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May 15, 2014

Honorable Martin Glenn
United States Bankruptcy Judge
United States Bankruptcy Court
Southern District of New York
1 Bowling Green
New York, NY 10004-1408

Re: *In re MF Global Holdings, Ltd.*, No. 11-15059 (MG);
In re MF Global Inc., No. 11-2790 (MG) (Bankr. S.D.N.Y.)

Dear Judge Glenn:

We represent Bradley Abelow and write on behalf of the 14 Individual Insureds in further support of our April 28, 2014 letter, which the Court deemed by Order dated April 29, 2014, be treated as a motion to lift the stay to permit additional insurance proceeds to be paid on behalf of the Individual Insureds (the "Motion").[1] In particular, we address letters filed on May 12, 2014, by four parties (collectively the "Objectors") that oppose or seek to impose onerous conditions on the relief sought by the Motion.[2]

None of the Objectors can reasonably dispute that the insurance policies at issue provide the Individual Insureds with a contractual right to policy proceeds to advance defense costs. Instead, they ask the Court to take the exceptional step of drastically limiting or cutting off entirely the Individual Insureds' access to these proceeds. The Objectors depend largely on two mistaken premises for their position. *First*, the Objectors—each of whom has sued one or more of the Individual Insureds—mistakenly assume that the Court may limit defendants' access to insurance proceeds to preserve amounts the Objectors hope they might recover in litigation or, more brazenly, to gain a tactical advantage over their opponents in the litigation. The Objectors are wrong on the law; indeed, as explained in greater detail below, it is now clear that the D&O Policy proceeds are not property of either MFGH or MFGI, and therefore are not subject to any court-imposed limitation on the insureds' contractual rights. *Second*, the Objectors assume without support that the fees incurred by 57 individual insureds over two and a half years of highly active investigations and litigation are unreasonable. But the Objectors' speculation is squarely contradicted by the May 12 submissions by counsel for the carriers[3]—the only parties

[1] Unless otherwise noted, abbreviations in this letter are the same as in the Motion.

[2] *See* Ltr. Davidoff & Entwistle to Glenn (May 12, 2014) (Doc. No. 1870) ("Customer Letter"); Ltr. Kobak to Glenn (May 12, 2014) (Doc. No. 1873) ("SIPA Trustee Letter"); Ltr. Bennett to Glenn (May 12, 2014) (Doc. No. 1874) ("Plan Administrator Letter"); Ltr. Grabowski to Glenn (May 12, 2014) (Doc. No. 1875) ("Sapere Letter").

[3] *See* Ltr. Ahari & Werner to Glenn (May 12, 2014) (Doc. No. 7861) ("D&O Letter"); Ltr. Doody to Glenn (May 12, 2014) (Doc. No. 1872) ("E&O Letter").

who have *both* a contractual obligation and a financial incentive to monitor the fees they advance.

As explained in the Motion, the individual insureds are suffering severe prejudice in defending the district court actions without access to additional advancement or reimbursement of insurance proceeds.[4] In light of that, and for the reasons set forth in the Motion and below, the Individual Insureds respectfully request that the Court (i) confirm that the D&O Policy proceeds are not property of either MFGH or MFGI and therefore are not subject to the stay or any court-imposed cap or limitation, and (ii) lift the stay to permit the E&O Policies to reimburse reasonable fees.

A. The Stay Does Not Apply to Proceeds of the D&O Policies

Since the Court issued its first order lifting the stay in 2012, it has become clear that any proceeds from the D&O Policies are not property of either MFGH or MFGI or their estates.[5] The Court noted at that time that when an insurance policy "provides exclusive coverage to directors and officers, courts have generally held that the proceeds are not property of the estate." 2012 Op. at 19 (citing *In re Allied Digital Techs. Corp.*, 306 B.R. 505, 510 (Bankr. D. Del. 2004)). This same principle holds even where the entity may once have enjoyed *potential* coverage for certain types of hypothetical claims under the terms of a policy, but no valid claims have been or could be made under the terms of the policy. As this Court explained, quoting from other federal bankruptcy precedent, where insurance policies provide direct coverage to both individuals and debtors, courts have concluded that the proceeds are property of the estate only "'if depletion of the proceeds would have an adverse effect on the estate to the extent the policy actually protects the estate's other assets from diminution.'" *Id.* at 20 (quoting *In re Downey Fin. Corp.*, 428 B.R. 595, 603 (Bankr. D. Del. 2010) (citing *Allied Digital*, 306 B.R. at 512)). Each of the cited precedents makes clear that proceeds of insurance policies that provide coverage to both entities and individuals are *not* property of the estate when there are no longer any covered claims against the debtors, nor are there likely to be. *See Downey*, 428 B.R. at 604-05; *Allied Digital*, 306 B.R. at 513; *accord In re First Cent. Fin. Corp.* 239 B.R. 9, 17 (Bankr. E.D.N.Y. 1999); *see also* Statement of the Chapter 11 Trustee in Support of the Motion of U.S. Specialty Insurance Company For Relief From the Automatic Stay, To The Extent Applicable (March 2, 2012) (Doc. No. 505), at 5 ("The Proceeds of the Policy are not Property of the Estate").

No claims have been made by MFGH or MFGI against the D&O Policies. And at this stage no valid claim could be made. As this Court is aware, the first $150,000,000 of coverage under the D&O Policies includes "entity coverage" for securities claims.[6] We

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[4] *See* Motion.

[5] In its opinion, the Court declined to decide whether D&O Policy proceeds were property of the estate, instead lifting the automatic stay based only on the showing of good cause. *See* Memorandum Opinion at 20-26 (Apr. 10, 2012) (Doc. No. 619) (the "2012 Opinion" or "2012 Op.").

[6] The policies also provide coverage to the entity for indemnification payments. However, even if MFGH or MFGI (neither of which is advancing attorneys' fees) were to indemnify the directors and officers, they would be providing indemnification in respect of the very same costs for which the Individual Insureds now seek

understand that it remains the case that no securities claims have been filed against either entity. And even if new securities claims were not barred by the applicable statutes of limitations – which they are[7] – no further securities claims could be filed against MFGH (the only entity with publicly traded securities) at this time, as the Court has confirmed a Plan of Liquidation that permanently enjoins all security holders from asserting claims against it. *See* Second Amended and Restated Joint Plan of Liquidation (May 3, 2013) (Doc. No. 1382) (the "Plan").

Thus, any uncertainty at the time of the 2012 Opinion[8] about the *possibility* that a claim might be filed by an entity against the D&O Policies has now been resolved, and it is clear that D&O Policy proceeds are not property of any relevant entity or estate. This conclusion flows both from the precedents cited by the Court in its 2012 Opinion, *see Downey Fin.*, 428 B.R. at 604-05; *Allied Digital*, 306 B.R. at 513, and (for MFGH) from the terms of the Plan itself, which incorporates the same definition of "property" as is applied by the Court's cited precedents and which bars all claims that could plausibly generate coverage under the D&O Policies. That the D&O Policies clearly provide individual directors and officers with priority of payment over any claim by any entity, *see* 2012 Op. at 11-12, 24, further confirms this conclusion.[9] And, as explained in detail in Section C below, it is well-established that the fact that proceeds of a wasting policy could potentially provide a source of recovery in *litigation* against the insureds does not make proceeds property of any estate or entity.

B. The Stay Should Be Lifted with Respect to the E&O Policies

The stay should likewise be lifted as to the proceeds from MF Global's E&O Policies. As this Court has acknowledged, the Individual Insureds are contractually entitled to E&O coverage in connection with the investigations and litigations. *See* 2012 Op. at 25. Though we understand that a claim has been made by MFGI against the E&O Policies, the various reasons why the stay should be lifted with regard to the E&O Policies in spite of that claim are explained at length in the May 12, 2014 submission by counsel for the E&O insurers.

We do not repeat those reasons here, other than to emphasize the extent to which cause exists to lift the stay as to policy proceeds. In its 2012 Opinion lifting the stay, this Court held that the Individual Insureds had a "present" need for payment of their defense costs under the D&O and E&O Policies, and disruption of payment from these policies would pose "immediate hardships" for the Individual Insureds. 2012 Op. at 23, 25. Those hardships have only become more acute since 2012, as explained in the Motion.

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reimbursement and advancement. Thus, potential indemnification rights cannot establish a cognizable interest here for MFGH or MFGI. *See, e.g.*, *Allied Digital*, 306 B.R. at 513-14 (citing *In re CyberMedica, Inc.*, 280 B.R. 12, 18 (Bankr. D. Mass. 2002)).

[7] *See* 15 U.S.C. § 77m (one year from discovery); 28 U.S.C. § 1658(b) (two years from discovery). Over two years have passed since the first securities complaint was filed on November 3, 2011.

[8] 2012 Op. at 20 ("The Chapter 11 Trustee has not yet filed a claim, *but he may do so*." (emphasis added)).

[9] The *Downey* court relied on a similar provision to support its conclusion that proceeds of that policy were not property of the estate. 428 B.R. at 607-08.

C. Litigation Filed by Objectors Against the Individual Insureds Does Not Provide a Basis to Limit Advancement and Reimbursement

This Court has already made clear that the law does not permit an objector to interfere with an insured's contractual right to advancement merely because that objector wishes either (1) to preserve a wasting policy to satisfy a potential judgment in litigation against the insured; or (2) to gain a tactical advantage in litigation. As the Court explained:

> 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.

2012 Op. at 29-30 (quoting *Allied Digital*, 306 B.R. at 512-13 and citing *In re Beach First Nat'l Bancshares, Inc.*, 451 B.R. 406, 411 (Bankr. D.S.C. 2011), and *First Cent.*, 238 B.R. at 21).

The Objectors' assertion that the district court has "sustained" certain claims against certain defendants is misleading at best. The fact that the District Court *partially* denied motions to dismiss is, of course, not a judgment that any defendant is liable for the conduct alleged, and therefore there are no competing covered losses at this time.[10] And contrary to the Objectors' assertions, no court has "set" the amount of any damages to the customers or MFGI estate. Rather, both the district court and this Court have made clear that the amount of damages remains to be litigated. Finally, the Objectors' assertions are also inconsistent with New York insurance law and public policy, neither of which requires insurers to delay payments and avoid settlements out of concern for other claims. *See* E&O Letter at 4. In short, the Objectors' position that liability can be presumed at this stage so as to limit the Individuals Insureds' ability to use insurance funds to conduct their defense is entirely meritless.

In the same way, the suggestion by various Objectors that the Individual Insureds should provide further evidence of "hardship" before receiving reimbursement finds no support either in the policies or the law. The policies are contracts. They provide the insureds with access to policy proceeds to reimburse or advance legal fees when certain triggering events occur without regard to hardship or need. Those events have occurred. The Objectors offer no legal basis to engraft any further requirement onto the policies, and there is none.

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[10] As explained in the E&O Letter, the E&O Policies require that the Individual Insureds' defense costs be advanced *before* any underlying claim is determined. *See* E&O Letter at 4. By contrast, a plaintiff's claims are to be paid only in the event of "judgments" or damages or costs "awarded" by a court or arbitrator against an insured, or "settlements" with an insured. *See* MFG Assur. Policy § 2.19. To the extent the Objectors seek to characterize the SIPA Trustee's settlement involving restitution paid by MFGI to customers as a competing covered loss, this is incorrect. It is well established that "[r]estitution of ill-gotten funds does not constitute 'damages' or a 'loss' as those terms are used in insurance policies." *Vigilant Ins. Co v. Credit Suisse First Boston Corp.*, 10 A.D.3d 528, 528 (N.Y. App. Div. 1st Dep't 2004); *accord* E&O Letter at 5.

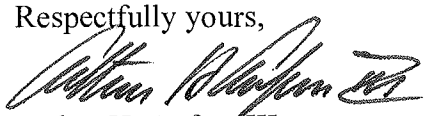
D. The Reasonable Fees Incurred Have Been Monitored Vigilantly by the Carriers

The fees to date have been commensurate with the extensive work needed to represent 57 individuals in connection with the sprawling prior and ongoing investigations and at least five significant litigations.[11] The Objectors' suggestions to the contrary are baseless.[12] The D&O Letter, and the Motion, detail the extent of the work that has been required, the level of coordination among counsel, and the extent of the review of invoices and demands for discounts by the insurers—who have every economic incentive (together with a contractual right) to ensure that fees are reasonable.[13]

E. Mediation and Settlement

Finally, the Objectors suggest that the Individual Insureds have been "intransigent" or have not made "reasonable efforts" to settle the MF Global matters, including through mediation. *See* Customer Letter at 5 & n.10; SIPA Trustee Letter at 3; Plan Administrator Letter at 4. These assertions are false. Unfortunately, our ability to respond further to such a charge is limited by the mediation privilege, which the Objectors have violated with their submissions. Should this Court have any questions about the mediation process to date or the Individual Insureds' (or any other party's) commitment to and conduct in that process, we would welcome the Court contacting the mediator—Hon. Daniel Weinstein (Ret.)—directly. Although we understand that all relevant parties to the mediation would need to provide consent to permit Judge Weinstein to speak freely with the Court, we are hopeful that the Objectors will not stand in the way of such a communication.

Respectfully yours,



Arthur H. Aufses III

cc: All Counsel by ECF

[11] By way of contrast only, we note that counsel for the customer plaintiffs alone had incurred a total lodestar as of February 2, 2014 of $22,396,821. They have done so solely for work performed in connection with the Customer Action – which is only one of five actions against which some or all of the Individual Insureds are defending in the MDL. Little discovery has taken place in that case.

[12] The Plan Administrator's suggestion that the Individual Insureds have incurred the requested fees "notwithstanding that discovery. . . was stayed until December 2013 or March 2014" is misleading. Fifty-seven individual insureds have faced multiple investigations by both regulators and trustees—including by the Plan Administrator's predecessor—and have participated in extensive mediation, involving briefing and experts, as well as motion practice and other work in litigation not impacted by any stay. *See* D&O Letter at 2.

[13] The suggestion by the Plan Administrator and Sapere that this Court impose a "reporting" requirement is not only without legal basis and violative of the Individual Insureds' contract rights, but is unnecessary and wasteful.