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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

RESPONSE OF SAPERE WEALTH MANAGEMENT LLC, GRANITE ASSET MANAGEMENT AND SAPERE CTA FUND, L.P. TO OBJECTION TO PROOF OF CLAIM NUMBER 1481

Sapere Wealth Management, LLC, Granite Asset Management and Sapere CTA Fund, L.P. (collectively, "Sapere"), as and for its response to the Objection to Proof of Claim Number 1481 Filed by Sapere CTA Fund, L.P. (the "Claim Objection") (ECF Doc. No. 1081), filed by the Creditor Co-Proponents and the Chapter 11 Trustee (collectively, the "Objectors"), respectfully states as follows:

PRELIMINARY STATEMENT

The Objectors' Claim Objection ignores facts that cannot be genuinely disputed: that MF Global Holdings, Ltd. ("Holdings") exerted direct, substantial control over its wholly-owned Futures Commission Merchant ("FCM") subsidiary, MF Global, Inc. ("MFGI"), including establishing its internal controls, conducting risk taking activities—including those resulting in

massive liquidity needs—and implementing its liquidity-fulfillment tactics; and that the tortious actions of individuals who were Holdings' directors, executives, officers, and employees resulted in a $1.6 billion shortfall to commodity customers' segregated funds as of October 31, 2011—of which Sapere's then out-of-pocket loss was approximately $271 million, and even today, remains at approximately $70 million. The Claim Objection should be overruled because Sapere has a valid claim against Holdings' estate for Holdings' direct liability to Sapere because of acts and omissions of Holdings' control group plus vicarious liability to Sapere for acts and omissions of individuals, which entitles Sapere to, among other things, compensatory damages, exemplary damages, treble damages, interest for interference with and deprivation of the enjoyment of Sapere's assets, etc. Moreover, the determination of damages for which Holdings has vicarious liability is a matter entrusted to the sound discretion of a jury.[1]

FACTS

On October 31, 2011, Holdings and various subsidiaries filed a voluntary petition for reorganization pursuant to Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Southern District of New York (Case No. 11-15059 (MG) (Jointly Administered)). Also on October 31, 2011, the United States District Court for the Southern

[1] With respect to exemplary damages, Holdings has, at a minimum, vicarious liability for damages associated with the acts and omissions of its managing agents, such as Corzine, et al. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 909. Also, because the acts and omissions of those individuals risked harm to many—including farmers, ranchers and investors across America—the assessment of the reprehensibility of the conduct for exemplary damages purposes, is especially entrusted to the jury. *Philip Morris USA v. Williams*, 549 U.S. 346, 357 (2007). Additionally, "In tort cases damages are to be measured by the jury's discretion. The court should never declare a verdict excessive merely because it is above the amount which the court itself considers the jury should have allowed. The verdict should not be disturbed unless it is so inordinately large as obviously to exceed the maximum limit of a reasonable range which the jury may properly operate." *See, e.g., Peer v. Lewis*, 2008 U.S. Dist. LEXIS 38908 (S.D. Fla. 2008).

District of New York ordered MFGI liquidated and appointed a SIPA liquidation trustee. Pursuant to SIPA, the liquidation case was removed to the United States Bankruptcy Court for the Southern District of New York (Case No. 11-2790 (SIPA)(MG)), where both it and the Holdings case are currently pending.

A. MF Global's Collapse

MF Global's scandalous downfall involved the "vanishing" of $1.6 billion in commodities customers segregated account funds held in accounts that were supposedly administered by MFGI, but over which, Holdings exerted direct control—funds that were required by federal, state and common law to remain segregated and to be protected as sacrosanct assets belonging to the commodities customers. The amount of commodities customer segregated funds improperly desegregated has, on multiple occasions, been admitted to have exceeded $1.6 billion on October 31, 2011. On October 31, 2011, Sapere had approximately $271 million on deposit at MFGI. As of today, Sapere's out-of-pocket loss still remains at approximately $70 million.

In the months following MF Global's collapse, various investigations were conducted in an effort to determine the events that caused MF Global's downfall and the shortfall of $1.6 billion in customer property. On June 4, 2012, the SIPA Trustee released the SIPA Trustee's Report of the Trustee's Investigation and Recommendations (the "SIPA Report") in which he discloses a number of detailed facts that demonstrate that Holdings exercised excessive control over MFGI to improperly gain access to commodities customer funds. On April 4, 2013, the Chapter 11 Trustee for Holdings released the Report of Investigation of Louis J. Freeh, Chapter 11 Trustee of MF Global Holdings Ltd, *et al.* (the "Freeh Report"), which arrived at a substantially similar conclusion as the SIPA Report.

Sapere incorporates by reference the facts included in the SIPA Report and the Freeh Report, but notes the following as being particularly relevant to the present response:

- "Jon Corzine became CEO and Chairman of the Board of Holdings in March 2010, at a time when MF Global had reported losses for five straight quarters. He quickly moved to transform what had been a longstanding FCM combined with a BD conducting a relatively modest customer and proprietary securities business into a full service global investment bank." (SIPA Report 13-14)

- "Moody's . . . indicated that to maintain its Baa2 rating, MF Global would need to generate $200 million to $300 million in annual before-tax profits and reduce leverage." (SIPA Report 66)

- "Among the lines of business that Mr. Corzine built up to attempt to improve profitability at MF Global was the trading of a portfolio of European sovereign debt securities. These trades provided paper profits booked at the time of the trades, but presented substantial liquidity risks including significant margin demands that put further stress on MF Global's daily cash needs." (SIPA Report 15)

- "When combined with other factors, strategic decisions and management lapses surrounding the Company's business, the Euro RTMs ultimately sowed the seeds of the Company's destruction." (Freeh Report 10)

- "On July 1, 2010, MFGI and MFGUK entered into an investment management agreement ("IMA") in relation to the European sovereign trades. Under the IMA, MFGUK, which had relationships with the LCGH and other European clearing entities, agreed to execute the European sovereign RTM trades, which would then be kept on the books of MFGI . . ." (SIPA Report 72)

- "Margin calls on the [RTM] portfolio from LCH went to MFGUK, which relayed the calls to MFGI. MFGUK could demand advance margin funding from MFGI. MFGI would transfer collateral, usually U.S. Treasury bills, to MFGUK to meet the margin calls; MFGUK, however, did not provide to MFGI any cash or collateral in exchange for the T-Bills, so MFGI was "out of pocket" for several days until MFGUK returned the T-bills." (SIPA Report 75)

- "The strategy of meeting earnings targets by relying on the Euro RTM revenues was inherently unsustainable over the long term because each new revenue-producing position required the posting of Initial Margin, which decreased the available liquidity for the duration of the investment. The liquidity demands and risks of the Euro RTM portfolio were exacerbated when Corzine lengthened the maturities of the investments, thereby further decreasing available liquidity for a longer period of time." (Freeh Report 36)

- Corzine took advantage of the Euro RTM trades to engage in "illegal window dressing" and paint an inaccurate and misleading picture of Holdings' financial health. "During several fiscal quarters between 2010 and 2011, Corzine placed Euro RTM trades at or near the end of the quarter in order to generate revenue and immediate earnings for that quarter, giving a skewed picture of the Company's financial health. For example, in the last four days of the quarter ending March 31, 2011, Corzine placed Euro RTM trades worth approximately $2.62 billion. On the last day of that fiscal quarter, March, 31, 2011, the Company executed several large Euro RTM trades worth approximately $1.03 billion in order to enable the Company to meet its projected revenue numbers for the quarter." (Freeh Report 36)

- "Corzine was very hands-on with respect to the sovereign debt trades." (SIPA Report 76)

- "In addition to his management duties, Mr. Corzine also acted as head of trading, executing trades for the firm on his own, while also instructing others to do so." (SIPA Report 26)

- "Corzine maintained his own portfolio for the company [in a division within MFGI called the Principal Strategies Group] in an account that bore his initials (JSC) and consisted of proprietary trades that he himself executed or instructed others to execute on his behalf." (SIPA Report 68)

- "With minimal oversight of his trading activities, Corzine remained a driving force behind the Company's expanding Euro RTM portfolio. Corzine communicated with MFGI and MFG UK personnel directly regarding those trades, personally instructing them when to enter and exit various positions. Notably, to the extent anyone actively tried to oversee his trading activities for any purpose, Corzine remained one day ahead of anyone in the United States. U.S. traders and Operations Department personnel first learned about Corzine's trades the day after they were entered by MFG UK traders in London." (Freeh Report 29)

- "Corzine himself acknowledged that the Euro RTM positions were his 'personal responsibility' and a 'prime focus' of his attention." (Freeh Report 37)

- Holdings' executives were regularly involved with MFGI's day-to-day activities and operations in a significant and meaningful way. Such involvement included:

    - "[Christine] Serwinski testified before Congress that she did not have the authority to transfer customer funds, which, she said, were managed by Mf. Mahajan and Ms. O'Brien." (SIPA Report 30)

    - "Steenkamp explained to [Corzine] the impact of a ratings downgrade below investment grade on liquidity: 'There would be no impact on RTM's from a ratings downgrade, as the legal analysis of sale is independent of credit rating until maturity.

However, there could be an impact on the reverse RTM netting trades as these are to different maturities than the original RTM's. The potential issue is whether some counterparties will choose not to roll over transactions or the trading counterpart can't trade with us due to our rating. If this were to happen, then MFG Inc. could lose its netting benefit on these reverses and thus be subject to higher margins, thereby increasing liquidity needs for the BD.'" (SIPA Report 78)

- "[Edith] O'Brien wrote that "Henri [Steenkamp] says to me today . . . 'we have plenty of cash.' I was rendered speechless – and wanted to say 'Really, then why is it I need to spend hours every day shuffling cash and loans from entity to entity?'", a process that she described as a 'shell game.'" (SIPA Report 83)

- "In July 2011, Mr. Steenkamp asked Ms. Serwinski to review trends in the FCM Customer Accounts to consider whether $250 million in funds could be 'loaned' overnight on a regular basis from the FCM to Operations in New York." (SIPA Report 83)

- "On October 6, 2011, Steenkamp addressed an email to Mr. Corzine which was copied to senior executives including Mr. Abelow and Mr. Mahajan stating: 'Jon . . . we need to address the sustained [liquidity] stress. In summary, we have three pools of liquidity for Inc. – (1) finco cash which is real and permanent, (2) FCM excess cash which is temporary and volatile, [and] depends on how customers post margin, and (3) the situation of our broker-dealer that is currently unable to fund itself, and more worrying continues to need more cash than we have [from] finco, thereby having us dip into FCM excess every day. This should be temporary but is becoming permanent and the FCM cash is not reliable. Why is the BD unable to fund itself? Part of it is the permanent pool of liquidity needed for RTM's, but we also see continued haircut increases in fixed income, increased funding needed PSG and box size being permanently large.'" (SIPA Report 89)

- "On October 14, 2011, Matthew Besgen wrote to Henri Steenkamp and Brad Abelow that liquidity was so strained that the broker-dealer would be relying upon a '$53mm FCM balance' plus $16mm of 'FCM buffer,' noting that this was the "[f]irst time that the B/D has relied upon the FCM buffer.'" (SIPA Report 90)

- "Mahajan in turn advised Mr. Steenkamp and Mr. Stockman that 'the B/D is leaning on FINCO and FCM's cash pool. We now require $16mm of the FCM's buffer as well. This leaves us with $24mm of liquidity – and no buffer – for the U.S. going into the weekend.'" (SIPA Report 90)

- "The Liquidity Dashboard circulated to senior management as of the close of business on October 24 including Messrs. Corzine, Abelow, Steenkamp, and Mahajan showed the BD had negative liquidity of $338 million." (SIPA Report 107)

- "MF Global's investment in sovereign debt peaked at nearly $7 billion (net) in October 2011, and still stood at nearly $6 billion as of the Filing Date." (SIPA Report 16)

- "The size of the RTM portfolio, in comparison to MF Global's size, was staggering . . . Thus, as the Board and management were aware, MF Global's appetite for sovereign debt had taken the Firm to a very precarious position." (SIPA Report 96-97)

- "Corzine spent time during each of these presentations [to Holdings' Board of Directors] telling the Board that there were no default risks associated with the Euro RTMS, because, among other reasons, the European zone, with the exception of Greece, was protected by the European Financial Stability Facility . . . Corzine also stressed that the risk of default was further minimized because MFGI held positions with varying maturities." (Freeh Report 40)

- Various internal audit reports informed the Holdings Board of Directors that the liquidity and risk monitoring controls were insufficient. Such reports included:

  - "In a presentation to the Holdings Board in April 2010, dozens of gaps in policies, procedures, and technology were identified in the various risk areas . . . This report also recognized that gaps in technology made the data needed for forecasting liquidity risks inadequate and unreliable. An October 2010 follow up to this report showed that necessary changes had not been made." (SIPA Report 68)

  - "A Corporate Governance internal audit issued in May 2010 identified MF Global's risk policies as not congruent with the changes to its broker-dealer business." (SIPA Report 68)

  - "A June 20, 2011 Global Liquidity and Capital Management Internal Audit Report noted 'numerous and significant gaps between the policy and existing practices.'" (SIPA Report 82)

- "From time to time, MFGI and other affiliates were funded by liquidity drawn from the committed lending facility on which Holdings was primary borrower. Those funds moved

through the account of another Holdings' subsidiary, MF Global Finance USA, Inc. ('FINCO')." (SIPA Report 25)

- "Holdings and a number of MFGI affiliates, including MF Global Special Investor, LLC, MFGUK and MF Global Canada Co. traded through accounts with MFGI as their commodities FCM or securities BD, in addition to maintaining their own depository accounts." (SIPA Report 57)

- "Regardless of whether Mr. Corzine's bets on European sovereign debt would ultimately have been profitable, in the short term, MF Global became increasingly vulnerable to the developments that ensued in the fall of 2011." (SIPA Report 18)

- "There were only thirteen days [in October 2011] when there was a Firm Invested in Excess, which ranged from only $10.8 million to $132 million. In other words, on eight days during the month of October, some customer funds were used for liquidity purposes." (SIPA Report 92)

- "As these events unfolded, Corzine and his management team failed to strengthen the Company's weak control environment, making it almost impossible to properly monitor the liquidity drains on the Company caused by Corzine's proprietary trading strategy." (Freeh Report 11)

- "The [April 2009 Enterprise Risk] Policy included an explicit recognition that segregated client funds were not available for MF Global to use for liquidity purposes: 'In the major jurisdictions in which it operates, MF Global is forbidden to use segregated funds for any purpose other than as directed by the client. Therefore, as a matter of policy MF Global considers that segregated funds are not available to it for liquidity purposes.'" (SIPA Report 33)

- "On August 24, FINRA informed MFGI that . . . MFGI was required to take a full haircut of approximately $257 million on all sovereign RTMs. The net impact on MFGI was an increased capital requirement of $255 million. FINRA notified MFGI that rather than applying the new capital charges only prospectively, the Firm was required to retrospectively reflect the modified capital treatment of the RTM transactions. This retrospective application resulted in a regulatory net capital deficiency of $150.6 million as of July 31, 2011." (SIPA Report 94)

- "In an amended Form 10-Q filed on September 1, 2011, [Holdings] disclosed that the net capital infusion had been made." (SIPA Report 94)

- "It was not until the October 17 article in *The Wall Street Journal* that the market reacted significantly to the news of the net capital charge and what it indicated about MF Global's financial health." (SIPA Report 98)

- "Credit events impacting MF Global throughout the week of October 24 to October 28 escalated its liquidity drain to crisis proportions." (SIPA Report 98) These events included:

    - "On October 24, Moody's Investors Service downgraded MF Global's credit rating to near-junk status . . . The next day, S&P put MF Global on "Credit Watch Negative," and on October 27, Moody's cut MF Global to junk status." (SIPA Report 21)

    - "On October 25, MF Global's stock price, which was already low, fell by 48%." (SIPA Report 99)

    - "On Thursday October 27, Moody's downgraded MF Global again by two notches into non-investment grade territory . . . Fitch also announced a two-notch downgrade." (SIPA Report 100)

- "Not surprisingly, the rating downgrades [to Holdings] were followed by an increase in margin calls against MFG UK, which were passed on to MFGI, a further exodus of its customers, and increased activity by MFGI's regulators." (Freeh Report 71)

- "[Holdings'] announcement of poor financial results coupled with the two Moody's ratings downgrades began a 'run on the bank' scenario [at MFGI]. Customers sought to liquidate their positions and withdraw their funds from MFGI." (SIPA Report 101)

- "The primary source of extra liquidity was the $1.2 billion unsecured RCF that Holdings used to finance the operations of MF Global, including MFGI." (SIPA Report 101)

- "After the ratings downgrade, MFGI and Holdings began liquidating investments and assets. Although these efforts resulted in billions of dollars of sales on a very short settlement cycle, the impact was insufficient to relieve MF Global's dire liquidity situation." (SIPA Report 153)

    - "Both MFGI and Holdings' proprietary investments were typically fully financed through repurchase agreements facilitated by MFGI's repo desk. As a result, sale of these investments reduced leverage (and potentially in the long term could have reduced the drain on liquidity) but did not generate significant liquidity in the short term as the cash received from the sale of the proprietary position was used to repay (or unwind) the repurchase agreement used to finance the purchase." (SIPA Report 154)

    - "In an attempt to meet increasing liquidity drains, [Holdings] drew down an additional $52.1 million on the unsecured RCF,

attempted to liquidate a portion of the hold to maturity portfolio and sold a large volume of commercial paper to Goldman Sachs." (Freeh Report 72)

- "Holdings also liquidated $4.5 billion in agency debentures on Friday October 28. These debentures had also been financed through a repurchase agreement with MFGI, which had in turn entered into repurchase agreements with external counterparties." (SIPA Report 155)

- "DTCC decreased the net debit cap from $300 million to $100 million after MF Global's credit downgrade. This required MFGI to fund the DTCC transactions in cash (by means of an intraday transfer from the Customer Segregated account) to continue clearing operations." (SIPA Report 160)

- "Corzine reportedly resisted until after the downgrade the idea of selling off any of the European sovereign debt portfolio. As of October 24, MFGI had a net sovereign debt RTM portfolio of $6.4 billion. MFGI sold a portion of the portfolio during the week of October 24, resulting in cumulative losses of nearly $7.3 million in the final two months of the firm's existence." (SIPA Report 154)

- "Had customer funds been properly protected, the customer property in Customer Accounts should have been largely if not completely unaffected by the liquidity crisis at MF Global. Instead, these funds were used to fund MF Global's liquidity needs in at least the latter part of the week of October 24." (SIPA Report 104)

B. Sapere's Civil Action

On December 13, 2011, Sapere filed a civil action in the Southern District of New York against former MF Global directors, executives and employees for tortious conduct under state and federal law including, among other things, common law torts, RICO violations, violations of the Commodities Exchange Act, breaches of fiduciary duties, fraud, and other state law violations. Sapere filed its amended complaint on December 18, 2012. Sapere's action is one of three actions currently in the Southern District of New York consolidated under the caption *DeAngelis v. Corzine et al.*, 11-cv-07866 (VM) (the "MF Global Litigation"). The other two actions are class actions generally referred to as the Commodities Customer Class Action and the Securities Class Action. In the MF Global Litigation, Sapere asserts a right to compensatory,

treble, and exemplary damages for the unlawful acts that led to the $1.6 billion shortfall in customer funds. The allegations that Sapere has set forth in the MF Global Litigation also form the basis for Sapere's claim against Holdings' estate.

C. Sapere's Proof of Claim

On August 22, 2012, Sapere filed its proof of claim in the administration of Holdings' Chapter 11 estate (claim number 1481). Sapere's proof of claim includes a priority claim to $93,216,243, which represented Sapere's out-of-pocket loss at the time of filing, and a general unsecured claim of $745,729,944, which represents the treble and exemplary damages to which Sapere is entitled. As explained in Attachment 1 to Sapere's proof of claim, Sapere's claim is based on Holdings' direct and vicarious liability for the illegal looting activities committed by Holdings' directors, officers, and employees that resulted in a $1.6 billion shortfall in customer segregated account funds, and an approximate $93 million shortfall in Sapere's accounts at the time of filing.

In its claim, Sapere asserts that Holdings has both direct and vicarious liability to Sapere on account of its excessive control over MFGI—the FCM entity subjected to the regulations of the Commodities Exchange Act ("CEA")—and because of the tortious conduct of Holdings' directors, officers, employees, and agents that led to Sapere's shortfall in funds deposited at MFGI. On February 13, 2013, the Objectors submitted the present Claim Objection requesting that this Court expunge Sapere's claim. This Court should overrule the Objection because Sapere has a valid claim against Holdings' estate for Holdings' direct and vicarious liability which entitles Sapere to compensatory and treble damages.

ARGUMENT

A properly filed proof of claim is prima facie evidence of the claim's validity and amount. 11 U.S.C. § 502(a); FED. R. BANKR. P. 3001(f); *Carey v. Ernst*, 333 B.R. 666, 672 (S.D.N.Y. 2005). A party objecting to a properly filed proof of claim bears the burden of rebutting the presumption of the claim's validity. *See, e.g., In re Gorgeous Blouse, Co.*, 106 F. Supp. 465 (S.D.N.Y. 1952). The relief requested in the Objection to Sapere's claim should be denied because the Objectors have failed to rebut Sapere's Claim's presumption of validity. Holdings has direct and vicarious liability to Sapere for its misuse of Sapere's segregated account funds and for the tortious conduct of MF Global's directors, officers, and employees. As a valid tort claimant against Holdings' estate, Sapere has a right to assert its claim in the Chapter 11 proceedings. *See, e.g., In re Chemtura Corp.*, 443 B.R. 601 (Bankr. S.D.N.Y. 2011) (allowing claims of private parties against a Chapter 11 debtor for the losses the debtor caused); *In re Hydrox Chem. Co.*, 149 B.R. 617, 628 (Bankr. N.D. Ill. 1996) (allowing a claim against the debtor's estate based on the creditor's RICO allegations against the debtor corporation's officers and directors). Because Sapere's out-of-pocket loss still remains at approximately $70 million and Holdings has vicarious liability for the tortious conduct of its directors and officers, Sapere has a valid claim Holdings' estate and this Court should deny the Objectors' motion to expunge Sapere's claim.

I. SAPERE'S CLAIM IS VALID AND PROPERLY ASSERTED AGAINST HOLDINGS

A tort claimant may assert a claim in a reorganization proceeding for the debtor's direct and vicarious liability to that claimant. *In re Johns-Manville Corp.*, 45 B.R. 823 (S.D.N.Y. 1984) (acknowledging the principle that tort claimants of a debtor's estate have a valid basis for

asserting a claim in reorganization proceedings); *see also In re Stamou*, 2013 Bankr. LEXIS 227 (Bankr. E.D.N.Y. Jan. 17, 2013) (allowing a claim against a debtor when the debtor's improper and excessive control over a subsidiary resulted in a loss to creditors). In addition to compensatory damages, tort claims against a debtor's estate may include treble, exemplary, and punitive damages. *In re American Fed'n of Television & Radio Artists*, 32 B.R. 672, 674 (Bankr. S.D.N.Y. 1983) (holding that a claim for treble damages was properly asserted against a Chapter 11 debtor); *In re Chavez*, 381 B.R. 582 (Bankr. E.D.N.Y. 2008) (allowing a claim for treble damages where such damages were allowed by statute). The Objectors' Claim Objection should be denied because Sapere has a valid proof of claim for Holdings' direct and vicarious liability that resulted in the illegal misuse of Sapere's segregated account funds held at MFGI. Holdings' excessive control of its FCM subsidiary, MFGI, imposes the same regulatory requirements on Holdings that are imposed upon MFGI. Likewise, the tortious conduct of Holdings' directors, officers, and employees results in Holdings' vicarious liability for Sapere's missing account funds. Because of Holdings' direct and vicarious liability to Sapere, Sapere has a valid claim for compensatory and treble damages against Holdings' estate and the Claim Objection should be denied.

A. Sapere has Asserted a Valid Tort Claim Against Holdings' Estate

Holdings has direct and vicarious liability to Sapere for due to Holdings excessive control over MFGI and the tortious conduct of Holdings' employees. The relevant statutes that establish Sapere's rights as a tort claimant for Holdings' direct liability are as follows:

> 1.) "Customer property" means cash, a security, or other property or proceeds of such cash, security, or property, received, acquired, or held by or for the account of the debtor, from or for the account of a customer, including property received, acquired, or held to margin, guarantee, secure, purchase, or sell

a commodity contract . . . [and] specifically identifiable customer property. 11 U.S.C. § 761(10).

2.) "[An FCM] shall . . . treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to extend the credit, of any customer or person other than the one for who the same are held." 7 U.S.C. § 6d(a)(2).

3.) Any person (other than a registered entity or registered futures association) who violates this Act or who willfully aids, abets, counsels, induces or procures the commission of a violation of this Act shall be liable for the actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person. 7 U.S.C. § 24(a)(1).

4.) Any person who commits, or who willfully aids, abets, counsels, commands, induces or procures the commission of, a violation of any of the provisions of this Act, or any of the rules, regulations or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations or orders may be held responsible for such violation as a principal. 7 U.S.C. § 13c(a).

5.) The act, omission, or failure of any official, agent or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person. 7 U.S.C. § 2(a)(1)(b).

Sapere maintained accounts at MFGI that were segregated, titled in Sapere's name and specifically identifiable by unique account numbers associated with Sapere's ownership.

Specifically, Sapere's accounts included cash in excess of $95 million and $125 in United States Treasury Bills. The cash and Treasury Bills in Sapere's account was "customer property" as defined by the CEA, and were entitled to the protections guaranteed by the CEA. The moment that Sapere's funds were removed from Sapere's account and used to benefit a party other than Sapere, Holdings violated the CEA. Although MFGI was the FCM registered with the National Futures Association, as will be shown herein, Holdings is also directly liable because of the direct and excessive control that it exerted over MFGI.

i. *Direct Liability*

A parent corporation has direct liability for the obligations of its subsidiary entities when the parent corporation exerts excessive control over the subsidiary. *U.S. v. BestFoods,* 524 U.S. 51, 52 (1998). In *BestFoods*, the court wrote, "the corporate veil may be pierced and the shareholder held liable for the corporation's conduct when, *inter alia*, the corporate form would otherwise be misused to accomplish certain wrongful purposes, most notably fraud, on the shareholder's [parent corporation's] behalf." *Id.* Further, a company whose actions are consistent with those of a commodities broker will be treated as such, regardless of its registration status as an FCM. *In re Bucyrus Grain Co., Inc.*, 127 B.R. 45 (Bankr. D. Kan. 1988) Here, because Holdings exerted excessive control over MFGI such that Holdings was acting as a commodities broker, Holdings is subject to direct liability for violations of its FCM subsidiary, MFGI.

As Sapere has alleged in its proof of claim, Holdings has liability as a principal for MFGI's violations of the CEA. Pursuant to *BestFoods*, for Holdings to be subjected to the same direct liability that a commodities broker would be subjected to—in this case MFGI—the relevant inquiry is whether Holdings controlled MFGI's compliance with the regulated portion of the businesses that MFGI violated. The facts elicited in the SIPA Report and the Freeh Report

demonstrate that the corporate structure of MF Global combined with the overlapping executives of Holdings and MFGI allowed Holdings to exercise excessive control over MFGI and the commodities customer funds. Further, Holdings executives, such as Jon Corzine, Laurie Ferber, Bradley Abelow, Henri Steenkamp, Vinay Mahajan, Michael Stockman, and J. Randy MacDonald dictated the internal affairs of MFGI and how the company operated on a day-to-day basis and directly participated in the illegal use of commodities customer money. Indeed, the Chapter 11 Trustee wrote, "The unwieldy corporate structure lacked cohesion both in its culture and in its operating structure." (Freeh Report 79) The facts demonstrate that Holdings put risky strategies in place that caused the misappropriation of commodities customer funds and that Holdings executives had excessive control over MFGI and the commodities customer funds.

Because Holdings exerted excessive control over MFGI in a manner that resulted in MFGI violating its segregation requirements imposed by the CEA, Holdings is directly responsible for those violations. Accordingly, Sapere has a valid tort claim against Holdings' estate for its direct liability to Sapere and the Objection should be dismissed.

ii. *Vicarious Liability*

Additionally, the activities described in the SIPA Report and addressed above establish that Holdings' directors, officers, employees and agents illegally caused Sapere's segregated account funds to be removed from Sapere's accounts for Holdings' own benefit to meet its heightened liquidity needs in the final weeks of operations. Holdings' vicarious liability includes its responsibility for its directors, officers, employees and agents acts that constituted RICO violations, conversion, trespass to chattels, interference with contract rights, violations of the CEA, violations of the Securities Exchange Act, and violations of New York General Business Law § 349.

It is well established that a corporation is subject to vicarious liability for the tortious conduct of its employees, including managerial personnel.[2] This principle is also recognized in bankruptcy proceedings and creditors may file claims for vicarious liability against a debtor corporation. *See, e.g., In re C.F. Smith & Assocs.*, 235 B.R. 153 (Bankr. D. Mass. 1999) (allowing a claim that a creditor asserted against a debtor corporation because the debtor was vicariously liable for the tortious conduct of its employees).

From the moment that Jon Corzine arrived at MF Global in March 2010 until its collapse in October 2011, Corzine and others engaged in activities that ultimately deprived Sapere of its legal right to its segregated funds. From Corzine's plan to turn MF Global into an investment bank, to the Holdings' Board of Directors' repeated increase of the European sovereign debt portfolio limits, to Holdings' executives' continual ignorance of the ever-increasing liquidity demands caused by the RTM transactions, to the eventual illegal use of customer funds to fulfill Holdings' obligations, Sapere's funds were continuously misused and ultimately illegally removed from segregation. Because Holdings is vicariously liable for its employees' improper use of Sapere's segregated account funds, Sapere's claim against Holdings' estate should not be expunged and the Objection should be overruled.

B. Sapere is Entitled to Treble and Exemplary Damages

A corporation is liable for the treble, exemplary, and punitive damages that arise out of actions by the corporations' employees. *Brink's, Inc. v. City of N.Y.*, 717 F.2d 700 (2d Cir. 1983). In its complaint in the MF Global Litigation against various MF Global directors and executives,

[2] In addition to note 1, *supra*, *see, e.g., Guttman v. CFTC*, 197 F.3d 33, 38 (2d Cir. 1999) (imposing vicarious liability for violations of the CEA on a "Principal-Agent Liability" standard); *see also In re Amaranth Natural Gas Commodities Litig.*, 587 F. Supp. 2d 513, 546 (S.D.N.Y. 2008) ("The CEA creates liability for those employers whose agents committed manipulative acts while functioning within the scope of the relationship.").

Sapere has made claims that entitle Sapere to treble and exemplary damages. Sapere's RICO allegation entitles it to treble damages,[3] and Sapere's claims of breach of common law duty of care, breach of fiduciary duty, constructive fraud, actual fraud, conversion, trespass, interference with contract rights, and aiding and abetting tortious conduct each warrant punitive damages against the Holdings' former directors and officers, and therefore Holdings as well. Claims including treble damages against a debtor are recognized as valid claims in bankruptcy proceedings. *In re Hydrox Chem. Co.*, 194 B.R. 617, 628 (N.D. Ill. 1996) ("Therefore the claims for treble RICO damages against the Debtor can be sought under § 1962(a)."); *In re Am. Fed. of Television & Radio*, 32 B.R. 672 (Bankr. S.D.N.Y. 1983) (allowing a creditor's claim for treble damages against a Chapter 11 debtor); *In re Chavez*, 381 B.R. 582 (Bankr. E.D.N.Y. 2008) (holding that a creditor was able to make a claim for treble damages against a debtor where treble damages were allowed by New York statute). The objection to Sapere's claim for treble and exemplary damages is completely meritless, as Sapere's claims for which Holdings is vicarious liable are statutorily entitled to treble damages. Accordingly, the Objector's argument that Sapere's claim for treble and exemplary damages is meritless should be disregarded and Sapere's claim should not be expunged.

C. The Objectors' Speculative Assertion that Commodities Customers will be Made Whole is Irrelevant

The Objectors' assertion that Sapere will be made 100% whole in MFGI's SIPA liquidation does not preclude Sapere's claim against Holdings' estate for two reasons: 1.) the

[3] "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee, except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962." 18 U.S.C. § 1964 (C).

Objectors' speculative allegations do not negate the fact that Sapere's out-of-pocket loss—for which, Holdings is responsible—has not yet been returned; and 2.) even if Sapere's out-of-pocket loss is eventually returned in MFGI's SIPA liquidation, Sapere has a valid basis for claiming a right to treble damages against Holdings' estate.

In their Claim Objection, the Objectors make the inconsistent assertions that "Sapere's unpaid commodity claims in the SIPA Case will not exceed $23.3 million" and "it is likely that Sapere's claims in the SIPA Case will be paid in full." (emphasis in original) (Objection p. 9) In support of the assertion that commodities customers will be made whole, the Objectors cite a letter agreement that states that the Chapter 11 Trustee would "support the allocation of or loan from MFGI unallocated properly sufficient to pay 100% of net equity claims of commodities . . . customers." (emphasis in original) (Objection p. 9) However, such an "allocation or loan" has not taken place, this Court has not ordered such an allocation or loan to take place, and the Chapter 11 Trustee has not sought to allocate or transfer any funds to MFGI that would make commodities customers 100% whole. By the Objectors' own admission, at the time of the Claim Objection, Sapere had still not received 20% of its allowed domestic commodity claim and 95% of its allowed foreign commodity claim. (Objection p. 8) The Objectors' aspirational statement that commodities customers will be made whole at some future date should not serve as a basis for expunging Sapere's claim.

II. ALTERNATIVELY, SAPERE RENEWS ITS REQUEST FOR RULE 2004 EXAMINATIONS TO OCCUR PRIOR TO THE COURT'S RULING ON SAPERE'S CLAIM

In anticipation of the possibility that the sufficiency of evidence is questioned, Sapere again requests that this Court order that Sapere may conduct Fed. R. Bankr. P. 2004 examinations of any party in interest relating to the relevant facts and that this is completed

before this Court rules on the Objection to Sapere's claim. Rule 2004 allows for the examination of any entity on the motion of any party in interest. Fed. R. Bankr. P. 2004(a). Rule 2004 allows for a broad and far-reaching inquiry. *In re Frigitemp Corp.*, 15 B.R. 263, 264 (Bankr. S.D.N.Y. 1981). The purpose of a Rule 2004 examination is to allow the court to gain a clear picture of the condition and whereabouts of the estate. *In re Johns-Manville Corp.*, 42 B.R. 362, 364 (S.D.N.Y. 1984). A creditor's discovery rights under a Rule 2004 examination are unfettered and broad. *In re GHR Cos.*, 41 B.R. 655, 661 (Bankr. D. Mass. 1984).

The Rule 2004 examinations would cover: the existence, amount and/or disposition of commodities customers' segregated account funds at MFGI (including without limitation access, dominion and/or control over the same by or for the benefit of any of the Debtors and/or any other non-debtor subsidiary or affiliate of the Debtors); and/or the circumstances under which any such funds became missing and/or have not been 100% transferred post-petition to commodities customers owning those segregated accounts; and/or the existence, description, nature, condition and location of any documents or other tangible things and the identity and location of persons who know of any matter relevant to the subject matter of Sapere's Priority Motion.

The 2004 examinations will include matters from the date one year prior to the filing of the Debtor's petition and SIPC's SIPA liquidation action against MFGI. The 2004 examinations will include examinations of: the Debtors; MFGI; the Debtors' and their non-debtor subsidiaries' and affiliates' present and former employees and representatives identified as being involved in such circumstances; witnesses potentially knowledgeable about any such circumstances; the banks and correspondents of the Debtors and their non-debtor subsidiaries and affiliates who received funds that may have originated from commodities customers' segregated accounts; the

trustees and their representatives involved in investigating the missing segregated account funds; and other persons. The 2004 examinations will include the production of documentary evidence.

CONCLUSION

Sapere respectfully requests that the relief requested in the Claim Objection is denied and that Sapere's claim is allowed.

Dated: New York, New York
April 11, 2013

Respectfully submitted,

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