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UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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

RESPONSE OF U.S. SPECIALTY INSURANCE COMPANY AND XL SPECIALTY INSURANCE COMPANY TO THE OBJECTION OF THE PLAN ADMINISTRATOR TO THE INDIVIDUAL INSUREDS' MOTION TO MODIFY THE AUTOMATIC STAY AND PLAN INJUNCTION TO EXTEND THE "SOFT CAP" ON THE USE OF CERTAIN MFG ASSURANCE COMPANY POLICIES OF PROFESSIONAL LIABILITY INSURANCE TO PERMIT ADVANCEMENT OF ADDITIONAL INSURANCE PROCEEDS

U.S. Specialty Insurance Company and XL Specialty Insurance Company (collectively, the "Insurers") respectfully submit this Response to the *Plan Administrator's Objection to the Motion of the Individual Insureds to Modify the Automatic Stay and the Plan Injunction so as to*

Extend the "Soft Cap" (Docket No. 2048 in Case No. 11-15059) to address the Plan Administrator's assertions regarding his discussions with the Insurers about allocation of the individual insureds' defense costs between the directors' and officers' ("D&O") liability policies and the professional liability ("E&O") policies.

The Insurers disagree with the Plan Administrator's assertion that they have failed to provide sufficient information concerning allocation of defense costs between the D&O and E&O policies. At the May 19, 2014 hearing, the Court requested the Insurers "to discuss with the debtors' counsel the allocation between the E&O and D&O." The Insurers advised the Court they could do so "in general terms" and would address "what's potentially covered under the E&O versus the D&O versus what's potentially covered under both." *See* Docket No. 1537 in Case No. 11-15059 (June 28, 2013 Transcript at pp. 86-87). The Plan Administrator, at least initially, similarly understood that the information to be provided would be "in general terms and without revealing attorney/client privileged information." *See* Plan Administrator Ex. 1 at p. 30 (October 1, 2014 email). The Insurers provided that information, in writing and by telephone. *See id.* at pp. 26, 29-30 (October 2, 2014 and December 3, 2014 emails). As the Insurers informed the Plan Administrator, solely for matters that potentially are covered by both the D&O and E&O policies (*e.g.*, the customer actions and CFTC proceedings), defense costs are allocated 59% to the D&O policies and 41% to the E&O policies. This allocation is based on the total limits provided by the two towers; that is, the $157.5 million in E&O limits equals 41% of the total limits provided by both towers. Because the E&O policies do not cover other matters for which defense costs have been incurred (*e.g.*, the securities action, the Plan Administrator's suit), of the total defense costs recognized for coverage, the D&O policies have paid about 72% and the E&O policies have paid about 28%. Of the defense costs incurred by 50 individuals over a

three year period, about $14.3 million has been allocated to the E&O policies (9% of the total E&O limits).

Rather than suggest an alternative allocation, the Plan Administrator asserts that the Insurers should be required to disclose confidential and privileged information about defense counsel's bills as a pre-condition to raising the E&O soft cap. Specifically, the Plan Administrator improperly seeks to delve into the details concerning how defense counsel are billing time to the various matters, purportedly to enable the Plan Administrator to ensure that defense counsel are recording their time accurately. In doing so, the Plan Administrator wrongly asserts that defense counsel, rather than the Insurers, are allocating between the policies. *See* J. Wittstein Declaration at ¶11 (the insurers "have essentially delegated to the Individual Insureds the task of making the allocation by invoicing separately to the E&O and D&O policies"). This assertion is baseless. At the Insurers' request, each defense firm issues separate bills *for each of the various lawsuits* and submits those bills for review and payment. Defense counsel are *not* issuing separate bills for the D&O and E&O policies. Accordingly, defense counsel's role is limited to accurately recording their time to the matters on which they are working, such that time spent on the securities action is recorded on the securities action invoice, and time spent on the customer action is billed to a separate customer action invoice. If an attorney's work relates to both the securities and customer actions, the time is split evenly between the two invoices. The nature of the work that affects both the securities and customer actions, such as document production, is equally relevant to both the securities and customer action. Contrary to the Plan Administrator's contention, defense counsel are not allocating their time into D&O and E&O buckets. Rather, the Insurers review the bills for all of the separate lawsuits, determine which matters potentially are covered by which policies, and in the case of potential coverage for the

customer actions under both policies, allocate payments between the D&O and E&O policies. Based on their review of the bills, the Insurers have no reason to suspect that defense counsel are inaccurately or unfaithfully recording the time spent on the matters in order to manipulate the amounts being paid by the E&O policies.[1]

Even assuming defense counsel had any involvement in the allocation between the D&O and E&O towers (which they do not), the Plan Administrator improperly seeks to force the Insurers to "produce very specific information . . . including, but not limited to, invoice dates, amounts, billing firms, payments made by insurers, auditing information, and reductions." *See* J. Wittstein Declaration at ¶ 14. As this Court previously has indicated, having filed suit against the individual insureds, the Plan Administrator, the SIPA Trustee and the Customers have completely adverse interests to the individual insureds and are not entitled to information about defense counsels' bills. *See* Docket No. 1537 in Case No. 11-15059 (June 28, 2013 Transcript at p. 23) (in requesting the Insurers to provide information to the Court concerning amounts billed by defense counsel, the Court stated, "I recognize it's sensitive information and I believe it satisfies Section 107(b) of the Bankruptcy Code for it to be filed under seal."); *id.* at 54 (The Court: "the plaintiff … doesn't get to see what the defendants are spending"); *see* Docket No. 1903 in Case No. 11-15059 (May 21, 2014 Transcript at pp. 61-62 (in response to Mr. Kobak's statements that "we have very little insight into what they have spent money on," and that it would be "helpful" to know "what's being spent" and how "they're proposing to split things in

[1] Under the 59/41 allocation, defense costs incurred solely in connection with the customer actions are paid 59% by the D&O and 41% by the E&O. By contrast, if defense counsel's time relates to both the securities action and the customer actions and is split between the two matters, the D&O policies pay 79.5% and the E&O policies pay 20.5% of the overall total. This is a result of reducing the E&O share by half and raising the D&O share by half of the amount allocated to the E&O policy. Notwithstanding that the percentage being borne by the D&O policies is far greater than that being paid by the E&O, the Plan Administrator has never articulated why the allocation is somehow improper or unfair.

the future," the Court stated "you don't get to review their fee applications . . . What you're not entitled to do is obtain attorney/client privileged information with respect to what each of the firms . . . has done"); *id.* at p. 86) (The Court: "The defendants are not going to have to reveal attorney/client privilege information in any discussions with the debtors and I've made that clear before"). The Plan Administrator's demand that the Insurers provide sensitive, confidential and privileged information about defense counsel's bills should be rejected again.

Moreover, the Plan Administrator's suggestion that the Insurers are conspiring to give the insureds a "blank check" to dissipate the E&O policy proceeds (J. Wittstein Declaration at ¶15) has no merit. The Plan Administrator cannot credibly argue that the Insurers or MFGA has an incentive to pay money from any of the policies for unreasonably or unnecessarily incurred fees. For the past three years, the Insurers have diligently and conscientiously reviewed and monitored the defense costs, and it plainly is in their interest to do so. U.S. Specialty's *in camera* submission on July 19, 2013 provided the Court with detailed information concerning the defense bills and the process of the Insurers' review of those bills, and included the Insurers' line by line audits resulting in substantial deductions from the bills. The Insurers have continued to apply the same high level of scrutiny to defense counsels' bills as that reflected in the July 19, 2013 submission to the Court. The Plan Administrator's assertion that he should be allowed to independently "verify" that the Insurers properly are reviewing the bills and allocating between the D&O and E&O towers is misplaced, and instead appears to be designed to enable the claimants in the lawsuits to interfere with and limit the individual insureds' defenses to the claims asserted against them.

Conclusion

The Insurers in good faith have engaged in discussions with the Plan Administrator concerning allocation between the D&O and Policies, and provided information in accordance with the Court's request.

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Respectfully submitted,

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