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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)
Debtors.	:	(Jointly Administered)
In re	:	
MF GLOBAL, INC.,	:	Case No. 11-2790 (MG) SIPA
Debtor.	:	

RESPONSE OF MFGA ASSURANCE COMPANY LIMITED TO (I) OBJECTION OF SAPERE WEALTH MANAGEMENT LLC, GRANITE ASSET AMANGEMENT AND SAPERE CTA FUND, L.P. AND (II) LIMITED OBJECTION AND RESERVATION OF RIGHTS OF THE CUSTOMER REPRESENTATIVES TO NOTICE OF PRESENTMENT OF STIPULATION TO LIFT THE AUTOMATIC STAY AND PERMIT PAYMENTS OF DEFENSE COSTS UNDER CERTAIN INSURANCE POLICIES

MFG Assurance Company Limited ("**Assurance**"), by its undersigned counsel, respectfully submits this Response to (i) *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 [Holdings Dkt. No. 1476] (the "**Sapere Objection**") and (ii) *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* [Holdings Dkt. No. 1474] (the "**Limited Objection**" and together with the Sapere Objection, the "**Objections**") and in support of the *Dual Notice of Presentment of Stipulation to Lift the Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* [Holdings Dkt. No 1466] (the "**Stipulation**").

For the reasons stated below, the Court should overrule the Objections and approve the Stipulation.

BACKGROUND

1. Pursuant to its *Order Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* [Holdings Dkt. No. 652] (the "**Lifting Order**") this Court authorized Assurance to make payments under the E&O Policies[1] and U.S. Specialty Insurance Company ("**Specialty**" and together with Assurance, the "**Insurers**") to make payments under the USSIC Policies to individual insureds on account of defense costs as provided in the E&O and USSIC Policies on the condition that aggregate payments be subjected to a $30 million "soft cap" (the "**Soft Cap**"). The Lifting Order specifically contemplated an increase in the Soft Cap amount, providing that it may be expanded either by agreement among the SIPA Trustee, the Chapter 11 Trustee and the Insurers, or by further order of this Court. Lifting Order at ¶¶ 1-3.

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Stipulation.

2. Sapere Wealth Management LLC, Granite Asset Management and Sapere CTA Fund, L.P. (collectively, "**Sapere**") appealed the Lifting Order and from this Court's *Memorandum Opinion Lifting Automatic Stay to Permit Payments of Defense Costs Under Certain Insurance Policies* [Holdings Dkt. No. 619] (the "**Memorandum Opinion**"). On November 14, 2012, the United States District Court for the Southern District of Court (the "**District Court**") affirmed the Lifting Order in its entirety. Sapere filed a further notice of appeal to the United States Court of Appeals for the Second Circuit (the "**Second Circuit**") on December 2, 2012, which appeal is currently pending. In connection with its appeal, Sapere has twice sought to stay the relief granted in the Lifting Order, once by motion to this Court and once by further motion to the District Court. Both motions for a stay pending appeal were denied.

3. Invoices submitted by individual insureds for the payment of defense costs are carefully monitored and reviewed by third-party professional firms (the "**Vetting Firms**") that have been retained by the Insurers to manage the claims process before any payments are made under the Soft Cap. The Vetting Firms manage the reimbursement of defense costs in accordance with the E&O and USSIC Policies pursuant to stringent litigation guidelines. The use of such guidelines is standard in the insurance industry in instances where fees of counsel are reimbursed as a form of loss under a policy of insurance. Indeed, the SIPA Trustee has obtained copies of the litigation guidelines used by the Vetting Firms in the instant matter and is therefore well aware of the constraints applied to counsel seeking reimbursement for defense costs from proceeds of the E&O and USSIC Policies. Further, because the structure of the E&O tower is such that E&O Policies issued by Assurance in the first instance have been

reinsured, defense costs are reviewed by one Vetting Firm on behalf of Assurance and by a different Vetting Firm on behalf of the reinsurer on the risk. Furthermore, Assurance's regulator, the Bermuda Monetary Authority, has demonstrated a strong interest in ensuring that the E&O Policies are being operated as intended and such interest has translated into increased regulatory oversight of Assurance's expenses. *See* Exhibit A to *Declaration of John Oliver Heyliger*, dated March 5, 2012 [Holdings Dkt. No. 519].

4. As it became clear that payments permitted for defense costs under the E&O and USSIC Policies were approaching $30 million under the Soft Cap, counsel for the Insurers sought to engage counsel for the SIPA Trustee and the Chapter 11 Trustee (together, the "**Trustees**") in negotiations regarding the need for an expansion of the cap. While the Trustees' counsel stated that they wanted more information about activities of defense counsel for the individual insureds, the Insurers' counsel sought a larger increase in the cap so as to avoid the need to make regular appearances before this Court in order to obtain approval for making necessary payments under the E&O and USSIC Policies. After extensive discussions with respect to the process of managing and reviewing defense costs, as well as the issues that arise where plaintiffs seek to exert control over the conduct of the legal defense of defendants' counsel, the parties reached a compromise agreement that the Soft Cap should be increased by $10 million and filed the Stipulation with this Court to memorialize that agreement

5. The revised Soft Cap of $40 million would permit payments for defense costs under the E&O Policies, the USSIC Policies and Excess Policy No. ELU121502-11 issued by XL Specialty Insurance Company, which excess policy is

potentially implicated by the agreed $10 million increase in the initial $30 million Soft Cap provided by the Lifting Order.

PRELIMINARY STATEMENT

6. It is clear that both Sapere and the interim customer representatives (the "**Customer Representatives**" and together with Sapere, the "**Objectors**") continue to operate on the erroneous assumption that they are presently vested with rights to Policy proceeds to the exclusion of the individual insureds. As has already been determined by this Court in its Memorandum Opinion, the individual insureds have rights under the Policies at least equal to the rights of entity insureds. The E&O Policies were obtained to protect the individual insureds and the D&O Policies create a priority for the individual insureds. Memorandum Opinion at 24-5. It is undisputed that litigation, arbitration and government and regulatory investigations involving the individual insureds are ongoing and continue to result in the incurrence of defense costs. As required by the Policies, and in full accord with standard insurance practice, Assurance and Specialty have paid reasonable defense costs on behalf of the individual insureds in connection with the various pending actions related to MF Global in which they are involved. As the Objectors' purported loss arises out of the same events for which the individual insureds are being reimbursed for immediate defense costs, it makes no sense that the Objectors should have a prior and superior right to policy proceeds as against individual insureds in circumstances where the Objectors' claims have not been determined or liquidated. With respect to the E&O Policies in particular, this Court has already determined that the Objectors have no present right to the proceeds and mere "accusations of misconduct

provide no basis for denying the Individual Insureds insurance protection under the MFGA policies." Memorandum Opinion at 24. As such, to deny individual insureds coverage they rightly expect under the E&O Policies is wholly inappropriate in these circumstances and would fly in the face of this Court's prior ruling that the E&O Policies are intended for the individual insureds in the first instance.[2]

7. As described in the Stipulation, the parties that were empowered by the Lifting Order to agree to a further expansion of the Soft Cap have in fact agreed that a $10 million increase is necessary and appropriate in the circumstances. Furthermore, as this Court has already decided, and as was affirmed by the District Court, the New York Insurance Law ("**Insurance Law**") requires that the E&O Policies be available to reimburse defense costs notwithstanding the pendency of the chapter 11 proceedings of MF Global Holdings Ltd. and the SIPA liquidation proceedings of MF Global, Inc. Assurance respectfully urges this Court to approve the Stipulation as a reasonable expansion of the Soft Cap in light of the ongoing actions involving the individual insureds, including those maintained by the Objectors, and as consistent with the Insurance Law.

A. **Response to the Customer Representatives' Limited Objection**

8. Assurance strongly disagrees with the Customer Representatives' characterization of the process by which claims for defense costs have been paid under the E&O and USSIC Policies to date as "unsupervised." Limited Objection at ¶ 4. Neither Assurance nor Specialty are in the business of giving away money, and, as

[2] "The MFGA Policies provide equal status to the Individual Insureds and the Debtors. However, in essence and at their core, the MFGA Policies 'were obtained for the protection of' the Individual Insureds and are 'not a vehicle for corporate protection.'" Memorandum Opinion at 25 (internal citation omitted).

described in Paragraph 3 above, the Insurers have put in place sufficient mechanisms for determining if and when defense costs of individual insureds should be paid. Assurance submits that the multiple levels of review of invoices that are currently in place not only amply ensure that the claims process is fairly managed but is a far superior approach to the one promoted by the Objectors, which at bottom would permit the Objectors to inappropriately dictate the terms on which legal defenses of parties against whom they have commenced litigation are mounted.

9. The rate at which defense costs have been paid to date is in no way reflective of any dereliction by the Insurers. Rather, it is directly related to the intensity of the wide variety of legal actions in which the individual insureds are presently involved. In addition to the civil litigations that have been commenced against the individual insureds by, *inter alia*, the very parties objecting to the Stipulation, individual insureds face a variety of governmental and regulatory investigations, including, but not limited to, investigations being conducted by the Commodity Futures Trading Commission, the Financial Industry Regulatory Authority, the Securities Exchange Commission, and the Department of Justice. In addition, and as noted by the Customer Representatives, the individual insureds are also participating in mediation related to some of these actions. That mediation is ongoing. To date, none of the civil litigations have been dismissed and the investigations are also pending.

10. Further, the Objectors could have chosen to litigate in a more direct and efficient fashion, but have not done so. For example, a review of the various complaints that have been filed reveals that a wide array of defendants have been named, which in turn has led to the involvement of a large number of defense firms. The

plaintiffs in the various civil litigations have also not resolved their competing rights to bring actions, which has led to a multiplicity of claims to defend and a significant question of proper standing to address. The Objectors should not be seen to cause a rise in defense costs elsewhere and then come to this Court to complain of rising costs.

11. In light of the foregoing, there can be no doubt that the individual insureds are in need of the continued services of defense counsel. Further, in its Memorandum Opinion, this Court has already determined that the individual insureds have a present right to proceeds on account of defense costs under *both* the E&O and USSIC Policies. Imposition of a "hard cap," which the Customer Representatives suggest is the "only answer" to escalating legal fees, would have the extremely prejudicial effect of leaving individual insureds without insurance proceeds to cover defense costs. It would also deny individual insureds their contractual rights under the Policies, which, as already determined by this Court, would be a clear violation of the Insurance Law. Finally, it would lead to a skewed valuation of any damages that might be assessed against the individual defendants in connection with their actions or inactions in connection with the bankruptcies of the companies at which they were employed.

12. In any event, pursuant to the Lifting Order, this Court provided that the Soft Cap could be further adjusted by agreement among the SIPA Trustee, the Chapter 11 Trustee, and the Insurers. After extensive negotiations, those parties reached agreement on a $10 million increase to the Soft Cap, which agreement is represented by the Stipulation presented to this court by the Chapter 11 Trustee. To the extent the parties to the Lifting Order cannot reach agreement with respect to a further expansion of the Soft Cap, if and when such an expansion is required the parties seeking the expansion

may attempt to obtain such relief by further application to this Court. Parties opposing such relief will have an opportunity to object. Assurance respectfully submits that the limited issue before the Court today is the approval of an expansion of the Soft Cap that has been agreed by all parties required to agree on such an expansion pursuant to the Lifting Order.

13. Finally, Assurance submits that granting the Customer Representatives' request that they be given access to the information shared among the parties to the Lifting Order would be wholly inappropriate. When this Court set out the requirement for the Lifting Order in its Memorandum Opinion, it recognized explicitly that the monitoring procedures should be limited to the Insurers, the SIPA Trustee, the Chapter 11 Trustee and the MFGH Creditors Committee. Memorandum Opinion at 30. This Court also recognized that the subject matter of the disclosures should be protected by the attorney-client privilege. *Id.* Such recognitions related to the fact that the objecting party, Sapere, was suing the individual insureds. The Customer Representatives, by disappearing from, and later reappearing in, the dispute related to access to policy proceeds by individual insureds have done nothing to alter their status as a mirror image of Sapere. The Customer Representatives should not be granted the litigation advantage of participating in the monitoring process, which could only serve to limit the individual insureds' ability to defend themselves and afford the Customer Representatives an insight into the individual insureds' defense strategy. Moreover, because of their control of the litigation against the individual insureds, and because of the Trustees' insistence on bringing this issue back to the Court on a regular basis, the Customer Representatives will have a very good idea of how quickly defense costs are

being incurred without being included in the monitoring process set forth in the Stipulation.

B. **Response to the Sapere Objection**

14. By its objection to the Stipulation, Sapere seeks to re-litigate matters that have already been determined by this Court and that are the subject of a pending appeal in the Second Circuit. Sapere should not be permitted the opportunity to re-argue issues that it has fully litigated and lost both before this Court and the District Court. Notwithstanding the pendency of an appeal, judgments of federal courts are considered final for collateral estoppel purposes. *See, e.g.*, *Haynes v. Law Firm of Aiello & Cannick*, No. 10-CV-5511, 2013 WL 1187439 *8 (S.D.N.Y May 21, 2013) ("[T]he law is clear that ordinarily the pendency of an appeal should not impact the collateral estoppel effect of an otherwise final and valid judgment.") (quoting *Russel-Newman, Inc. v. Robeworks, Inc.*, No. 00-CIV-9797, 2002 WL 1918325 *1 n. 1 (S.D.N.Y. Aug. 19, 2002); *see also Huron Holding Corp. v. Lincoln Mine Operating Co.*, 312 U.S. 183, 189 (1941) (pending appeal does not detract from the decision's decisiveness). In addition, the doctrine of "law of the case," which permits a court to refuse to rehear matters *ad nauseam* where they have already been considered and decided, fully applies in this context. *See, e.g.*, *Arizona v. California*, 460 U.S. 605, 618 ("[The doctrine of the law of the case] posits that when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case.").

15. Here this Court has already considered and determined, *inter alia*, that: (i) proceeds of the E&O and USSIC Policies are available for payment of defense costs to individual insureds; (ii) individual insureds will suffer harm and be denied their

rights under the E&O and USSIC Policies if they do not receive coverage for defense costs; (iii) Sapere does not have "vested rights" in proceeds at this time; and (iv) the "Debtors' bankruptcy is of no consequence under section 3420(a)(1) as it relates to the Individual Insureds' defense costs . . . [a]nd . . . Sapere and the Customer Objectors do not have any rights to those proceeds pursuant to section 3420(a)(1)." Memorandum Opinion at 28. Sapere should not be afforded an opportunity to re-litigate these holdings.

16. Sapere also argues, for the first time, that this Court does not have jurisdiction to enter the Stipulation. However, the cases cited by Sapere on this point do not support this proposition and, in fact, confirm the Court's jurisdiction over this matter. The relief sought in the Stipulation was specifically contemplated by the Lifting Order and it is well settled that notwithstanding the pendency of an appeal a Bankruptcy Court or District Court cannot be denied jurisdiction to implement and/or enforce its orders where the appealed order has not been stayed. *In re Winimo Realty Corp.* 270 B.R. 99 (S.D.N.Y. 2001) ("[I]t is also well established that while an appeal of an order is pending, the [bankruptcy] court retains jurisdiction to implement or enforce the order . . . . 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." (internal quotations and citations omitted)).

17. The Lifting Order explicitly provides that the Soft Cap may be expanded either by agreement between the SIPA Trustee, the Chapter 11 Trustee, and the Insurers or by further order of this Court. Lifting Order at ¶3. Those parties have reached agreement and, as such, the Soft Cap may be increased pursuant to the terms of the Lifting Order. The approval of the Stipulation in no way "expands" or "alters" the

relief that has already been granted but merely memorializes a Soft Cap expansion that has been pre-approved by this Court in the event certain conditions are met. Nothing in the relief contemplated by the Stipulation will interfere with the appeal process and as such this Court is fully empowered to enter the Stipulation as drafted as a measure intended to implement the explicit provisions of the Lifting Order permitting expansion of the Soft Cap.

CONCLUSION

For the foregoing reasons, Assurance respectfully requests that the Court overrule the Objections and approve the Stipulation.

Dated: June 25, 2013
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