UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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| In re: | : | Case No. 11-15059 (MG) |
| MF GLOBAL HOLDINGS, LTD., *et al.*, | : | Chapter 11 |
| Debtors. | : | Jointly Administered |
| In re: | : | Case No. 11-02790 (MG) SIPA |
| MF GLOBAL INC., | : | |
| Debtor. | : | |

**REPLY OF THE INDIVIDUAL INSUREDS TO OBJECTIONS TO THEIR MOTION 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 Individual Insureds respectfully submit this reply to the Objections of the Plan Administrator and the Customer Representatives (together, the "Objectors") to the Individual Insureds' Motion (the "Motion") for an order (1) modifying the automatic stay (as to MFGI) and the Plan injunction (as to MFGH), to the extent necessary, with respect to the proceeds of certain professional liability insurance policies issued by MFG Assurance for the 2011-2012 policy years; (2) authorizing MFG Assurance, to the extent necessary, to make payments of an additional $7,500,000 for the reimbursement of Defense Costs in accordance with the terms of the E&O Policies; and (3) authorizing MFG Assurance or its designee, to the extent necessary, to provide certain additional information to the SIPA Trustee and the Plan

Administrator concerning invoices that are submitted for payment of Defense Costs from the E&O Policies.[1]

**Preliminary Statement**

1. The Objectors do not dispute the key points on which the Motion rests:

- The Individual Insureds are contractually entitled to have certain of their defense costs advanced from proceeds of the E&O Policies, but no E&O Policy proceeds have been paid for months, and the lawsuits that the E&O policies are intended to cover are becoming increasingly active.

- The SIPA Trustee negotiated extensively with the insurers and the Individual Insureds to develop a sensible proposal for an extension of the soft cap on spending of E&O policy proceeds, and the SIPA Trustee believes that the proposal which came out of those negotiations is "reasonable."

- A core element of the proposal insisted upon by the SIPA Trustee is a new reporting requirement that will provide the SIPA Trustee and the Plan Administrator with information on defense billings before any payments are made on those bills. With this new requirement, even the Plan Administrator admits that the reporting of defense costs has been "beefed up."

2. Despite these undisputed facts, the Objectors still complain about the way the negotiations were carried out and the proposal the negotiations yielded. As we show below, none of their objections has merit.

## I. The Views of the Customer Representatives and the Plan Administrator Deserve No Special Deference

3. The MFGI SIPA Proceeding remains active. The SIPA Trustee bears a statutory fiduciary duty to protect the interests of all creditors of MFGI, not just MFGH. Under the "Assignment Agreement" between the SIPA Trustee and the Customer Representatives, the SIPA Trustee paid all of the net equity claims of the customers, and received an assignment of all

[1] In this Reply, all defined terms will have the same meaning as they had in the Motion.

of those claims. As a result of this arrangement, any recovery in the customer class action is for the principal benefit of the SIPA Trustee.

4. At this point, the Objectors have no cognizable claim to the proceeds of the E&O Policies. The complaints of the Customer Representatives are especially strange. As an initial matter, they have no legal interest in the E&O Policies and their continuing effort to deprive the Individual Insureds of access to payment of Defense Costs is plainly a litigation tactic. Further, because the net equity of the customers has been paid in full, the only claims for damages that remain for the customers are dubious demands for "opportunity costs and/or prejudgment interest." (*In re Global Holdings Ltd. Investment Litigation*, Case No. 12-MD-2338 (VM), Customer Representatives' Memorandum in Support of Motion for Class Certification [ECF Doc. 788 at 2]). Thus as the Plan Administrator notes, the customers "no longer have a financial interest in the SIPA estate." (ECF Doc. 8535 at 2). In fact, if the "Customer Representatives" today represent anyone at all, it is the SIPA Trustee in a lawsuit to recover the general estate funds the SIPA Trustee advanced through the "Assignment Agreement."

5. The Plan Administrator also has no claim at present to the proceeds of the E&O Policies, and it absented itself from direct negotiations with the insurers and the Individual Insureds for the apparent purpose of waiting until they compromised with the SIPA Trustee (the only other party with a potential claim on the E&O Policies), so that the Plan Administrator could then attempt to extract further concessions. The Court told the parties to work together to resolve the soft cap, and the Plan Administrator's refusal to do so should not redound to his benefit in the litigation against the Individual Insureds.

## II. The Proposed Extension of the E&O Soft Cap Was Negotiated Exhaustively

6. The negotiations that led to the Motion took months. As in most negotiations, the parties started far apart. In agreeing to extend the E&O soft cap by $7.5 million, the parties ended the negotiations far closer to the SIPA Trustee's opening offer than to the Individual Insureds' opening request. In addition, in order to obtain an agreement on the amount of the extension of the soft cap, the insurers and the Individual Insureds also agreed to provide all parties with prompt disclosure, not just as to the amounts of E&O Policy proceeds that have been paid, but also as to the aggregate amounts that are billed each month, with that disclosure being made before any policy proceeds are paid on the bills. The law firms do not determine the allocation between D&O and E&O coverage.

7. The Objectors suggest that they were excluded from the negotiations, but that is not true. If the customers have any continuing financial interest in the SIPA estate, the SIPA Trustee represented that interest. The Plan Administrator knew about the discussions and was welcome to join them any time. During the course of the discussions, the Individual Insureds understood that the SIPA Trustee was reporting regularly to the Plan Administrator about the progress of the negotiations. With its objections, the Plan Administrator has submitted emails which show that it communicated directly with the insurers and made its positions clear to them. (*See, generally*, ECF Doc. 8535 Ex. A).

8. Nor were the views of the Plan Administrator ignored. In fact, the arguments of the Plan Administrator largely drove the outcome of the negotiations. The Plan Administrator acknowledges that it would have agreed to an extension of $5 million, subject to an additional agreement on increasing the extent of reporting (ECF Doc. 8535 at 22 [Email from Wittstein to Werner, 12/10/14] and 41 [Email from Wittstein to Werner, 12/3/14]). The

proposed extension of $7.5 million is far closer to the Plan Administrator's position than to the Individual Insureds' starting point. Similarly, the Plan Administrator previously asked the Court for additional reporting, the "beefed up" reporting requirement is far closer to what the Plan Administrator wanted than to what the insurers and the Individual Insureds were initially prepared to offer, and the Plan Administrator "supports the imposition" of that part of the proposal now. (ECF Doc. 8535 at 10 ¶14).

9. The Plan Administrator makes much of the questions that it asked the insurers and that the insurers supposedly did not answer. But the Plan Administrator's own cited e-mails refute that claim. The Court always made clear that any arrangement for the disclosure of defense costs could not be allowed to create an advantage in litigation. As the Court put it, ". . . because you assert a claim [that doesn't mean] you get to tie everybody's hands behind their backs so that they can't afford a defense." (Transcript of Hearing on June 28, 2013, at 57:2-57:4). Nor could disclosure be permitted to compromise the attorney-client privilege. (*See, e.g.*, ECF Doc. 7947, Transcript of Hearing of May 19, 2014, at 62:15-62:19 [The Court: "What you're not entitled to do is obtain attorney/client privileged information with respect to what each of the firms . . . has done."]). Thus disclosures of defense costs were to be made only on an aggregate basis.

10. The emails between the lawyers for the Plan Administrator and the insurers show that the insurers answered all of the Plan Administrator's questions, within the limits the Court has set. The Plan Administrator breezily declares that it was only trying to "verify" how the "allocation methodology" is being "applied to the variety of tasks involved" (ECF Doc. 8535 at 22 [Email from Wittstein to Werner, 12/10/14]). But parties in litigation are not permitted to do that. As the Court stated, ". . . the plaintiff . . . doesn't get to see what the

defendants are spending." (Transcript of Hearing on June 28, 2013, at 54:2-54:5). Such "verification" also would require the insurers to divulge information on the billings by individual law firms on specific tasks and claims. Since the time when the reporting requirement was first imposed in April 2012, the Court recognized that such granular disclosure threatened privilege and confidentiality, and the insurers would not be required to provide it.

## III. The Proposed Extension of the E&O Soft Cap Is Reasonable and Should Be Approved

11. The SIPA Trustee led the negotiations. He was uniquely positioned -- and obligated -- to consider the interests of all MFGI creditors, and he determined that the proposal is reasonable and that he would not oppose the Motion. The Objectors say nothing that warrants disturbing the SIPA Trustee's conclusion.

12. The activity in the lawsuits that the E&O Policies cover clearly is increasing. The customers have moved for class certification. The plaintiffs in the MDL cases are pressing for depositions of the Individual Insureds to begin next month. At the same time, many parties, including the Customer Plaintiffs, the CFTC, and the Litigation Trustee, have outstanding document production obligations, and some of those parties are forcing the Individual Insureds to file motions to compel them to make substantially complete productions.

13. The Plan Administrator makes the very odd assertion that because (on the Plan Administrator's assumptions as to the amounts of future spending) the proposed soft cap may not be reached until 2016, the proposal does not provide the insurers and the Individual Insureds with enough "incentive" to control spending. (ECF Doc. 8535 at 8 ¶10 and 10 ¶14). But the Court stated that the parties should try to agree on an arrangement which would keep them from having to burden the Court with these issues again. (ECF Doc. 7947 [Transcript of Hearing of May 19, 2014] at 84:22-85:1 [The Court: "It would be my strong preference, if

possible, you avoid having to come back here on another contested matter about how much more should be approved for advancement or reimbursement of attorneys' fees, costs, that includes experts, et cetera."]). Because the future course of the litigation is uncertain, the Motion does not rest on a precise prediction of the amount of time it will cover, but the Motion definitely is intended to satisfy the Court's direction.

14. In any event, the insurers and the Individual Insureds have the most powerful incentive of all to control defense costs. The E&O Policies are wasting assets. The insurers want to preserve those assets. The Individual Insureds need those assets to cover both defense costs and any potential settlements or judgments in the cases covered by those policies. Any undue drains on the E&O Policies harm the Individual Insureds.

15. Consistent with those incentives, the insurers have been rigorously monitoring the billings. Firms have agreed to significant discounts on their rates. The insurers issued guidelines to the firms both on how time is to be billed and on the kinds of charges that will be paid. The firms are billing their time to the matters to which the work corresponds. Each month, the insurers review the bills before making any payments.

16. As always, the customers complain about the issues that the Individual Insureds are litigating. The fact that the Objectors continue to make that argument only underscores the fact that their real aim is to use the soft cap as a way to create an unfair litigation advantage.

17. The example the customers cite in support of their objection is most telling. The Individual Insureds have moved to compel production of the work papers that Ernst & Young created for its work on the SIPA Trustee's report, which is the principal source for the charges in the customers' complaint. The defendants in the customer action regard the Ernst &

Young work papers as being important to their defense and after those defendants requested a pre-motion conference, Judge Francis instructed the parties to brief the issue. The customers' argument that the motion is "costly" (ECF Doc. 2049 at 4 n.5) is just another way of saying that the Individual Defendants should be punished for litigating their case.

18. The Plan Administrator notes that to date roughly 72 percent of total defense costs have been paid out of the D&O Policies, with the remaining 28 percent coming out of the E&O Policies. The Plan Administrator even says that the insurers have "allocate[d] 72% of the costs to the D&O policies and 28% to the E&O policies." (ECF Doc. 8535 at 11 ¶16). That assertion is not correct. The allocation between the D&O and E&O Policies applies only in the cases where both the D&O and E&O Policies provide coverage, and in those cases the allocation has been for the D&O Policies to pay 59 percent of the Defense Costs and for the E&O Policies to pay 41 percent. The 72/28 overall actual split results from the fact that in some of the cases, such as the securities class action, Defense Costs are covered only by the D&O Policies.

19. The inference that the Plan Administrator tries to draw from the 72/28 split of payments is equally in error. The Plan Administrator argues that "even if there is no increase to the soft cap . . . the Individual Insureds will continue to recover . . . over 70% of all costs on an ongoing basis." (ECF Doc. 8535 at 8 ¶11). But the D&O Policies have not been paying the bills that the E&O Policies have not paid. So if the soft cap is not extended, then in the cases where the E&O Policies provide coverage, the 59/41 allocation still will apply, and subject to an ultimate "true-up," more than 40 percent of the Individual Insureds' defense costs in those cases will continue to go unpaid. This will continue to cause extreme hardship to the

Individual Insureds who are defendants in only the customer class action, the Sapere case, and/or the CFTC case – the actions for which the E&O Policies provide coverage.

20. The Customer Representatives raise other objections that have been addressed before, so they can and should be dismissed quickly now. They point to the total defense spending to date, but they ignore the fact that much of that money was spent to defend more than 50 persons in investigations by government regulators and the two trustees. They also ignore the many ways in which the plaintiffs in each of the lawsuits filed against the Individual Defendants have shifted an extraordinary amount of the cost of litigating to the Individual Defendants. For instance, both the SIPA Trustee and the Litigation Trustee have refused to conduct targeted searches for documents in response to various document requests. Instead, each has produced large – and at least in the case of the Litigation Trustee, materially incomplete – "data dumps" that are costly to process, host, and review.

21. In addition, there have been extraordinary costs created simply by a lack of cooperation, as, for example, when Sapere refused to agree to let the defendants in its action deem the answer to the Customer Complaint to be the answer to the Sapere complaint. This forced six defendants to separately answer a 110-page, 217-paragraph complaint. Indeed, there has been virtually no coordination among the plaintiffs, with each of the CFTC, Sapere, the securities plaintiffs, and the customer plaintiffs serving separate document requests on each of the defendants. Further, in every case there have been significant and on-going discovery disputes, each of which had to be negotiated and, in some cases, litigated separately.

22. The Customer Representatives suggest that "victims and creditors" share a common right with the Individual Insureds to E&O Policy proceeds. (ECF Doc. 2049 at 3 ¶6).

But the Court ruled long ago that until plaintiffs obtain a judgment or settlement, they have no such right. (ECF Doc. 619 at 28).

23. The Customer Representatives also suggest that the Individual Insureds should be made to pay some of their defense costs. (ECF Doc. 2049 at 4 ¶6). But this ignores the fact that the Individual Insureds have a contractual right to coverage and that the insurance contracts do not condition coverage in any way on an insured's ability to pay, let alone on actual payment of defense costs. *See In re Hoku Corp.*, No. BR 13-40838-JDP, 2014 WL 1246884 at *5 (Bankr. D. Idaho Mar. 25, 2014) (rejecting trustee's argument that insureds who were seeking access to a D&O insurance policy should be required to show that personally paying the defense costs would be a burden). Thus, as with the other objections, this argument provides no basis for denying approval to the proposed extension of the E&O soft cap.

**Conclusion**

For these reasons and those set forth in the Motion, the Individual Insureds respectfully request that the Court enter an order (1) modifying the automatic stay (as to MFGI) and the Plan injunction (as to MFGH), to the extent necessary, with respect to the proceeds of the E&O Policies, (2) authorizing MFG Assurance, to the extent necessary, to make payments of an additional $7,500,000 for the reimbursement of Defense Costs in accordance with the terms of the E&O Policies, and (3) authorizing MFG Assurance or its designee, to the extent necessary, to provide certain additional information to the SIPA Trustee and the Plan Administrator concerning invoices that are submitted for payment of Defense Costs from the E&O Policies.

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DECHERT LLP

/s/ Jonathan R. Streeter
Jonathan R. Streeter
1095 Avenue of the Americas
New York, New York 10036
Telephone: (212) 698-3826
Facsimile: (212) 698-3599
jonathan.streeter@dechert.com
*Attorneys for Jon S. Corzine*

KRAMER LEVIN NAFTALIS & FRANKEL LLP

/s/ Arthur H. Aufses III
Arthur H. Aufses III
Paul H. Schoeman
1177 Avenue of the Americas
New York, New York 10036
Telephone: (212) 715-9100
Facsimile: (212) 517-8000
aaufses@kramerlevin.com
*Attorneys for Bradley Abelow*

SULLIVAN & WORCESTER LLP

/s/ Laura Steinberg
Laura Steinberg
One Post Office Square
Boston, Massachusetts 02109
Telephone: (617) 338-2800
Facsimile: (617) 338-2880
lsteinberg@sandw.com
*Attorneys for David Dunne*

DAVIS POLK & WARDWELL LLP

/s/ Edmund Polubinski III
Edmund Polubinski III
450 Lexington Ave.
New York, New York 10017
Telephone: (212) 450-4000
Facsimile: (212) 701-5695
edmund.polubinski@davispolk.com
*Attorneys for David P. Bolger, Eileen S. Fusco, David Gelber, Martin J. G. Glynn, Edward L. Goldberg, David I. Schamis and Robert S. Sloan*

WILLIAMS MONTGOMERY & JOHN LTD.

/s/ Christopher J. Barber
Christopher J. Barber
Willis Tower
233 S. Wacker Drive, Suite 6100
Chicago, Illinois 60606-6359
Telephone: (312) 443-3200
Facsimile: (312) 630-8500
cjb@willmont.com
*Attorneys for Edith O'Brien*

AKIN GUMP STRAUSS HAUER & FELD LLP

/s/ Robert H. Hotz, Jr.
Robert H. Hotz, Jr.
One Bryant Park
New York, New York 10036
Telephone: (212) 872-1028
Facsimile: (212) 872-1002
rhotz@akingump.com
*Attorneys for John R. MacDonald*

BINDER & SCHWARTZ LLP

/s/ Neil S. Binder
Neil S. Binder
28 West 44th Street, 7th Floor
New York, New York 10036
Telephone: (347) 334-5081
Facsimile: (347) 772-3072
nbinder@binderschwartz.com
*Attorneys for Henri Steenkamp*

DE FEIS O'CONNELL & ROSE, P.C.

/s/ Gregory J. O'Connell
Gregory J. O'Connell
500 Fifth Avenue, 26th Floor
New York, New York 10110
Telephone: (212) 768-1000
Facsimile: (212) 768-3511
gjo@dorlaw.com
*Attorneys for Vinay Mahajan*