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UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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

RESPONSE OF U.S. SPECIALTY INSURANCE COMPANY TO OBJECTIONS BY CUSTOMER REPRESENTATIVES AND SAPERE WEALTH MANAGEMENT LLC AND TO THE RESPONSE OF THE TRUSTEE FOR MF GLOBAL INC. IN CONNECTION WITH THE DUAL NOTICE OF PRESENTMENT OF STIPULATION TO LIFT THE AUTOMATIC STAY TO PERMIT PAYMENTS OF DEFENSE COSTS UNDER CERTAIN INSURANCE POLICIES

U.S. Specialty Insurance Company ("U.S. Specialty") respectfully submits this Response to: (1) *Customer Representatives' Limited Objection and Reservation of Rights Concerning Stipulation and Order to Lift the Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* (Docket No. 1474 in Case No. 11-15059) (the "Customer

Objection"); (2) *Sapere Wealth Management LLC, Granite Asset Management and Sapere CTA Fund, L.P. Objection to Dual Notice of Presentment of Stipulation to Lift the Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* (Docket No. 1476 in Case No. 11-15059) (the "Sapere Objection"); and (3) *Response of the Trustee For MF Global Inc. to the Customer Representatives' Limited Objection and Reservation of Rights Concerning Stipulation and Order to Lift the Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* (Docket No. 1479 in Case No. 11-15059) (the "SIPA Trustee Response").

The Customer Representatives, the Sapere Parties and the SIPA Trustee filed their papers in response to the Dual Notice of Presentment of Stipulation to Lift The Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies (Docket No. 1466 in Case No. 11-15059) (the "Stipulation"). In the Stipulation, the Chapter 11 Trustee for MF Global Holdings, Ltd. (the "Chapter 11 Trustee"), the SIPA Trustee, U.S. Specialty and MFG Assurance Company Ltd. agreed pursuant to Paragraph 3 of this Court's April 25, 2012 Order (Docket No. 652 in Case No. 11-15059) to adjust the "soft cap" to $40 million without court intervention.

Notwithstanding that the Stipulation is self-implementing under the April 25, 2012 Order, the Customer Representatives and Sapere filed objections. As detailed below, the objections should be disregarded by the Court and lack merit in any event.

I. <u>The Objections Should Be Disregarded By The Court</u>

The Objections filed by the Customer Representatives and Sapere should be disregarded as procedurally improper under the April 25, 2012 Order because the Stipulation is self-implementing. As stated in Paragraph 3 of the Order, "The aggregate payments permitted under the Policies shall be subject to a 'soft cap' of $30 million *subject to further adjustment either by*

agreement among the SIPA Trustee, the Chapter 11 Trustee, and the Insurers, or by further order of this Court" (emphasis added). Accordingly, the Stipulation is not subject to objection because the Court previously ruled that the soft cap could be adjusted by agreement among those specified parties, and without further judicial proceedings or interference from claimants such as the objectors.

II. Sapere's Jurisdictional Objection Lacks Merit

Even assuming its objection was proper, Sapere's argument that this Court lacks jurisdiction to consider the Stipulation has no merit. In that regard, Sapere has appealed to the Second Circuit the Court's April 25, 2012 Order and the April 10, 2012 opinion (Docket No. 619 in Case No. 11-15059), and contends on that basis that the appeal divests this Court of jurisdiction to address the Stipulation. However, the case law relied on by Sapere undermines its position. As explained in *Cibro Petroleum Prods., Inc. v. Albany* (*In re Winimo Realty Corp.)*, 270 B.R. 99 (S.D.N.Y. 2001), the divestiture rule only applies to subsequent proceedings that "expand" or "alter" the ruling on appeal. As that court explained:

> [I]t is also well established that while an appeal of an order is pending, the [bankruptcy] court retains jurisdiction to implement and enforce the order. This is true because in implementing an appealed order, the court does not disrupt the appellate process so long as its decision remains intact for the appellate court to review. Accordingly, courts have recognized a distinction between actions that 'enforce' or 'implement' an order, which are permissible, and acts that 'expand' or 'alter' that order, which are prohibited.

270 B.R. at 105-106. Here, the Stipulation does nothing more than implement the April 25, 2012 Order, which expressly contemplates and orders in Paragraph 3 that the insurers and the trustees could adjust the cap by agreement without assistance from the Court. The Stipulation in no way interferes with the appellate process or the Second Circuit's review of the order.

III. Even If Objections Are Considered, None Have Merit.

Even if the Court was inclined to consider the Objections, none of the arguments have merit.

First, in its April 10, 2012 opinion, this Court previously considered and rejected the same arguments made again by Sapere in its Objection. The District Court, on appeal, affirmed this Court's decision twice, after two rounds of briefing and oral argument. *See Sapere Wealth Management LLC, et al. v. MFG Assurance Company, Ltd., et al.*, 12-mc-00143 (S.D.N.Y. May 23, 2012); *Sapere Wealth Management LLC, et al. v. MFG Assurance Company, Ltd., et al.*, 12-mc-00143 (S.D.N.Y. Nov. 14, 2012). There is no reason for the Court to revisit the same issues.

Second, the complaint by the Customer Representatives, echoed by the SIPA Trustee, about the purportedly "alarming rate" at which defense costs are being incurred is ironic, to say the least. The Customer Representatives, the SIPA Trustee and Sapere are in large part responsible for the defense costs being incurred by individual defendants, as all have asserted claims against individuals. Indeed, Sapere has named 26 individual insureds as defendants in its lawsuit, notwithstanding that by doing so, it does nothing to increase the amount or likelihood of its damages recovery, while at the same time it has forced each defendant to retain defense counsel. *See Sapere CTA Fund, LP v. Corzine, et al.*, No. 11 CV 9114 (VM) (S.D.N.Y.).

Moreover, given all the proceedings and investigations at issue, the defense costs incurred since November 2011 are entirely reasonable. The cases before Judge Marrero include consolidated securities class actions and customer class actions. *See In re MF Global Holdings Limited Securities Litigation*, Case No. 11 Civ. 7866 (VM) (S.D.N.Y.); *In re MF Global Holdings Limited Investment Litigation*, 12 MD 2338 (VM) (S.D.N.Y.). As reflected in the Consolidated Amended Complaint filed on November 5, 2012 in the *Investment Litigation*, the

SIPA Trustee is actively cooperating with the customer representatives and purportedly assigned claims against individual insureds for the customers' counsel to prosecute on his behalf. Also pending is Sapere's separate case, which is duplicative of the *Investment Litigation* action. Moreover, although the District Court stayed those cases beginning in February 2013 so the parties could pursue mediation, in April 2013, the Chapter 11 Trustee filed a new suit which has not been stayed. *See Freeh v. Corzine, et al.*, Adv. Proc. No. 13-01333 (Bankr. S.D.N.Y.). Further, many governmental bodies have been investigating MF Global, including the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Financial Industry Regulatory Authority (FINRA), the United States Attorneys' Offices for the Southern District of New York and the Northern District of Illinois, and various Congressional committees, including the Senate Agricultural Committee. While none have filed charges or claims against any individuals, the investigations nevertheless have consumed and continue to consume a tremendous amount of resources.

In connection with all of the foregoing, since November 2011, U.S. Specialty has received requests for coverage from 50 individuals represented by 36 law firms under the Directors' and Officers' (D&O) and Professional Liability (E&O) policies. In addition to negotiating rate discounts with the defense firms and experts, U.S. Specialty has laboriously reviewed every single invoice submitted and made significant cuts for amounts it deemed unreasonable or unnecessary. U.S. Specialty has every incentive to control the defense costs being incurred, and has acted reasonably and responsibly in doing so. The suggestion by the SIPA Trustee that U.S. Specialty is not adequately monitoring or reviewing the bills, and his complaint about the insurers' so-called "lack of attention" to the claims for the proceeds is baseless.

In suggesting that the Court should impose a "hard cap" of $40 million, delay signing off on the Stipulation until after the mediation, or give the customer representatives veto power over the future adjustment of the "soft cap," the customer representatives and the SIPA Trustee improperly are seeking a tactical advantage over the individual insureds and the insurers in the litigation and the mediation. But as this Court previously found, it is fundamentally unfair for the claimants to prosecute their claims while seeking to deprive the individuals of a vigorous defense:

> The bottom line is that the Trustee seeks to protect the amount he may receive in his suit against the directors and officers while limiting coverage for the defense costs of the directors and officers. This is not what the directors and officers bargained for. In bringing the action against the directors and officers, the Trustee knew that the proceeds could be depleted by legal fees and he took that chance. The law does not support the Trustee's request to regulate defense costs.

April 10, 2012 Opinion at p. 29-30 (quoting *In re Allied Digital Techs., Corp.*, 306 B.R. 505, 513 (Bankr. D. Del. 2004)). The law does not permit the objectors and the SIPA Trustee – who as claimants are completely adverse to the insureds – to control the payment of defense costs under the policies. The mischief of allowing them to do so is readily apparent.

Third, the SIPA Trustee's complaint about the "lack of transparency" on how the proceeds are being spent likewise is baseless. The trustees have been kept fully informed of the total amounts being paid out under the policies. Any request for additional disclosures is an obvious and improper attempt to pry into the insureds' defense strategy and disadvantage them in the litigation and mediation.

Finally, the suggestion by Sapere that the Bankruptcy Court should halt payments under the E&O policies on the theory that the costs can be shifted to the D&O policies is improper. The terms of the policies cannot be rewritten to foist upon the D&O policies additional costs

otherwise allocable to the E&O policies. Such manipulation harms the insureds who are entitled to coverage under the D&O policies and prejudices the D&O insurers through the improper exhaustion of the policies.

Conclusion

For the foregoing reasons, U.S. Specialty respectfully requests that the Court enter the Stipulation.

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