

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

----- X
NEW HAMPSHIRE INSURANCE COMPANY,
VIGILANT INSURANCE COMPANY, CERTAIN
UNDERWRITERS OF LLOYDS OF LONDON
SUBSCRIBING TO CERTIFICATE NO.
0576MMU280, ST. PAUL FIRE & MARINE
INSURANCE COMPANY, FIDELITY & DEPOSIT
COMPANY OF MARYLAND, CONTINENTAL
CASUALTY COMPANY, LIBERTY MUTUAL
INSURANCE COMPANY, GREAT AMERICAN
INSURANCE COMPANY and AXIS
REINSURANCE COMPANY,

Index No.: 601621/09

**ORDER WITH
NOTICE OF ENTRY**

Hon. Bernard J. Fried, J.S.C.

Motion Sequence No. 2

Plaintiffs,

-against-

MF GLOBAL, INC.,

Defendant.

----- X
PLEASE TAKE NOTICE, that a Decision and Order of which the within is a
true copy was duly entered in the above-named Court on October 5, 2010.

Dated: New York New York
October 5, 2010

KATTEN MUCHIN ROSENMAN LLP

By: 

Michael I. Verde

Michael F. Gallagher

575 Madison Avenue
New York, New York 10022-2585
(212) 940-8800

Attorneys for Defendant MF Global, Inc.

TO: Mark J. Pastuszak, Esq.
Clausen Miller, P.C.
One Chase Manhattan Plaza
New York, New York 10022
(212) 805-3900

*Attorneys for all Plaintiff Insurance Companies
except Liberty Mutual Insurance Co.*

Kevin Mattessich, Esq.
Kaufman Dolowich Voluck & Gonzo, LLP
100 William Street – 2nd Floor
New York, New York 10006
(212) 509-9400

Attorneys for Plaintiff Liberty Mutual Insurance Co.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: **HON. BERNARD J. FRIED**

E-FILE

PART 60

Index Number : 601621/2009

NEW HAMPSHIRE INSURANCE

vs

MF GLOBAL, INC.,

Sequence Number : 002

SUMMARY JUDGEMENT

INDEX NO.	_____
MOTION DATE	_____
MOTION SEQ. NO.	_____
MOTION CAL. NO.	_____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

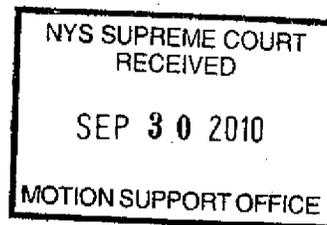
PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

This motion is decided in accordance with the attached memorandum decision.

SO ORDERED



Dated: 9/28/2010

Bernard J. Fried
HON. BERNARD J. FRIED s.c.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 60

-----X
NEW HAMPSHIRE INSURANCE COMPANY, VIGILANT
INSURANCE COMPANY, CERTAIN UNDERWRITERS OF
LLOYDS OF LONDON SUBSCRIBING TO CERTIFICATE
NO. 0576MMU280, ST. PAUL FIRE & MARINE
INSURANCE COMPANY, FIDELITY & DEPOSIT
COMPANY OF MARYLAND, CONTINENTAL
CASUALTY COMPANY, LIBERTY MUTUAL
INSURANCE COMPANY, GREAT AMERICAN
INSURANCE COMPANY, and AXIS REINSURANCE
COMPANY,

Plaintiffs,

Index No.
601621/09

-against-

MF GLOBAL, INC.,

Defendant.

-----X
APPEARANCES:

For Plaintiffs –

For Defendants –

Representing Liberty Mutual:

Kevin Mattessich
KAUFMAN DOLOWICH VOLUCK &
GONZO LLP
100 William Street, Suite 215
New York, NY 10038
Tel: (646) 599 9420
Fax: (212) 485 9700

Michael I. Verde
Michael F. Gallagher
KATTEN MUCHIN ROSENMAN LLP
575 Madison Avenue
New York, NY 10022-2585
Tel: (212) 940 8800
Fax: (212) 848 7179

Representing Remaining Plaintiffs:

Mark J. Pastuszak
Scott L. Schmookler (pro hac vice)
CLAUSEN MILLER P.C.
One Chase Manhattan Plaza
New York, NY 10005
Tel: (212) 805 3900
Fax: (212) 805 3939

FRIED, J.:

This insurance coverage matter arises in connection with a claim for losses sustained by the trading activity of an employee, Evan Dooley, of defendant MF Global, Inc. (Global) on the Chicago Mercantile Exchange (the CME), a financial and commodity derivative exchange based in Chicago. Plaintiff insurers (collectively, the Insurers) move, pursuant to CPLR 3212, for summary judgment on the complaint denying coverage for Global's losses. For the following reasons, Insurers' motion for summary judgment is denied, and summary judgment is granted, upon a search of the record (CPLR 3212 [b]) to Global.

Trading on the CME is conducted in two methods: an open outcry format; and the CME Globex electronic trading platform (Globex). In the evening of February 26, 2008, Dooley began trading commodities futures on the Globex overnight electronic exchange. He apparently traded well in excess of his margin, and entered into a large number of "sell contracts" for various commodities, primarily May wheat. By entering into various sell contracts for May wheat, Dooley created an "open position." That position could be liquidated by physical delivery, or, as is the more common practice, by entering into corresponding "buy contracts." Thus, if the market price of the commodity dropped, Dooley could purchase buy contracts for the commodity for less than the price of the sell contracts, and thus gain the difference. Conversely, if the price of the commodity increased, the value of the buy contract would increase, and a loss would ensue. At the close of the Globex overnight exchange, at 6 A.M. on February 27, 2008, Dooley's aggregate position in May wheat showed a Net Liquidation Value ("NLV") of \$44,880,082.

As one might surmise by the existence of this litigation, when the trading resumed on the CME at 9:30 A.M. on February 27, 2008, the price of May wheat began to rise quickly and sharply. By 10:00 A.M., the NLV of Dooley's position dropped from a prospective gain of \$44,880,082, to prospective loss of \$7,394,534. This prospective loss more than materialized as Dooley began to close his open positions by entering into blocks of buy contracts. The final loss on the series of transactions was some \$141,024,494, which was charged to MF Global, who, as a clearing house member of CME,¹ was primarily obligated² to the cover losses incurred on its accounts as a result of Dooley's trades.

As of midday, February 27, 2008, CME Clearing House apparently demanded, under Board of Trade of the City of Chicago, Inc. (CBOT), Rule 814, an intra-day settlement of Global's accounts. *See* CBOT Rule 814 (“[i]f the market conditions or price fluctuations are such that the Clearing House deems it necessary, it may call upon the clearing members which in its opinion are affected to deposit with the Clearing House by such time as specified

1

It is uncontested that Global is a CME Clearing House member, and, as such, it has agreed: “to guarantee and assume complete responsibility for the financial obligations attendant to: 1) all trades and orders executed or accepted for execution by a member it qualifies, including trades and orders executed, or which such member fails to execute, negligently, fraudulently or in violation of Exchange rules” CME Rule 901.I.

2

See Board of Trade of the City of Chicago, Inc. (CBOT), Rule 804 (“the Clearing House shall, through the process of novation, be substituted as, and assume the position of, seller to the buyer and buyer to the seller of the relevant number of Exchange or Marketplace contracts upon the successful matching of trade data submitted to the Clearing House by the clearing members on the long and short sides of a trade. ... Upon such substitution, each clearing member shall be deemed to have bought the contracts from or sold the contracts to the Clearing House, as the case may be, and the Clearing House shall have all the rights and be subject to all the liabilities of such member with respect to such transaction. *Such substitution shall be effective in law for all purposes.*” Emphasis added.

by the Clearing House the amount of funds that it estimates will be needed to meet such settlements as may be necessary”). The eventual settlement comprised payments of \$107,641,000 and \$43,131,037.56, for total of \$150,773,037, of which \$141,024,494 was attributable to Dooley’s actions.

Global submitted a claim under its primary insurance policy, and its excess financial institution bonds, issued by the Insurers. The primary insurance, New Hampshire Insurance Company’s (NHIC’s) policy (Bond Number 64738, hereinafter, the NHIC Policy) issued in favor of Global,

indemnif[ies Global] for their *loss* sustained at any time for: (i) any *wrongful act* committed by any *employee*, or (ii) any theft, *fraudulent act* or malicious act committed by *any other person*, which is committed with the intent to cause [Global] to sustain a *loss* or with the intent to obtain financial gain for themselves or another person or entity they intended to obtain such gain and is first *discovered* by [Global] during the *bond period* or the *discovery period*.

See NHIC Policy, § 1 (emphasis original).

The remaining Insurers herein are issuers of excess bonds providing coverage subject to the insurance clauses and conditions of the NHIC Policy. Together with NHIC, the remaining Insurers move for summary judgment on the complaint, which seeks a declaration that Global did not sustain a covered loss (as defined in the NHIC Policy), Dooley was not an employee of Global, and Dooley did not commit a *fraudulent act*, or a *wrongful act*, as defined in the foregoing insuring clauses. In addition, the plaintiffs maintain that if Global knew of Dooley’s trading activities, they failed to mitigate damages.

Summary judgment is governed by CPLR 3212, which normally requires a showing that “there is no defense to the cause of action or that the cause of action or defense has no

merit.” CPLR 3212 (b). Thus, the plaintiffs herein, as movants, must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact. *Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 (1985); *Zuckerman v City of New York*, 49 NY2d 557, 562 (1980); *Sillman v Twentieth Century-Fox Film Corp.*, 3 NY2d 395, 404 (1957). In opposition, Global is entitled to the benefit of every favorable inference that may be drawn from the pleadings, affidavits, and competing contentions of the parties. *Myers v Fir Cab Corp.*, 64 NY2d 806 (1985).

Here, there is no dispute that there was coverage during the alleged period. As such, the burden upon this motion for summary judgment is for Insurers to prove that the alleged exception or exclusion to the policy coverage applies. *See Consolidated Edison Co. of New York, Inc. v Allstate Ins. Co.*, 98 NY2d 208, 218-220 (2002); *Northville Indus. Corp. v National Union Fire Ins. Co.*, 89 NY2d 621, 634 (1997); *Technicon Elecs. Corp. v American Home Assur. Co.*, 74 NY2d 66, 73-74 (1989).

Employee Status

From all indications in their memoranda, which scarcely address the issue at all, Insurers have relinquished the claim in the complaint that Dooley was not an employee of Global. In all events, it is uncontroverted that Dooley was an “associated person” in Global’s Memphis, Tennessee office. Meanwhile, the complaint offers only conclusory assertions about the relationship between Dooley and Global to claim that he was not an employee. Such allegations are insufficient to support summary judgment. *See e.g. First American*

Bank of N.Y. v L.V. Lowden, 197 AD2d 774, 775 (3rd Dept 1993).

To the satisfaction of the courts of this state, the New York Stock Exchange, and the National Association of Securities Dealers (now the Financial Industry Regulatory Authority), an “associated person” is, by definition, “any partner, officer, director, or branch manager of such member, or any employee of such member.” *Steinberg v W.J. Nolan & Co.*, 6 Misc 3d 1003(A), 2004 NY Slip Op 51709(U) (Sup Ct, NY County 2004), *affd as mod* 18 AD3d 244 (1st Dept 2005); *see also Reiner v Scandinavian Securities Corp.*, 107 Misc 2d 805, 809 (Sup Ct, NY County 1980); Securities Exchange Act of 1934 (15 USC 78c [21]). What is more, mere status as an “associated person” is deemed sufficient for courts to compel such persons to engage in mandatory employee arbitration. *See e.g. CDC Capital Inc. v Gershon*, 282 AD2d 217, 218 (1st Dept 2001); *Slade v Metropolitan Life Ins. Co.*, 231 AD2d 467, 468 (1st Dept), *lv denied* 89 NY2d 805 (1996). As such, and as a matter of law, “associated persons” have an implied contract with their applicable exchange member.

It appears, therefore, from the plain language of the NHIC Policy that Dooley is an employee of Global. The Policy provides that an employee is a natural person under an implied contract of employment or service. That contract is implied in law. Moreover, there was direct supervision and controls on Dooley’s trading (even if the supervision and controls failed here). *See* NHIC Policy, ¶¶ 2.25 (i) (a), (b), (d), (ii), and (ix). Dooley is an employee of Global for purposes of interpreting the NHIC Policy.

Direct Loss

The core of Insurers' argument for summary judgment is that the NHIC Policy, upon which the other coverages follow, requires a direct loss to the insured, whereas the loss that Global suffered was indirect. More specifically, the NHIC Policy defines "loss" as "the *direct financial loss* sustained by [Global] as a result of any single act, single omission or single event, or a series of related or continuous acts, omissions or events. A series of related or continuous acts or omissions or events up to the time of *discovery* shall be treated as a single act, omission or event." NHIC Policy, § 2.38 (emphasis added). As such, the Insurers maintain, the loss suffered by Global was not a direct one, and there is no coverage obligation.

The NHIC Policy is a "creature[] of contract, and accordingly, subject to principles of contract interpretation." *Matter of Covert*, 97 NY2d 68, 76 (2001) (citations omitted). The Policy is, thus, "to be construed according to the sense and meaning of the terms which the parties have used, and if they are clear and unambiguous the terms are to be taken and understood in their plain, ordinary and proper sense." *Id.*, quoting *Hartol Prods. Corp. v Prudential Ins. Co. of Am.*, 290 NY 44, 47 (1943). Any "ambiguities in an insurance policy are, moreover, to be construed against the insurer, particularly when found in an exclusionary clause." *Ace Wire & Cable Co., Inc. v Aetna Cas. & Sur. Co.*, 60 NY2d 390, 398 (1983), citing *Breed v Insurance Co.*, 46 NY2d 351, 353 (1978).

The NHIC Policy purports, on its face, to give coverage for Global's loss sustained for *any wrongful act committed by any employee with the intent to obtain financial gain*. See NHIC Policy, ¶ 1. In turn, a "wrongful act" is defined to include any dishonest act. By the

simple language of the contract therefore, coverage is indicated: Dooley committed a wrongful act (he made unauthorized trades beyond his margin), he was an employee of Global, and he did so for financial gain.

Nonetheless, Insurers note that the term “loss” in the NHIC Policy refers to “*direct financial loss* sustained by the insured as a result of any single act, single omission or single event, or a series of related or continuous acts, omissions, or events.” See NHIC Policy, ¶ 2.38. Insurers then offer that the interpretation of the term “direct loss” should be based on prior court interpretations *involving a different form of bond*. A series of inapposite cases are used to support this frail contention. See Memorandum in Support, at 6, citing *Drexel Burnham Lambert Group v Vigilant Ins. Co.*, 157 Misc 2d 198, 209 (Sup Ct, NY County 1993); see also *175 E. 74th Corp. v Hartford Acc. & Indem. Co.*, 51 NY2d 585 (1980); *Aetna Cas. & Sur. Co. v Kidder, Peabody & Co. Inc.*, 246 AD2d 202 (1st Dept 1998), *lv denied* 93 NY2d 805 (1999); *City of Burlington v Western Surety Co.*, 599 NW2d 469, 472-473 (Iowa 1999); and *ITT Hartford Life Ins. Co. v Pawson Assoc.*, 1997 WL 345345, *7, 1997 Conn Super LEXIS 1646 (Conn Super 1997). The problem with all the cases relied upon by Insurers is that in all those matters, the alleged loss incurred to another party first, and only subsequently, upon voluntary or involuntary action as the case may be, to the insured. Here, the exact opposite situation obtains: the alleged loss was directly incurred by Global, and the loss incurred was never due from Dooley. It is Dooley who has incurred an indirect loss, not Global.

Insurers cite *Drexel Burnham Lambert Group* (157 Misc 2d at 209) to suggest that “bonds [such as the NHIC Policy] require [] proof [of direct financial loss] because they are

‘not liability insurance policies.’” First, the claim for coverage in that matter arose from frauds not against Drexel, but against the public generally. The coverage was sought for reimbursement due to criminal and civil claims made against Drexel, for which Drexel sustained, and continued to sustain losses. Those losses incurred to a third party, and not directly to Drexel. Second, the court’s discussion was not in reference to whether there might be coverage in general, but to whether there might be repeated coverage for previously discovered improper acts which did not implicate the assets of Drexel.

As noted above, the matter here is quite different. Dooley’s actions did not result in any pertinent criminal or civil claims against Insurers. Moreover, his actions resulted in the direct incurrence of debt by Global: CME never sought to collect from any other party, because Dooley was an “associated person” of Global. The loss was that of Global, not of any third party. Finally, Dooley’s actions were not a fraud on the public, but rather, a series of acts that created a debt for Global.

This interpretation of facts is underscored by *Aetna Cas. & Sur. Co.* (246 AD2d 202, *supra*), upon which Insurers also rely. That matter involved, once again, the claims of a third party against an employee for misconduct. Thus, the claims arose from settlement for frauds on the public, as opposed to frauds on the employer. For the avoidance of doubt, the primary layer fidelity bonds in *Aetna* were “typified by Lloyd’s Standard Form No. 14 blanket bond” (Lloyd’s Bond). That bond type is not at issue here. A simple comparison of the corresponding insurance coverage language indicates crucial differences. In the Lloyd’s Bond, the coverage language not only identifies the direct loss requirement overtly, but requires *both* the manifest intent of the employee to cause loss to the insured, *together with*

the manifest intent to gain improper personal financial benefit. The NHIC Policy does not identify the direct loss requirement overtly, and in contrast, requires only a wrongful act *or* a fraudulent act which is committed to cause loss to the insured *or* for financial gain. In listing disjunctive instead of conjunctive coverage requirements, the NHIC Policy is starkly different than the fidelity bond in *Aetna*. The coverage requirements under the Lloyd's Bond are, as a result, completely different than the coverage requirements under the NHIC Policy. Indeed the Lloyd's Bond does not appear to allow coverage at all for a wrongful act by an employee committed with the simple intent to obtain financial gain, whereas the NHIC Policy clearly allows coverage for exactly that.

Similarly, distinguishable is *Continental Bank, N.A. v Aetna Cas. & Sur. Co.* (164 Misc 2d at 888) which dealt with provisions that required a manifest intent to cause loss. Indeed, the court states plainly, “[t]he key words are manifest intent. The manifest intent provision ... limit[s] protection under th[e] bond to losses due to embezzlement or embezzlement-like acts.” Citation and internal quotation marks omitted. Here the words “manifest intent” do not appear in the NHIC Policy. Moreover, as noted above, the intention to obtain financial gain is sufficient under the NHIC Policy. There need not be any intent, manifest or otherwise, to cause Global to sustain any loss.

Insurers also rely on out-of-state cases in order to narrowly define “direct loss” under the NHIC Policy. Those cases, however, largely support the position of Global, that their loss in this matter was direct and without intervening third-party liability or cause. For instance, in *RBC Mtge. Co. v National Union Fire Ins. Co. of Pittsburgh* (349 Ill App 3d 706, 717, 812 NE2d 728, 736 [Ill App 1st Dist 2004]), “[t]he court noted that in the fidelity bond

cases applying the proximate cause standard, causation was at issue only in the context of losses of the insured's own property, or that for which it was legally responsible, and the question to be resolved was whether some intervening event broke the causal connection between the dishonest conduct of an employee and the insured's loss." Citation omitted. Here, there was no intervening event creating the liability of Global to CME. Global's account with CME was financially unstable, and CME required Global to engage in an intraday settlement.

In all events, any doubt as to whether the losses incurred by Dooley's actions were a direct loss of Global falls away when I consider the uncontroverted affidavit of Timothy Doar, the Managing Director of Risk Management in the clearing house division of CME.

Doar states that

[o]n the morning of February 27, 2008, the Clearing House required MF Global to make an intraday settlement primarily due to an unusually large shortfall it faced as a result of a large volume of overnight trading Had MF Global failed to pay these amounts, the Clearing House would have declared MF Global to be in default and deducted those amounts from the performance bond, Guaranty Fund and other assets that MF Global had pledged to the Clearing House. Had MF Global attempted to impede these actions, it would have been subject to serious sanctions pursuant to Rule 802.A.2.

Doar Affidavit, ¶¶ 17-20. There can be no clearer indication of the directness of the liability than CME going directly to Global to satisfy the excessive open position. If CME did not even go to Dooley, it would be inaccurate to ascribe the debt primarily to him. His liability to CME was indirect; Global's liability to CME was patently direct.

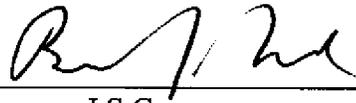
Finally, it is telling that CME required the intraday settlement from Global before ever even knowing Dooley's identity. Doar states that "[t]he Clearing House subsequently

learned that the shortfall ... was primarily the result of the trading of one of MF Global's brokers, Evan Dooley ("Dooley")." If the debt accrued before knowledge of Dooley's identity, the debt cannot be directly his debt.

Accordingly this motion for summary judgment is denied.

DATED: 9/28/2010

ENTER:



J.S.C.

HON. BERNARD J. FRIED