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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

MOTION FOR STAY PENDING APPEAL OF ORDER LIFTING AUTOMATIC STAY TO PERMIT PAYMENTS OF DEFENSE COSTS UNDER CERTAIN INSURANCE POLICIES AND MEMORANDUM OPINION LIFTING AUTOMATIC STAY TO PERMIT PAYMENTS OF DEFENSE COSTS UNDER CERTAIN INSURANCE POLICIES

Sapere Wealth Management LLC, Granite Asset Management and Sapere CTA Fund, L.P. (collectively, "Sapere") hereby moves for a stay of this Court's Order Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies and Memorandum Opinion Lifting the Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies pending an appeal of that order pursuant to Federal Rule of Bankruptcy Procedure 8005(f) and hereby states as follows:

MFG Assurance Company, Ltd. ("MFGA") issued twelve (12) policies of primary and excess insurance (the "Policies"),[1] collectively insuring MF Global, Inc. ("MFGI") as insured for a collective cover of $120,000,000. The Policies cover MFGI's liability for the claims made by commodities customers (including Sapere) during the period May 31, 2011, through May 31, 2012, for MFGI's breach of its duty to return to the commodities customers all of the funds in their segregated accounts. Through its Order Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies and Memorandum Opinion, this Court found that it did not need to decide whether the MFGA Policies' proceeds were part of the MFGI estate and that, in any event, "cause" existed to lift any stay that may be in place and use the proceeds of the MFGA Policies and pay the defense costs of former officers and directors of MFGA. Sapere filed a Notice of Appeal on April 24, 2012 and is appealing this Court's decision as it applies to the MFGA Policies. MFGA should be enjoined from paying proceeds of the MFGA policies prior to resolution of this matter on appeal because:

- There is a substantial likelihood that Sapere will prevail on the merits of its appeal because it has vested rights to the MFGA policy proceeds under New York Law. Indeed, the SIPA Trustee has admitted facts that establish that MFGI and its management committed covered wrongful acts under the MFGA Policies.
- Sapere and other commodities customers will suffer irreparable harm if $30 Million of the $120 Million of available MFGA policy proceeds are paid to the former officers and directors of MF Global Holdings, Ltd. ("Holdings"). The MFGA Policies are "wasting policies," meaning that funds spent to indemnify

[1] The Policies have policy numbers 1-18001-00-11, 1-18002-00-11, 1-18003-00-11, 1-18004-00-11, 1-18005-00-11, 1-18005-01-11, 1-18006-00-11, 1-18009-00-11, 1-18010-00-11, 1-18011-00-11, 1-18011-01-11, and 1-18012-00-11, respectively. The Policies stack to provide cover of $120,000,000 collectively.

directors and officers deplete policy limits, thereby reducing the available funds left to compensate injured parties such as Sapere.

- The officers and directors of Holdings will suffer no harm if MFGA is enjoined because, as the has Court already noted, there is other insurance available, such as the $250 Million in D&O insurance issued by U.S. Specialty Insurance Company. Additionally, although not disclosed before this Court, it has been brought to light in the insurance industry press that MF Global is insured for another $150 Million in Side A, B, and C coverage with an additional $100 Million in exclusive Side A coverage that sits atop that.
- The public interest undoubtedly favors the 25,000+ commodities customer claimants, which include farmers, ranchers, and other individuals, who have suffered from the actions of the officers and directors of MF Global.

1. In considering whether the payment of the MFGA policy proceeds should be stayed, the Court should look to four factors: 1.) the likelihood of the appellant's success on the merits of the appeal, 2.) that the movant will suffer irreparable injury if the stay is denied, 3.) that no substantial harm will be suffered by others if the stay is granted, and 4.) any potential harm to the public in granting the stay. *Hirschfield v. Bd. of Elections*, 984 F.2d 35, 39 (2d Cir. 1993); *In re Advanced Mining Sys.*, 173 B.R. 467, 468 (S.D.N.Y. 1994). In analyzing whether a party will suffer prejudice, the relevant consideration is the "prejudice to either party during the interim between appeal and appellate decision, if a stay is granted or denied." *Advanced Mining Sys.*, 173 B.R. at 468. In determining whether to grant a stay pending appeal, courts in the Second Circuit will balance the four factors in question. *See, e.g.*, *Mohammed v. Reno*, 309 F.3d 95, 101 (2d Cir. 2002). Sapere's appeal convincingly satisfies all four criteria and, accordingly, this

Court's Order Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies and Memorandum Opinion Lifting Automatic Stay To Permit Payments of Defense Costs Under Certain Insurance Policies as it applies to the MFGA Policies should be stayed pending the resolution of Sapere's appeal.

A. **There is a Substantial Possibility that Sapere Will Succeed on the Merits of its Appeal**

2. The 2011-2012 MFGA Policies are professional corporate liability policies that cover MFGI's liability for third-party claims by its commodities customers. The 2011-2012 MFGA Policies are not "D&O" policies whose distinct purpose is often to provide coverage only for the directors and officers.

3. From and after October 31, 2011, MFGI's liability to commodities customers for MFGI's breach of its duty as a futures commission merchant ("FCM") (also called a commodities broker) to return to the commodities customers all of the funds in their segregated accounts has been known to exceed substantially the combined limits of the Policies. This fact is not subject to genuine dispute. Indeed, the Trustee's latest estimate of MFGI's shortfall in commodities customers' segregated account funds is $1.6 Billion. *See* SIPA Trustee's Feb. 10, 2012 Update on Estimated Commodities Deficiency and Claims Process. Because the covered loss exceeds the policies' combined limits, the proceeds of the policies must be paid now, in full, to the injured victims (MFGI's commodities customers) toward reducing the massive damages they sustained.

4. The Court's ruling is based on the finding that "Here, Sapere and Customer Objectors have not conclusively established that the Debtors or the Individual Insureds are liable for any wrongdoing that would be covered by the [MFGA] Policies." (Memorandum Opinion at

28). The Court's ruling does not address that the SIPA Trustee has conceded MFGI's commodities customers' property "should have been segregated by MFGI's former management for the benefit of MFGI's U.S.-based trading customers." (Docket no. 495, ¶ 8, at 6) The SIPA Trustee has conceded that MFGI un-segregated at least approximately $1 Billion as of October 28, 2011. (Docket No. 896, at 13) SIPC commenced the SIPA liquidation of MFGI on October 31, 2011. The SIPA Trustee, on January 12, 2012, stated that his best estimate of MFGI's shortfall in accounts that should have been segregated was then $1.2 Billion. (Docket no. 835, at 40). The Trustee has since raised his estimate of the segregated account shortfall to $1.6 Billion. (*See* Chapter 11 Case Docket No. 382-1, Ex. A, p. 199) The Trustee has conceded that commodities customers filed in excess of 25,000 written claims in this SIPA liquidation case in respect of segregated-account funds that MFGI has not returned to them. (Docket no. 977, ¶ 9 at 4) As demonstrated by the preceding concessions, the Trustee has conceded that MFGI owes its commodities customers far in excess of $120,000,000 for customers' segregated account funds that MFGI wrongfully released from segregation and which since at least October 31, 2011, have been missing.

5. Controlling precedent specifically addresses and dispels the notion that the commodities customers must first obtain an adjudication against MFGI before they can recover their damages from the liability policies' proceeds. The US Court of Appeals for the Second Circuit has rejected this argument. To begin with, the New York Insurance Law and bankruptcy principles operate in tandem when an insured is liquidated in a bankruptcy proceeding and the insured has liability insurance for the claims of injured persons. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 239 (2d Cir. 2011).

6. The New York Insurance Law contains provisions addressing the effect of an insured's bankruptcy. Section 3420(a)(1) applies to the Liability Insurer's insurance policies. Section 3420(a)(1) had been numbered Section 167(1)(b) until New York recodified and renumbered its Insurance Law in 1984.

7. The US Court of Appeals for the Second Circuit, in *In re F.O. Baroff Co.*, 555 F.2d 38, 43-44 (2d Cir. 1977), addressed this specific NY Insurance Law provision and its operation when an insured is subject to bankruptcy proceedings. The Second Circuit flatly rejected the proposition that an injured person was required to obtain a judgment against the bankrupt insured as a condition to recovering the insurance proceeds. The Second Circuit held instead that "in formulating the mechanism whereby an injured person could receive the benefit of his insurer's insurance 'in case judgment against the insured . . . shall remain unsatisfied,' section 167(1)(b) [now 3420(a)(1)] simply reflected the general principles that the Legislature had in mind when it adopted section 167(1)(a). The legislative history of section 167(1) [now 3420(a)(1)] makes clear that *it was not intended to establish any difference in the substantive rights of one who has procured a judgment against his injurer before bankruptcy and one who has not*." *Id.* at 44 (emphasis added).

8. Additionally, the Second Circuit held that "Section 167 [now 3420(a)(1)] was designed by the New York Legislature to ensure that injured persons with unsatisfied claims against a bankrupt receive the proceeds of insurance *before they enrich the bankrupt's general creditors.*" *Id*. at 44 (emphasis added). The Second Circuit explained that "Section 167(1) applies to all insurance policies indemnifying against liability." *Id*. The Second Circuit further held that "the thrust of section 167(1) [now 3420 (a)(1)] . . . *is to transform the contract of insurance from one indemnifying the insured against loss to him resulting from liability to a*

third person, into an arrangement whereby insurance proceeds are made directly available to the third person irrespective of the insured's own loss." *Id.* (emphasis added).

9. Even if the Second Circuit had not already addressed the issue of whether MFGI's commodities customers must obtain an adjudicative determination before collecting the policies' proceeds, other established law holds that the commodities customers must not first obtain an adjudication adverse to MFGI.

10. A court must construe an insurer's liability insurance policy as a contract, but with any ambiguities construed against the insurer. *Mostow v. State Farm Ins. Co.*, 88 N.Y.2d 321, 326-27, 668 N.E.2d 392, 394 (1996). Here, the policies' definition of *loss* makes clear that damages exist irrespective of the recovery by a third-party of a judgment for those damages. Paragraph 2.19 (ii) defines *loss* to include "damages" in addition to "judgments." Under New York law, the word "damages" as used in the policies is therefore not limited to "judgments" and "damages" receives its ordinary meaning. "The idea of compensation is fundamental in the conception of damages, and the term is generally used synonymously with compensation." 36 N.Y. JUR., *Damages* § 1 (2011). "Compensatory damages proceed from a sense of natural justice, and are designed to repair that of which one has been deprived by the wrong of another." *Reid v. Terwilliger*, 116 N.Y. 530, 534, 22 N.E. 1091, 1092 (1889). "Damages" means "payment in money for a plaintiff's losses caused by a defendant's breach of duty." 36 N.Y. JUR., *Damages* § 1 (2011).

11. The commodities customers sustained "damages" the moment that MFGI un-segregated their segregated account funds. From that moment onward, the commodities customers were due compensation at least equal to the missing segregated account funds. No

genuine dispute exists that the amount missing exceeds the policies' combined limits and that this has been true since at least October 31, 2011.

12. The SIPA Trustee's form "letter of determination" further confirms that the commodities customers' claims filed in the SIPA liquidation case comprise *claims* for "damages" arising from MFGI's *wrongful acts* (a policy term that we further discuss below). For example, using docket no. 1167 as an illustration, the Trustee states that his letter of determination "determines the claim that you submitted for the return of property form the MF Global, Inc. account number referenced above." A commodities customer's monetary claim for the return of segregated account property that MFGI did not return plainly constitutes a *claim* by a third-party (i.e., the commodities customer) against MFGI for "damages."

13. Second, N.Y. INS. L. § 3420(a)(1) requires that the insolvency or bankruptcy of the person insured [i.e., MFGI], or the insolvency of the insured's estate [i.e., MFGI's estate], shall not release the insurer [i.e., MFGA] from the payment of damages for injury sustained or loss occasioned during the life of and within the coverage of such policy or contract." Because of MFGI's insolvency, SIPC placed MFGI into SIPA liquidation. SIPA liquidation is governed by Chapter 7 of the Bankruptcy Code, with some adjustments not relevant here. Because of the "automatic stay" that exists in a SIPA liquidation case, MFGI's commodities customers cannot recover a "judgment" against MFGI.[2] Yet, the notion that liability must be conclusively established, if accepted, would mean that the insolvency of MFGI precludes commodities customers from recovering their damages because SIPA precludes them from

[2] The commencement of a SIPA liquidation operates as an automatic stay of, *inter alia*, "the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor," or "any act to obtain possession of . . . or to exercise control over property of the estate." 11 U.S.C. § 362(a)(1), (3); SIPA § 78fff(b) (applying chapter 3 of Title 11).

obtaining a judgment against MFGI. That would stand N.Y. INS. L. § 3420(a)(1) on its head and yield the opposite outcome mandated by the statute.

B. **Sapere and Other Commodities Customers will Suffer Substantial Prejudice if this Court's Order is not Stayed**

14. The MFGA Policies are "wasting policies," meaning that funds spent to indemnify directors and officers deplete policy limits, thereby reducing the available funds left to compensate injured parties such as Sapere. If this Court's order is not stayed, those funds will be paid to the former officers and directors of MF Global and will no longer be available to commodities customers with vested rights in those proceeds. As to the second factor enumerated in *Advanced Mining*, it is indisputable that Sapere and other commodities customers would suffer significant prejudice if this Court's order is not stayed pending appeal. Every dollar that is spent funding the defenses of the various directors and officers is money that cannot be spent to compensate commodities customers for the cumulative $1.6 Billion loss they have suffered from their segregated accounts. If this court does not stay its order while this appeal pends, funds will immediately begin to be spent to defend the various directors and officers who have been sued in federal courts across the country. It cannot be seriously disputed that such a situation would constitute prejudice to commodities customers who have vested rights in those proceeds.

C. **Other Parties will not Suffer Prejudice if this Court's Order is Stayed**

15. The existence of additional D&O coverage, beyond the MFGA Policies, completely negates any possibility of prejudice to other parties. Here, the only two fathomable "other parties" with an interest would be the directors and officers who the Trustees and insurance providers assert need insurance proceeds to fund their defenses and the Chapter 11 estate as a whole, as the Chapter 11 Trustee has argued that the "inability to defend properly the

suits brought against [the directors and officers] could result in the entry of judgments that could have an even greater adverse impact on the Debtors' estates should those judgments result in the assertion of new or additional claims against the Debtors' estates."

16. Ultimately, granting the present motion to stay will ensure that MFGA does not begin to pay out on its portion of the $30 Million "soft cap" that this Court authorized in its April 25, 2012 order. At the April 2, 2012 hearing, this Court expressed concern with the fact that "[commodities customers] want to continue suing [officers and directors] but [commodities customers] don't want them to have their defense costs covered by the insurance policies." (April 2, 2012 Hearing Transcript, p. 98:20-22). This concern will not be realized if its order is stayed because of the existence of $225 Million in insurance coverage issued by U.S. Specialty. Additionally, although not disclosed before this Court, it has been brought to light in the insurance industry press that MF Global is insured for another $150 Million in Side A, B, and C coverage with an additional $100 Million in exclusive Side A coverage that sits atop that.[3] When asked about these policies, counsel for the Chapter 11 Trustee responded that disclosure of these policies was premature, saying "As neither the insurance carrier nor the Chapter 11 Trustee has filed a motion regarding these policies, your request for information is premature. If such motion/stipulation is filed, we will note your request for copies of the policies."[4]

17. Accordingly, there are ample insurance proceeds available to fund the defenses of the various officers and directors while Sapere's appeal regarding MFGA's policies' proceeds is resolved. Because the MF Global officers and directors have access to these defense funds, there is no risk whatsoever that they will be prejudiced while the merits of this appeal are

[3] *See* *HCC leads $250mn Willis-brokered MF Global D&O cover*, THE INSURANCE INSIDER, http://www.insuranceinsider.com/hcc-leads-250mn-willis-brokered-mf-global-d-and-o-cover.
[4] Correspondence is attached as Exhibit A

resolved. Likewise, any concern that the Chapter 11 Trustee expressed that the estate will be subjected to increased claims should the various directors and officers not be able to defend themselves are similarly negated by the existence of this additional D&O coverage.

D. **The Public Interest Supports a Stay of this Court's Order**

18. MF Global collapsed on October 31, 2011, in the largest scandal in the history of the American commodities business. For the first time in American history, commodities customers' supposedly tightly-controlled, segregated account funds putatively vanished and commodities customers were left without *their* money. The magnitude of the "missing" segregated account funds, originally estimated at $600 Million, has now grown to an estimated $1.6 Billion. The US commodities futures market has been rocked, shaken to its foundation. Commodities customers—from farmers in America's heartland to investors in its cities—have been deprived of an enormous amount of assets, taken from segregated accounts that by law were to be safeguarded by the FCM and its officers, directors and employees and maintained as sacrosanct.

19. The SIPA Trustee has received claims from over 25,000 commodities customers claiming loss to their segregated accounts. The $120 Million in insurance proceeds at stake can have a significant impact in making whole commodities customers who had funds improperly taken from their segregated accounts. If any of the $120 Million in MFGA policy proceeds is used to fund defenses of the individuals who allegedly caused this shortfall, the commodities customers are that much less likely to be made 100% whole. Accordingly, it is vitally important that this Court's order is stayed, and funds are not spent from the $120 Million in MFGA Policy proceeds, while this appeal is pending.

Conclusion

For the foregoing reasons, Sapere respectfully requests that this Court's Order Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies is stayed pending the appeal of that order.

Dated: New York, New York
April 27, 2012

FORD MARRIN ESPOSITO WITMEYER
& GLESER, L.L.P.

By */s/ John J. Witmeyer*
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Attorneys for Sapere Wealth Management, LLC, Granite Asset Management, and Sapere CTA Fund L.P.

Exhibit A

Kenneth D. Walsh

From: Miller, Brett H. <BrettMiller@mofo.com>
Sent: Monday, April 02, 2012 11:19 AM
To: Jon R. Grabowski
Cc: John J. Witmeyer; Stephen R. Chuk; Kenneth D. Walsh; Hildbold, William M.; Marinuzzi, Lorenzo; Lewis, Adam A.
Subject: RE: Ch-11 15059 [MG] MF Global Holdings Ltd.

We do not believe that the coverage you reference in your correspondence is "funding" any of the referenced defense costs. As neither the insurance carrier nor the Chapter 11 Trustee has filed a motion regarding these policies, your request for information is premature. If such motion/stipulation is filed, we will note your request for copies of the policies.

With regard to the "position" of the Chapter 11 Trustee on matters, it will be stated in relevant court filings.

Regards,
Brett

From: Jon R. Grabowski [mailto:jrgrabowski@FMEW.com]
Sent: Tuesday, March 13, 2012 5:57 PM
To: Miller, Brett H.; Hildbold, William M.
Cc: John J. Witmeyer; Stephen R. Chuk; Kenneth D. Walsh
Subject: Ch-11 15059 [MG] MF Global Holdings Ltd.

Gentlemen,

Please see attached.

Best,
Jon

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March 13, 2012

VIA EMAIL

Brett H. Miller, Esq.
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Re: In re MF Global Holdings, Ltd., et al.
Case No. 11-15059 (MG)

Dear Brett:

We have learned that MF Global purchased $150+MM of D&O insurance containing Side A, B and C coverage from an insurer syndicate including HCC Holdings, Axis, Ace, Chartis, Chubb, Ironshore, Hartford, Travelers, Iron Star and perhaps others, brokered by Willis. We believe that the defense of all or some of the former officers and directors of MF Global in securities and commodities lawsuits is being funded in whole or in part by this D&O insurance. This situation is troubling as the Bankruptcy Court has not approved the use of this D&O insurance for such purposes nor released such proceeds from the automatic stay.

Please advise me by return email whether there exists any liability insurance, including but not limited to the foregoing D&O insurance, which by its terms would cover MF Global and/or its former directors, officers and/or employees for alleged liabilities to securities and/or commodities customers and/or any other post-petition claims for which the policy has not already been submitted to Judge Glenn for review. If so, please in your return email identify each such policy, the date it was purchased, the premium paid by MFG and MFG's relationship(s) with the insurer(s) and broker(s). Please also include copies of each such policy

and identify all claims made against such policy. Please also advise us as to the Chapter 11 Trustee's position separately, whether, for each policy if the policy and/or the proceeds thereof are estate property and whether the automatic stay applies to the disbursal of policy proceeds by the insurers involved and the reasons therefor.

Very truly yours,

Jon R. Grabowski