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Bank of New York-Mellon Wins Right to Press \$312 Million Lien on Sentinel

By Andrew M. Harris - Nov 3, 2010

Bank of New York Mellon Corp. won a U.S. judge's ruling allowing the lender to pursue in bankruptcy court a \$312 million lien on the failed Sentinel Management Group Inc. cash management firm.

U.S. District Judge James B. Zagel in Chicago today issued a 68-page ruling in which he rejected liquidation trustee Frederick Grede's claim that the New York-based bank had enabled the firm's insiders to deceive clients.

"The court rejected the trustee's claim in its entirety," Kevin Heine, a Bank of New York Mellon spokesman, said today in a telephone interview. The bank had denied those claims.

Sentinel, based in Northbrook, Illinois, filed for bankruptcy in August 2007 four days after it froze client accounts, citing credit market instability.

Three days later, the U.S. Securities and Exchange Commission sued the firm for allegedly comingling client funds and improperly using them as collateral for its BNY-Mellon credit line. That case is still pending.

Grede, a former chief executive officer of the Hong Kong Futures Exchange who was initially appointed Chapter 11 trustee, sued the bank seeking to quash the lien resulting from the unpaid balance on that line of credit.

Grede had sought to recover about \$600 million from the bank for the firm and its creditors while subordinating that lien to the claims of other Sentinel creditors. Customer claims totaled about \$1.2 billion.

Outstanding Balance

BNY Mellon, denying any knowledge of wrongdoing by firm principals, sought to enforce its collateralized claim for the outstanding balance extended to the firm when it failed, plus accrued interest and attorney fees.

"We think it's incorrect on a number of counts," Grede said of the ruling in a telephone interview. The next step, he said, is to meet with Sentinel creditors to discuss the merits of an appeal.

“The issue of whether the bank knew or suspected that Sentinel was engaged in fraud is a close question,” Zagel wrote in his ruling. Zagel heard 16 days of trial testimony and evidence in April, then closing arguments in May.

Still, the judge said, while the trustee contended that bank employees knew or should have known that the firm had misappropriated client assets for its collateral, “if BNYM should have been more diligent with regard to verifying the source of collateral, such a lack of care does not rise to the level of the egregious misconduct necessary for equitable subordination.”

The case is Grede v. Bank of New York, 08cv2582, U.S. District Court, Northern District of Illinois (Chicago). The SEC case is U.S. Securities and Exchange Commission v. Sentinel Management Group Inc., 07cv4684, U.S. District Court, Northern District of Illinois (Chicago).

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