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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: MF GLOBAL HOLDINGS, LTD., *et al.*, Debtor.	Chapter 11 Case No. 11-15059 (MG) Jointly Administered
In re: MF GLOBAL INC., Debtor.	Case No. 11-2790 (MG) SIPA

CUSTOMER REPRESENTATIVES' OBJECTION TO MOTION OF THE INDIVIDUAL INSUREDS TO EXTEND THE "SOFT CAP" ON DEFENSE COSTS

The Customer Representatives in the class action on behalf of former commodity customers of MF Global Inc. (the "Customer Class Action") respectfully submit this objection to the Motion of the Individual Insureds To Modify The Automatic Stay And The Plan Injunction So As To Extend The "Soft Cap" On The Use Of The Proceeds Of Certain MFG Assurance

Company Policies Of Professional Liability Insurance (the "Motion" or "Def. Mot.") (ECF No. 2039).[1]

1. At the close of the May 19, 2014 hearing on the Individual Insureds' previous request to raise the soft cap, the Court directed counsel for the SIPA Trustee, Plan Administrator, carriers, and Customer Representatives to meet-and-confer in an attempt to agree on the proper allocation of defense costs between the E&O and D&O Policies (ECF No. 1904 at pp. 84-85, 86-87, 89).[2] The Court contemplated that the parties would see whether they could "resolve these issues without having to come back" to court. (*Id*. at 87).

2. The Customer Representatives have not been included in any discussions as to the allocation of defense costs between the E&O and D&O Policies. Moreover, to Customer Representatives' knowledge, no agreement has been reached. Now the Individual Insureds come before this Court and seek to justify the current application on the grounds that it is needed to "maintain" the previously unacceptable 40/60 allocation of defense costs between the E&O and D&O Policies.

3. The E&O and D&O carriers (many of whom provided both E&O and D&O coverage) unilaterally determined the original 40/60 allocation as a matter of their convenience, without regard to the fact that would result wasting of estate assets. Counsel for the Customer Representatives have maintained from the outset that the E&O Policies must respond to cover the shortfall in customer funds and the proceeds should not be wasted on defense costs. To the contrary, the E&O proceeds should flow – directly or indirectly – to the SIPA Trustee and the estate (on behalf of victims), not to benefit individuals who caused the harm.

[1] "ECF" cites herein refer to the docket in *In re MF Global Holdings Ltd.*, No. 11-15059 (MG).

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

4. Nevertheless, the Individual Insureds are back before this Court asking for more money from the E&O Policies. The $43.80 million "soft cap" that previously governed both the E&O and D&O Policies has been exceeded (Def. Mot. ¶ 3), and the Individual Defendants ask this Court to extend the soft cap by another $7.50 million (Def. Mot. ¶ 4). Assuming that the allocation of defense costs is 40/60 between the E&O and D&O Policies (Def. Mot. ¶ 22), this means the Individual Defendants also apparently intend to spend or have already spent an additional $11.25 million from the D&O Policies. This would bring the total expenditure of defense costs to $62.55 million, a staggering sum considering the litigation is just now, as Individual Defendants describe it, "entering into increasingly active discovery" (Def. Mot. ¶ 21).

5. The Individual Insureds characterize the extension of the soft cap as "fair to all parties." (Def. Mot. ¶ 23). But it is not. The Individual Defendants have no superior right to the proceeds of the E&O Policies over the SIPA Trustee on behalf of creditor and customer victims of the collapse of MFGH and MFGI. The E&O Policies contain no priority payment provision in favor of the Individual Insureds. The policies will be among the main sources available for the SIPA Trustee (on behalf of the estate, creditors and as assignee of customers' net equity claims) to recover a fraction of losses that exceed any available coverage by hundreds of millions of dollars. Continuously allocating dwindling insurance proceeds to defense costs over preserving those proceeds for the Individual Insureds' victims is the antithesis of "fair."

6. The Individual Defendants' rationale for the increase in the soft cap is two-fold. *First*, they seek "to ensure that they will be able to pay their defense costs." (Def. Mot. ¶ 21). But, once again, the mere fact that they *want* the E&O Proceeds to pay defense costs does not in itself explain *why* they have a superior right to the proceeds over victims and creditors who similarly *want* to be compensated for their losses. Furthermore, the Individual Defendants have

never been required to demonstrate that they *need* the insurance proceeds.[3] In the past, the Individual Defendants have paid lip service to conducting the litigation in a cost-effective manner (*see*, *e.g.*, ECF No. 1537 at 43-44), but the rate at which they are incurring defense costs provides little evidence to support their claims. And, until now, the Individual Insureds have gone so far as to vehemently object to providing any additional information to the SIPA Trustee and Plan Administrator concerning how they were expending policy proceeds to pay defense costs. (ECF No. 1881 fn. 13).[4] If some or all of the Individual Insureds were paying at least a portion of their own defense costs, perhaps they would identify additional efficiencies rather than exhibit a willingness to spend insurance proceeds chasing minor potential litigation advantages.[5]

7. *Second*, the Individual Insureds argue that the Court must permit the expenditure of additional proceeds of the E&O Policies to maintain the provisional 40/60 allocation with the D&O Policies.[6] In other words, they assert that expenditures from the E&O Policies should be

[3] Indeed, the Individual Insureds have conceded that at least some of them may have the financial resources to pay their own defense costs. *See* ECF No. 1668 ¶ 10 ("*With only a handful of exceptions*, the Individual Insureds lack the financial resources to pay their lawyers to defend them.") (emphasis added).

[4] Even the Individual Defendants new agreement to provide aggregate monthly defense costs to the SIPA Trustee and Plan Administrator before invoices are paid in exchange for the SIPA Trustee's consent to the $7.50 million request (Def. Mot. ¶ 19) provides only a pyrrhic benefit. The agreement does not contemplate any ability to determine if the expenditures are necessary or to object to the payment of invoices. Instead, the SIPA Trustee and Plan Administrator just get to see the bad news about defense expenditures before rather than after invoices are paid.

[5] For example, the Individual Defendants in the Customer Class Action recently filed a costly motion seeking to compel the SIPA Trustee to produce confidential attorney-client communications and work product exchanged with Ernst & Young, the accounting firm retained by the SIPA Trustee to assist it in preparing the report and examining potential litigation claims. *See DeAngelis v. Corzine, et al.*, 11 Civ. 7866 (VM) (JCF) (S.D.N.Y. 2011), ECF Nos. 789-791. This motion necessitated lengthy oppositions from the SIPA Trustee and Customer Representatives. *See id*., ECF Nos. 793-795.

[6] Def. Mot. ¶ 22 ("On the claims that are being covered by both D&O and E&O insurance, the E&O Policies have been advancing more than 40 percent of the total Defense Costs. Since the time when the current soft cap was reached, no further payments have been made from the E&O Policies, and the D&O Policies have covered only the portion of the total defense costs that was originally allocated to the D&O Policies under the insurers' provisional agreement.").

permitted *because of* the expenditures from the D&O Policies. This reasoning is backward. While, as the Individual Insureds correctly note (Def. Mot. ¶ 21), the D&O Policies are no longer subject to supervision of this Court, the remaining soft cap would be meaningless if unfettered spending of proceeds from the D&O Policies was an automatic justification for commensurate expenditures from the proceeds of the E&O Policies. Instead, the parties should resolve the outstanding allocation issue (as discussed above), and then the Court should determine whether to extend the soft cap or whether, in the alternative, the Individual Insureds should be responsible for paying at least a portion of the defense costs allocable to the E&O Policies. The Customer Representatives respectfully submit that, at very least, it is premature for the Court to extend the soft cap on the E&O Policies.

8. The Customer Representatives reserve their rights to supplement this objection and to make any further or additional arguments at the hearing on the Motion.

Respectfully Submitted,

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