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Missing MF Global Customer Funds Remain A Mystery

By **Hilary Russ**

Law360, New York (November 16, 2011, 8:27 PM ET) -- Attorneys for MF Global Holdings Inc. and the trustee who is liquidating its broker-dealer subsidiary told a New York bankruptcy judge Wednesday that they still have no idea how much money is missing from customers' accounts, how it may have disappeared or where it went.

"Exactly what the amount is hasn't been reconciled, exactly what happened, I don't think anyone knows at this point," said James B. Kovak Jr., of Hughes Hubbard & Reed LLP, counsel for liquidating trustee James W. Giddens.

He and Kenneth S. Ziman of Skadden Arps Slate Meagher & Flom LLP, counsel for debtors in the Chapter 11 case, told U.S. Bankruptcy Judge Martin Glenn they could not even say with certainty whether there had been commingling of the company's money with commodities customers' accounts — a possibility that several regulators, the trustee and the FBI are investigating.

"There seem to have been transfers among accounts. That basically is what we know at this point," Kovak said, noting that transfers between various accounts might not amount to commingling at all.

MF Global filed for Chapter 11 protection on Oct. 31 after a potential buyer reportedly walked away from acquiring the company following the discovery of a large shortfall. Also preceding its rapid unraveling into bankruptcy were a \$192 million quarterly loss and a series of credit ratings downgrades on news that the company may have been exposed to \$6.3 billion in troubled European sovereign debt.

The holding company is now in the eighth-largest U.S. bankruptcy ever, and its broker-dealer subsidiary, MF Global Inc., is being liquidated under the Securities Investor Protection Act.

In the aftermath, thousands of customers — from traders at hedge funds to farmers who use futures as a hedge against potentially poor crop prices — began trying to get cash out of the accounts they had held with MF Global. Altogether, the company had about 38,000 commodities accounts, the trustee said.

The bankruptcy judge allowed many of their open positions to be transferred to new clearing organizations. The trustee has so far been able to transfer about 3 million positions held by 14,500 customers, worth about \$1.57 billion altogether, Kovak said.

Other positions have not yet been transferred, and even for those that have, most cash remains frozen, in some instances leaving former MF Global customers unable to pay their mortgages.

But by Thursday, Kovak said, the trustee is hoping to begin the transfer a second tranche of cash-only accounts, which would allow him to start returning 60 percent of the more than \$800 million — or about \$520 million — that he has said he could currently distribute.

Letters and court filings from customers and groups that represent them have flooded the court. Judge Glenn held up a thick folder full of faxed letters and said he had read every one of them.

Many have expressed concerns about the fact that the trustee must use a claims process to return their money, saying that in some cases, their livelihoods depend on the money tied up in the case and they need it back immediately.

The judge directed customers to confer with Giddens' office in an attempt to resolve some of those objections. A meeting is now scheduled for Thursday afternoon, Giddens' response to objections is due on Monday and a hearing is slated for Nov. 22.

"If they're going to open a dialog with us, we're there to help," said James L. Koutoulas, a lawyer for the Commodity Customer Coalition, which claims to represent at least 7,000 customers who had a combined \$100 million in their accounts, after the hearing.

Customers are hoping to form an ad hoc committee and want to have a representative on the creditors' committee, he said.

He was concerned about the ability of MF Global's key creditors — including JPMorgan Chase NA and the hedge fund Elliott Management Corp. — to represent the interests of the customers.

That's in part because Elliott won permission Wednesday to begin trading in MF Global bankruptcy claims as long as it adheres to strict procedures to separate its trading activity from its duties on the unsecured creditors' committee.

While he was heartened by what the judge and the trustee said at the hearing, Koutoulas anticipated a possible battle over a proposal that, if the missing money can't be recovered, customers will get a pro rata recovery instead of full recovery. If that happens, customers will likely seek to claw back the money in court, Koutoulas said.

Also on Wednesday, Ziman, MF Global's attorney, said the company still had not secured debtor-in-possession financing but that it had reached an agreement with JPMorgan to continue using up to \$8 million in cash collateral until Nov. 30.

At least one potential DIP lender wanted to "pause" to see how events played out, Ziman said.

It's not clear exactly how much MF Global is currently worth. It had about \$1 billion in book value, but even the judge wasn't sure whether that was a reliable figure for the purposes of future recoveries.

"I don't know if that's a real number or not," Judge Glenn said.

Ziman acknowledged that the value of the company had degraded but that there was still "substantial value that will flow back up" when liquidation is completed.

MF Global's Asian businesses are up for sale, both together and as individual entities, and a sale would add money to the estate, Ziman said.

What's more, the company's actual losses from the European debt exposure may not be as

bad as believed, Martin J. Bienenstock, of Dewey & LeBoeuf LLP, counsel for the statutory creditors committee, said at the hearing.

Some of MF Global's exotic sovereign debt and derivatives had been converted to more stable securities over the summer, Bienenstock said, though he couldn't provide specific numbers.

There is "potentially quite an estate to be amassed here," he said.

Giddens is a partner with Hughes Hubbard & Reed LLP. The team working on the case also includes James B. Kobak Jr. and Christopher K. Kiplok.

MF Global is represented by Kenneth S. Ziman, J. Gregory Milmo, J. Eric Ivester and George Panagakos of Skadden Arps Slate Meagher & Flom LLP.

The bankruptcy case is In re: MF Global Holdings Ltd. et al., case number 1:11-bk-15059, in the U.S. Bankruptcy Court for the Southern District of New York.

The liquidation case is In re: MF Global Inc., case number 1:11-ap-02790, in the U.S. Bankruptcy Court for the Southern District of New York.

--Editing by John Quinn.

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