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UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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

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

Louis J. Freeh (the "Trustee"), the duly-appointed chapter 11 trustee of MF Global Holdings Ltd. ("MF Ltd."), MF Global Finance USA Inc., MF Global Capital LLC, MF Global FX Clear LLC and MF Global Market Services LLC (collectively, the "Debtors"), respectfully submits this statement in support of U.S. Specialty Insurance Company's ("USI") *Motion of U.S. Specialty Insurance Company for Relief from the Automatic Stay, to the Extent Applicable* (the "Motion") and in response to the following objections (the "Objections"): *Objection of Sapere Wealth Management, LLC., Granite Asset Management and Sapere CTA Fund, L.P. (collectively "*Sapere") *to Motion of U.S. Specialty Insurance Company for Relief from the Automatic Stay, to the Extent Applicable* (the "Sapere Objection"); *Objection of Certain Commodities Customers (the "*Customers*") of MF Global Inc. to Motion of U.S. Specialty Insurance Company for Relief*

from the Automatic Stay (the "Customers' Objection", together, the "Objectors"), *and Statement of SIPA Trustee on Certain Insurance Issues*.

In support of this response, the Trustee represents as follows:

PRELIMINARY STATEMENT

The Trustee respectfully requests that the Motion be granted. The Trustee believes that even if the proceeds of the subject directors' and officers' policies (the "Policies") were deemed to be property of the Debtors' estates, cause exists for lifting the automatic stay to allow for the advancement and payment of defense costs. The officers and directors who are the subject of the investigations and litigations for which coverage has been sought from USI are incurring significant costs in connection with those pending and threatened proceedings. The inability of those individuals to defend themselves appropriately in these proceedings poses risks to the Debtors' estates – primarily the risk that an adverse decision against the individuals (or even an adverse finding of fact) will form the basis for the assertion by others of claims against the Debtors' estates. Although the Trustee, in theory, could attempt to protect itself from such rulings by seeking to obtain orders extending to these non-debtor individuals the benefits of the automatic stay imposed under Bankruptcy Code Section 362, the burden on the estates of such efforts is too great to consider as a reasonable option.

The Objectors, most of which lack standing to oppose the requested relief, fail to provide a cogent legal argument for denying the relief requested in the Motion. Instead, they ask this Court to ignore the firm legal basis—established through years of case law in this Circuit and in others—for approving the Motion. The Objectors further ask for rights that are neither contemplated under the Policies nor under the Bankruptcy Code.

The SIPA Trustee, James Giddens, has suggested that parameters be established to assist the Court and others in monitoring and controlling the funds that are dispersed under the Policy.

The Trustee does not object to the implementation of appropriate controls, but urges that they be reasonable and sufficient to allow the individual insureds to defend themselves appropriately.

For the reasons set forth herein, the relief requested should be approved.

ARGUMENT

A. The Objectors do not have Standing

1. Apart from the SIPA Trustee, none of the parties opposing the relief requested in the Motion satisfies the "party in interest" standard in 11 U.S.C. § 1109(b) to "appear and be heard on any issue" in this case.[1] Neither Sapere nor the Customers have established that they are creditors of the Debtors' estates. Nor have they established that they have rights against the Policies (contractual or equitable) that are directly affected by the Motion. Although the Trustee recognizes the concerns of the customers of MF Global, Inc. ("MFGI"), these chapter 11 bankruptcy cases can not serve as a forum for customers of MFGI to be heard where standing is lacking.

2. Courts of the Second Circuit have held that "a party in interest is one that would require representation, or a pecuniary interest that will be directly affected by the case." *In re Innkeepers USA Trust, et al.*, 448 B.R. 131, 141 (Bankr. S.D.N.Y. 2011); Although this is a broad interpretation of § 1109(b), these same courts have "limited 'party in interest' standing where a party's interest in the proceeding is not a direct one." *Id. See also, In re St. Vincent's Catholic Medical Centers of N.Y.*, 429 B.R. 139, 151 (Bankr. S.D.N.Y. 2010)

> When Bankruptcy Code § 1109(b) and Fed. R. Bankr. P. 2018(a) are read together, the long list of interested parties set out in § 1109 does not guarantee a party on that list the right to object to every motion; rather the party must be directly interested in the motion at

[1] A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter. 11 U.S.C. § 1109(b).

> hand. Otherwise, the party needs the Court's permission to intervene.

Krys, et al. v. Official Committee of Unsecured Creditors of REFCO, Inc. (*In re Refco*), 505 F.3d 109, 117 n.9 (2d Cir. 2007); *In re Comcoach Corp.*, 698 F.2d 571, 573 (2d Cir. 1983).

3. In these chapter 11 cases, and in regards to the insurance proceeds specifically, the Objectors do not have a direct pecuniary interest that would provide them standing as a "party in interest" under § 1109(b), regardless of their assertion. The Objectors are not directly affected by this Motion as they are not an insured under the Policies. Nor can the Objectors directly claim a right under the Policies to any of the proceeds. They are not entitled to recover directly from USI or the Policies for any judgment they may obtain against an insured. At best, they are indirectly affected by this Motion through their various lawsuits and their assertions that they are customers of MF Global Inc. As described below, these factors do not provide them with standing in these cases.

4. The Objectors have failed to provide anything beyond conjecture that would suggest that they are actually creditors of the Debtors. As the Second Circuit in *REFCO* stated

> Courts in our Circuit have consistently (and correctly) interpreted *Comcoach* to stand for the principle that party-in-interest standing under *§* 1109(b) does not arise if a party seeks to assert some right that is purely derivative of another party's rights in the bankruptcy proceeding. *See S. Blvd., Inc. v. Martin Paint Stores (In re Martin Paint Stores), 207 B.R. 57, 61-62 (S.D.N.Y. 1997)* ("The concept [of party-in-interest standing] does not, according to the Second Circuit, encompass a creditor of one of the debtor's creditors . . . [Appellant] cannot establish standing by raising another person's legal rights." (internal quotation marks and citations omitted)); *In re Ionosphere Clubs, Inc., 101 B.R. 844, 849 (Bankr. S.D.N.Y. 1989)* (citing *Comcoach* to reject a party's "assertion that due to its [self proclaimed] status as protector of consumer [] [creditors], it has the unique power to step into the[ir] shoes . . ., and receive their status as a party in interest" (first alteration in original))

REFCO, 505 F.3d at 117 n.9.

5. In *REFCO*, the Second Circuit ruled, as Judge Lifland stated in *In re Ionosphere Clubs, Inc.*, 101 B.R. 844, 850-51, that

> [I]t is important that a bankruptcy court is not too facile in granting applications for standing. Overly lenient standards may potentially over-burden the reorganization process by allowing numerous parties to interject themselves into the case on every issue, thereby thwarting the goal of a speedy and efficient reorganization. . . . Granting peripheral parties status as parties in interest thwarts the traditional purpose of bankruptcy laws, which is to provide reasonably expeditious rehabilitation of financially distressed debtors with a consequent distribution to creditors who have acted diligently.

REFCO 505 F.3d at 119-20. This Court should apply the same standard here where the Objectors continue to disrupt "the Code's goal of a speedy and efficient reorganization" and would cause a substantial delay in the bankruptcy case.

A. The Proceeds of the Policy are not Property of the Estate

6. In the Motion, USI amply demonstrates why the facts and applicable law warrant the stay relief USI seeks. The Trustee concurs in those legal arguments.

7. As provided in the Motion, the relative rights of a debtor's estate in the proceeds of an insurance policy are controlled by the language and scope of the specific policies at issue. *In re Downey Fin. Corp*, 428 B.R. 595, 603 (Bankr. D. Del. 2010). As the court in *In re Downey Fin. Corp.*, 428 B.R. at 603, summarized:

> Cases determining whether the proceeds of a liability insurance policy are property of the estate are controlled by the language and scope of the specific policies at issue. [Citations omitted.]
>
> When a debtor's liability insurance policy only provides direct coverage to the debtor, courts generally hold that the proceeds are property of the estate. [Citations omitted.] Conversely, when the liability insurance policy only provides direct coverage to the directors and officers, courts generally hold that the proceeds are not property of the estate. [Citations omitted.] When the liability insurance policy provides direct coverage to both the debtor *and* the directors and officers, "the proceeds will be property of the

> estate 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." [Citations omitted.]

In re Downey Fin. Corp., 428 B.R. at 603; *see also In re Allied Digital Techs.*, 306 B.R at 512.[2]

8. "The legislative history of the 1978 Bankruptcy Code makes clear that despite the broad scope of § 541(a) [that defines and creates the bankruptcy estate], it 'is not intended to expend [sic] the debtor's rights against others more than they exist at the commencement of the case." S. Rep. No. 95-989, at 82 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5868.'" *In re Vote*, 276 F.3d 1024, 1026 (8th Cir. 2002); *accord Demczyk v. Mutual Life Ins. Co. of N.Y. (In re Graham Square, Inc.)*, 126 F.3d 823, 831 (6th Cir. 1997); *Gendreau v. Gendreau (In re Gendreau)*, 122 F.3d 815, 819 (9th Cir. 1997); *Matter of Sanders*, 969 F.2d 591, 593 (7th Cir. 1992) (estate takes property subject to burdens and limitations of state law rights).

9. Thus, the question here is whether the Debtors' estates have an interest in the proceeds available under the Policies. As noted by Bankruptcy Court Judge Sontchi in *In re Downey Fin. Corp.*, 428 B.R. at 604, where, as here, a liability insurance policy provides coverage to both the debtor and the directors and officers, the proceeds will be property of the estate if "depletion of the proceeds would have an adverse effect on the estate . . . ."

10. The Policies contain two types of coverages available to the Debtors' estates: (a) coverage for indemnity provided to the Debtors' officers and directors, and (b) coverage for securities claims (as defined in the Policies). The Trustee has no current plans to provide or allow for any payments of indemnity to current or former officers and directors arising out of any of the pending proceedings. In addition, none of the Debtors has been named in any action for which the Trustee would seek coverage under the "Securities Claims" portion of the Policies.

[2] Historically, the cases have not been uniform, with some splits in authority on some of these points. However, this excerpt from *Downey* represents a trend towards uniformity.

Moreover, the Trustee would seek to subordinate, under section 510(b), any securities claims asserted against the Debtors. Thus, at best, the Debtors' current interest in the insurance proceeds is speculative. *See, e.g., In re Downey Fin. Corp.*, 428 B.R. at 606-7, *In re Adelphia Communications Corp. v. Associated Electric & Gas Insurance Services, Ltd., et al., (in re Adelphia Communications Corp.)*, 285 B.R. 580, 592, n.13 (coverage for securities claims is "rarely meaningful in bankruptcy cases (even in chapter 11 cases), because under section 510(b) of the Code, claims for securities fraud -- claims 'arising from rescission of a purchase or sale' of a security, or for damages arising from such -- are subordinated."). Without question, the individual insureds that are the subject of the various proceedings (currently ongoing) enjoy a greater interest in the proceeds of the Policies than do the Debtors.

B. **A Balancing of the Equities Warrants Granting at Least Partial Relief**

11. Even assuming that the Debtors' estates had an interest in the proceeds of the Policies, a balancing of the equities in these cases clearly favors granting USI relief from the stay to permit the individual insureds to obtain the funds necessary to defend themselves in these proceedings. As the cases cited in the Motion demonstrate, courts in this and other districts recognize that the hardships upon officers and directors, who are the subject of third-party litigation, are great and warrant relief from the automatic stay. *See, e.g., In re CyberMedica, Inc.*, 280 B.R. 12, 18 (Bankr. D. Mass. 2002) ("This Court further finds that there is cause to lift the automatic stay because [director and officer direct insureds under the D&O policies there] may suffer substantial and irreparable harm if prevented from exercising their rights to defense payments. [They] are in need *now* of their contractual right to payment of defense costs and may be harmed if disbursements are not presently made to fund their defense of the Trustee's Complaint") (emphasis in original).

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that (a) the Court grant the Motion, (b) the Court determine that the Objectors lack standing to assert their Objections and (c) any restraint or limitation imposed by the Court on any distributions of insurance proceeds under the Policies be reasonable so as to permit the individual insureds to defend themselves in a reasonable manner, and (d) that the Court grant such other relief as is just and proper.

Dated: New York, New York
March 2, 2012

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