
New York County Clerk's Index No. 601629/2009

**NEW YORK STATE SUPREME COURT
APPELLATE DIVISION – FIRST DEPARTMENT**

**NEW HAMPSHIRE INSURANCE COMPANY, VIGILANT INSURANCE
COMPANY,
CERTAIN UNDERWRITERS OF LLOYDS OF LONDON Subscribing to
Certificate No. B0576MMU280, 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-Appellants

-- against --

MF GLOBAL, INC.

Defendant-Respondent

March 4, 2013

**BRIEF OF THE AMICI CURIAE CHICAGO MERCANTILE EXCHANGE
INC. AND FUTURES INDUSTRY ASSOCIATION
IN SUPPORT OF DEFENDANT-RESPONDENT MF GLOBAL, INC.**

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I. INTRODUCTION AND INTERESTS OF AMICI CURIAE

Chicago Mercantile Exchange Inc. (“CME”) and the Futures Industry Association (“FIA”) respectfully submit this brief as Amici Curiae in support of Defendant-Respondent, MF Global, Inc. (“MF Global”).¹ This appeal implicates rules that have been adopted, and are being administered, by CME and its affiliate exchange, The Board of Trade of the City of Chicago, Inc. (collectively referred to herein as “CME Rules”), pursuant to authority granted by the Commodity Futures Trading Commission (“CFTC”). The CME Rules apply to FIA members that are Futures Commission Merchants (“FCMs”) and CME clearing members. The CME Rules impose a *direct* obligation on a CME clearing member to immediately pay CME’s clearing house (“CME Clearing”) the full amount of losses incurred on accounts cleared by the clearing member.

CME and the FIA each have a substantial interest in ensuring that the courts correctly understand the nature of a clearing member's legal and regulatory

¹ As the exchange on which MF Global transacted the majority of its futures business, CME itself has a claim in the MF Global bankruptcy. Pursuant to an agreement between CME and the SIPC trustee which was approved by Bankruptcy Court order dated August 10, 2012, *In re MF Global Inc.*, No. 11-2790 (MG) (Bankr. S.D.N.Y. Aug. 10, 2012), ECF No. 2825, CME voluntarily subordinated its priority right to payment from MF Global assets on account of its claim for \$21,211,829.00 plus contingent amounts, Claim No. 300000652, until all customer claims are paid in full. See *Limited Agreement and Reservation of Rights Between CME Group Inc. and James W. Giddens, as Trustee for the SIPA Liquidation of MF Global, Inc.* at ¶ 3.3, *In re MF Global Inc.*, No. 11-2790 (MG) (Bankr. S.D.N.Y. June 14, 2012), ECF No. 2029, Ex. B. FIA does not have a claim in the MF Global bankruptcy.

obligations to a clearing house like CME Clearing, because an accurate understanding of these obligations is critical to the proper administration of the futures clearing process. In this matter, CME seeks to ensure that the CME Rules are not misconstrued in a way that mischaracterizes the relationship between clearing members and CME Clearing and thereby results in denying coverage to a CME clearing member that purchased insurance to protect against direct losses to it caused by certain wrongful, fraudulent, or malicious acts. As the leading trade association for the futures, options, and over-the-counter cleared derivatives markets, the FIA also has a strong interest in any case that affects the futures industry and believes that the sound and efficient operation of a clearing house requires that clearing members have a primary responsibility for all of their obligations to the clearing house with respect to trades cleared by that clearing member. The CME Rules confirm the primary responsibility of the clearing members.

CME and the FIA support the trial court's correct reading of the CME Rules and urge this Court to reject the contrary interpretations promoted by plaintiffs-appellants. The authority for CME and the FIA to file this brief as amici curiae rests with the accompanying Motion for Leave to File Brief as Amici Curiae.

II. AMICI CURIAE

A. CME

CME, a Delaware corporation, is a registered with the CFTC as a designated contract market (“DCM”) and derivatives clearing organization (“DCO”). CME Clearing, a division of CME, serves as one of the world’s leading central counterparty clearing services. CME Clearing provides clearing and settlement services to contracts traded on a variety of CFTC-registered DCMs, including CME, CBOT, New York Mercantile Exchange, and Commodity Exchange Inc. Member firms of CME Clearing—MF Global was one such firm at the time this matter arose—are authorized to clear trades through CME Clearing for the member firm’s accounts.

For every cleared trade, CME Clearing acts as the central counterparty, becoming the buyer to each seller and the seller to each buyer and, in turn, mitigating risk of default. The clearing process for futures contracts thus protects the financial integrity of transactions on the futures markets. North American financial futures markets cleared trades totaling \$823 trillion in underlying contract value for 2011, the most recent year for which such figures are available,² equaling

² See Statistical Annex of the BIS Quarterly Review, December 2012, table 23A at page A146 (published by the Bank For International Settlements). A copy may be found at: http://www.bis.org/publ/qtrpdf/r_qa1212.pdf.

approximately \$3.3 trillion in value per business day. To ensure the proper functioning of these critical markets and to prevent systemic risk in the financial system, the clearing process—and the rules governing that process—must be respected. The CME Rules address all crucial aspects of the clearing process, including the relationship between clearing member firms and CME Clearing.

B. FIA

The FIA is the leading trade association for the futures, options, and over-the-counter cleared derivatives markets. Its membership includes the world's largest derivatives clearing firms as well as leading derivatives exchanges from more than 20 countries. The CME Rules apply to FIA members that are CME clearing member firms.

III. ARGUMENT

A. The Trial Court Correctly Concluded that MF Global, as a CME Clearing Member, Was Directly and Primarily Obligated to CME Clearing for Losses Sustained in MF Global's Accounts Due to Dooley's Trades

In ruling in favor of MF Global, the trial court determined that “MF Global . . . as a clearing house member . . . was *primarily obligated* to the cover [sic] losses incurred on its accounts as a result of Dooley's trades.” *See* Order and Memorandum Decision of the Honorable Bernard J. Fried at 3 (dated September 28, 2010; entered October 5, 2010) (emphasis added) (hereinafter the “Order and Decision”). The trial court's conclusion is fully in accord with the controlling law

and regulations. Under the federal regulatory framework for futures clearing, including the CME Rules approved by the CFTC, clearing members are directly responsible for covering all losses on cleared trades in their accounts.

Clearing in the futures industry is a two-tiered system in which the DCO's rights and obligations stand against the rights and obligations of its clearing members, which in turn are responsible to their customers with respect to customer trading activity. In its release promulgating updated rules for the clearing of swaps contracts, the CFTC confirmed that when a transaction is cleared, the obligations between the original parties who executed the specific transaction are "replaced by sets of equivalent obligations: between the Clearing Member FCMs acting for the original parties and the DCO and between the Clearing Member FCMs and their individual customers." Protection of Cleared Swaps Customer Contracts and Collateral, 77 Fed. Reg. 6336, 6337 (Feb. 7, 2012).

While the CEA and CFTC regulations prescribe many requirements designed to protect end customers' interests, a regulated DCO like CME Clearing looks to its clearing members for satisfaction of all obligations on their cleared trades.³ In this highly regulated industry, the nature of the clearing member's

³ See, for example, CFTC Regulations 39.11(a)(1), requiring the DCO to have sufficient financial resources to "meet its financial obligations *to its clearing members* notwithstanding a default by the clearing member creating the largest financial exposure...", 39.12(a)(2), requiring the DCO to establish requirements for *its clearing members* to have financial resources sufficient to "meet obligations arising from participation in the [DCO]", and

(cont'd)

obligation to a DCO is not an indirect obligation undertaken by contract to guarantee a primary obligor. Instead, it is a direct and primary legal obligation. Customers and associated persons like Dooley have no such direct and primary legal obligation to CME Clearing and, as the trial court correctly noted, may not even be known to CME Clearing at any point during the clearing process. *See* Order and Decision at 11-12. Individual customers and associated persons do not have accounts at the DCO. Instead, each clearing member's obligations to CME Clearing are divided into multiple account classes under CFTC regulations in which positions resulting from trades originally executed by customers or associated persons, among others, are aggregated. *See generally* 17 C.F.R. § 1.3(y) (defining proprietary account); 17 C.F.R. § 190.01(a), (n) & (x) (defining account class, customer class, and house account). Such CFTC regulations and the CME Rules impose obligations directly on clearing members with respect to such account classes.

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39.12(a)(3), requiring the DCO to require *its clearing members* to have “adequate operational capacity to meet obligations arising from participation in the [DCO] ... [and] the ability to fulfill collateral, payment, and delivery obligations imposed by the [DCO].” 17 C.F.R. §§ 39.11 and 39.12 (emphasis added).

Under the CME Rules, each clearing member bears financial responsibility for all contracts cleared for their accounts. As CBOT Rule 804 makes clear, this obligation of the clearing member is directly owed to CME Clearing:

Upon [the] substitution [of CME Clearing as seller to the buyer and buyer to the seller of such contracts], *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. (emphasis added)

The trial court correctly cited and relied upon CBOT Rule 804 to support its conclusion that MF Global, as a CME clearing member, was *primarily obligated* to pay the charge imposed on it by CME Clearing for losses in MF Global's account due to its Dooley's unauthorized CBOT wheat trades.

That the CME Rules impose not only a direct, but also an immediate obligation on clearing members vis a vis CME Clearing is underscored in CME Rule 802.A. Pursuant to Rule 802.A, CME Clearing would declare a clearing member in default when the clearing member "fails to *promptly* discharge any obligation to the Clearing House." (emphasis added). Further, Rule 802.A provides that, if a clearing member is in default, CME Clearing "shall" apply to the losses the clearing member's performance bond, guaranty fund contributions, and any other assets pledged by the clearing member to CME Clearing.

Timothy Doar, Managing Director in the clearing house division of CME, made reference to Rule 802.A in his uncontroverted affidavit, explaining that "the

clearing member, and only the clearing member, is responsible for settling the obligations resulting from trades that have been submitted to the Clearing House” and that the Clearing House had no mechanism for collecting from MF Global’s customer or broker. The trial court found that the Doar affidavit removed “any doubt as to whether the losses incurred by Dooley’s actions were a direct loss of [MF] Global.” Order and Decision at 11.

Overall, the CME Rules unambiguously mandate that clearing members have a *direct, primary, and prompt* obligation to cover losses on cleared trades in their accounts. This Court should thus reject any assertion that is contrary to the clear import of these rules, such as any contention that MF Global, as a clearing member, had a *secondary* obligation under the CME Rules. The trial court correctly applied the CME Rules in finding that, as a result of Dooley’s unauthorized trades, MF Global sustained losses in its account for which it owed a direct debt to CME Clearing.

As a matter of federal law, CME Clearing not only was required to “have rules to allow for efficient, fair, and safe management of events when members . . . default in their obligations to the derivatives clearing organization,” but also was required to enforce those rules. *See* 7 U.S.C. § 7a-1(c)(2)(G); 7 U.S.C. § 5b(c)(2)(H). In accordance with its rights and obligations under federal law and the CME Rules, CME Clearing went directly to MF Global to secure immediate

payment for the losses on Dooley's trades that were cleared in MF Global's account. MF Global immediately met its obligation in this case by submitting the requisite payments to CME Clearing. Had MF Global failed to pay its debt to CME Clearing, CME Clearing would have collected from all the available assets of MF Global, as required by the CME Rules adopted pursuant to federal law and CME Clearing's federal law obligation to enforce those rules. Again, CFTC regulations set forth that the DCO looks to its clearing members, not associated persons like Dooley or even public customers, to meet the collateral and settlement variation obligations associated with all contracts cleared by the clearing member. CFTC Regulation 39.16 requires the DCO to adopt rules "for the efficient, fair, and safe management of events during which clearing members become insolvent or default on *the obligations of such clearing members* to the [DCO]" and to continue to meet its obligations "in the event of a default *on the obligations of a clearing member* to the [DCO]." 17 C.F.R. § 39.16(a) and (c) (emphasis added). Neither CFTC regulations nor the CME Rules impose such requirements on associated persons or public customers, nor do they provide for CME to seek satisfaction from such persons, because in futures clearing, it is the clearing member that has the primary, immediate and direct obligation to the DCO on all cleared trades.

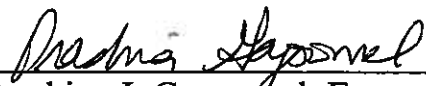
Accordingly, this Court should reject any suggestion from plaintiffs-appellants that MF Global's obligation to pay CME Clearing was secondary to

Dooley's obligation, or any suggestion that MF Global's obligation did not arise under this federal regulatory framework for clearing and instead was purely a voluntary guarantee obligation undertaken by contract.

IV. CONCLUSION

CME and the FIA believe that the trial court properly interpreted the CME Rules in reaching its decision in this case and ask that this Court reject any contrary interpretations of the CME Rules.

Dated: March 4, 2013
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