

Dan M. Berkovitz
General Counsel

Jonathan L. Marcus
Deputy General Counsel

Robert B. Wasserman
Chief Counsel, Division of Clearing and Risk

Martin B. White
Assistant General Counsel

Robert A. Schwartz
Assistant General Counsel

Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
(202) 418-5129
jmarcus@cftc.gov
rwasserman@cftc.gov
mwhite@cftc.gov
rschwartz@cftc.gov

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re:

MF GLOBAL Inc.,

Debtor.

Case No. 11-2790 (MG) SIPA

**REPLY BRIEF OF THE COMMODITY FUTURES TRADING COMMISSION
REGARDING THE LEGAL PRINCIPLES AND FRAMEWORK APPLICABLE TO
THE ALLOCATION AND DISTRIBUTION OF CUSTOMER PROPERTY**

On November 17, 2011, this Court instructed the Commodity Futures Trading Commission (“CFTC” or the “Commission”), Securities Investor Protection Corporation (“SIPC”), and the Trustee (“SIPA Trustee”) for MF Global, Inc. (“MFGI”), to submit briefs on the rules and procedures applicable to the allocation and distribution of property within the MFGI estate. The CFTC, SIPC, and SIPA Trustee did so on December 12, 2011. (Docs. # 724, 725, 726.) On January 9, 2012, several entities filed responses (Docs. # 814, 817, 818, 819, 822, 823), and on January 10, 2012, the Chapter 11 Trustee for MF Global Holdings, Ltd. (“MFG Holdings”) late-filed an additional response. In accordance with the Court’s orders, the CFTC respectfully submits this reply addressing certain issues raised in the responsive briefs.

I. Errors and Misstatements by the Chapter 11 Trustee

The brief of the Chapter 11 Trustee contains errors and misstatements of law that, if accepted, may inhibit commodity customers from recovering their property. As explained below, contrary to the Chapter 11 Trustee’s assertions, customer protections in the Bankruptcy Code, Commodity Exchange Act (“CEA”), and CFTC regulations apply to these proceedings and require that commodity customers be made whole in preference to substantially all other claims, including any claims by the MFG Holdings estate.

a. Part 190 Applies to All Commodity Broker Liquidations.

The Chapter 11 Trustee repeats the erroneous statement of the MFG Holdings Creditors Committee that “Part 190 Regulations do not apply in a SIPA proceeding.” (Doc. # 824 at 4.) This theory, which explicitly is intended to “maximize the value of the [MFG Holdings] estate” at the expense of commodity customers who entrusted their property to MFGI (Doc. # 824 at 2), is incorrect because it conflicts with the plain language of SIPA. *See* 15 U.S.C. § 78fff-1; *SIPC v. Poirier*, 653 F. Supp. 63, 66 (D. Or. 1986) (explaining that SIPA requires the trustee to

“liquidate a stock broker who is also a commodity broker under the rules of the Commodities Exchange Act”). If, contrary to the language of the statute, the Chapter 11 Trustee were correct, the senseless result would be to render inapplicable the key regulations of the Commodity Futures Trading Commission in the largest commodity broker bankruptcy in U.S. history, and to strip of a remedy all MFGI commodity customers who entrusted their property to MFGI in reliance on applicable segregation requirements, based solely on the happenstance that the commodity broker also operated a much smaller securities business. As explained below, that is not the law.

Although the Chapter 11 Trustee correctly notes that this is a proceeding under SIPA rather than chapter 7, SIPA Section 78fff-1(b) states that a SIPA trustee “shall be subject to the same duties as a trustee in a case under chapter 7 of title 11, including, if the debtor is a commodity broker, as defined under section 101 of such title, the duties specified in subchapter IV of such chapter 7.” 15 U.S.C. § 78fff-1(b); *see also id.* § 78fff-1(a) (providing that a SIPA trustee is “vested with the same powers . . . as a trustee in a case under title 11”). Substantially all of the operative provisions of subchapter IV of chapter 7 convey powers and impose duties on the trustee. *See, e.g.*, 11 U.S.C. § 764(a) (identifying transfers that “may be avoided by the trustee, and shall be treated as customer property”); *id.* § 765(b) (“The trustee shall comply, to the extent practicable, with any instruction received from a customer”); *id.* § 766(c) (“The trustee shall return promptly to a customer any specifically identifiable security, property, or commodity contract to which such customer is entitled”). The main provision at issue here is chapter 7, Section 766(h), which directs the trustee to distribute all “customer property” to its rightful customer-owners in preference to substantially all other claims:

Except as provided in subsection (b) of this section, ***the trustee shall distribute customer property ratably to customers on the basis and to the***

extent of such customers' allowed net equity claims, and in priority to all other claims, except claims of a kind specified in section 507 (a)(2) of this title that are attributable to the administration of customer property.

11 U.S.C. § 766(h) (emphasis added).

To implement and clarify this and other provisions of subchapter IV, Congress, in CEA Section 20(a), authorized the CFTC to establish rules and regulations with respect to “a commodity broker that is a debtor under chapter 7 of title 11.” 7 U.S.C. § 24(a). Pursuant to that grant of authority, the Commission has promulgated Part 190 to govern commodity broker liquidations under chapter 7 and, perforce of 15 U.S.C. § 78fff-1—which provides that “the same duties” apply under either statute—those SIPA proceedings in which “the debtor is a commodity broker.” MFGI was without question a “commodity broker” under SIPA and the Bankruptcy Code. (*See* Memorandum Opinion & Order (Nov. 23, 2011) (Doc. # 426 at 3) (“The collapse of MFGI has given rise to a commodities broker liquidation of immense scope and complexity.”).) Therefore, Part 190 applies and governs the SIPA Trustee’s allocation and distribution of property in this proceeding.¹

SIPC and the SIPA Trustee have rejected the Chapter 11 Trustee’s erroneous argument (*see, e.g., Memorandum of the SIPC* (Doc. # 725 at 15, 16, 17, 18, 24, & 25) (citing Part 190); *Reply of SIPC* (Doc. # 851 at 3); *Trustee’s Memorandum* (Doc. # 726 at 13, 14, 15, 16, 23, & 29) (same)), and this Court, in ordering each of the first three transfers of commodity customer property as well as the establishment of the customer claims process, has explicitly invoked the Part 190 regulations as they pertain to the SIPA Trustee’s duties (Doc. # 14 at 2 (concluding that

¹ CEA Section 20(a) empowers the Commission not only to define “customer property,” but also, *inter alia*, to define “specifically identifiable property,” to establish the “method by which the business of such commodity broker is to be conducted or liquidated after the filing of the petition,” and to prescribe “how the net equity of a customer is to be determined.” 7 U.S.C. § 20(a). The Commission has promulgated detailed regulations pursuant to this statutory grant of authority. *See* 17 C.F.R. §§ 190.02-.07 (implementing aspects of the Commission’s Section 20(a) authority). If the Chapter 11 Trustee were correct, these regulations too may be inapplicable, for no apparent purpose other than to privilege private interests over the interests of commodity customers. But that is not what Congress intended, as set forth clearly in SIPA.

the terms of the first transfer motion were “appropriate exercises of the Trustee’s authority pursuant to [*inter alia*] the Part 190 Regulations”); Doc. # 316 at 2 (equivalent finding under Part 190 with respect to the second transfer motion); Doc. # 717 at 2 (equivalent finding under Part 190 with respect to the third transfer motion); Doc. # 423 (“ORDERED that the Trustee shall implement the procedures prescribed in 17 C.F.R. § 190.08 for allocation and distribution of commodity futures customer property[.]”). In issuing these orders, the Court correctly applied SIPA and the Bankruptcy Code. The Chapter 11 Trustee’s theory is erroneous and should be rejected.

b. The Chapter 11 Trustee Misstates the Holding of *In re Griffin Trading*.

The Chapter 11 Trustee incorrectly states that “one bankruptcy court has rejected 17 C.F.R. § 190 (the “Part 190 Regulations”) as being beyond the CFTC’s rule making authority and as being inconsistent with the plain language of title 11.” (Doc. # 824 at 2 (citing *In re Griffin Trading Co.*, 245 B.R. 291 (Bankr. N.D. Ill. 2000).) Contrary to the Chapter 11 Trustee’s representation, *Griffin* pertained to a single subsection of the CFTC’s regulations, 17 C.F.R. § 190.08(a)(1)(ii)(J), not to Part 190 as a whole. *See* 245 B.R. at 310.² In any event, as the Chapter 11 Trustee acknowledges, the *Griffin* decision was vacated by the U.S. District Court for the Northern District of Illinois shortly after it was issued. *See Inskeep v. MeesPierson, N.V.*, 270 B.R. 882, 883 (N.D. Ill. 2011).

c. The Court Need Not Address Subparagraph (J) at This Time.

The Chapter 11 Trustee’s misstatement of the holding in *Griffin* obscures the fact that, as explained in the CFTC’s December 12 memorandum, MFGI commodity customers have many

² As the Commission will explain in full should Section 190.08(a)(1)(ii)(J) become directly relevant, *Griffin* was wrongly decided, and the proposition that this subsection could be “rejected” as “inconsistent with the plain language of title 11 of the United States Code” (Doc. # 824 at 2) overlooks Section 20(a) of the CEA, which empowers the Commission to establish such rules and regulations “[n]otwithstanding Title 11 of the United States Code.” 7 U.S.C. § 24(a).

rights to reclaim their property that must be satisfied before Section 190.08(a)(1)(ii)(J) becomes operative. (*See generally* *Brief of the CFTC* (Doc. # 724 at 3-6).) Paragraph (J) states that it applies “only to the extent that the property enumerated in (a)(1)(i)(E) and (a)(1)(ii)(A) through (a)(1)(ii)(H) of this section [17 C.F.R. § 190.08] is insufficient to satisfy in full all claims of public customers.” *Id.* § 190.08(a)(1)(ii)(J).

Commodity customers are entitled, for example, to *pro rata* distribution of property “that was unlawfully converted but is part of the debtor’s estate,” *id.* § 190.08(a)(1)(ii)(F), and of property that should have been segregated but was “withdrawn” from the MFGI estate and “subsequently is recovered by the avoidance powers of the [SIPA] trustee,” *id.* § 190.08(a)(1)(ii)(D). Thus, to the extent that diverted customer property may reside elsewhere within the MFGI estate or subsequently is recovered from some other entity, including from MFG Holdings, that property must be returned on a *pro rata* basis to its rightful customer-owners.³ Section 190.08(a)(1)(ii)(J) becomes directly relevant only if and when it is determined that such property is “insufficient to satisfy in full all claims of public customers.”

II. Property Belonging to Customers of MF Global Hong Kong Ltd.

As noted in the Commission’s December 12 brief, while some MFGI “insiders” or affiliates may meet the definition of “customer” under the Bankruptcy Code and CFTC regulations (called “non-public” customers), no such insiders may be paid until all public customers’ claims are fully satisfied. 11 U.S.C. § 766(h); 17 C.F.R. § 190.08(b) & (c)(2). The distinction between public and non-public customers depends largely on whether the customer is

³ As discussed in the *Memorandum of the Commodity Futures Trading Commission in Response to the Motion by Sapere Wealth Management, LLC, et al., to Direct the Debtors’ Estate to Be Administered Pursuant to 11 U.S.C. §§ 761-767 and 17 C.F.R. § 190* (*In re MF Global Holdings, Ltd.*, No. 11-15059 (Doc. # 342)), if MFG Holdings is in possession of any customer property as defined in subchapter IV and Part 190, the Chapter 11 Trustee must return that property forthwith. If this Court determines that MFG Holdings disregarded the corporate form or that MFGI acted as an agent or *alter ego* of MFG Holdings, it is possible that MFG Holdings itself may become directly subject to subchapter IV and Part 190.

the owner of a “proprietary account,” defined to include, *inter alia*, an account “which is owned by . . . [a] business affiliate that, directly or indirectly is controlled by or is under common control with” the commodity broker in liquidation. 17 C.F.R. §§ 1.3(y), 190.01(bb).

The MF Global Hong Kong liquidator describes a set of “segregated omnibus accounts” maintained “for the benefit of clients of MFG HK” and states that claims based on those accounts “are properly distinguishable from” that affiliate’s “proprietary claims.” (Doc. # 817 at 2-4.) Although MF Global Hong Kong does not provide detail concerning the accounts or the identities of their beneficial owners, the Commission agrees that property in accounts that is “owned by” customers who are not insiders, *see* 17 C.F.R. § 1.3(y), which would be subject to the segregation requirements of CEA Section 4d, 7 U.S.C. § 6d(2), should be treated as “public customer” property under Part 190, *see* 17 C.F.R. §§ 190.01(bb), 190.08(b) & (c)(2).

III. Claims of Certain Physicals and Metals Customers

a. Specifically Identifiable Property of Certain “Physicals Customers”

“Physicals Customers” Bruce Eisen, Dale Mancino, Denis Brink, Patrick O’Malley, M.D., and William Hackenberger argue in response to the SIPA Trustee’s memorandum that, although their property may meet the definitions of “customer property” and “specifically identifiable property” under the relevant federal statutes and regulations, it is nevertheless not subject to the distribution plan insofar as it is not part of the MFGI estate because, they argue, it is “questionable” that MFGI has title to the physicals under Article 7 of the UCC. (Doc. # 818 at 3-9.) Although the Physicals Customers’ memorandum may not include a complete recitation of all facts necessary to determine the status of this property, the Commission notes that the applicable federal statutes and regulations must be applied according to their terms, notwithstanding any provisions of the UCC that might lead to a contrary result. U.S. Const., Art

VI., cl. 2.; *see generally Levitin v. Painewebber, Inc.*, 159 F.3d 698, 705 (2d Cir. 1998)
(discussing preemption of the UCC by federal law).

Section 761(10) of the Bankruptcy Code provides that “customer property” includes, in relevant part, “property . . . held by or for the account of the debtor, from or for the account of a customer” that is “specifically identifiable customer property.” 11 U.S.C. § 761(10). CFTC regulations codify a substantively equivalent provision. 17 C.F.R. § 190.08(a)(1)(2)(C). The regulations then define “specifically identifiable” property to include, “[w]ith respect to . . . physical commodities received, acquired, or held by or for the account of the debtor for the purpose of making or taking delivery or exercise from or for the account of a customer, any such . . . commodity which as of the entry of the order for relief can be identified on the books and records of the debtor as received from or for the account of a particular customer as held specifically for the purpose of delivery or exercise.” *Id.* § 190.01(kk)(3).

The memorandum of the Physicals Customers states that the property at issue includes metals “reflected in certain accounts with or records of” MFGI that were entrusted to MFGI’s custody “for the purpose of delivery or exercise.” (Doc. # 818 at 2.) If so, this property would meet the definition of “specifically identifiable” property and, therefore, of “customer property.” 11 U.S.C. § 761(10); 17 C.F.R. § 190.08(a)(1)(2)(C); *id.* § 190.01(kk)(3). As detailed in the Commission’s December 12 brief (Doc. # 724 at 14-17), a customer may avoid liquidation of and recover such specifically identifiable property, even if it is more valuable than the *pro rata* share to which that customer is entitled, upon depositing with the trustee an amount equal to the difference between the value of the specifically identifiable property and the funded balance. 17 C.F.R. § 190.08(d).

b. Property of Certain “Metals Clients”

In contrast to the Physicals Customers, “Metals Clients” Alexander Coxe, Greenbriar Partners, L.P., and Paul Poger state in their response that their property, including metals receipts, warrants, and proceeds thereof, was given to MFGI to act “solely as a custodian” of that property. (Doc. # 822 at 2.) Specifically, the Metals Clients state that this property does not meet the definitions of “customer property” or “specifically identifiable” customer property because it was not given to MFGI to margin, guarantee, secure, purchase or sell a commodity contract, is transferable by delivery, and is not held by MFGI for the purpose of delivery or exercise. (Doc. # 822 at 6-7.)

If these recitations are correct, and the property of the Metals Clients was entrusted to MFGI for the sole purpose of safekeeping, and not as part of a commodity futures trading account, such property would not be customer property as defined in the Bankruptcy Code and CFTC regulations, and the requirement in Bankruptcy Code Section 766(h) of ratable distribution in priority to substantially all other claims would not apply. Relevant evidence of the nature of MFGI’s possession of this property may be available in account-opening documents and recent customer account statements, as well as in MFGI’s books and records, including records of whether the property was separately accounted for and held in segregated customer accounts as would be required under CEA Section 4d if the property were conveyed to MFGI to margin, guarantee, or secure trades or contracts, *see* 7 U.S.C. § 6d(a)(2).

The Commission takes no position on what remaining rights, if any, would inure to the Metals Clients if their property is not “customer property,” including their assertion that MFGI holds such property separately in trust for the benefit of the Metals Clients.

COMMODITY FUTURES TRADING COMMISSION

Dated: January 18, 2012
Washington, D.C.

By: /s/Robert A. Schwartz

Dan M. Berkovitz
General Counsel

Jonathan L. Marcus
Deputy General Counsel

Robert B. Wasserman
Chief Counsel, Division of Clearing and Risk

Martin B. White
Assistant General Counsel

Robert A. Schwartz
Assistant General Counsel

Commodity Futures Trading Commission
Three Lafayette Plaza
1155 21st Street N.W.
Washington, DC 20581
(202) 418-5000
jmarcus@cftc.gov
rwasserman@cftc.gov
mwhite@cftc.gov
rschwartz@cftc.gov