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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:

MF GLOBAL HOLDINGS LTD., *et al.*,

Debtors.

Chapter 11

Case No. 11-15059 (MG)

(Jointly Administered)

**OBJECTION OF CERTAIN COMMODITIES CUSTOMERS OF
MF GLOBAL INC. TO MOTION OF U.S. SPECIALTY INSURANCE
COMPANY FOR RELIEF FROM THE AUTOMATIC STAY**

Members of the Representative Customer Group,¹ parties in interest in the instant chapter 11 case of MF Global Holdings Ltd. (“MF Global”) under 11 U.S.C. § 1109(b) and commodities customers of MF Global Inc. (“MFGI”) under 11 U.S.C. § 761(9)(A), hereby object to the Motion of U.S. Specialty Insurance Company for Relief From the Automatic Stay, to the Extent Applicable (Document No. 428) (the “Motion”).

PRELIMINARY STATEMENT

1. No later than October 26, 2011 and continuing until the collapse of MF Global,

¹ The Representative Customer Group consists of Paradigm Global Fund I Ltd., Paradigm Equities Ltd., Paradigm Asia Ltd., Augustus International Master Fund, L.P., William Schur, Futures Capital Management, LLC and Ali A. Rangchi Bozorki.

certain of the company's senior management caused, authorized and/or allowed MF Global to steal funds from securities and commodity customer accounts at MFGI for the benefit of MF Global and its corporate subsidiaries, including using such customer assets to meet margin calls and other cash demands from MF Global's trading counterparties and banks.

2. As a futures commission merchant ("FCM"), MFGI's conversion of commodities customer funds to meet the obligations of its parent MF Global – which caused a \$1.6 billion shortfall in funds available for return to customers – violated numerous provisions of the Commodities Exchange Act (the "CEA") that required MFGI to keep customer assets segregated and prohibited the use of such assets to cover obligations of anyone but the customer. As a result, numerous customer groups have instituted direct and class actions against senior management of MF Global and MFGI ("Senior Management") and other third parties for violations of the CEA and related causes of action. Based on the anticipated shortfall at MFGI, such lawsuits are vital for customers to recover their funds in full.

3. According to the Motion, before MF Global and its affiliated debtors' bankruptcy filings, U.S. Specialty Insurance Company ("U.S. Specialty") issued a \$25.0 million Directors, Officers and Corporate Liability Insurance Policy (the "D&O Policy") covering the period from May 31, 2011 to May 31, 2012. By its motion, U.S. Specialty seeks relief from the automatic stay to allow it to make payments from the D&O Policy related to Senior Managements' defense of the customer cases arising from conversion of customer funds during this period.

4. By this objection, the Representative Customer Group submits that insurance proceeds from the D&O Policy, which expressly covers "damages, settlements, judgments or other amounts" that members of Senior Management are obligated to pay as the result of any claim against them, should be maintained in their entirety to, *inter alia*, satisfy customer claims

or lawsuits arising from the shortfall at MFGI. For all intents and purposes, MF Global, MFGI and Senior Management stole customers' funds for their own uses. Respectfully, the automatic stay should remain in place so that the proceeds of the D&O Policy remain intact as a potential source to make customers whole rather than to offset Senior Managements' cost of defending their wrongdoing – at least until certain questions about the ownership of the proceeds of the D&O Policy are resolved.

BACKGROUND

A. The Bankruptcy Case

5. Commencing on the morning of October 31, 2011 (the “Petition Date”), and, in some instances, periodically thereafter, MF Global and certain of its affiliates and subsidiaries (collectively, the “Debtors”) filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) in the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”). Pursuant to the Court’s order, the Debtors’ chapter 11 cases are being jointly administered (the “Bankruptcy Case”).

6. On November 7, 2011, the U.S. Trustee appointed the statutory committee of unsecured creditors of MF Global (the “Statutory Creditors’ Committee”) in the Bankruptcy Case.

7. On November 28, 2011, the Bankruptcy Court granted the Joint Emergency Motion of the Debtors and Statutory Creditors’ Committee for Order Pursuant to 11 U.S.C. §1104 and Fed. R. Bankr. P. 2007.1 Directing Appointment of Chapter 11 Trustee, and approved the appointment of Louis J. Freeh as Chapter 11 trustee in the Bankruptcy Case (the “Chapter 11 Trustee”).

B. The SIPA Case

8. MFGI was the principal subsidiary of MF Global that transacted business with the public in the U.S. and held securities and commodities client assets in its custody. MFGI was a registered FCM with the U.S. Commodity Futures Trading Commission (“CFTC”) and a broker-dealer with the U.S. Securities and Exchange Commission (“SEC”). Under the CEA and CFTC regulations, MFGI was required at all times (with a few minor exceptions) to segregate client funds from those of the brokerage firm and was prohibited from using client funds for its own purposes.

9. Beginning no later than October 26, 2011, Senior Management of MF Global and MFGI – including former Chairman and CEO Jon Corzine – caused, authorized and/or allowed MFGI to steal customer assets to satisfy MF Global’s own obligations in an attempt to keep the foundering company afloat. By causing MFGI and MF Global to use commodity customer funds for their own purposes, Senior Management egregiously violated multiple provisions of the CEA – the backbone of the regulatory scheme designed to protect participants in commodities and futures trading activities since 1936 – and other statutory and common law.

10. Following MF Global’s bankruptcy filing on October 31, the Securities Investor Protection Corporation (“SIPC”) initiated the liquidation of MFGI under the Securities Investor Protection Act of 1970 (“SIPA”), and sought a declaration in the United States District Court for the Southern District of New York (the “District Court”) that MFGI’s customers were entitled to the protections available under SIPA. Later on the Petition Date, the District Court granted the application, appointed James W. Giddens as SIPA Trustee (the “SIPA Trustee”) for the liquidation of MFGI, and transferred the case to the Bankruptcy Court (the “SIPA Case”).

11. On November 17, 2011, this Court instructed the CFTC, SIPC, and the SIPA Trustee to submit briefing in the SIPA Case concerning the regulations applicable to the remaining distributions of customer property by the SIPA Trustee.

12. On December 12, 2011, the SIPA Trustee filed (in the SIPA Case) the Trustee's Memorandum Regarding the Legal Principles and Framework for the Allocation and Distribution of Customer Property. In it, the SIPA Trustee pointed out that applicable regulations accord customer property claims priority "over all claims except claims 'attributable to the administration of customer property.'" (SIPA Document No. 726)

13. In addition, the SIPA Trustee argued that shortfalls in satisfying customer property claims can be paid out of the general estate:

Under SIPA § 78111(4)(E), where property "would have been set aside or held for the benefit of customers" in compliance with applicable law but was not, "any other property of the debtor" may be devoted to filling the gap. Thus, "if the debtor miscalculated the funds to be set aside . . . or otherwise under funded such account, the trustee can recoup any deficiency from 'firm' property."

Put another way, the SIPA Trustee believes he has the authority to use non-customer assets in MFGI's estate to satisfy customer claims, even if it is to the detriment of other creditors.

14. In response, on December 22, 2011, counsel for the Statutory Creditors' Committee submitted a letter to the Court disputing that the SIPA Trustee may use general estate property to satisfy customer claims to the possible detriment of other creditors on MF Global and MFGI:

The issue is critical to the Committee because 17 CRF 190.08 moves general property into customer property beyond the extent permitted by subchapter IV of the Bankruptcy Code as made applicable by SIPA, and thereby diminishes the assets MFGI can use to pay claims of the Chapter 11 Debtors and other creditors, including any deficiency claims of securities customers.

(SIPA Document No. 781.)

15. In this regard, on January 18, 2012, the Statutory Creditors' Committee submitted its memorandum of law in support of its right formally to appear and be heard on the issue of the SIPA Trustee's right to use general estate assets to pay customer claims. The briefing is ongoing and the issue of the use non-customer assets to pay such claims is still unresolved.

16. On February 6, 2012, the SIPA Trustee submitted the Trustee's Preliminary Report on Status of His Investigation and Interim Status Report on Claims Process and Account Transfers. (SIPA Document No. 896.) In addition to details about his investigation of missing customer funds, the SIPA Trustee's report stated that he "has already distributed nearly \$4.0 billion to former MFGI retail commodities customers with U.S. futures positions via three bulk transfers" that have "restore[d] 72% of U.S. segregated customer property to all former MFGI retail commodities customers with U.S. futures positions."²

17. Unfortunately for customers, including the Representative Customer Group, to date the SIPA Trustee has not recovered all the missing client funds nor is there an expectation that he will be able to do so. The shortfall in available funds may be as much as \$1.6 billion.

18. As more time passes, the belief that a continuing shortfall is inevitable appears more and more accurate. On January 30, 2012, *The Wall Street Journal* reported that "officials hunting for [the] estimated \$1.2 billion in missing customer money increasingly believe that much of it might never be recovered." Indeed, according to such officials, some of the missing

² According to the SIPA Trustee, his investigation into the shortfall "will continue, in coordination with the regulatory and law enforcement investigations that are being conducted by the Department of Justice, the Commodity Futures Trading Commission, and the Securities Exchange Commission on an ongoing basis."

money may simply have “vaporized” amidst the reckless trading at MF Global in the days and weeks proceeding the collapse:

As the sprawling probe that includes regulators, criminal and congressional investigators, and court-appointed trustees grinds on, the findings so far suggest that a “significant amount” of the money could have “vaporized” as a result of chaotic trading at MF Global during the week before the company’s Oct. 31 bankruptcy filing, said a person close to the investigation.³

19. Notably, the \$1.6 billion anticipated shortfall means that the instant case will be the first FCM liquidation *in history* where commodities customers do not receive their funds back in full through the SIPA process.

C. The Customer Actions

20. On January 30, 2012, the Representative Customer Group filed a class action complaint in the District Court against senior management on behalf of its members and any persons and entities who held cash and/or other assets at MFGI that were or should have been segregated in commodities customer accounts as of October 31, 2011, provided such cash and/or other assets (or the cash equivalent to any such assets) has not been transferred to another FCM on behalf of such putative class member or returned to such putative class member. The Representative Customer Group’s putative class action is one of a number of direct and class actions around the country against former management of MF Global and MFGI brought under, *inter alia*, the CEA on behalf of former customers whose customer funds deposited at MFGI are missing. A number of these commodities customer actions have been consolidated before the District Court and that court is awaiting a ruling from the United States Judicial Panel on Multi-

³ Scott Paterson and Lucchetti, *Money From MF Global Feared Gone*, THE WALL STREET JOURNAL, January 30, 2012.

District Litigation on the transfer of certain other customer class actions before it appoints lead plaintiff(s) and lead counsel in the consolidated customer class actions.

D. The Chapter 11 Trustee's Proposed Stipulation with the Statutory Creditors' Committee Concerning MF Assurance Company Ltd.

21. On February 3, 2012, MF Assurance Company Ltd. ("MF Assurance") and the Chapter 11 Trustee presented a stipulation (Document No. 409) (the "Stipulation") concerning twenty one professional liability policies issued to MF Global providing coverage of up to \$190.0 million "on behalf of the insured for all loss arising out of a wrongful act which gives rise to a claim first made against an insured by a third party during the policy period." At least thirteen of these policies providing coverage of \$120.0 million cover the period when senior management caused, authorized and/or allowed MF Global to steal funds from securities and commodity customer accounts at MFGI.

22. Instead of reserving these funds for the customer victims of MF Global and MGFI, the Chapter 11 Trustee and MF Assurance presented the Stipulation asking that MF Assurance be authorized at its discretion to make payments under the policies to MF Global affiliated persons and entities that it "deems appropriate," including advancing defense costs to the very persons who created the shortfall.

23. On February 7, 2012, at least four individual customers and/or groups of customers – including the Representative Customer Group – timely filed objections to the Stipulation (Document Nos. 416, 417, 419 and 422) (the "Objections"). The Representative Customer Group argued, *inter alia*, that the Court should temporarily reserve the proceeds of the applicable MF Assurance policies potentially to satisfy customer claims. (Document No. 416.) In particular, the Representative Customer Group argued that insurance payments to finance the defense costs of the wrongdoers were premature while the issue of the ownership of the MF

Assurance policies and what, if any, property of MFGI and MF Global's estate can be used to satisfy customer claims in priority over all other creditors, remains unresolved. (*See Id.* at ¶ 26.)

24. On February 9, 2012, this Court held a status conference regarding the notice of presentment of the Stipulation and the Objections. During the conference, the Court requested additional briefing prior to entering the Stipulation and suggested that defense costs may be advanced on open claims covered by the insurance policies inapplicable to the time-period relevant to the customer claims.

25. Thereafter, counsel for the Chapter 11 Trustee and MF Assurance circulated a stipulation to the objecting customers that would permit MF Assurance to advance defense costs from policies predating the period relevant to the customer claims and it appears the parties will be able to reach an agreement concerning the earlier policies.

E. U.S. Specialty's Motion for Relief from the Automatic Stay

26. On February 8, 2012, U.S. Specialty filed its Motion for relief from the automatic stay, to the extent applicable, to permit the advancement and/or payment of certain defense costs under, among others, the D&O Policy issued to MF Global and its affiliated debtors and subsidiaries.

27. According to the Motion, the D&O Policy, among other things, "provides for a covered **Loss**⁴ incurred by the **Insured Persons** for **Claims** made against them if such **Loss** is not indemnified by MF Global or its **Subsidiaries**" or "provides coverage to the **Company** to the extent it indemnifies the **Insured Person** for covered **Loss**" (*See* Motion at ¶¶ 6-7).

"**Insured person** includes any past, present or future director, officer, managing member or manager of the **Company**, including any person in a position which is the functional equivalent

⁴ The Motion presents in bold any terms defined in the D&O Policy.

of a director, officer, managing member or manager with respect to any entity included within the definition of **Company** . . .⁵” (See Motion at ¶ 9). Loss means “**Defense Costs** and any damages, settlements, judgments () or other amounts () that an **Insured Person** is legally obligated to pay as a result of any **Claim**”.

ARGUMENT

28. The Representative Customer Group submits that lifting the stay to allow U.S. Specialty to make payments to current and former MF Global persons and affiliates, including the costs of Senior Management defending their wrongdoing concerning customer accounts, is premature and would be manifestly unjust to the tens of thousands of MFGI customers from whom MF Global and its Senior Management caused, authorized and/or allowed \$1.6 billion to be taken in violation of a seventy-six year old regulatory scheme designed to protect customers. The reasoning in this regard is virtually identical to the MF Assurance policies at issue in the Stipulation.

29. Insurance payments to finance the defense of the culprits of the MF Global disaster out of proceeds that could potentially be applied to satisfy missing customer funds is particularly premature where, as here, the issue of the ownership of the D&O Policy and what, if any, property of MFGI and MF Global’s estate can be used to satisfy customer claims in priority over all other creditors, remains unresolved.⁶ Both the Stipulation and the Motion acknowledge that ownership of the proceeds of insurance policies is unresolved in this case. Moreover, the

⁵ According to the Motion, the D&O Policy defines **Company** as “meaning MF Global and its **Subsidiaries**,” which includes MFGI.

⁶ Courts generally consider insurance policies to be property of the estate. There is, however, some uncertainty whether *the proceeds* of such policies are estate property. Generally, court must analyze the question in light of the facts of each case. See *In re Sfuzzi, Inc.*, 191 B.R. 664, 668 (Bankr. N.D. Tex. 1996); *In re CyberMedica, Inc.*, 280 B.R. 12, 17 (Bankr. D. Mass. 2002).

Statutory Creditors' Committee is contesting whether the SIPA Trustee can use general MFGI property to satisfy customer claims in priority over all other creditors. Until such issues are resolved – including the issue of the entitlement of Senior Management's to indemnification from MFGI and MF Global and the priority of any such claims – payments to Senior Management that decrease the available proceeds to satisfy customer claims with potential priority is simply premature and unjust.

30. Under section 105 of the Bankruptcy Code, this Court has the authority to fashion appropriate relief to protect the interest of all potential claimants. To protect the interests of all claimants, the Representative Customer Group respectfully submits that U.S. Specialty should not be granted relief from the automatic stay that would permit it to make premature payments from the D&O Policy until the question surrounding the proper ownership/treatment of the proceeds are resolved.

Dated: New York, New York
February 28, 2012

By: /s/ Andrew J. Entwistle

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