LEVINE LEE LLP
Kenneth E. Lee
Scott B. Klugman
Miriam L. Alinikoff
570 Lexington Avenue, 7th Floor
New York, New York 10022
Tel.: (212) 223-4400
Fax: (212) 223-4425

Attorneys for Defendant James W. Giddens,
Trustee for the SIPA Liquidation of MF Global Inc.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re: MF GLOBAL INC., Debtor.	Case No. 11-2790 (MG) SIPA
KOCH SUPPLY & TRADING, LP, Plaintiff, v. JAMES W. GIDDENS, Trustee for the SIPA Liquidation of MF Global Inc., Defendant.	Case No. 1:12-cv-05596-NRB

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF TRUSTEE'S MOTION FOR SUMMARY JUDGMENT ON COUNTERCLAIM

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James W. Giddens (the "Trustee"), as Trustee for the liquidation of MF Global Inc. ("MFGI" or "Debtor") under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa *et seq*., by and through his undersigned counsel, respectfully submits this reply memorandum of law in further support of his Motion for Summary Judgment on the Trustee's Counterclaim for declaratory relief.

PRELIMINARY STATEMENT

The Trustee's motion for summary judgment should be granted pursuant to 17 C.F.R. § 190.08(a)(1)(i)(E) ("Part 190.08"). Part 190.08, and the Commodity Futures Trading Commission's (the "CFTC") controlling interpretation thereof, dictate that the "full proceeds" of the letter of credit posted by KS&T as margin in support of its futures trading with MFGI (the "30.7 LOC") are property of the MFGI customer estate subject to pro rata distribution.

In an attempt to divert the Court's attention from the Trustee's efforts to enforce the *statutory right* of the MFGI customer estate under Part 190.08, KS&T attacks the viability of the Trustee's *contractual rights* to enforce the terms of the 30.7 LOC—such arguments, however, are misplaced where the Trustee does not seek recovery from the issuing bank on the 30.7 LOC and where Part 190.08 does not require him to do so. Also in the vein of distraction, KS&T, rather heedlessly, accuses the Trustee and the CFTC of concocting a "scheme to leverage monies from KS&T." (KS&T Br. in Opposition ("KS&T Opp.") at 1, 3 [ECF No. 43].)

Such tactics, of course, fall flat in the face of the Part 190.08's plain language and the CFTC's controlling interpretation thereof, both of which mandate equal treatment of customers in a futures commission merchant ("FCM") liquidation. In light of this guiding principle, KS&T's arguments that the CFTC's interpretation exceeds the scope of its authority,

or that some unidentified semblance of state law trumps application of Part 190.08, are meritless. Instead, the Trustee, in exercise of his fiduciary obligations to the former customers of MFGI, respectfully submits that Part 190.08 requires inclusion of the 30.7 LOC's "full proceeds" in the customer estate and that summary judgment in favor of the Trustee is therefore appropriate.

ARGUMENT

I. THE CFTC'S INTERPRETATION OF PART 190.08 IS CONTROLLING BECAUSE IT IS NEITHER PLAINLY ERRONEOUS NOR INCONSISTENT WITH THE REGULATION

KS&T's contention that the Court should not defer to the CFTC's interpretation under *Auer v. Robbins*, 519 U.S. 452 (1997), is meritless where that interpretation is (i) consistent with the regulation's plain language and (ii) reflects the CFTC's fair and considered judgment.

A. KS&T Has Failed to Establish that the CFTC's Interpretation Is Inconsistent with Part 190.08's Plain Meaning

KS&T contends that the CFTC's interpretation is not entitled to *Auer* deference because the CFTC's interpretation of Part 190.08 renders the regulation inconsistent with the unambiguous meaning of the word "proceeds" contained therein. (KS&T Opp. at 12.) But it is KS&T's own proposed construction of Part 190.08—which would include as customer property *only* the proceeds of a letter credit drawn in accordance with its terms—that ignores the regulation's plain meaning.

Most notably, KS&T ignores the fact that the Trustee here is seeking to enforce his *statutory rights* under Part 190.08, not the Debtor's *contractual rights* under the 30.7 LOC. In so ignoring, KS&T—not the CFTC or the Trustee—seeks to rewrite the plain language of Part 190.08 by importing the *conditions* of the 30.7 LOC into the regulation even though they do not appear on its face. For example, Part 190.08 unconditionally directs the Trustee to obtain the "full proceeds" of the 30.7 LOC, yet KS&T would have the Court require an event of default as a

condition precedent to collection. Similarly, despite the absence of any limitation on the party from whom the Trustee can collect the "full proceeds," KS&T asserts that this Court should read in a requirement that the Trustee must collect from the issuing bank, as opposed to the customer that posted the letter of credit as margin. Also, despite the regulation's plain language, KS&T seeks to apply the 30.7 LOC's expiration date to the Trustee's ability to collect the "full proceeds" thereof *from KS&T*—notwithstanding the fact that the Trustee's unconditional right to those proceeds vested upon commencement of MFGI's liquidation because the 30.7 LOC was "received, acquired or held to margin . . . [KS&T's] commodities contract." KS&T's attempted revisions to Part 190.08's plain language do not withstand the Court's independent interpretation of the regulation, let alone the deferential standard required by *Auer*. 519 U.S. at 461.

Further, while acknowledging that the Court must reject a literal interpretation that leads to an "absurd result" (KS&T Opp. at 29), KS&T fails to address the implausibility of its own proposed definition of "customer property" to encompasses only property *not* susceptible to inclusion in the MFGI customer estate. (*See* CFTC Stmt. in Support at 10 [ECF No. 40].) Whereas Part 190.08 defines a category of "customer property" subject to pro rata distribution, the property to which this regulation would apply under KS&T's interpretation—the funds received following a certification of default—is not available for distribution to former MFGI customers. Rather, those funds would be owed to clearinghouses to cover trading losses on the customers' accounts. *See* 46 Fed. Reg. 57535-01, 57542, 1981 WL 112816 (Nov. 24, 1981) ("margin payments would not be able to be distributed pro rata" because these funds are owed to the clearinghouse to cover losses). Thus, the incongruity of KS&T's proposed interpretation further refutes its assertion that the Court should overturn the CFTC's interpretation as inconsistent with the regulatory language.

Moreover, KS&T's persistent refusal to acknowledge the import of the modifier "full" on the regulation's definition of "proceeds," also undermines its own reliance on the regulation's plain language. Indeed, under KS&T's proposed interpretation of the word "proceeds," the modifier "full" is redundant if "proceeds" is *limited* to the funds that the beneficiary receives from the issuing bank on a letter of credit draw. Moreover, Part 190.08's modification of the word "proceeds" with the word "full" flatly contradicts KS&T's proposed construction because a liquidating trustee would be entitled to only a partial or, as KS&T contends here, no proceeds at all depending on the letter of credit's terms and conditions. (KS&T Mem. in Supp. Mot. at 8 [ECF No. 36].) Because KS&T excises the word "full" from Part 190.08, its contention that the unambiguous language supports its proposed interpretation is baseless. *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("[A] cardinal principle of statutory construction" that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant."). As KS&T has not, and cannot, establish that the unambiguous language of Part 190.08 supports its interpretation of the regulation, *Auer* deference is warranted and the CFTC's interpretation of Part 190.08 is controlling.

B. KS&T's Assertion that the CFTC's Interpretation Does Not Reflect Its Fair and Considered Judgment Is without Merit

In an effort to circumvent *Auer*, KS&T baldly contends, without a shred of support, that the CFTC's interpretation of Part 190.08 does not reflect its fair and considered judgment, but is instead a "forced interpretation" specifically designed to advance the Trustee's litigation position. (KS&T Opp. at 17.) KS&T offers no basis to substantiate this claim, and its *ad hominem* attack on the CFTC's and the Trustee's motives appears designed merely to conceal the flaws in its litigation position. KS&T's assertion that the CFTC's interpretation of Part

190.08 is not the product of its fair and considered judgment because it appears in a legal brief is without merit, especially where that interpretation is consistent with the CFTC's interpretation upon adoption of Part 190.08. Moreover, because the interpretation of Part 190.08 submitted by the CFTC in briefing reflects its fair and considered judgment, there is no basis for KS&T to claim it was unaware of the CFTC's treatment of letters of credit under the regulation.

1. The CFTC's briefing reflects its fair and considered judgment

KS&T asserts that this Court should find that the CFTC's interpretation does not reflect its fair and considered judgment merely because it was announced in a brief submitted in this litigation. KS&T ignores the fact that the Supreme Court has rejected this very argument on multiple occasions. The Court has made clear that where an agency's position announced in a legal brief is not a *post hoc* rationalization seeking to justify prior agency action, "there is no reason to suspect that the position the [agency] takes in its *amicus* brief reflects anything other than the agency's fair and considered judgment as to what the regulation required at the time this dispute arose." *Chase Bank USA, N.A. v. McCoy*, 131 S.Ct. 871, 881 (2011); *accord Talk Am, Inc. v. Mich. Bell Tel. Co.*, 131 S.Ct. 2254, 2263 (2011); *Auer*, 519 U.S. at 462.

KS&T ignores this well-settled law and cites only to the Supreme Court's decision in *Christopher v. SmithKline Beecham Corp.*, 132 S.Ct. 2156 (2012), to erroneously assert that an agency's regulatory interpretation lacks the "'hallmarks of thorough consideration'" where it was first announced in a brief. (KS&T Opp. at 15-16 (quoting *Christopher*, 132 S.Ct. at 2169).) Contrary to KS&T's suggestion, however, *Christopher* did not overturn the Court's prior decisions referenced above; rather, the Court relied on two additional factors not present in this case to conclude that it should withhold the deference that *Auer* normally requires. *See Christopher*, 132 S.Ct. at 2166-69. *First*, the agency in *Christopher*—

unlike the CFTC here—announced inconsistent interpretations in a "series" of *amicus* briefs throughout the course of the proceedings in that case. *Id.* at 2165-66, 2169. *Second*, because the industry at issue had a "decades-long practice" of violating the regulation as interpreted by the agency in its *amicus* brief and because the agency had never taken any enforcement action in furtherance of its interpretation, the Court concluded that the only plausible explanation for this inaction was that the agency did not previously believe the industry's practice was unlawful. *Id.* at 2168. Conversely, the CFTC's interpretation of Part 190.08 has been consistent throughout its briefing here and in *ConocoPhillips Co. v. Giddens*, Case No. 12-CV-6014 (KBF), and there is no issue as to lack of prior enforcement as the issue before this Court has never before arisen in an FCM liquidation. *See Talk America*, 131 S.Ct. at 2263 ("novelty alone is not a reason to refuse deference").

Moreover, KS&T's own papers refute its assertion that the CFTC's current interpretation does not reflect its well-reasoned judgment in that it conflicts with the interpretive guidance issued by the CFTC in promulgating Part 190.08 (the "Interpretive Guidance"). (KS&T Opp. at 16.) Disproving its own argument, KS&T concedes elsewhere that the Interpretive Guidance "excuses trustees from complying with default certification requirements" (*Id*. at 25 n.17) and is silent as to the "the treatment of expired letters of credit" (*Id.* at 3). KS&T's admissions illustrate that there is no conflict between the CFTC's Interpretive Guidance and its brief. Accordingly, "[t]here is simply no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment." *Auer*, 519 U.S. at 462.

2. KS&T was on notice of the CFTC's interpretation of Part 190.08

While KS&T does not raise the issue of notice, KS&T clearly had "fair warning" of the CFTC's interpretation of Part 190.08. The "fair warning" requirement is derived from the Due Process Clause's notice requirement. *See Christopher*, 132 S.Ct. at 2167 (citing *Gates &*

Fox Co. v. Occupational Safety and Health Review Comm'n, 790 F.2d 154, 156 (D.C. Cir. 1986)). The notice standard applicable to civil regulations is less stringent than that which applies in the criminal context because, in addition to imposing less severe penalties, "businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action." *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982) ("Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to administrative process."). Civil regulations satisfy due process "as a long as a reasonably prudent person, *familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve*, has fair warning of what the regulations require." *Rock of Ages Corp. v. Sec'y of Labor*, 170 F.3d 148, 156 (2d Cir. 1999) (emphasis added).

Here, the Interpretive Guidance expressly states that the CFTC "singled out" letters of credit for "special treatment" to make clear that a liquidating trustee would be entitled to the "full value" of the letter of credit "irrespective of its terms" which would become property of the customer estate subject to pro rata distribution. 48 Fed. Reg. at 8718; 46 Fed. Reg. at 57553. Nothing in the Interpretive Guidance limits a trustee's right to obtain the "full value." Therefore, the CFTC's determination that a letter of credit's expiration similarly does not limit a trustee's rights should be no surprise to KS&T given the Interpretive Guidance's clear statement of the CFTC's regulatory objective: "to assure that customers using a letter of credit to meet original margin obligations *would be treated no differently* than customers depositing other forms of non-cash margin or customers with excess cash margin deposits." 48 Fed. Reg. at 8718 (emphasis added). Accordingly, the CFTC's interpretation fulfills that objective, and KS&T

cannot establish that it did not have "fair warning" that the CFTC would support the Trustee's position in this case. *E.g., Rock of Ages* 170 F.3d at 156.

II. THE CFTC'S INTERPRETATION OF PART 190.08 IS NOT PRECLUDED BY EITHER THE LEGAL CERTAINTY FOR BANK PRODUCTS ACT NOR STATE LAW

A. The LCBPA Did Not Impliedly Repeal Part 190.08

KS&T asserts that section 27a of the Legal Certainty for Bank Products Act (the "LCBPA"), enacted in 2000, implicitly repealed Part 190.08 by precluding the CFTC from "exercise[ing] regulatory authority" over letters of credit. Congress itself refuted KS&T's argument, making clear in enacting section 27a that its intention was *only* to "clarify what [was] already the *current state of the law*." 146 Cong. Rec. 27078 (2000) (emphasis added). Indeed, KS&T concedes that should the Court conclude the CFTC's brief is consistent with the Interpretive Guidance, then its reliance on section 27a is misplaced. (*See* KS&T Opp. at 19 & 20 n.14 (premising its argument on a finding that the CFTC's interpretation is "brand-new" and arguing that *Chevron* deference is not available because the CFTC "expressed its interpretation for the first time in a legal brief.").)

In addition, the LCBPA did not purport to curtail the CFTC's "exclusive" jurisdiction to regulate *futures contracts,* including the treatment of property used to margin those contracts in a FCM liquidation. *See* 7 U.S.C. § 2(a); 7 U.S.C. § 24(a). Thus, the CFTC's treatment of letters of credit under Part 190.08 is as valid today as it was when it adopted Part 190.08, and section 27a is not applicable. Moreover, in amending section 27a pursuant to the Dodd-Frank Act in 2010, Congress reaffirmed its approval of the CFTC's exercise of its regulatory powers—including Part 190.08—stating that the amendments "do not divest . . . the [CFTC] . . . of any authority derived from any other applicable law." 12 U.S.C. § 5301, Pub. L. 111-203, 2010 H.R. 4173, at Title VII, Subtitle A, Part II, § 743, 124 Stat. at 1735 (July 21,

2010). Given that "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change," *Forest Grove Sch. Dist, v. T.A*. 557 U.S. 230, 239-40 (2009), KS&T's assertion that section 27a implicitly repealed Part 190.08 is meritless, and the CFTC's interpretation is entitled to deference under *Chevron v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984).

B. The CFTC's Interpretation of Part 190.08 is not Preempted by State Law

KS&T's contention that "the CFTC cannot preempt expiration dates in letters of credit" (KS&T Opp. at 21) is baseless. As an initial matter, KS&T's assertion that the CFTC's interpretation of Part 190.08 conflicts with state letter of credit law is moot because the Trustee is not seeking to enforce the Debtor's *contractual rights* by collecting the "full proceeds" of the 30.7 LOC from the issuing bank. Rather, the Trustee here seeks to enforce his *statutory right* to collect the "full proceeds" of the 30.7 LOC directly from KS&T pursuant to Part 190.08—an issue to which state letter of credit law is indisputably irrelevant.

Even assuming *arguendo* that state law applied here, KS&T has failed to demonstrate any conflict between Part 190.08 and state letter of credit law because KS&T did not—and cannot— identify any state letter of credit law provision that would prevent a party from agreeing to extend or eliminate expiration dates in letters of credit. *See, e.g.*, U.C.C. § 1-102(3) (recognizing that "the effect of provisions of this Act may be varied by agreement"). By opting to participate in the CFTC's jurisdictional markets, KS&T agreed that all of its transactions would be subject to the CFTC's regulations, including Part 190.08 which, as shown above, eliminates any barrier (such as an expiration date) to the Trustee's right to collect the full face value of a letter of credit posted as margin. *See, e.g.*, *2 Tudor City Place Assocs. v. 2 Tudor City Tenants Corp.*, 924 F.2d 1247, 1254 (2d Cir. 1991) (holding under New York law that

"[l]aws and statutes in existence at a time a contract is executed are considered part of the contract.").)[1] Accordingly, KS&T's argument that the CFTC's interpretation of Part 190.08 conflicts with state law is meritless.

Finally, even if KS&T were able to articulate an actual conflict between state law and Part 190.08, Congress conferred upon the CFTC "exclusive" jurisdiction over transactions involving commodities futures. 7 U.S.C. § 2(a)(1)(A). By virtue of the CEA's grant of exclusivity, the CFTC's regulation of futures transaction preempts conflicting state law. *See*, *e.g.*, *Leist v. Simplot*, 638 F.2d 283, 322 (2d Cir. 1980) ("[T]he courts have held that § 2(a)(1) of the CEA preempts the application of state law.").

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests the Court grant the Trustee's request for summary judgment. The Trustee also respectfully requests that Court grant such other and further relief that the Court deems just and proper.

Dated: New York, New York
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LEVINE LEE LLP

By: */s/ Kenneth E. Lee*
Kenneth E. Lee
Scott B. Klugman
Miriam L. Alinikoff
570 Lexington Avenue, 7th Floor
New York, New York 10022
Tel.: (212) 223-4400
Fax: (212) 223-4425

Attorneys for Defendant James W. Giddens, Trustee for the SIPA Liquidation of MF Global Inc.

[1] For the same reason, KS&T's reliance on *Wyeth v. Levine*, 555 U.S. 555, 576 (2009), is also misplaced because there is no conflict between state letter of credit law and the CFTC's interpretation of Part 190.08.