**United States Bankruptcy Court**
**Northern District of Illinois**
**Eastern Division**

**Transmittal Sheet for Opinions for Posting**

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Bankruptcy Caption: **In re UAL Corporation**

Bankruptcy No. **02 B 48191**
Adversary Proceeding No. **03A04771**
Date of Issuance: **9/20/2004**

Judge: **Wedoff**

Appearance of Counsel:

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**UNITED STATES BANKRUPTCY COURT**
**NORTHERN DISTRICT OF ILLINOIS**
**EASTERN DIVISION**

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| **In re:** | ) | **Chapter 11** |
| | ) | |
| **UAL CORPORATION, et al.** | ) | **Case No. 02-B-48191** |
| | ) | **(Jointly Administered)** |
| **Debtors.** | ) | |
| | ) | |
| **UNITED AIR LINES, INC., Debtor,** | ) | **Adv. Pro. No. 03A04771** |
| | ) | |
| **Plaintiff,** | ) | |
| | ) | |
| **v.** | ) | |
| | ) | |
| **U.S. BANK TRUST NATIONAL ASSOCIATION,** | ) | |
| | ) | |
| **Defendant.** | ) | |

## MEMORANDUM OF OPINION

This adversary proceeding has come before the court on cross-motions for summary judgment brought by United Air Lines, Inc., as Chapter 11 debtor in possession ("United") and U.S. Bank National Association as Indenture Trustee ("the Bank"). United seeks a turnover, pursuant to 11 U.S.C. § 542(b), of certain construction bond funds held by the Bank under a trust agreement for the benefit of bondholders; the Bank seeks a declaration that the funds are not property of United's bankruptcy estate, or alternatively, that the Bank has a perfected security interest in the funds, that it has recoupment rights in the funds or that it has setoff rights in the funds.

As discussed below, United has three different turnover claims, all seeking reimbursement for construction expenses. The first, in the amount of $1,191,547.29,

was reflected in a written request for payment that United submitted to the Bank, in the form required by the parties' agreement, prior to United's bankruptcy filing. Because the Bank had a nondiscretionary duty to honor this request "upon receipt," equitable principles, as enforced under California law, require turnover of the requested funds. United's next claim, for an additional $233,824.48, was also set out in a written request. However, since this request was submitted after the bankruptcy filing, the Bank's payment obligation is fully subject to setoff under 11 U.S.C. § 553. United's third claim, in the amount of $30,093.51, has never been submitted to the Bank in the written request required for payment, and so is also not payable. Accordingly, the motions for summary judgment of both United and the Bank will be granted in part and denied in part.

## Jurisdiction

Federal district courts have exclusive jurisdiction over bankruptcy cases. 28 U.S.C. § 1334(a). Pursuant to 28 U.S.C. § 157(a), district courts may refer bankruptcy cases to the bankruptcy judges for their district, and, by Internal Operating Procedure 15(a), the District Court for the Northern District of Illinois has made such a reference of the pending case. When presiding over a referred case, a bankruptcy judge has jurisdiction, under 28 U.S.C. § 157(b)(1), to enter appropriate orders and judgments in core proceedings within the case. The pending motions are core proceedings under 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate), (b)(2)(E) (orders to turn over property of the estate), (b)(2)(G) (motions to terminate or modify the automatic stay), (b)(2)(K) (determinations of validity, extent or priority of liens) and (b)(2)(O) (other proceedings affecting adjustment of debtor-creditor relationship). This court therefore has jurisdiction to enter a final order with respect to the motions now before it.

## Statement of Facts

The facts relevant to the pending motions are undisputed.

*The Agreements.* U.S. Bank National Association serves as the trustee pursuant to the terms of a Trust Agreement dated April 1, 2001 (the "Trust Agreement"), between itself and the California Statewide Communities Development Authority (the "Authority"). On or about April 1, 2001, in accordance with the Trust Agreement, the Authority issued California Statewide Communities Development Authority Special Facilities Revenue Bonds (United Air Lines, Inc. – Los Angeles International Airport Cargo Project) Series 2001 (the "Bonds") in the aggregate principal amount of $34,590,000. Concurrent with the execution of the Trust Agreement, the Authority and United entered into a Payment Agreement also dated April 1, 2001 (the "Payment Agreement").

The Bonds were issued to finance the costs of constructing certain improvements at the Los Angeles International Airport (the "LAX Project"). Trust Agr., Fourth Recital; Payment Agr., § 2.1(b). The Authority deposited proceeds from the sale of the Bonds into a construction fund established pursuant to the Trust Agreement (the "Construction Fund"). Trust Agr., § 3.04. All of the monies in the Construction Fund are pledged to the repayment of principal and interest on the Bonds, Trust Agr., § 5.01; Payment Agr., § 4.4, and are held in trust for the benefit of the bondholders, Trust Agr., § 3.04. However, the Construction Fund — as its name implies — was designed to reimburse United for its costs in constructing the LAX Project. *Id*. United, in turn, is obligated under the Payment Agreement to make payments of principal and interest on the Bonds. Payment Agr., § 4.2.

*Requirements for disbursement of funds.* In order for United to obtain disbursements from the Construction Fund, United must submit to the Bank a

"Written Request of Corporation." See Trust Agr., § 3.04; Payment Agr., § 3.3. Section 3.04 of the Trust Agreement sets out the information that must be provided and the representations that must be made in a Written Request. The Trust Agreement expressly provides that the Bank may rely on a Written Request that fulfills the requirements of § 3.04 as "sufficient evidence" that the costs stated were incurred and are properly paid out of the Construction Fund and that there are no liens on the monies to be paid. Trust Agr., § 3.04. Payment to United is to be made "upon receipt" of a Written Request. Payment Agr., § 3.3.

*United's requests for payment.* Prior to December 5, 2002, United had submitted numerous draw requests from the Construction Fund to the Bank, and the Bank had paid them promptly, In each of these situations, the Bank made the requested payment without taking any action to substantiate the information set out in the request. United Air Lines, Inc.'s Statement of Undisputed Facts, Exh. B, Response to Interrogatory No. 10.

On December 5, 2002, United submitted Trustee Requisition No. 11 (the "December 5 Draw Request"), requesting the Bank to disburse $1,191,547.29 from the Construction Fund as reimbursement for costs incurred by United with respect to the LAX Project. The Bank has never contended that the December 5 Draw Request fails to conform to the requirements of § 3.04 of the Trust Agreement or that it is in any way deficient. Nevertheless, the Bank has not paid it.

On December 9, 2002, four days after the December 5 Draw Request, United and its affiliate debtors filed voluntary petitions under Chapter 11 of the Bankruptcy Code, giving rise to the pending bankruptcy cases. Necessarily, then, the reimbursement sought in the December 5 Draw Request antedates any default under

the Payment Agreement triggered by United's bankruptcy filing. All of the costs included in the December 5 Draw Request were prepetition obligations of the Bank.

On December 13, 2002, United submitted Requisition No. 12 (the "December 13 Draw Request"), requesting the Bank to disburse $233,824.48 from the Construction Fund. Although this draw request was submitted after United's bankruptcy petition was filed, the costs for which it sought reimbursement were incurred prepetition. Again, while not asserting that the December 13 Draw Request is deficient, the Bank has refused to pay it.

Finally, United asserts that it has incurred an additional $30,093.51 in construction costs for the LAX Project in the time after its bankruptcy filing (the "Postpetition Costs"). United has not submitted a Written Request of the Corporation for these costs.

Payments of interest on the Bonds were due on April 1, 2003, October 1, 2003 and April 1, 2004. United has not made these payments. The failure to make these payments constitutes a default under the Trust Agreement and the Payment Agreement. Trust Agr., § 7.01(a); Payment Agr., § 6.1(a).

**Conclusions of Law**

The standard for ruling on summary judgment motions is whether the party seeking judgment has demonstrated through admissible evidence that no genuine issue of material fact exists for trial and that the movant is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c), incorporated by reference in Fed.R.Bank.Proc. 7056(c). Contract interpretation is particularly suited for disposition on summary judgment, unless the contract is ambiguous. *United States. v. 4500 Audek Model Number 5601 AM/FM Clock Radios*, 220 F.3d 539, 543 (7th Cir. 2000). In this case, there are no

material facts in dispute and the relevant agreements are unambiguous; therefore the matter is appropriate for summary judgment.

Each of the three claims for reimbursement asserted by United raises distinct legal issues, and so addressed separately below. Because the complexity of the issues raised by these claims is inverse to the order in which the claims were made, they are treated here in reverse chronological order.

*Postpetition Costs*. United's most recent claim — seeking payment of postpetition costs associated with the LAX Project — was never the subject of a Written Request of the Corporation. United argues that it is nonetheless entitled to reimbursement of these costs from the Construction Fund on the ground that it immediately obtained a property interest in the Construction Fund upon incurring construction costs, so that the submission of a Written Request was "ministerial and peripheral" and therefore not required. Complaint, ¶ 22. The Agreements do not support this argument. Under the terms of the Agreements, United must submit a Written Request before the Bank has a payment obligation of any kind. Section 3.04 of the Trust Agreement provides that "[b]efore any payment is made from the Construction Fund by the Trustee, the Corporation [United] *shall cause to be filed* with the Trustee a Written Request for the Corporation." Trust Agr., § 3.04 (emphasis added). Similarly, § 4.1 of the Payment Agreement, addressing payment for costs of the LAX Project, states that "[t]he Corporation *shall* submit a Written Request of Corporation for disbursements from Construction Fund in accordance with § 3.04 of the Trust Agreement." Payment Agr., § 4.1 (emphasis added).

With respect to each payment sought, the Written Request must show "(1) the item number of the payment; (2) the name of the person to whom payment is due; (3) the amount to be paid and (4) the purpose for which the obligation to be paid was

incurred." Trust Agr., § 3.04. The Written Request must also state that (a) each item for which reimbursement is sought has been incurred, is a proper charge and has not been previously reimbursed; and (b) there are no liens or other claims affecting the right to receive payments of the funds. *Id.*

In light of these provisions, the requirement that United submit a Written Request was a substantive condition precedent to obtaining payment from the Construction Fund and cannot be ignored by United. Since United failed to submit a Written Request with respect to the postpetition costs, the Bank has no obligation to pay United on this claim.

*The December 13 Draw Request*. The costs claimed in the December 13 Draw Request, though submitted after the filing of United's bankruptcy petition, were incurred prepetition. These costs represent a valid claim against the Bank (the Bank having raised no objection to its validity) but the claim is fully subject to setoff under § 553 of the Bankruptcy Code, since the Bank has a much larger prepetition claim against United.[1]

Section 553 allows setoff if, among other things, a creditor's claim against the estate and the estate's claim against the creditor arose before the filing of the debtor's bankruptcy case. 11 U.S.C. § 553(a). United does not dispute that both claims arose prebankruptcy. Section 553(a) also requires mutuality of the parties. Mutuality exists here because United is obligated to pay the Bank as trustee and the Bank as trustee is obligated to pay United. *See In re Doctors Hosp. of Hyde Park, Inc.*, 337 F.3d 951, 955 (7th Cir. 2003) ("the general rule is that mutuality is satisfied when the offsetting

[1] United's obligation to the Bank apparently exceeds $34 million, since its payments to date have covered interest accruing on the bond issue. See Trust Agr., Ex. A (Form of Bond) at A-1 (providing for interest only payments on April 1 and October 1 of each year until final maturity).

obligations are held by the same parties in the same capacity"). United's reliance on *In re Ben Franklin Retail Store, Inc.*, 202 B.R. 955 (Bankr. N.D. Ill. 1996), in an effort to defeat the claim of mutuality, is misplaced. That case involved a debtor which had borrowed money from a bank prior to its bankruptcy filing, and which also had a special purpose account with the bank. The court found that the special purpose account was held by the bank in trust for the debtor, who continued to "own" the account beneficially rather than simply being owed the money in account. 202 B.R. at 958. Thus, unlike the present case, there was no mutality of obligation: the bank's equitable obligation to debtor with respect to the special account was of a different nature than the debtor's legal obligation to the bank. Here, by contrast, the Construct Fund is not held in trust for United—United simply has a legal claim to it; just as the Bank has a legal claim against United. Because the competing claims of United and the Bank meet the requirements of § 553, the Bank is entitled to setoff under § 553.

Pursuant to the Bank's setoff right, United's claim here merely reduces its liability to the Bank under the Payment Agreement. The Bank's motion for a determination that United does not have a property interest in the amount claimed by the December 13 Draw Request is granted, and United motion for turnover is denied.[2]

*The December 5 Draw Request*. The costs associated with the December 5 Draw Request were incurred prepetition and the request itself was submitted prepetition. United argues that upon submission of the Written Request the Bank had a nondiscretionary duty to disburse the money sought. The Bank argues it had a right to withhold payment to verify the accuracy of the information submitted, and that

[2] Given these conclusions, the Bank's arguments regarding its security interest and its right to recoupment need not be addressed.

thereafter United's bankruptcy filing constituted an Event of Default that suspended the Bank's obligation to pay United.

The Bank is mistaken. United's right to reimbursement from the Construction Fund arose upon the submission of a request in the proper form. Section 3.3(a) of the Payment Agreement sets forth the key language. It provides in relevant part as follows:

> The Corporation [United] will authorize and direct the Trustee, upon compliance with Section 3.04 of the Trust Agreement, to disburse the monies in the Construction Fund to or on behalf of the Corporation only for the following purposes, subject to the provisions of Section 3.4 hereof : . . .
>
> Each of the payments referred to in this section 3.3(a) *shall be made upon receipt by the Trustee* of a Written Request of the Corporation.

Payment Agr., § 3.3(a) (emphasis added). Section 3.04 of the Trust Agreement provides that a Written Request of the Corporation that meets the requirements of that section "shall be sufficient evidence to the Trustee" that the obligations set forth in the Written Request have been incurred by United, that each item is a proper charge and that there are no liens on the monies to be disbursed. Trust Agr., § 3.04.

Neither the Trust Agreement nor the Payment Agreement imposes any duty on the Bank to confirm the validity of the submission. Rather, the agreements evidence an intent by the parties to eliminate any duty both by allowing the Bank to rely solely on the representations made in the Written Request and by specifying that prior to a default, the Bank has "such duties and only such duties as are specifically set forth in this Trust Agreement." Trust Agr., § 8.01. Similarly, prior to an Event of Default, "the duties and obligations of the Trustee . . . shall be determined solely by the express provisions of this Trust Agreement . . . ; and no covenants or obligations shall be implied into this Trust Agreement which are adverse to the Trustee . . ." *Id.*, § 8.01(a).

The Bank asserts that it nonetheless had discretion to investigate the bona fides of Written Requests, even if in proper form. However, the Trust Agreement accords no such discretion, and exercising such a discretion would contradict the Bank's express duty of making payment payment to be made to United "upon receipt by the Trustee of a Written Request of the Corporation." Accordingly, the Bank cannot exercise discretion.

> It is a principle in the law of trusts that the directions contained within the trust agreement are the sole guide to the conduct of the trustee. It is to the trust agreement and to that only to which he must look for his orders and which orders, *in the absence of conferred discretionary powers, he must follow without question or hesitation*.

*Bryson v. Bryson*, 62 Cal. App. 170, 176, 216 P. 391, 393 (1923) (emphasis added), citing 4 *Pomeroy's Equity Jurisprudence* (5th ed. 1941) §1062. This is particularly true for indenture trustees. *See Elliott Associates v. J. Henry Schroder Bank & Trust Co.*, 838 F.2d 66, 71 (2d Cir. 1988) (Under New York law, the duties of an indenture trustee are strictly defined and limited to the terms of the indenture); *Eldred v. Merchants National Bank of Cedar Rapids*, 468 N.W.2d 221, 223 (Iowa 1991) (trustee's duties limited to terms of indenture); *National City Bank v. Coopers & Lybrand*, 409 N.W.2d 862, 866 (Minn. Ct. App. 1987) ("[A]n indenture trustee is more like a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture agreement.") (quoting *Meckel v. Continental Resources Co.*, 758 F.2d 811, 816 (2d Cir. 1985)).

Interpretation of a trust agreement and the determination of an appropriate remedy for breach of that agreement are within the jurisdiction of equity. *Alexander v. Hilman*, 296 U.S. 222, 239, 56 S. Ct. 204, 210 (1935) ("All trusts, those implied as well as those expressly created, are within the jurisdiction of courts of equity."). "A court of equity will always by its decree declare the rights, interest, or estate of the [bene-

ficiary], and will compel the trustee to do all the specific acts required of him by the terms of the trust." 1 *Pomeroy's Equity Jurisdiction*, § 158. *See Eychaner v. Gross*, 202 Ill. 2d 228, 779 N.E.2d 1115, 1145 (2002) ("Courts of equity possess original and inherent power to recognize, execute, and control trusts and trust funds.") (quoting *Village of Hinsdale v. Chicago City Missionary Society*, 375 Ill. 220, 233, 30 N.E.2d 657 (1940)); *Whan v. Whan*, 542 S.W.2d 7, 11 (Mo. Ct. App. 1976) (courts of equity have inherent jurisdiction over express trusts); *Dexter Horn Building Co. v. King County*, 10 Wash. 2d 186, 191, 116 P.2d 507, 510 (1941) (all cases involving trusts are exclusively within the court's equity jurisdiction). Here, United's motion to compel the Bank to do the specific acts required by the terms of the Trust Agreement — namely to turn over certain funds, and to determine that United has an interest in the Construction Fund — also determines the rights and interest of the beneficiaries in the fund.

California law governs the Payment Agreement and the Trust Agreement. See Payment Agr., § 9.5; Trust Agr., § 11.08. In interpreting California law, this court must look to the decisions of California's highest court. *In the Matter of Wheaton Oaks Office Partners Limited Partnership*, 27 F.3d 1234, 1243, n. 5 (7th Cir. 1994). California Civil Code § 3529 codifies the common law equitable maxim that "[t]hat which ought to have been done is to be regarded as done, in favor of him to whom, and against him from whom, performance is due." Cal. Civ. Code § 3529. *Corpus Juris Secundum* explains the principle as follows:

> The broad meaning or effect of this maxim is that where an obligation rests on a person to perform an act equity will treat the person in whose favor the act should be performed as clothed with the same interest and entitled to the same rights as though the act were actually performed. It is applied only for the purpose of doing equity between the parties.

> The basis of the maxim is the existence of a duty and it can only be invoked against a party who has failed or refused to perform a duty imposed on him. . . .
>
> . . .
>
> Ordinarily, by application of the maxim, acts agreed to be done or directed to be done are considered as done at the time agreed or directed to be done. The principle lends its force to working out justice by fixing rights as of the time when the obligation first accrued rather than according to circumstances subsequently arising. . . .

30A C.J.S. *Equity*, § 121 (2003) (footnotes omitted).

The maxim was most recently applied by the California Supreme Court in *Cortez v. Purolator Air Filtration Products Company*, 23 Cal.4th 163, 999 P.2d 706 (2000). There, an employee sued her employer under the California Labor Code and a California unfair competition law, seeking restitution and other relief in connection with the employer's failure to pay overtime wages. The California unfair competition law provided that the courts had authority to order the restitution of property acquired by unfair competition, but not to award damages. *Id.* at 173, 999 P.2d at 712. The Court concluded that unlawfully withheld wages were property of the employee when due and owing and thus could be the subject of a restitutionary order for the return of property. The Court relied upon the maxim that equity regards that which ought to have been done as done; the wages should have been paid to the employees, and thus the court treated the wages as property of the employee that the employer equitably converted and could be compelled to "return." *Id.* at 178, 999 P.2d at 716.

Several earlier California cases have also applied the maxim. In *Campbell v. Bauer*, 104 Cal. App. 2d 740, 232 P.2d 590 (1951), the court held that an application to transfer a liquor license should be deemed to have been submitted by the seller of the business that used the license. *Id.* at 744, 232 P.2d at 593. "[S]igning by the transferor constitutes a compliance with the transferor's agreement to transfer. It should have

been done in this case and it must therefore be regarded as done." *Id.* at 744, 232 P.2d at 593. In *Epstein v. Gradowitz*, 76 Cal. App. 29, 243 P. 877 (1925), the appellate court held that the trial court properly denied plaintiff's claim on a promissory note when the evidence supported the affirmative defense that plaintiff agreed to cancel the note and to deliver it to defendant. "Under well-established principles, in such a situation plaintiff will be held to do the thing which he agreed to do, and for which he accepted a valuable consideration." *Id.* at 32, 243 P. at 878. And in *Lowe v. Los Angeles Suburban Gas Co.,* 24 Cal. App. 367, 378-79, 141 P. 399, 403-04 (1914), the court applied the maxim to treat principal and interest on certain bonds as immediately due and payable even though the indenture trustee refused to issue a declaration to that effect, since the trustee had the duty to do so under the trust agreement.

United made a proper demand on the Bank, which refused without justification to take the required course of action. It now seeks to avoid that obligation by reliance on the subsequent bankruptcy filing. "That which ought to have been done" – the Bank's payment of the December 5 Draw Request to United – may be regarded "as done" but for the mechanical act of transmitting the funds. This effectuates the intent of the maxim, to accord United "with the same interest and entitled to the same rights" as though the Bank had transmitted the funds.[3] *See* 30A C.J.S. *Equity*, § 121.

The *Cortez* case requires consideration of equities on both sides of a dispute. *See Cortez*, 23 Cal. 4th at 180-181; 999 P.2d at 717. The Bank argues that the balance

[3] Section 3517 of the California Civil Code provides further support for this conclusion. It states, "[n]o one can take advantage of his own wrong." To permit the Trustee to assert an offset to United's claim under the December 5 Draw Request would allow the Trustee to take advantage of its own wrong in the form of an otherwise unavailable setoff. *See also Campbell v. Bauer*, 104 Cal. App. 2d at 744, 232 P.2d at 593 (to permit defendants to retain liquor license securing loan following default would "permit defendants to retain the advantage of their own wrong [which] would be unconscionable.")

of equities favor the Bank and not United given United's subsequent postpetition failure to make payments due under the bonds and its continuing right to use Los Angeles cargo facility built with bond funds. However, the Bankruptcy Code requires United to suspend payments on the bonds and allows continued use of the cargo facility. These statutory provisions are designed to effect an equitable distribution among all creditors of a bankruptcy estate, while maximizing the value of the estate. It was not inequitable for United to comply with them. Nor is it inequitable if, as unsecured creditors, the bondholders receive less than the full amount of their claim, since in a less than fully solvent bankruptcy, incomplete satisfaction of claims necessarily occurs. By contrast, it would be inequitable for the Bank to use the intervention of the bankruptcy filing to obtain a benefit – the right of setoff – that did not exist at the time the payment to United was due. In order to prevent the Bank from gaining an advantage over other creditors on account of United's subsequent bankruptcy filing, payment to United of the amounts sought in the December 5 Draw Request must be considered to have been made at the time of that the Written Request was submitted, prior to the bankruptcy filing.

Treating the funds as having been transferred to United before the filing of its bankruptcy case has the effect of terminating any security interest held by the Bank as trustee. *See* Cal. Com. Code §§ 9312(b)(3) (security interest in money perfected only by possession); 9313(d) (if perfection of security interest depends on possession, perfection continues only while secured party retains possession). Nor is setoff available to the Bank. The transfer implied by California law places the Bank in the position of holding the reimbursement requested by the December 5 Draw Requesst in a special account, actually owned by United and not merely owed to United by the Bank. Accordingly, the mutuality required for setoff does not exist. See *In re Ben*

*Franklin Retail Store, Inc.*, 202 B.R. 955 (Bankr. N.D. Ill. 1996), discussed in connection with the December 13 Draw Request.

Section 542 of the Bankruptcy Code provides for the turnover of property of the estate. In light of the determination that California law requires that funds sufficient to pay the December 5 Draw Request be treated as having been transfered to United, funds in the requested amount, now held by the Bank, are property of the estate and are subject to turnover to United.

**Conclusion**

For the reasons set forth above, United's motion for turnover will be granted as to the December 5 Draw Request and denied as to United's other claims. The Bank's motion for summary judgment declaring that the monies in the Construction Fund are not property of the estate will be denied as to the December 5 Draw Request and granted as to United's other requests. The Bank's motion will also be granted so as to allow the Bank to setoff the amount sought in the December 13 Draw Request against the Bank's claim under its Payment Agreement with United.

A separate judgment will be entered in conformity with this opinion.

Dated: September 20, 2004

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Eugene R. Wedoff
United States Bankruptcy Judge