the Bankruptcy Code (the complete Commodity Broker Liquidation subchapter) and 17 C.F.R. §§ 190.01 and 190.08.[11] But the Court need consider only one authority—17 C.F.R. § 190.08(a)(1)(i)(E)—which specifically governs letters of credit and squarely contradicts the Trustee's position. And although the Court need not take this next step, the Trustee's position also conflicts with the general definition of "customer

[10] In that both parties are requesting declaratory judgments, they do not dispute it would be appropriate for this Court to enter such a judgment. That position is squared with the law: (i) the judgments will serve a useful purpose in resolving the Trustee's allegations in connection with the Letter of Credit; (ii) the judgments will finalize the controversy between KS&T and Trustee and offer KS&T relief from uncertainty; (iii) the parties' requests are not being used for "procedural fencing or a race to res judicata" because neither party has commenced any other action as to that subject matter; (iv) for the same reason, the judgments will not increase friction between any other sovereign legal systems or improperly encroach on the domain of a state or foreign court; and (v) there are no other remedies available to the parties. *See New York v. Solvent Chem. Co.*, 664 F.3d 22, 26 (2d Cir. 2011) (listing factors for consideration).

[11] The Trustee's Counterclaim asserts that the "face value" of the Letter of Credit includes unspecified "interest." The Trustee offers no support for that assertion, because there is none. KS&T reserves all of its rights to respond to any argument the Trustee may present on this issue.

property" set forth in section 761(10) of the Bankruptcy Code and 17 C.F.R. § 190.08.[12] Thus, as a matter of law, judgment must be entered against the Trustee and in favor of KS&T.

A. The Plain Language of 17 C.F.R. § 190.08 Refers to Letter of Credit "Proceeds," Not "Face Value," and There are No Letter of Credit Proceeds.

The CFTC promulgated 17 C.F.R. § 190.08(a)(1)(i)(E) pursuant to its authority to decide what property is included in or excluded from the definition of "customer property." *See* 7 U.S.C. § 24(a)(1). That regulation specifically addresses letters of credit and in plain language provides that only "[t]he full **proceeds** of a letter of credit" constitute customer property. 17 C.F.R. § 190.08(a)(1)(i)(E) (emphasis added). *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) ("[W]here, as here, the statute's language is plain, the sole function of the courts is to enforce it according to its terms."). Of course, the "proceeds" of a letter of credit are the funds that the beneficiary receives from the issuing bank when it draws on the letter of credit. *See, e.g.*, U.C.C. § 5-114(a) (defining "proceeds of a letter of credit" as "the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer"). The CFTC's interpretive guidance confirms this self-evident and well-known meaning, stating that a trustee is "required to **draw** the full value of a letter of credit . . . and treat the **funds received** as customer property." Supplementary Information, 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983) (emphasis added).[13] *See Auer v. Robbins*, 519 U.S. 452, 461 (1997) (holding that an agency's interpretation of its own regulation is "controlling unless plainly erroneous or inconsistent with the regulation") (quotation omitted); s*ee also Lorrilard v. Pons*, 434 U.S. 575, 583 (1978) ("Where words are employed in a statute which had at the time a well-known

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[12] *See also* 17 C.F.R. § 190.01(o) (defining "customer property" by cross-reference to 17 C.F.R. § 190.08).

[13] *See also* Supplementary Information, 48 Fed. Reg. 8716, 8719 (Mar. 1, 1983) (referring to the "funds affected by drawing upon the letter").

meaning . . . in the law of this country they are presumed to have been used in that sense unless the context compels to the contrary.") (quotation omitted).[14] Moreover, the CFTC's decision to treat only the "proceeds" (*i.e.*, the "funds received") from a letter of credit as customer property is eminently sensible in light of the Trustee's obligation under section 766(f) of the Bankruptcy Code and 17 C.F.R. § 190.02(f)(3) to "reduce to money" all property, including letters of credit, "promptly," "in an orderly manner," and "consistent with good market practice."[15]

Here, it is undisputed that the Trustee did not follow the CFTC's mandate with regard to any letter of credit in his possession, did not draw (or even attempt to draw) on the Letter of Credit, and thus did not receive any funds from the Issuing Bank on account of the Letter of Credit. (SUF, ¶¶ 16, 18, 19.) Further, because the Letter of Credit expired without any action by the Trustee (SUF, ¶ 20), he cannot obtain any such funds in the future either. *See, e.g.*, *Todi*

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[14] In the interpretive guidance, the CFTC goes on to state that the Trustee can draw on letters of credit "irrespective of their terms even though they . . . condition payment on delivery of a certification that additional funds are required . . . to cover a default with respect to a contract." Supplementary Information, 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983). To be clear, KS&T believes that portion of the interpretive guidance is inconsistent with the regulation, the plain terms of which do not purport to override the terms and conditions of a letter of credit, and also plainly erroneous because such an interpretation would render the regulation in excess of its statutory authority and thus void. *See* 5 U.S.C. § 706(2)(E) (stating that court must "hold unlawful and set aside" agency action that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."); 7 U.S.C. § 24(a) (granting CFTC authority only to supplement the definition of customer property by "include[ing] or exclude[ing]" "cash, securities, [or] other property," not to alter property rights); 7 U.S.C. §§ 27a(a)(1), 27(b) (providing that the CFTC "shall not exercise regulatory authority . . . with respect to, an identified banking product," which includes "a letter of credit issued or loan made by a bank."); *cf. In re Griffin Trading Co.*, 245 B.R. 291 (Bankr. N.D. Ill. 2000) (striking regulation 17 C.F.R. §190.08(a)(1)(ii)(j) as in excess of the CFTC's statutory authority), *vacated by settlement*, *Inskeep v. Meespierson, N.V. (In re Griffin Trading Co.)*, 270 B.R. 882 (N.D. Ill. 2001). Depending on the positions taken by the Trustee in this matter, the Court may not need to reach this issue because here the Trustee did not draw on the Letter of Credit and it expired.

[15] As discussed in section II.A. below, section 108(b) of the Bankruptcy Code guaranteed that the Trustee received at least sixty days after the Filing Date to draw on letters of credit, even if the letters of credit would have otherwise expired before the end of that sixty-day period.

Exports v. Amrav Sportswear Inc., No. 95 Civ. 6701, 1997 WL 61063, *4 (S.D.N.Y. Feb. 13, 1997) (holding that an issuing bank had no obligation to pay a beneficiary after a letter of credit expired). Thus, there are not, and never will be, any "proceeds" of the Letter of Credit.

The Trustee understands this, and having painted himself into a corner by taking no action with regard to the Letter of Credit in the sixty days before it expired, is left with no recourse but to ask the Court to completely rewrite 17 C.F.R. § 190.08(a)(1)(i)(E). The Trustee would like the regulation to say: "Customer property" includes "the face value of a letter of credit, irrespective of whether it has expired," and "the Trustee is hereby excused from the requirement of drawing on the letter of credit and receiving funds from the issuing bank." But this Court cannot, of course, rewrite the plain language of a regulation to completely change its meaning and make it fit what the Trustee would like it to say,[16] particularly when the proposed rewrite directly conflicts with the CFTC's interpretative guidance, which expressly distinguishes between the "value" of a letter of credit and the "funds received" from a "draw," and requires the Trustee to "draw" on letters of credit and "treat the **funds received** as customer property."

Thus, the plain language of 17 C.F.R. § 190.08(a)(1)(i)(E), as confirmed by the CFTC's interpretive guidance, disposes of the Trustee's First Requested Declaratory Judgment.

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[16] In a parallel matter pending before the District Court, the Trustee argued that if the Court were not to interpret (*i.e.*, rewrite) the regulation to substitute the term "full proceeds" with the term "face value," the regulation would be nugatory. It is difficult to follow his reasoning. The regulation, on its face, requires the Trustee to reduce letters of credit to their "proceeds." Thus, applying that plain language makes it operative, not nugatory. The District Court disagreed with the Trustee's argument. *ConocoPhillips Co. v. Giddens (In re MF Global, Inc.)*, No. 12 Civ. 6014, 2012 WL 4757866, at *5 n.6 (S.D.N.Y. Oct. 4, 2012) ("The Trustee argues that interpreting 'full proceeds' as anything other than the face value of the letters of credit renders the regulation nugatory. . . . [T]he Court noted at oral argument that the regulation could apply to a situation where 'there has been a trigger for a letter of credit and the trigger may have actually occurred thereby making the CFTC provision live and actually relate to real proceeds . . . .'").

B. The "Face Value" of the Letter of Credit is Not a Legally Cognizable Property Interest and, Thus, Does Not Constitute Customer Property.

Even if the specific language of 17 C.F.R. § 190.08(a)(1)(i)(E) did not squarely control this case (it does), it would still be the case that the Trustee's First Requested Declaratory Judgment conflicts with section 761(10) of the Bankruptcy Code and 17 C.F.R. § 190.08(a).

Pursuant to the plain language of section 761(10) of the Bankruptcy Code and 17 C.F.R. § 190.08(a)(1), and consistent with simple logic, only "property" can be "customer property." *See* 11 U.S.C. § 761(10) (defining customer property as "cash, a security, or other **property**") (emphasis added); 17 C.F.R. § 190.08(a)(1)(i), (ii) (same); *see also* 7 U.S.C. § 24(a)(1) (authorizing CFTC to designate that "certain cash, securities, [or] other **property** . . . are to be included in or excluded from customer property") (emphasis added). The Trustee would again have the Court rewrite these authorities to say that "something that is not a legally cognizable property interest"—in this case the "face value" of a letter of credit—may also be customer property. Such a rewrite is needed because the only property interest that the Debtor had in the undrawn and now expired Letter of Credit was the conditional right to payment from the Issuing Bank if it made a presentation that complied with all of the Letter of Credit's terms and conditions. (SUF, ¶ 7.) *See Barnhill v. Johnson*, 503 U.S. 393, 398 (1992) ("In the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law."). Here, it is undisputed that the Trustee did not present the Letter of Credit to the Issuing Bank before its expiration date, December 31, 2011, and thus failed to comply with its terms and conditions.[17] (SUF, ¶¶ 9, 18.) As a result, the Debtor's right to payment under certain specified

[17] The commencement of the Debtor's liquidation did not toll the expiration date for the Letter of Credit. *See, e.g.*, *In re Policy Realty Corp.*, 242 B.R. 121, 126 (S.D.N.Y. 1999) ("It is well established that the automatic stay does not toll a time limitation."), *aff'd*, *Policy Realty Corp. v. Treber Realty LLC (In re Policy Realty Corp.)*, 213 F.3d 626 (2d Cir. 2000).

conditions is no longer legally enforceable. The simple reality is that the Debtor does not have, and will never obtain, any other property interest of **any** kind, whether it be cash, security, or anything else, on account of the Letter of Credit. *See, e.g.*, *Todi Exports v. Amrav Sportswear Inc.*, No. 95 Civ. 6701, 1997 WL 61063, *4 (S.D.N.Y. Feb. 13, 1997) (holding that an issuing bank had no obligation to pay a beneficiary after a letter of credit expired).

Thus, the Trustee's First Requested Declaratory Judgment fails for this additional reason.

II. KS&T IS ENTITLED TO SUMMARY JUDGMENT ON THE TRUSTEE'S REQUEST FOR A DECLARATORY JUDGMENT THAT KS&T MUST PAY $20 MILLION TO THE DEBTOR .

The Trustee's Second Requested Declaratory Judgment is that "KS&T must immediately pay to the Debtor the face value of the [Letter of Credit], $20 million, with interest," pursuant to 17 C.F.R §§ 190.01 and 190.08 and sections 362, 542, 549, 551, and 764 of the Bankruptcy Code. The Trustee's request is again not supported by any of the authorities that he relies on, and therefore, as a matter of law, judgment must be entered against him and in favor of KS&T.

A. The Trustee's Request is Not Supported by 11 U.S.C. §§ 549, 551, or 764.

Turning first to sections 549, 551, and 764 of the Bankruptcy Code, the Trustee faces a threshold problem: None of those three authorities provides for the relief that he is seeking. Instead, section 549 simply states that a "trustee may avoid a transfer of property of the estate . . . that occurs after the commencement of the case" and "is not authorized under [the Bankruptcy Code] or by the court." Section 764, which applies in commodity broker liquidations such as this case, similarly states that "any transfer . . . of property that, but for such transfer, would have been customer property, may be avoided by the trustee, . . . if and to the extent that the trustee avoids such transfer under section . . . 549 . . . of [the Bankruptcy Code]." By their plain terms, these two sections of the Bankruptcy Code only empower the Trustee to "avoid" a transfer.

Section 551, in turn, merely "preserves" for the estate any transfer that the Trustee avoids. Accordingly, even if the Trustee obtained a judgment under sections 549, 551 and 764 (he cannot), that would not create an obligation on the part of KS&T to pay money to the Debtor.

To actually obtain a judgment that KS&T must affirmatively pay money to the Debtor, the Trustee must establish that KS&T is liable under section 550 of the Bankruptcy Code. *See, e.g., Savage & Assocs., P.C. v. BLR Servs. SAS (In re Teligent, Inc.),* 307 B.R. 744, 749 (Bankr. S.D.N.Y. 2004) ("The Code separates the avoidance of a . . . transfer from the recovery of a . . . transfer. Once the grounds for setting aside a transfer have been shown, the Trustee faces the second hurdle of establishing a means of recovery under [section] 550(a), the remedies section . . . ."). Curiously, the Trustee failed to even plead a claim under section 550. But assuming for the sake of argument that the Trustee had relied on section 550, it nevertheless remains the case that he does not have a valid claim under sections 549 and 764, which is a predicate for relief under section 550. *See* 11 U.S.C. § 550(a) (authorizing recovery "to the extent that a transfer is avoided"); *see, e.g., Geltzer v. Fur Warehouse, Ltd. d/b/a Kaufman Furs (In re Furs by Albert & Marc Kaufman, Inc.),* Adv. No. 05-1838, 2006 WL 3735621, at *8 (Bankr. S.D.N.Y. Dec. 14, 2006) ("The Trustee cannot recover the value of the transfer from any of the transferees . . . unless he first avoids the underlying transfer. . . . The Trustee has not avoided these transfers, and accordingly, has failed to prove an essential element of his right to recover under § 550(a).").

The Trustee does not have a valid claim under either section 549 or section 764 because he cannot establish an essential element of a claim under those sections, specifically that he made a "transfer" of property. *See, e.g., Merrill Lynch Bus. Fin. Servs., Inc. v. Am. Reprographics Co. (In re Louis Frey Co.),* Adv. No. 03-91486, 2006 WL 2090083, at *28 (Bankr. S.D.N.Y. July 28, 2006) (entering judgment against trustee in action pursuant to section 549 of the Bankruptcy

Code because the trustee failed to prove that it made a "transfer"); *see also* 10 Collier on Bankruptcy ¶ 6001.01[1] (16th ed.) (listing elements of section 549 claim).[18] This is because section 101(54) of the Bankruptcy Code defines a "transfer" as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (i) property; or (ii) an interest in property." *See also Barnhill v. Johnson*, 503 U.S. 393, 397 (1992) ("What constitutes a transfer . . . is a matter of federal law.") (quotation omitted). Thus, in order for the Trustee to have made a "transfer" within the meaning of section 101(54), the Trustee must have "disposed of or parted with" an interest in property. *See, e.g.*, *Merrill Lynch Bus. Fin. Servs.*, 2006 WL 2090083, at *28 (entering judgment against trustee who "failed to support the legal proposition that the unauthorized appropriation and use of confidential business information is a 'transfer'—*i.e.*, that it disposes of or parts with an interest in property.").[19] But the Trustee cannot make that showing. In fact, he admits that he did not pay any money to KS&T upon the expiration of the Letter of Credit (SUF, ¶ 22), and has not identified in his Counterclaim, and cannot identify, any other property that he "disposed of or parted with."

To date, to overcome his inability to identify property that he "disposed of or parted with," the Trustee has repeatedly argued that the expiration of the Letter of Credit was itself a "transfer" of property. (SUF, ¶¶ 23, 25, 26.) But that argument fails too. As discussed in section I.B. above, the only property right that the Debtor had on account of the Letter of Credit

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[18] As the alleged transferee, KS&T does not have the burden of proving that it did not receive a transfer. *See* 10 Collier on Bankruptcy ¶ 6001.01[2] (16th ed.) ("It would . . . be an unusual extension of normal principles of evidence if the [alleged transferee] were required to prove that a transfer did not happen.").

[19] *See also Geltzer v. Mooney (In re MacMenamin's Grill Ltd.)*, 450 B.R. 414, 429 (Bankr. S.D.N.Y. 2011) ("A 'transfer' . . . is ultimately a disposition of property."); *cf. Barnhill*, 503 U.S. at 399-401 (holding that check payment is not a "transfer" until the payor's property interest—its claim against the bank—passes to the payee).

was a conditional right to payment. (SUF, ¶ 7.) When the Letter of Credit expired by its terms due to the passage of time (SUF, ¶ 20), the Trustee did not "dispose of" or "part with" any property (nor did KS&T acquire anything). Rather, the Debtor's conditional right to payment simply ceased to be legally enforceable; it expired when the Letter of Credit expired.

It is well-established that under these circumstances—where a debtor's rights expire due to the mere passage of time—no "transfer" of property takes place. *See, e.g., Sullivan v. Willock (In re Wey)*, 854 F.2d 196, 199 (7th Cir. 1988) (affirming lower court ruling that the termination of a sales contract after the expiration of a specified period for the debtor to close on the sale was not a transfer of the debtor's property because "the contract expired by its own terms when the closing did not occur" and thus "[the debtor] possessed no right which he could transfer"); *Edgewater Med. Ctr. v. Edgewater Prop. Co. (In re Edgewater Med. Ctr.)*, 373 B.R. 845, 853 (Bankr. N.D. Ill. 2007) (holding that the expiration of an option right was not a "transfer" because "when the option lapsed, the right simply disappeared").[20] Thus, the expiration of the Letter of Credit is not a "transfer," as a matter of law.

The Trustee's "expiration = transfer" theory fails for an additional reason. Treating the expiration of the Letter of Credit as a "transfer" of property subject to avoidance and recovery creates an irreconcilable conflict with section 108(b) of the Bankruptcy Code. In that section,

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[20] *See also Coast Cities Truck Sales, Inc. v. Navistar Int'l Transp. Co. (In re Coast Cities Truck Sales, Inc.)*, 147 B.R. 674, 678 (D.N.J. 1992) (holding that automatic termination of a contract after expiration of a specified period for the debtor to cure its breach was not a transfer because "[the debtor] possessed no rights as a matter of law which it could relinquish since the contract . . . had expired by its own terms"), *aff'd*, 5 F.3d 1488 (3d Cir. 1993); *Durwick, LLC v. Doe (In re Durwick, LLC)*, 2012 WL 2046877, at *3 (Bankr. D. Colo. June 1, 2012) (explaining that the definition of "transfer" in section 101(54) of the Bankruptcy Code "involves something more than the mere passage of time" and thus "[w]hen a debtor's interest in property, by operation of non-bankruptcy law, ceases to exist upon the mere passage of time, the extinguishment of the debtor's interest in property is not an avoidable transfer"); 2 Collier on Bankruptcy ¶ 101.54 (16th ed.) ("The prepetition lapse of an option held by the debtor is not a transfer. The option does not transfer to or vest in anyone else; it simply no longer exists.").

Congress expressly circumscribed the Trustee's right to submit untimely claims for payment on agreements that expire after the Filing Date, granting the Trustee up to a sixty-day extension of the applicable expiration dates. 11 U.S.C. § 108(b).[21] Thus, Congress has already squarely answered the question: "How much extra time is a Trustee allowed to act on rights provided for under expiring agreements?" And the answer is no more than sixty days. If a trustee could otherwise claim on an expired agreement by asserting that expiration was a "transfer" of property, the limitations Congress established in section 108(b) would be rendered meaningless.

Moreover, regulation 17 C.F.R. § 190.08(a)(1)(i)(E) and the CFTC's interpretive guidance further support that expiration of the Letter of Credit does not constitute a transfer of property. As discussed in section I.A. above, 17 C.F.R. § 190.08(a)(1)(i)(E) provides that "[t]he full **proceeds** of a letter of credit" constitute customer property. (Emphasis added.) The CFTC's interpretive guidance, in turn, provides that "the trustee [is] required to **draw** the full value of a letter of credit . . . and treat the **funds received** as customer property." Supplementary Information, 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983) (emphases added). Neither authority states nor even hints that the Trustee is excused from timely presenting the Letter of Credit for payment, or that the expiration of the Letter of Credit constitutes a "transfer" of property to KS&T. *See ConocoPhillips Co. v. Giddens (In re MF Global, Inc.)*, No. 12 Civ. 6014, 2012 WL 4757866, at *6 n.11 (S.D.N.Y. Oct. 4, 2012) ("[T]he Supplemental Information does not address how a Trustee should treat *expired* letters of credit . . . ."). To the contrary, the plain language of both authorities confirms that the Trustee is required to actually draw on the Letter of Credit and

[21] Section 108(b) of the Bankruptcy Code states that "[i]f . . . an agreement fixes a period within which the debtor . . . may file any pleading, demand, notice, or proof of claim . . ., or perform any similar act, and such period has not expired before the date of the filing of the petition, the trustee may **only** file . . . or perform, as the case may be, before the later of—(1) the end of such period . . .; or (2) 60 days after the [filing date]." (Emphasis added.)

receive funds (*i.e.*, "proceeds") from the Issuing Bank, which is consistent with the Trustee's obligation in section 766(f) of the Bankruptcy Code and 17 C.F.R. § 190.02(f)(3) to "reduce to money" all property "promptly," "in an orderly manner," and "consistent with good market practice." For KS&T to have received a "transfer" of property, the Trustee would then have had to have paid those funds to KS&T, something he did not do, by admission (SUF, ¶ 22).

In sum, the Trustee cannot satisfy his burden of proving an essential element of his claim—that he made a "transfer" of property within the meaning of section 101(54)—and thus sections 549, 550, 551, and 764 of the Bankruptcy Code do not provide support for the Trustee's Second Requested Declaratory Judgment.[22]

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[22] By focusing herein on the absence of a "transfer" of property, KS&T is not conceding that any of the other elements of sections 549, 550, 551, or 764 of the Bankruptcy Code are satisfied. Indeed, even taking the Trustee's position that the expiration of the Letter of Credit was a "transfer" of property, the Trustee's Second Requested Declaratory Judgment still fails because the Trustee was fully authorized to let the Letter of Credit expire.

Pursuant to section 766(f) of the Bankruptcy Code, the Trustee is authorized, and in fact required, to "reduce to money, consistent with good market practice, all . . . property of the estate." It is undisputed that "good market practice" requires the Trustee to comply with applicable law. *See* Trustee's Memorandum of Law in Opposition to ConocoPhillips' Motion to Withdraw the Reference, Case No. 12-CV-06014 (S.D.N.Y. filed Aug. 23, 2012), ECF No. 18, at 17 (Trustee stating that "ConocoPhillips . . . argues that unlawful conduct is not 'good market practice' as used in the Bankruptcy Code" and "[t]he Court can rest assured that th[is] proposition[] [is] common ground between the parties"); *see also* 28 U.S.C. § 959(b) (obligating Trustee to "manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof").

Here, the Trustee could not present the Letter of Credit for payment without committing material fraud. *See* U.C.C. § 5-109 cmt. 1 (beneficiary commits "material fraud" when it "has no colorable right to expect honor and where there is no basis in fact to support such a right to honor"). Thus, the Trustee was authorized by section 766(f) of the Bankruptcy Code, and indeed required, to let the Letter of Credit expire, thus liquidating it at its effective value: $0.

Moreover, because the value of the Letter of Credit was $0, that is all that the Trustee could recover under section 550(a) of the Bankruptcy Code even if the supposed transfer was unauthorized. *See McCord v. Agard (In re Bean)*, 252 F.3d 113, 117 (2d Cir. 2001) ("[A] trustee cannot recover that which did not belong to the estate at the time the debtor filed for bankruptcy

B. The Trustee's Request is Not Supported by 11 U.S.C. §§ 362 or 542.

The Trustee's Second Requested Declaratory Judgment also fails to the extent that it is based on sections 362 and 542 of the Bankruptcy Code.

Section 542 of the Bankruptcy Code obliges entities that are in the possession, custody, or control of property of the estate to deliver that property to the Trustee. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 202-03 (1983) (interpreting section 542 as requiring turnover of property of the estate). Section 362, in turn, makes the failure to comply with this obligation a violation of the automatic stay.[23] *See Metromedia Fiber Network Servs. v. Lexent, Inc. (In re Metromedia Fiber Network, Inc.)*, 290 B.R. 487, 490 (Bankr. S.D.N.Y. 2003).

But to obtain a judgment pursuant to either of these authorities, the Trustee bears the burden of proving, among other things, that KS&T currently is in possession, custody, or control of property of the estate. *See* 5 Collier on Bankruptcy ¶ 542.02 (16th ed.) ("To support a cause of action for turnover, the trustee has the burden of proof, by a preponderance of the evidence, to establish that: (1) the property is in the possession, custody or control of a noncustodial third party; [and] (2) the property constitutes property of the estate . . . ."). In other words, the Trustee must identify property in which the Debtor has a legal or equitable interest. *See* 11 U.S.C. § 541(a)(1) (defining "property of the estate" as "all legal and equitable interests of the debtor").

(footnote continued from preceding page)

protection."). KS&T expressly reserves these and all other arguments, positions, and rights available to it in this proceeding.

[23] Sections 362 and 542 of the Bankruptcy Code do not permit the Trustee to bypass the requirements of sections 549 and 764 of the Bankruptcy Code. *See, e.g., Picard v. Estate of Stanley Chais (In re Bernard L. Madoff Inv. Secs. LLC)*, 445 B.R. 206, 236-38 (Bankr. S.D.N.Y. 2011) (dismissing claim by trustee pursuant to section 542 to compel turnover of funds allegedly received through a fraudulent transfer); *Savage & Assocs., P.C. v. BLR Servs. SAS (In re Teligent, Inc.)*, 307 B.R. 744, 751 (Bankr. S.D.N.Y. 2004) (same).

The Trustee cannot meet this burden. He has not identified, and cannot identify, any property in the possession, custody, or control of KS&T in which the Debtor has any interest.

Accordingly, the Trustee's Second Requested Declaratory Judgment finds no support in either section 362 or 542 of the Bankruptcy Code.

C. The Trustee's Request is Not Supported by 17 C.F.R. §§ 190.01 or 190.08.

Finally, 17 C.F.R. §§ 190.01 and 190.08 also afford the Trustee no relief. As even the title to 17 C.F.R. § 190.01 ("Definitions") makes clear, that regulation only sets forth the applicable definitions of terms used elsewhere in 17 C.F.R part 190. Likewise, subpart (a) of 17 C.F.R § 190.08 is also definitional, serving to supplement the definition of "customer property" in section 761(10) of the Bankruptcy Code. As for the other subparts of 17 C.F.R. § 190.08, they merely direct the Trustee as to performance of his duty to allocate and distribute customer property. Neither 17 C.F.R § 190.01 nor 17 C.F.R § 190.08 gives the Trustee any right to require a customer to pay money to the Debtor's estate. Accordingly, they do not support the Trustee's Second Requested Declaratory Judgment.

III. KS&T IS ENTITLED TO SUMMARY JUDGMENT ON ITS OWN CLAIMS.

Independent of the Trustee's Counterclaim, KS&T filed a complaint against the Trustee. KS&T's complaint asserts two claims for declaratory judgments that the expiration of a Letter of Credit does not give rise to any liability from KS&T to the Trustee under sections 362, 542, 549, 550, or 764 of the Bankruptcy Code. As noted, KS&T's claims are essentially the flip side of the Trustee's Counterclaim. Accordingly, for the same reasons as set forth in sections II.A. and II.B. above, KS&T also is entitled to summary judgment on both of the claims in its complaint.

CONCLUSION

For all of the reasons set forth herein, KS&T respectfully requests that the Court (i) grant the Motion, (ii) enter summary judgment in favor of KS&T on the Trustee's Counterclaim and both of the claims in KS&T's complaint, (iii) enter KS&T's Declaratory Judgments, and (iv) award such other relief as the Court deems proper.

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Washington, D.C.

Respectfully submitted,

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