UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: MF GLOBAL INC., Debtor.	Case No. 12 Civ. 6014 (KBF)
CONOCOPHILLIPS COMPANY, *et al.*, Plaintiffs, v. JAMES W. GIDDENS, Trustee for the SIPA Liquidation of MF Global, Inc., Defendant.	

CONOCOPHILLIPS' BRIEF IN OPPOSITION TO THE TRUSTEE'S AMENDED MOTION TO CONFIRM HIS TREATMENT OF LETTERS OF CREDIT PROVIDED BY CONOCOPHILLIPS

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PRELIMINARY STATEMENT

The Trustee for MF Global Inc. has erred in determining that the face amount of letters of credit provided by ConocoPhillips to MF Global — as to which there has not been, and will never be, an event of default — should be treated as "customer property" to be distributed among MF Global's former customers. The Trustee's motion to confirm that determination should thus be denied and the Trustee directed to recalculate ConocoPhillips' claims without reference to the letter-of-credit amounts.

It is common ground that, as a matter of state law and contract, MF Global was not entitled to draw upon the letters of credit at issue absent a default by ConocoPhillips; indeed, under uniform state law, it would have been "material fraud" for MF Global to do so. It is also common ground that there has been no such default. The Trustee nonetheless insists that he, unlike his predecessor-in-interest, is entitled to seize the face amount of the letters of credit because, under CFTC Rule 190.08(a), "[t]he full proceeds of a letter of credit" are treated as "customer property" in a brokerage liquidation. 17 C.F.R. § 190.08(a)(1)(i)(E).

As to all the letters of credit provided by ConocoPhillips, whether expired or unexpired, the Trustee's legal position is meritless in numerous respects:

First, CFTC Rule 190.08(a), rather than supporting the Trustee's position, explicitly refutes it. By its plain terms, the regulation provides that the "full proceeds" of a letter of credit — *not* its "full face amount" — are "customer property." Moreover, as a matter of common sense and plain meaning, the Rule in no way authorizes a trustee to *create* such "proceeds" illegally in violation of contract as well as state (and federal) law. By its plain terms, therefore, the Rule complements and coexists with state law: it in no way purports to override such law. To the extent that there are lawful proceeds of a letter of credit, they are to be treated

as "customer property" to which customers have priority. Any other reading is at odds not only with the plain language of the Rule but also with the fundamental principle of bankruptcy law that "property of the estate" — of which "customer property" is a subset — consists only of the *state-law* rights of the debtor, and thus is limited to the debtor's *conditional* contract right to draw upon a letter of credit. And, given the unambiguous language of the Rule itself, the CFTC's purported "interpretation" by way of a non-binding "Supplementary Information" avails the Trustee naught. *See* Point I, *infra*.

Second, the Legal Certainty for Bank Products Act (as amended and reaffirmed in the Dodd-Frank Act, and codified in the Commodity Exchange Act, 7 U.S.C. § 27a) is unambiguous in specifying that the Commodity Exchange Act shall not "apply to," and the CFTC shall not exercise "regulatory authority" with respect to, letters of credit. As *mis*interpreted by the Trustee, a CFTC "regulation," Rule 190.08(a), would fundamentally alter the terms of each letter of credit provided to a broker, permitting the debtor-beneficiary — upon filing for bankruptcy — to draw on the letter in contravention of the parties' contracts, state law, and fundamental precepts of bankruptcy jurisprudence. It is hard to imagine a clearer exercise of "regulatory authority" with respect to letters of credit. *See* Point II, *infra*.

Third, the Trustee and the CFTC have failed to demonstrate that the CFTC has validly preempted state letter-of-credit law. As noted above, CFTC Rule 190.08(a) says nothing about state letter-of-credit law and by its terms offers *no* support for any notion that such state law has been overridden. Moreover, the "Supplementary Information" — a CFTC commentary upon which the Trustee and the CFTC attempt to rely — does not have the force of law, is inconsistent with the Rule that the CFTC actually adopted, says nothing about preemption, and is entitled to "no weight" under controlling Supreme Court precedent. *See* Point III, *infra*.

The analysis above applies to *all* of the letters of credit and establishes that the Trustee has erred in his determination of ConocoPhillips' claims regardless of whether the letters expired. But as to the *expired* letters of credit, the Trustee's and the CFTC's position is plainly erroneous for additional reasons: (1) the CFTC Rule refers to "proceeds," making perfectly clear that the Trustee — *even if* so entitled — would have to *draw* on a letter of credit rather than permitting it to expire; (2) the Supplementary Information likewise expressly *requires* a draw, again making clear that a trustee cannot fail to draw and yet still seek to capture the value of a letter of credit; and (3) the Bankruptcy Code's automatic stay does *not* prevent expiration of letters of credit — rather, under Section 108(b) of the Code, certain expiration dates are merely extended to 60 days from the commencement of the proceeding, *but no longer*.

Accordingly, the Trustee's unilateral failure to draw on the *expired* letters while they were still extant — or within the 60-day grace period provided by Section 108(b) of the Bankruptcy Code — means that he lacks even a colorable claim to the value of those letters. There is nothing in the Bankruptcy Code, CFTC regulations, or even agency commentary to support the extraordinary notion that a trustee can sit back and permit a letter of credit to expire and yet make a claim thereunder. *See* Point IV, *infra*.

BACKGROUND

This proceeding arises out of the collapse and bankruptcy of MF Global Inc., a commodity brokerage firm. ConocoPhillips Company and ConocoPhillips Canada Marketing & Trading ULC (together, "ConocoPhillips") are former customers of MF Global.

A. The letters of credit

On June 18, 2001, ConocoPhillips Company entered into a customer agreement with MF Global. Ex. A.* Pursuant to the customer agreement, ConocoPhillips Company provided two standby letters of credit — which expired by their terms on November 23, 2011, and had a combined face value of $60 million — to support commodity contract trading on certain foreign exchanges (the "Expired Letters of Credit"). *See* Exs. B, C.

ConocoPhillips Company also posted three other standby letters of credit, with a combined face value of $135 million (the "Domestic Letters of Credit"). The Domestic Letters of Credit were due to expire on March 30, 2012, and were provided by ConocoPhillips Company to support commodity contract trading on domestic exchanges. *See* Exs. D, E, F.

The customer agreement between ConocoPhillips Company and MF Global requires an event of default on the part of ConocoPhillips before MF Global can present any of these letters of credit or otherwise dispose of collateral. *See, e.g.*, Ex. A §§ 4-5. Moreover, as a prerequisite to presentment, each of the Expired Letters of Credit on its face required an authorized representative of MF Global to certify that ConocoPhillips Company "has defaulted in accordance with the terms and conditions of the [parties'] agreement." Ex. B, at p. 5; Ex. C, at p. 4. It is undisputed that there has not been, and will not be, any such event of default.

On October 23, 2008, ConocoPhillips Canada entered into a customer agreement with MF Global. Ex. G. Pursuant to that customer agreement, ConocoPhillips Canada posted a $10 million standby letter of credit issued by Svenska Handelsbanken (the "Canada Letter of Credit"). Ex. H. The Canada Letter of Credit was due to expire on July 25, 2012, and prior to presentment, likewise required an authorized representative of MF Global to certify that

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* References to "Exs." are to the exhibits to the accompanying Declaration of Emil A. Kleinhaus.

ConocoPhillips Canada had "defaulted in accordance with the terms and conditions of the . . . agreement." Ex. H, at p. 9.

As with the U.S. customer agreement, the Canada customer agreement permits MF Global to present letters of credit only if certain specified events of default occur. Ex. G § 4. Again, it is undisputed that no such default has occurred or will occur.

B. The expiration of the $60 million foreign letters of credit

On October 31, 2011, the Trustee was appointed following MF Global's bankruptcy filing. On November 23, 2011, the Expired Letters of Credit (which had a combined face value of $60 million) expired by their terms without the Trustee attempting to draw on them. Nor did the Trustee attempt to draw on those letters by the end of December 2011, the expiration of the 60-day grace period provided for by Section 108(b) of the Bankruptcy Code.

C. The parties' interim agreement

On March 26, 2012, after the expiration of the Expired Letters of Credit but prior to the expiration of the Domestic Letters of Credit and the Canada Letter of Credit, the Trustee and ConocoPhillips entered into an interim agreement. The agreement provided for the return to ConocoPhillips of all letters of credit, both unexpired and expired, and reserved without prejudice the parties' claims, positions, and defenses as of that time. Ex. I ¶¶ 1, 6.

D. The Trustee's determination of ConocoPhillips' claims

On December 16, 2011, ConocoPhillips filed customer claims against the MF Global estate. Exs. J, K. On May 22, 2012, ConocoPhillips received the Trustee's determination of those claims. Exs. L, M. The Trustee determined that ConocoPhillips Company has an allowed claim to "Section 4d" property (*i.e.* for domestic futures accounts)[*] totaling

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[*] Domestic futures accounts are governed by Section 4d(2) of the Commodity Exchange Act (codified at 7 U.S.C. § 6d(a)(2)). Foreign futures accounts are governed by 17 C.F.R. § 30.7.

$175,790,952, but that it had already received $135,000,000 in satisfaction of that claim. Ex. L. Included in both the allowed claim amount and the amount supposedly received by ConocoPhillips Company is the face amount of the Domestic Letters of Credit ($135,000,000).

The Trustee also determined that ConocoPhillips Company has an allowed claim to "Rule 30.7" property (*i.e.* for foreign futures accounts) totaling $85,755,528, but that it had already received $60,000,000 of that amount. Ex. L. Included in both of those calculations is the face amount of the Expired Letters of Credit ($60,000,000).

In addition, the Trustee determined that ConocoPhillips Canada has an allowed claim to Rule 30.7 property totaling $34,866,553, but that it had already received $10,000,000 in respect of that claim. Ex. M. Included in both of the Trustee's calculations is the face amount of the Canada Letter of Credit ($10,000,000).

The Trustee's determinations have a substantial effect on the recoveries available to ConocoPhillips. If the face amounts of the Domestic Letters of Credit were excluded from the Trustee's calculation of ConocoPhillips Company's claim and the distribution thereon — as they should have been — ConocoPhillips Company would possess a net equity claim to Section 4d property in an amount equal to $40,790,952, and would be entitled to *pro rata* distributions on that amount. Under the Trustee's calculation, which includes the face amount of the Domestic Letters of Credit in both ConocoPhillips Company's net equity claim and the amount already distributed on account of that claim, ConocoPhillips Company's recovery is significantly diluted.

Similarly, if the Trustee were to exclude the face amount of the Expired Letters of Credit and the Canada Letter of Credit from his calculation of ConocoPhillips' claims and distributions, then ConocoPhillips would in the aggregate possess net equity claims to Rule 30.7 property in an amount equal to $50,622,081 and would be entitled to distributions as a

percentage of that amount. Again, the Trustee's treatment significantly dilutes ConocoPhillips' recovery by improperly including the face amount of the letters of credit in both the numerator and denominator of the distribution calculus. Moreover, the Trustee's treatment, if accepted, could result in an affirmative claim *against* ConocoPhillips for alleged excess recoveries.

E. The Trustee's motion to confirm

On June 22, 2012, ConocoPhillips filed its opposition to the Trustee's determination of its claims. *See* Ex. N. The Trustee subsequently filed a motion in bankruptcy court seeking to confirm his determination of the claims. ConocoPhillips moved to withdraw the reference with respect to that contested matter, and this Court granted that motion. *In re MF Global, Inc.*, 2012 WL 4757866 (S.D.N.Y. Oct. 4, 2012). On October 26, 2012, the Trustee filed an amended motion to confirm his claim determinations. The CFTC has since intervened in this proceeding without objection from ConocoPhillips.

ARGUMENT

It is undisputed that under the governing customer agreements and state law, MF Global was not permitted to draw on *any* of the letters of credit provided by ConocoPhillips absent a default by ConocoPhillips. Indeed, as to the Expired Letters of Credit and the Canada Letter of Credit, the condition of an Event of Default appears on the face of the letters of credit themselves — so no draw could conceivably be honored by a bank absent a false and felonious certification. It is also undisputed that there has been no default by ConocoPhillips and, therefore, that MF Global was never entitled to draw on any letter of credit. The Trustee nonetheless contends that he is entitled to treat the face *amount* of all of these letters of credit — including those that expired — as "customer property" subject to *pro rata* distribution, even though, concededly, none of these letters of credit could lawfully have been presented for payment under state law and, accordingly, no "proceeds" ever became property of the estate.

The Trustee is wrong. For the reasons set forth below, the Trustee is not entitled to treat the face amount of *any* of the letters of credit at issue as "customer property."

I. THE CFTC RULES AND THE BANKRUPTCY CODE DO NOT PERMIT THE TRUSTEE TO SEIZE THE FACE AMOUNT OF LETTERS OF CREDIT THAT MF GLOBAL WAS LEGALLY BARRED FROM PRESENTING.

The Trustee and the CFTC rely on a distorted interpretation of CFTC Rule 190.08(a) to support their theory that "the full *amounts* reflected in the ConocoPhillips LOCs are customer property." Tr. Br. 7 (emphasis added). The Rule does not say what the Trustee claims: under the plain language of the Rule, and under the Bankruptcy Code, a trustee is only entitled to the "proceeds" of letters of credit drawn in compliance with state law and the parties' contracts — not the "face amount" or the "face value" of such letters of credit. No such lawful proceeds have been, or ever could be, created here.

A. The Trustee's interpretation of CFTC Rule 190.08(a) is refuted by the Rule's plain language.

CFTC Rule 190.08(a)(1)(i)(E) — the regulation on which both the Trustee and the CFTC rely to support their position — states that "[t]he full *proceeds*" of a letter of credit are "customer property." *Id.* (emphasis added). It does *not* say that the "full *face amount*" of a letter of credit is customer property, as the Trustee and the CFTC assert. Tr. Br. 7, 9-10; CFTC Br. 9. The Rule also says nothing to suggest that a trustee may *generate* "proceeds" of a letter of credit by violating contracts, uniform state law under which a draw on a letter of credit in the absence of an underlying claim is "material fraud," and federal law under which such conduct is a felony.

"Proceeds" means "[t]he value of land, goods, or investments when converted into money," or in the context of collateral, "[s]omething received upon selling, exchanging, collecting, or otherwise disposing of collateral." Black's Law Dictionary 1325 (9th ed. 2009). With respect to letters of credit in particular, the Uniform Commercial Code defines "proceeds"

to mean "the cash, check, accepted draft, or other item of value paid or delivered *upon honor or giving of value by the issuer*." U.C.C. § 5-114(a) (emphasis added).

As repeatedly set forth by the Court of Appeals, regardless of the agency's interpretation, "the plain meaning of language in a regulation governs unless that meaning would lead to absurd results." *Lin* v. *U.S. Dep't of Justice*, 459 F.3d 255, 262 (2d Cir. 2006) (internal quotation marks omitted); *accord N.Y. Currency Research Corp.* v. *CFTC*, 180 F.3d 83, 88-89 (2d Cir. 1999) (rejecting CFTC's interpretation of Rules it adopted as inconsistent with the "plain language" of the Rules); *cf. Lamie* v. *U.S. Trustee*, 540 U.S. 526, 534 (2004) (in the context of the Bankruptcy Code, explaining that "when the statute's language is plain, the sole function of the courts — at least where the disposition required by the text is not absurd — is to enforce it according to its terms" (quoting *Hartford Underwriters Ins. Co.* v. *Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotation marks omitted))). "Full proceeds" has a plain meaning: namely, all of the cash generated by draw and honor of a letter of credit. There is no warrant to replace those words with "full face amount."

Moreover, the Supreme Court has squarely held that when a term in a bankruptcy law is not defined, that term must be given its accepted meaning under state law. *See Travelers Cas. & Sur. Co. of Am.* v. *Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007). In *Travelers*, the issue was the meaning of the term "claim" under the Bankruptcy Code. To answer that question, the Court "recognized that the basic federal rule in bankruptcy is that *state law* governs the substance of claims, *Congress having generally left the determination of property rights in the assets of a bankrupt's estate to state law*." *Id.* at 450-51 (internal quotation marks omitted) (emphasis added). Thus, the Court held that when the Bankruptcy Code uses the word "claim," "it is usually referring to a right to payment recognized under state law." *Id.* at 451; *see also*

Super Nova 330 LLC v. *Gazes*, 693 F.3d 138, 142 (2d Cir. 2012) (holding that the term "unexpired," as used in the Bankruptcy Code, should be defined in accordance with state law).

The same principles apply to the term "full proceeds" in CFTC Rule 190.08(a). Under uniform state law governing letters of credit, "proceeds" are the cash "paid or delivered upon honor or giving of value by the issuer." U.C.C. § 5-114(a). Under the same uniform state law, the "proceeds" of a letter of credit may only be generated in accordance with the parties' agreements: any attempt to generate "proceeds" from a letter of credit when there is no colorable right to do so under those agreements is "material fraud" and breach of warranty. *Id.* §§ 5-109 cmt. 1, 5-110(a)(2). By its terms — and as a matter of common sense — Rule 190.08(a) therefore requires and presumes that any "proceeds" will be acquired lawfully, consistent with uniform state law and not fraudulently.

B. The Trustee's interpretation of CFTC Rule 190.08(a) is at odds with bedrock bankruptcy law.

The Trustee's position that the term "full proceeds" in Rule 190.08(a) should be replaced with "full face amount" (Tr. Br. 9) — and that the "full face amount" of a letter of credit may be accessed by a trustee regardless of whether the letter could be drawn under state law (Tr. Br. 9-10) — is at odds not only with the plain language of the Rule but also with bedrock bankruptcy law, under which a trustee's rights, including under a letter of credit, derive from and are limited to the state-law rights of the debtor.

In the seminal case of *Butner* v. *United States*, 440 U.S. 48, 54-55 (1979), the Supreme Court held that "[p]roperty interests are created and defined by state law," and that Congress has "generally left the determination" of property rights in bankruptcy to state law. Section 541(a) of the Bankruptcy Code "creates an estate" that consists of "all legal or equitable interests of *the debtor* in property as of the commencement of the case." 11 U.S.C. § 541(a)(1)

(emphasis added).[*] Consistent with *Butner*, this provision "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case." S. Rep. No. 95-989, at 82 (1978), H.R. Rep. No. 95-595, at 367-68 (1977); *accord, e.g.*, *Brown* v. *Dellinger (In re Brown)*, 734 F.2d 119, 124 (2d Cir. 1984). To the contrary, if "an interest is limited in the hands of the debtor, it is, therefore, equally limited in the hands of the estate." *Cohen* v. *Drexel Burnham Lambert Grp. (In re Drexel Burnham Lambert Grp., Inc.)*, 138 B.R. 687, 710 (Bankr. S.D.N.Y. 1992) (quoting 4 *Collier on Bankruptcy* ¶ 541.01 (15th ed. 1991)) (internal quotation marks omitted). And this basic rule applies with full force to debtors who are beneficiaries under a letter of credit. In *Farmer* v. *Crocker National Bank (In re Swift Aire Lines, Inc.)*, 30 B.R. 490 (B.A.P. 9th Cir. 1983), the Bankruptcy Appellate Panel held that, when a trustee succeeds to a debtor's rights in a letter of credit, "the Bankruptcy Code [does] not give the trustee the power to automatically enforce payment thereunder if state law requiring strict compliance of tender documents would dictate otherwise," *id.* at 495.

Here, the relevant customer agreements and letters of credit gave MF Global the right to draw on the letters *only* if certain conditions were met. That conditional contract right — and nothing else — became property of MF Global's estate under Section 541(a) of the Bankruptcy Code. By contrast, the "face amounts" of the letters of credit — which are not a recognized form of "property" to begin with — never became "property of the estate."

Nor did it become "customer property." Not only does Rule 190.08(a) make clear that "customer property" includes only the "proceeds" of a letter of credit, but Sections 761 through 767 of the Bankruptcy Code — read in conjunction with that Rule — confirm that

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[*] Section 541(a) is fully applicable to SIPA proceedings. *See* 15 U.S.C. § 78fff(b) (incorporating provisions of title 11 "[t]o the extent consistent with" SIPA); *accord Picard* v. *JPMorgan Chase & Co.*, 460 B.R. 84, 91 (S.D.N.Y. 2011) (applying Section 541(a)(1) to hold that the SIPA trustee "steps into the shoes of the debtor for the purpose of bringing property into the bankruptcy estate, and as such possesses only the rights of the debtor").

"customer property" is a *subset* of "property of the estate," not some broader category of property rights. Rule 190.08, in its very first sentence, explicitly states that it is intended to "allocate" the "*property of the debtor's estate*"; it says nothing about expanding that estate. Likewise, Section 766 of the Bankruptcy Code provides that, *after* customer claims are satisfied, "customer property" is distributed to general creditors of the bankrupt brokerage — demonstrating again that "customer property" is simply a subset of "property of the estate" to which customers have priority. 11 U.S.C. § 766(j)(1) (providing for distribution of excess customer property in accordance with Section 726, which governs "[d]istribution of property of the estate"); *see also id.* § 761(10)(B) (providing that property is not "customer property" to the extent a customer lacks a claim "against the debtor" for such property).

Because "customer property" is a subset of "property of the estate" — and the only "property of the estate" relating to the letters of credit was MF Global's *conditional* right to draw on those letters — the Trustee's claim that he has *greater* rights under the letters of credit is meritless. MF Global never had any more than a contingent contract right to draw on the letters of credit, and even that contingent right was effectively extinguished when ConocoPhillips transferred all of its positions away from MF Global, thereby removing any possibility of a default. Rule 190.08(a) offers no support for expanding the "property of the estate" with respect to letters of credit or for departing from bedrock principles of bankruptcy law.

C. The Trustee's interpretation of CFTC Rule 190.08(a) is further at odds with the statutory requirement that letters of credit be reduced to cash in accordance with "good market practice."

The Trustee's interpretation of Rule 190.08(a) also runs afoul of the Bankruptcy Code provision that requires a brokerage trustee to reduce non-cash estate property to cash in accordance with "good market practice." Sections 761 through 767 of the Bankruptcy Code establish the framework for the liquidation of a commodity broker. Subject to exceptions not

relevant here, Section 766(h) requires that "customer property" be distributed ratably to customers in the form of (1) cash or (2) the return of certain "specifically identifiable" property. To facilitate the cash distributions, Section 766(f) directs the trustee, "[a]s soon as practicable after the commencement of the case," to "reduce to money, *consistent with good market practice*, all securities and other property . . . held as property of the estate" except for specifically identifiable customer property. 11 U.S.C. § 766(f) (emphasis added). The CFTC's own regulations expressly incorporate this requirement, as they direct the trustee to liquidate, subject to "*applicable procedures under the Bankruptcy Code*," all "property held by or for the account of a debtor." 17 C.F.R. § 190.02(f) (emphasis added).

Here, had the Trustee attempted to draw on the letters of credit, he would have engaged not only in breach of contract but also in "material fraud" under state law. U.C.C. § 5-109 cmt. 1 (beneficiary commits "material fraud" by presenting a letter of credit despite having "no colorable right to expect honor and where there is no basis in fact to support such a right to honor"); *see also Ground Air Transfer, Inc.* v. *Westates Airlines, Inc.*, 899 F.2d 1269, 1273 (1st Cir. 1990) (Breyer, J.); *Itek Corp.* v. *First Nat'l Bank of Bos.*, 730 F.2d 19, 24-25 (1st Cir. 1984) (Breyer, J.); *Rockwell Int'l Sys., Inc.* v. *Citibank, N.A.*, 719 F.2d 583, 585, 588-89 (2d Cir. 1983). Any such attempted draw also would have constituted a felony under federal criminal statutes. 18 U.S.C. §§ 1014, 1344; *United States* v. *Agne*, 214 F.3d 47 (1st Cir. 2000). Such unlawful conduct cannot be reconciled with any notion of "good market practice."

D. The Trustee's and the CFTC's arguments regarding CFTC Rule 190.08(a) are meritless.

The arguments advanced by the Trustee and the CFTC regarding Rule 190.08(a)(1)(i)(E) are uniformly meritless.

First, the Trustee claims that ConocoPhillips' interpretation of the Rule does not give meaning to the word "full" in the phrase "full proceeds." Not so. The word "full" in "full proceeds" has the simple effect of making clear that *all* cash obtained from a lawful draw on a letter of credit is treated as "customer property." This is an important specification. Inclusion of the word "full" is in no way surplusage. For, under state law, in certain circumstances, a beneficiary may be permitted to present a letter of credit for the full amount thereof, even when the default is for some *lesser* amount.[*] By including the word "full" in "full proceeds," Rule 190.08(a) mandates that *all* proceeds obtained from a *lawful* draw should be treated as "customer property," thus equating the cash resulting from such lawful draw with other "cash" held as margin, as specified by Rule 190.08(a)(1)(i)(A).

Accordingly, ConocoPhillips' reading of the Rule *does* give effect to each word, including "full." By contrast, the Trustee and the CFTC want the Court to delete the term "proceeds" from "full proceeds" and replace it with "face amount" — a radical change to the Rule that could not be countenanced *even if* the word "full" were superfluous. *See Lamie*, 540 U.S. at 536 ("Surplusage does not always produce ambiguity and our preference for avoiding surplusage constructions is not absolute. Where there are two ways to read the text" — one consistent with plain meaning but that yields surplusage, and another that eliminates surplusage but creates textual ambiguity — "the rule against surplusage is, absent other indications, inappropriate." (citation omitted)).

[*] *E.g.*, *In re Spring Ford Indus., Inc.*, 338 B.R. 255, 262 (E.D. Pa. 2006) (letter of credit permitted draw of full face amount even when draw exceeded amount of underlying obligations); *FDIC* v. *Vogel*, 437 F. Supp. 660, 664 (E.D. Wis. 1977) (letter of credit permitted beneficiary to draw "to the full extent of its terms"); *WestLB AG N.Y. Branch* v. *TPS McAdams, LLC (In re Enron Corp.)*, 370 B.R. 583, 594 (Bankr. S.D.N.Y. 2007) (declining to enforce any extracontractual limitations on the amount that could be drawn on a letter of credit "once a triggering event occurred").

Second, both the Trustee and the CFTC contend that reading Rule 190.08(a) to require a lawful draw would make the regulation ineffectual, because letter-of-credit "proceeds" — when drawn by the broker to make itself whole following a trading loss incurred on behalf of the customer — become *the broker's* property rather than "customer property." This argument ignores the plain terms of the governing Rule. Under Rule 190.08(a)(1)(ii)(E), "customer property" explicitly *includes* "[a]ll cash, securities, or other property which . . . [r]epresents recovery of any debit balance, margin deficit, or other claim of the debtor against a customer account." Accordingly, when the proceeds of a letter of credit are lawfully drawn and used to make the broker whole following a trading loss, such proceeds *are* "customer property" to which customers have priority over general creditors. Moreover, putting aside this controlling Rule, the Trustee and the CFTC again ignore the fact that a beneficiary of a letter of credit may in some cases draw the *full* proceeds of a letter of credit when only *some* of those proceeds are needed to cure a default. In those situations, even if the proceeds used to reimburse the broker for a trading loss were not customer property, the remaining proceeds would still be "customer property" in the form of cash margin.

Third, the CFTC and the Trustee contend that margin in the form of letters of credit should be treated the same way as margin in the form of cash. Tr. Br. 4, 15; CFTC Br. 3, 13. But Rule 190.08(a) on its face distinguishes between cash and letters of credit: while "cash" held as margin is expressly defined as a form of "customer property," *see* Rule 190.08(a)(1)(i)(A), only the "proceeds" of a letter of credit are defined as such, *see* Rule 190.08(a)(1)(i)(E). The distinction drawn by the Rule is well-grounded: whereas cash provided by a customer as margin is deposited with and held by a broker and thus can be marshaled by the trustee in a liquidation, a letter of credit is no more than a conditional contract right to generate

cash under specified circumstances and, in addition, involves the actions of a third party — namely, the issuing bank. Moreover, cash does not expire; letters of credit do. Recognizing these critical *differences* between "cash" and "letters of credit," the Federal Reserve *prohibits* the use of letters of credit as margin for customer accounts held at securities broker-dealers, and the CFTC itself (in coordination with the SEC) has likewise *prohibited* the use of letters of credit in various contexts, including security futures accounts.[*] That the CFTC — despite having expressed reservations about the "viability" of letters of credit as margin for commodity futures trading, CFTC Br. 6 — nonetheless decided to permit letters of credit to be used as such margin, in no way operates to transform letters of credit to be the *same* as cash.

Finally, the Trustee and the CFTC attempt to rest their position on a "Supplementary Information" published by the CFTC in 1983, in which the CFTC asserted that Rule 190.08(a)(1)(i)(E) requires a trustee "to draw the full value of a letter of credit posted as margin . . . irrespective of the margin obligation secured thereby." 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983). The Trustee and the CFTC claim that this "interpretation" is entitled to deference under *Auer* v. *Robbins*, 519 U.S. 452 (1997). But — putting aside the other deficiencies in the Supplementary Information discussed below in connection with preemption, *see* Point III, *infra* — the Supreme Court has held that *Auer* deference is warranted "only when the language of the regulation is ambiguous." *Christensen* v. *Harris Cnty.*, 529 U.S. 576, 588 (2000); *accord, e.g.*, *Christopher* v. *SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2166 (2012)

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[*] *See, e.g.*, 12 C.F.R. §§ 220.2, 220.4 (securities broker-dealers may accept margin in the form of cash or certain securities, but not letters of credit); 17 C.F.R. § 242.404(b) (joint SEC/CFTC regulation specifying permissible margin for security futures and not including letters of credit); *see also id.* § 39.13(g)(10) (stating that a clearinghouse "shall not accept letters of credit as initial margin for swaps"); *id.* § 39.11(b)(2) (setting forth the types of financial resources a derivatives clearing organization may use to satisfy its exposures); 76 Fed. Reg. 69334, 69346 (Nov. 8, 2011) (stating that "the Commission is not including letters of credit as an acceptable financial resource [for a derivatives clearing organization] because they are only a promise by a bank to pay and not an asset that can be sold," but reserving the right to permit such use of letters of credit on a "case-by-case basis").

(no deference available for agency interpretation that is "inconsistent with the regulation"). To defer to an agency's position when the language of a regulation is *not* ambiguous would be to permit the agency, "under the guise of interpreting a regulation, to create *de facto* a new regulation." *Christensen*, 529 U.S. at 588; *see also Cuomo* v. *Clearing House Ass'n*, 557 U.S. 519, 531 (2009) (refusing to give effect to an agency regulation that did not "comport with the statute" or to "the [agency's] *interpretation* of its regulation" that "differ[ed] from the text" of the regulation (emphasis in original)); *Lin*, 459 F.3d at 262 (where agency's interpretation "is inconsistent with the plain language of the regulation, [a court] owe[s] no deference to it[]").

The Supplementary Information suffers from precisely this vice. There is nothing ambiguous about the Rule itself. Rather, here, the CFTC is using its commentary to *create* ambiguity — effectively rewriting the regulation it actually adopted, which merely sets forth that the "proceeds" of a letter of credit are "customer property," to say instead that "customer property" includes the "face amount" of a letter of credit and that a trustee may *generate* such "proceeds" in violation of state law and the parties' contract.

It is no answer, moreover, for the CFTC to point to decades-old comments made in response to the CFTC's proposed rulemaking. That certain market participants feared the Rule might be understood to permit a trustee to draw upon letters of credit where the debtor would have been unable to do so cannot and does not change the unambiguous meaning of the words the CFTC actually adopted: Executive agencies have a "responsibility to promulgate clear and unambiguous" rules. *Bethlehem Steel Corp.* v. *Occupational Safety & Health Review Comm'n*, 573 F.2d 157, 161 (3d Cir. 1978). In interpreting those rules, the test for the courts is not "what [the agency] might possibly have intended, but what [it] said. If the language is faulty, the [agency] has the means and the obligation to amend." *Id.*

Persons posting letters of credit with a broker as margin are deemed to "know the law." But they are not chargeable with knowledge of a 30-year-old Supplementary Information that does not constitute law or have the force of law, is not binding, stands diametrically contrary to the unambiguous terms of the regulation that *does* constitute law, and would operate to confiscate such persons' rights under letters of credit for the benefit of others.

* * *

For all of the reasons discussed above, the correct reading of CFTC Rule 190.08(a) is the one suggested by this Court in granting ConocoPhillips' motion to withdraw the reference: "[T]he regulation could apply to a situation where there has been a trigger for a letter of credit and the trigger may have actually occurred thereby making the CFTC provision live and actually relate to real proceeds as opposed to the generation of proceeds." 2012 WL 4757866, at *5 n.6 (internal quotation marks omitted). Any other reading, including one under which the term "full proceeds" is replaced by "full face amount," represents an impermissible departure from the language and plain meaning of the Rule as well as bedrock bankruptcy law.

II. CFTC RULE 190.08(a), AS INTERPRETED BY THE TRUSTEE AND THE CFTC, WOULD EXCEED THE AGENCY'S LIMITED AUTHORITY.

The Trustee's reading of Rule 190.08(a) is independently foreclosed by the Commodity Exchange Act itself, which, as amended by the Legal Certainty for Bank Products Act (codified in relevant part in Section 27a of the CEA), unequivocally prohibits the CFTC from promulgating a rule that would alter the terms and characteristics of a letter of credit.

A. The Legal Certainty for Bank Products Act prohibits the CFTC from exercising the authority that it claims to have exercised here.

Since Congress enacted the Legal Certainty for Bank Products Act of 2000, Congress has made clear that the CEA "shall not apply to," and the CFTC "shall not exercise

regulatory authority under the [CEA] with respect to," any "identified banking product." 7 U.S.C. § 27a(a)(1). For these purposes, "identified banking product[s]" include bank-issued "letter[s] of credit." *Id.* § 27(b); 15 U.S.C. § 78c note.*

This limitation on the CFTC's authority to regulate letters of credit is categorical and unambiguous. To state the obvious, an agency may not "exercise its authority in a manner that is inconsistent with the administrative structure that Congress enacted into law." *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000) (internal quotation marks omitted). Thus, under the plain language of the statute, the CFTC may not exercise *any* "regulatory authority" with respect to letters of credit. *See, e.g.*, *La. Pub. Serv. Comm'n* v. *FCC*, 476 U.S. 355, 374 (1986) (stating that "an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it," and concluding that the FCC could not "expand its power in the face of a congressional limitation on its jurisdiction" that was embodied in a statute).

It is beyond cavil that CFTC Rule 190.08(a), if interpreted as the Trustee and the CFTC suggest, would both "apply to," and constitute an exercise of "regulatory authority" with respect to, letters of credit. Under state law, MF Global or any successor to MF Global would be barred, as a matter of contract and statute (*i.e.* the U.C.C.), from drawing on the letters of credit provided by ConocoPhillips absent a default. The CFTC — under color of a Rule adopted pursuant to the CEA — would be purporting to *alter* that result, changing the terms and operation of the letters of credit to deprive ConocoPhillips and similarly situated parties of protections to which they are entitled under state law. While case law on the Part 190 Rules is

* The limitation on the CFTC's authority to regulate letters of credit originated in the Legal Certainty for Bank Products Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763. In 2010, Congress amended Section 27a of the CEA as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1694, but those amendments did not alter the limitation on the CFTC's regulatory authority with respect to letters of credit.

sparse, the available decisions confirm the obvious: Rule 190.08(a) is a purported exercise of regulatory authority under the CEA. *See In re Griffin Trading Co.*, 245 B.R. 291, 318-19 (Bankr. N.D. Ill. 2000) (holding that Rule 190.08(a)(1)(ii)(J) "exceeds the CFTC's statutory authority to regulate"), *vacated on appeal following settlement*, 270 B.R. 882 (N.D. Ill. 2001). Rule 190.08 manifestly is part of the Code of Federal *Regulations*; moreover, the plain meaning of the word "regulate" certainly encompasses what the CFTC now claims it has done in Rule 190.08(a). *See* Webster's Third New Int'l Dictionary 1913 (2002) (defining "regulate" to mean "to govern or direct according to rule," and to "make regulations for or concerning"). And it is certainly incontrovertible that the Rule, as interpreted by the Trustee and the CFTC, "appl[ies] to" letters of credit.

Faced with the plain and sweeping language of the statute, the Trustee and CFTC mischaracterize ConocoPhillips' position as resting on the notion that Section 27a effects an "implied repeal" of Rule 190.08(a)(1)(i)(E). Tr. Br. 17-18; CFTC Br. 18. But there is nothing "implied" about the limitation on the CFTC's regulatory authority. To the contrary, in enacting Section 27a, Congress was *explicit* that the CFTC "shall not exercise regulatory authority under the [CEA] with respect to" bank products, including letters of credit. Moreover, there was no need for Congress to repeal Rule 190.08(a)(1)(i)(E). By its terms, that regulation does *not* purport to alter any facet of state law or contractual rights. Rather, it merely specifies how, within the liquidation scheme of the CEA and Bankruptcy Code, the lawfully drawn "proceeds" of letters of credit are to be allocated — *i.e.*, to customers first as "customer property."

The Trustee also argues that by amending unrelated provisions of both the Legal Certainty for Bank Products Act and the commodity broker subchapter of the Bankruptcy Code without altering the definition of "customer property," Congress obliquely indicated its assent to

the CFTC's "interpretation" of 190.08(a)(1)(i)(E). Tr. 17-18. But Congress's lack of attention to an agency commentary on a previously untested rule is not meaningful. *See, e.g.*, *Demarest* v. *Manspeaker*, 498 U.S. 184, 190 (1991) (where there was no "indication that Congress was aware" of an agency's construction of a statute, Congress's reenactment of that statute "does not constitute an adoption of [that] administrative construction"); *SEC* v. *Sloan,* 436 U.S. 103, 120-21 (1978) (rejecting SEC's argument that Congress, by reenacting a provision of the Securities Exchange Act without disapproving of a particular SEC interpretation thereof, had implicitly adopted the Commission's interpretation where there was no basis to "presume general congressional awareness of the Commission's construction," and where that construction was "at odds with the language of the section in question").

The Trustee and the CFTC also claim that enforcing the statute by its terms would lead to "absurd" or "illogical" results. Tr. Br. 20; CFTC Br. 18-19. They contend that applying the plain meaning of the statute would call into question other aspects of the regulatory scheme, such as the CFTC rules requiring segregation of customer property. To the extent this argument about other rules is even relevant, it is misguided. The Trustee's interpretation of Rule 190.08(a) would change the key terms of a letter of credit in ways that other rules do not. For example, the CFTC's requirements that customer property be held in segregated accounts do not affect the basic attributes of a letter of credit. By contrast, Rule 190.08(a) — as *mis*interpreted by the Trustee and the CFTC — would have the extreme result of altering the terms of letters of credit, including their conditions and even their duration. By any standard, effectuating that result would be an exercise of "regulatory authority" and would "apply to" letters of credit.

B. The legislative history of the Legal Certainty for Bank Products Act is consistent with its language.

In an attempt to evade the plain meaning of Rule 190.08(a), the Trustee and the CFTC selectively quote the legislative history of Section 27a. But, as the Supreme Court and Second Circuit have made clear, such resort to legislative history is precluded: "[W]here, as here, the statute's language is plain, the sole function of the courts is to enforce it according to its terms." *United States* v. *Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (internal quotation marks omitted); *United States* v. *Colasuonno*, 697 F.3d 164, 173 (2d Cir. 2012) ("Only if we discern ambiguity do we resort first to canons of statutory construction, and, if the meaning remains ambiguous, to legislative history." (internal quotation marks omitted)); *Gildernew* v. *Quarantillo*, 594 F.3d 131, 134 (2d Cir. 2010) ("[B]ecause the statute is clear and unambiguous, we will not endeavor to divine the intent of Congress by resort to legislative history.").

In any event, the legislative history of Section 27a of the CEA is quite consistent with its language in critical respects. Senator Gramm, then Chairman of the Senate Banking Committee and a key sponsor of the Legal Certainty for Bank Products Act, stated that Section 27a was intended to "clarify the jurisdictional line between the regulation of banking products and futures products," thus "provid[ing] legal certainty for existing banking products so that they can continue to be offered, entered into, or provided by banks *without being subject to CFTC regulation*." 146 Cong. Rec. 27176 (Dec. 15, 2000) (emphasis added). Other legislators shared Senator Gramm's view, emphasizing that the CFTC was *never* intended to exercise regulatory authority over letters of credit. *See, e.g.*, *id.* at 27208 (statement of Sen. Harkin) ("[T]he language of the bill clarifies what is already the current state of the law[:] The [CFTC] does not regulate traditional banking products[,] [including] . . . letters of credit."); *id.* at 27078 (statement of Rep. Dingell) (same). While the 2010 Dodd-Frank Act narrowed the CEA's

exclusion with respect to identified banking products that resemble "swaps," nothing in that Act provided the CFTC with authority to regulate ordinary letters of credit like those at issue here. Rather, the Dodd-Frank Act continued to reserve exclusive regulatory authority over bank products, including letters of credit, for federal bank regulators. The relevant legislative history thus confirms that Congress fully intended to prevent the CFTC from interfering with letters of credit.

Moreover, unlike the contorted reading of Rule 190.08(a) urged by the Trustee and the CFTC, the regulations of those federal agencies that *are* tasked with regulating bank products do *not* purport to upend the basic state-law characteristics of letters of credit. For example, the Office of the Comptroller of the Currency, which is the primary regulator of national banks, has adopted a regulation authorizing banks to issue letters of credit. That regulation expressly contemplates that letters of credit will and should be governed by the parties' agreements and applicable state law.[*] What is more, the OCC has declared that "[a]s a matter of safe and sound banking practice, banks that issue [letters of credit] should not be exposed to undue risk," and, accordingly, has advised that letters of credit should be limited in amount *and duration*. 12 C.F.R. § 7.1016(b)(1). In sum, national bank regulators have made policy determinations regarding letters of credit that are at odds with the approach asserted here by the CFTC under which critical terms of letters of credit would simply evaporate in a brokerage liquidation.

[*] *See* 12 C.F.R. § 7.1016(a) ("A national bank may issue and commit to issue letters of credit and other independent undertakings *within the scope of the applicable laws or rules of practice recognized by law* [including the U.C.C.]." (footnote omitted) (emphasis added)).

C. The *Chevron* deference doctrine does not support the CFTC's arguments.

The CFTC attempts to buttress its position on Section 27a by proclaiming that it is entitled to deference under *Chevron, U.S.A., Inc.* v. *Natural Res. Defense Council, Inc.*, 467 U.S. 837 (1984). No *Chevron* deference is applicable here. Once again, where Congress has "directly spoken to the precise question at issue," "that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842-43; *accord, e.g.*, *Brown & Williamson*, 529 U.S. at 125-26 ("[A]lthough agencies are generally entitled to deference in the interpretation of statutes that they administer, a reviewing court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." (internal quotation marks omitted)). Here, Congress has stated plainly that the CEA does not "apply to," and the CFTC may not "exercise regulatory authority . . . with respect to," letters of credit. The CFTC may not defy that command and attempt to buttress its position by invocation of *Chevron*. *See, e.g.*, *Ins. Co. of N. Am.* v. *Gee*, 702 F.2d 411, 414 (2d Cir. 1983) ("this Court will not interpret an agency regulation to thwart a statutory mandate").

Moreover, the view of Section 27a expressed in the CFTC's brief could not under any circumstance be entitled to *Chevron* deference. *Chevron* deference is reserved for agency interpretations contained in "formal adjudication or notice-and-comment rulemaking." *Christensen* v. *Harris Cnty.*, 529 U.S. 579, 587 (2000); *accord Estate of Landers* v. *Leavitt*, 545 F.3d 98, 106 (2d Cir. 2008). The CFTC's brief plainly does not meet that test. The Second Circuit has repeatedly held that less-than-formal statutory interpretation set forth in an agency amicus brief does not qualify for *Chevron* deference.[*]

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[*] *See Conn. Office of Prot. & Advocacy for Persons with Disabilities* v. *Hartford Bd. of Educ.*, 464 F.3d 229, 239 (2d Cir. 2006) (Sotomayor, J.) ("Where, as here, an agency advances a statutory interpretation in an amicus brief

III. THE CFTC HAS NOT VALIDLY PREEMPTED STATE LETTER-OF-CREDIT LAW.

As discussed above, CFTC Rule 190.08(a) does not purport to alter state letter-of-credit law: the Rule permits a trustee to distribute only the lawfully drawn "proceeds" of a letter of credit — those proceeds being obtained, as required by the Bankruptcy Code, by means of "good market practice" — and therefore does not purport to conflict with, much less preempt, state law. Although the Supplementary Information invoked by the Trustee and the CFTC appears to express a different intent — *i.e.*, an intent to permit a trustee to draw on a letter of credit notwithstanding contractual limitations — that non-binding commentary cannot operate to preempt the law of the states.

A. Neither the Commodity Exchange Act nor CFTC Rule 190.08(a) purports to alter state law governing letters of credit.

"Pre-emption fundamentally is a question of congressional intent . . . ." *English* v. *Gen. Elec. Co.*, 496 U.S. 72, 78-79 (1990). Congress often expresses its preemptive intent by "defin[ing] explicitly the extent to which its enactments pre-empt state law." *Id.* at 78. In the CEA, Congress expressly stated its intent to authorize the CFTC by regulation to preempt certain narrow categories of state law, while also prohibiting preemption of certain others. *See* 7 U.S.C. § 16. None of those express provisions, however, says anything about state letter-of-credit law.

The lack of any express provision in its governing statute authorizing the CFTC to preempt state letter-of-credit law at the threshold casts serious doubt on the broad preemption theory asserted by the Trustee and the CFTC. *See La. Pub. Serv. Comm'n*, 476 U.S. at 375 (an agency lacks power to preempt state law "unless and until Congress confers [such] power upon it"). It is a "cornerstone" of preemption jurisprudence that "in all pre-emption cases, and

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that has not been articulated before in a rule or regulation, we do not apply the high level of deference due under *Chevron* . . . ."); *accord In re Enter. Mortg. Acceptance Co. Sec. Litig.*, 391 F.3d 401, 410 n.8 (2d Cir. 2004).

particularly in those in which Congress has legislated in a field which the States have traditionally occupied," courts must "start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Wyeth* v. *Levine*, 555 U.S. 555, 565 (2009) (internal quotation marks omitted); *accord Arizona* v. *United States*, 132 S. Ct. 2492, 2501 (2012). That presumption against preemption is "particularly" applicable here, as letters of credit have long "traditionally" been governed by Article 5 of the Uniform Commercial Code as a matter of *uniform* state law. *See* U.C.C. § 5-103(a). Thus, there is no sound basis to conclude that Congress had any intent to give the CFTC authority to preempt such settled state law.

Nevertheless, even assuming the CEA could be read to endow the CFTC with the requisite preemptive authority, it is evident that the CFTC has not properly exercised any such authority to upend settled state letter-of-credit law. Although courts have held that a validly promulgated regulation may preempt state law even in the absence of an express preemption provision, this is so only "to the extent that" the state law and federal regulation "actually conflict[]." *E.g.*, *Hillsborough Cnty.* v. *Automated Med. Labs., Inc.*, 471 U.S. 707, 713 (1985). But as discussed above, no plausible reading of Rule 190.08(a), which defines "the full *proceeds* of a letter of credit" as "customer property," requires or permits a trustee to *generate* such proceeds in a manner that violates the U.C.C. or other state law. There is accordingly no "actual conflict" between CFTC Rule 190.08(a) and state law that could lead to a finding of preemption. *See Cal. Coastal Comm'n* v. *Granite Rock Co.*, 480 U.S. 572, 583 (1987) (no preemption where "[u]pon examination," agency regulations alleged to preempt state law "not only are devoid of any expression of intent to pre-empt state law, but rather appear to assume that [regulated

parties] will comply with state laws"); *Luna* v. *Harris*, 888 F.2d 949, 953 (2d Cir. 1989) (no preemption where federal regulation envisions compliance with state law).

Unable to point to any such actual conflict, the CFTC invokes an irrelevant House Report stating that "the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned." CFTC Br. 23-24. But the uniform state law governing letters of credit is not encompassed in the "field" of "futures regulation." The U.C.C. provisions that address letters of credit say nothing about futures, do not purport to regulate futures contracts, and do not interfere with the CFTC's regulation of futures markets.[*]

B. The Supplementary Information is not a valid implementation of any CFTC power to preempt state law.

Absent any indication of preemptive intent in Rule 190.08(a) itself, the Trustee and the CFTC are forced to rely on statements in the CFTC's Supplementary Information. *See* 48 Fed. Reg. 8716 (Mar. 1, 1983). However, even assuming a statutory grant of preemptive power to the CFTC, that Supplementary Information is ineffectual as an exercise of preemption.

In *Wyeth* v. *Levine*, 555 U.S. 555 (2009), a landmark Supreme Court case concerning the preemptive force of agency commentary, the Court considered whether a preamble to an FDA drug labeling regulation could support the preemption of state tort law when the regulation itself said nothing about preemption. Although the Court recognized that "an agency *regulation* with the force of law [could] pre-empt conflicting state requirements," the

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[*] *See Goodspeed Airport LLC* v. *E. Haddam Inland Wetlands & Watercourses Comm'n*, 634 F.3d 206, 211 (2d Cir. 2011) (state laws not preempted when they "do not interfere with federal laws and regulations sufficiently to fall within the scope of the preempted field"); *Kotz* v. *Bache Halsey Stuart, Inc.*, 685 F.2d 1204, 1207 (9th Cir. 1982) ("Congress clearly intended [in the CEA] to create a single agency to regulate the field" in commodities trading, but "[i]t does not follow . . . that creation of a central regulatory authority means abolition of common law rights, unless their retention would render the regulatory scheme ineffective.").

Court held that the agency's "assertion" of preemption in some preamble or purported interpretation of a regulation lacked the "force of law," that the FDA's position rested upon an "overbroad view of an agency's power to pre-empt state law," and that the agency's commentary could not have that effect. *Id.* at 573, 576, 581 (emphasis added).

Further, in *Wyeth*, the Supreme Court held that the "weight [to] accord the agency's explanation of state law's impact on the federal scheme" is a function of "its thoroughness, consistency, and persuasiveness." *Id.* at 577. *No* deference was to be accorded to any such agency assertion if it failed to "provid[e] a reasoned explanation" of the perceived conflict between state and federal law. *Id*. Thus, the Court held that the FDA's explanation in the preamble was entitled to "no weight" because, among other things, it lacked justification for the FDA's position that state tort law inhibited the agency's regulatory aims. *Id.* at 577, 581.

Here, as in *Wyeth*, the Supplementary Information lacks the force of law. In addition, it lacks "thoroughness, consistency, and persuasiveness" in its discussion of how state law would impact the federal scheme, and fails to provide a "reasoned explanation" of the interplay between state and federal law. *Id.* at 577. The Supplementary Information does not so much as *mention* the U.C.C. or any other aspect of state letter-of-credit law and says *nothing* about preemption or its statutory authority to effect such preemption. The Supplementary Information cannot, in the absence of such consideration, be thorough or persuasive on these points. *See Sloan*, 436 U.S. at 117-18 (where agency "interpretation" of its authority to take certain actions does not offer "a concomitant exegesis" of the statutory basis for that authority, the "interpretation" "obviously lacks 'power to persuade' as to the existence of such authority").

Moreover, in the one sentence in the Supplementary Information that even *impliedly* references state law, the CFTC graphically demonstrates its *misunderstanding* of that

law. Thus, the Supplementary Information asserts that "[t]he bank issuer of the letter of credit cannot refuse to pay upon it based upon nonperformance of an underlying contract." 48 Fed. Reg. at 8718. But under longstanding case law, an issuing bank *can* "refuse to pay" if the issuer is aware that a required document presented to the bank, "although correct in form, is, in point of fact, false or illegal." *E.g.*, *Old Colony Trust Co.* v. *Lawyers' Title & Trust Co.*, 297 F. 152, 158 (2d Cir. 1924).[*] And where, as here, with respect to the Expired Letters of Credit and the Canada Letter of Credit, the requirement of a certificate of default appears on the face of the letters of credit themselves, is the Supplementary Information to be read as suggesting that a trustee provide a false certification in order to deceive the bank into paying out proceeds?

In addition, under the U.C.C., then as now, the applicant for a letter of credit could obtain an injunction against any such "fraudulent" presentation. U.C.C. § 5-109(b) & cmt. 1 (1995); *see also, e.g.*, *Itek Corp.* v. *First Nat'l Bank of Bos.*, 730 F.2d 19, 25 (1st Cir. 1984) (Breyer, J.); *Rockwell Int'l Sys. Inc.* v. *Citibank, N.A.*, 719 F.2d 583, 589 (2d Cir. 1983); *Dynamics Corp.* v. *Citizens & So. Nat'l Bank*, 356 F. Supp. 991, 999-1000 (N.D. Ga. 1973); *United Bank Ltd.* v. *Cambridge Sporting Goods Corp.*, 360 N.E.2d 943, 948-49 (N.Y. 1976); *Touche Ross & Co.* v. *Mfrs. Hanover Trust Co.*, 107 Misc. 2d 438, 443 (N.Y. Sup. Ct. 1980). The agency's reasoning in the Supplementary Information therefore reflects profound ignorance of the actual structure of state law with respect to letters of credit and how it relates to any federal scheme. Under *Wyeth*, it is entitled to no weight.

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[*] *Accord, e.g.*, *Prutscher* v. *Fid. Int'l Bank*, 502 F. Supp. 535, 536-37 (S.D.N.Y. 1980); *Sztejn* v. *J. Henry Schroder Banking Corp.*, 177 Misc. 719, 722-23 (N.Y. Sup. Ct. 1941); *see also* U.C.C. § 5-114(2) (1965) (permitting issuing bank to dishonor presentation where, even though required documents "appear on their face to comply with the terms of a letter of credit," there is nonetheless "fraud in the transaction"); U.C.C. § 5-109 cmts. 1-2 (1995) (noting that the "fraud in the transaction" exception has been "recodifi[ed]" to permit issuer to dishonor where "the circumstances plainly show that the underlying contract forbids the beneficiary to call a letter of credit" (internal quotation marks omitted)).

C. ConocoPhillips did not consent to be bound by flawed CFTC interpretations.

Finally, the Court should reject out of hand the CFTC's claim that the terms of ConocoPhillips' customer agreements somehow eliminate the need to decide the preemption questions raised by the Trustee's motion. CFTC Br. 21. As the CFTC acknowledges, the customer agreement entered by ConocoPhillips Company refers to the applicability of CFTC "regulations," not "interpretations." *See* Ex. A § 2. As shown, the CFTC's *regulations* do not purport to alter the terms of the parties' letters of credit. And, although the ConocoPhillips Canada agreement does state generically that the "[c]ontracts, transactions, and agreements" between the broker and the customer are subject to the "rules and interpretations" of the CFTC "as applicable," once again, just as the word "proceeds" in Rule 190.08(a) presumes *lawful* proceeds, the word "interpretations" here presumes *valid* interpretations that do not exceed the agency's statutory authority.

IV. THE TRUSTEE IS PLAINLY WRONG IN HIS TREATMENT OF THE EXPIRED LETTERS OF CREDIT.

As to *all* of the letters of credit, the analysis above defeats the Trustee's position and requires denial of his motion to confirm. For the additional reasons set forth below, that is *a fortiori* the case as to the Expired Letters of Credit.

The analysis bearing on the Expired Letters is extremely simple: A letter of credit embodies a contract right; when the contract expires, the right is lost. As a result, when the Trustee allowed two of the letters of credit to expire after MF Global's bankruptcy, the Trustee lost any conceivable rights he previously could have had under those letters. Neither the Trustee nor the CFTC can point to a single word in any statute, regulation, or even agency commentary that supports a different result.

A. Both CFTC Rule 190.08(a) and the Supplementary Information itself prevent the Trustee from seizing the face amount of expired letters of credit.

CFTC Rule 190.08(a) and the Supplementary Information alike unmistakably require that a letter of credit be *drawn* in order for a trustee to distribute its value as "customer property." As discussed, Rule 190.08(a) provides that the "proceeds" of a letter of credit are treated as "customer property," making plain that a letter of credit must be presented and *drawn* before there are "proceeds" to be distributed. The Supplementary Information is also explicit that a trustee is "*required to draw* the full value of a letter of credit posted as margin and treat the funds received as customer property." 48 Fed. Reg. at 8718 (emphasis added).

The requirement that a trustee *draw* on letters of credit leads inexorably to the conclusion that he or she must do so *before* a letter's expiration. "An essential element of a letter of credit is an expiration date. . . . Courts and commentators have long recognized that strict regard for the expiration dates in letters of credit is critical to their continuing commercial viability." *B.E.I. Int'l, Inc.* v. *Thai Military Bank*, 978 F.2d 440, 442 (8th Cir. 1992). If a beneficiary permits a letter of credit to expire undrawn, it has no further rights thereunder: After the expiration date, "the bank has no obligation to pay." *Todi Exps.* v. *Amrav Sportswear Inc.*, 1997 WL 61063, at *4 (S.D.N.Y. Feb. 13, 1997); *accord Knic Knac Agencies* v. *Masterpiece Apparel, Ltd.*, 1994 WL 582590, at *2 (S.D.N.Y. Oct. 21, 1994).

Notwithstanding its continued reliance upon the Supplementary Information in other areas, the CFTC does an about-face with respect to expiration. It contends that the expiration of the Expired Letters of Credit can be ignored because, *contrary* to the Supplementary Information, the Trustee was *not* "required to draw" on those letters at all. According to the CFTC, the term "full proceeds" in Rule 190.08(a) really means "full value as margin, equivalent to cash, at the time of the bankruptcy filing." CFTC Br. 24. That argument

distorts the meaning of both the word "proceeds" (as used in the Rule) and the word "draw" (as used in the Supplementary Information). There is no reason to consider, much less defer to, an argument of an agency that is so blatantly inconsistent with its operative regulation and the agency's own prior interpretation. *See Christopher*, 132 S. Ct. at 2166 (deference not warranted to agency interpretation that "conflicts with a prior interpretation").

The CFTC further asserts that giving effect to the expiration of letters of credit would interfere with the need to fix the amount of each customer's claim at one "particular point in time." CFTC Br. 25. Not at all. If the trustee is legally entitled to draw on a letter of credit, nothing prevents him from doing so *prior* to the date on which customer claims are calculated (or between the date that customer claims are calculated and the date of expiration). Moreover, by its own account, the CFTC addressed this timing issue by establishing a "primary liquidation date," which is the date "on which the 'bankruptcy loss' with respect to each customer claim would be fixed," and by enacting a formula for calculating claims under which "activity in customer accounts subsequent to the primary liquidation date should be attributed only to the account in which that activity occurs and should not be attributed to the estate as a whole." 46 Fed. Reg. 57535, 57538, 57547 (Nov. 24, 1981); *see also* 17 C.F.R. § 190.07. Never before has the CFTC drawn any connection between fixing the amount of customer claims and rewriting letters of credit so that they are perpetual in duration.

The CFTC also points to certain Comments received by the Commission prior to the adoption of the Rule, which are noted in the Supplementary Information, stating that the Rule "would require a trustee to draw the full proceeds of letters of credit *irrespective of their terms*." CFTC Br. 24 (emphasis added). The CFTC appears to be suggesting that such use by third persons of the phrase "irrespective of their terms" should be deemed to refer to expiration. But

the CFTC's brief omits the remainder of the sentence, which continues: "even though [letters of credit] generally condition payment on delivery of a certification that additional funds are required to margin or to cover a default with respect to a contract." 48 Fed. Reg. at 8718. As demonstrated by the remainder of the sentence, the commentators' concerns (as paraphrased in the Supplementary Information) relate to a trustee's ability to draw in the absence of a default; they had nothing to do with expiration.

The CFTC's strained and unsuccessful attempts to find evidence of regulatory intent to alter the duration of letters of credit only confirm that, in adopting the Regulation, the Commission never considered or endorsed the incredible notion that, in the context of a brokerage liquidation, letters of credit *never expire*.

B. The Bankruptcy Code likewise prevents the Trustee from seizing the face amount of expired letters of credit.

Parting ways from the CFTC, the Trustee attempts to defend his treatment of the Expired Letters of Credit by reference to bankruptcy concepts. Without citing a single authority, the Trustee asserts that the expiration of the Expired Letters of Credit amounted to "distributions" in violation of the automatic stay, thereby subjecting those distributions to avoidance as unauthorized "transfers." *See* Tr. Br. 15 & n.3.

The Trustee's position is again squarely at odds with settled law. Consistent with the principle that a bankruptcy trustee succeeds to the rights of the pre-petition debtor, the Bankruptcy Code's automatic stay "does *not* toll the running of time under a contract and does *not* prevent the automatic termination of a contract" following a bankruptcy. *In re Policy Realty Corp.*, 242 B.R. 121, 126 (S.D.N.Y. 1999) (emphasis added), *aff'd*, 213 F.3d 626, 2000 WL

534265, at *2 (2d Cir. 2000).[*] Likewise, the expiration of a contract right is *not* a "transfer" of property within the meaning of the Bankruptcy Code.[**] Rather, under the Bankruptcy Code, as under state law, "[p]ossession of expired rights is the equivalent of the possession of no rights." *Sullivan* v. *Willock (In re Wey)*, 854 F.2d 196, 199 (7th Cir. 1988).

Although the automatic stay does not have the effect of staying the expiration of a contract, the Bankruptcy Code does provide for extensions of certain deadlines. Section 108(b) of the Bankruptcy Code states that a trustee may file any "pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act" before the *later* of the date set by agreement or 60 days after a bankruptcy filing. 11 U.S.C. § 108(b); s*ee* 2 *Collier on Bankruptcy* ¶ 108.03 (16th ed. 2012) (Section 108(b) addresses situations where the trustee would otherwise face "a time limit . . . for the doing of certain acts" to allow "the trustee [to] take necessary steps to preserve for the estate rights which might otherwise be barred"). The statute, accordingly, extends these deadlines for *60 days* after a bankruptcy filing, but no longer.[***]

Section 108(b) is a complete answer to the argument that CFTC Rule 190.08(a) has the unstated effect of rendering letters of credit perpetual in duration. By enacting Section 108(b), Congress made a policy decision to protect trustees from the risk of missing deadlines

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[*] *Accord, e.g.*, *Moody* v. *Amoco Oil Co.*, 734 F.2d 1200, 1213 (7th Cir. 1984); *see also In re Lauderdale Motorcar Corp.*, 35 B.R. 544, 548 (Bankr. S.D. Fla. 1983) (the automatic stay "does not stay the passage of time").

[**] *See Coast Cities Truck Sales, Inc.* v. *Navistar Int'l Transp. Co. (In re Coast Cities Truck Sales, Inc.)*, 147 B.R. 674, 678 (D.N.J. 1992) (where a contract "expired by its own terms" under state law, there was no "transfer" within the meaning of the Bankruptcy Code), *aff'd*, 5 F.3d 1488 (3d Cir. 1993); *Durwick, LLC* v. *Doe (In re Durwick, LLC)*, 2012 WL 2046877, at *3 (Bankr. D. Colo. June 1, 2012) ("When a debtor's interest in property, by operation of non-bankruptcy law, ceases to exist upon the mere passage of time, the extinguishment of the debtor's interest in property is not an avoidable transfer."); *Edgewater Med. Ctr.* v. *Edgewater Prop. Co. (In re Edgewater Med. Ctr.)*, 373 B.R. 845, 853 (Bankr. N.D. Ill. 2007) ("The plaintiff has not pointed to, and the court cannot find, any cases in which the simple expiration of an option prior to execution has been considered a transfer . . . when the option lapsed, the right simply disappeared. It was not transferred.").

[***] *See, e.g.*, *In re Empire Equities Capital Corp.*, 405 B.R. 687, 692 (Bankr. S.D.N.Y. 2009) (under Section 108(b) a debtor has "60 days after the order for relief to take up a[] [contractual] option that would otherwise have expired").

immediately on the heels of a bankruptcy filing. But Congress chose to *limit* the grace period to 60 days. Here, if the Trustee was ever entitled to present the Expired Letters of Credit posted by ConocoPhillips, Section 108(b) provided him with ample time to do so. Having failed to present the letters within 60 days, the Trustee has no basis to seek relief from the consequences of his own inaction.

CONCLUSION

For the reasons set forth herein, ConocoPhillips respectfully requests that the Court deny the Trustee's Amended Motion.

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