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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
MF GLOBAL HOLDINGS LTD., et al.,	Case No. 11-15059 (MG)
Debtors.	(Jointly Administered)

LIMITED OPPOSITION OF THE COMMODITY FUTURES TRADING COMMISSION TO THE AMENDED THIRTEENTH OMNIBUS OBJECTION OF PLAN PROPONENTS SEEKING TO RECLASSIFY CERTAIN CLAIMS

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The Commodity Futures Trading Commission ("CFTC" or "Commission") opposes the *Amended Thirteenth Omnibus Objection of Plan Proponents Seeking to Reclassify Certain Claims* ("Amended Objection") (ECF Doc. 1317) to the extent the Amended Objection seeks to subordinate the CFTC's contingent equitable claims for disgorgement or restitution on behalf of injured MF Global, Inc., commodity customers. As explained below, the Bankruptcy Code provides for subordination of any fine, penalty, or forfeiture. It does not allow subordination of non-punitive claims for restitution or disgorgement. Thus, the Amended Objection should be overruled in part.

BACKGROUND

1. The Commodity Exchange Act ("CEA" or the "Act") charges the CFTC with, among other things, protecting commodity-market participants from fraudulent or other abusive practices and misuses of customer assets. 7 U.S.C. § 5(b). The CEA provides that a futures commission merchant (FCM) must segregate and separately account for all customer property that the FCM receives to margin, guarantee, or secure a commodity transaction. *Id*. § 4d(a)(2). The Act also provides that a principal is liable for its agent's violations of the Act. *Id*. § 2(a)(1)(B). Section 6c of the Act states that "[w]henever it shall appear to the Commission that any" person, including any entity, "has engaged, is engaging, or is about to engage in any" violation of the CEA or any CFTC regulation, the "Commission may bring an action in the proper district court of the United States." *Id*. § 13a-1(a).

2. The Act specifies several remedies the Commission may pursue and that a court may grant to redress such violations. The Commission may obtain:

(i) a "permanent or temporary injunction or restraining order," *id*. § 13a-1(b);

(ii) "writs of mandamus," *id*. § 13a-1(c);

(iii) "a civil penalty," *id*. § 13a-1(d)(1)(A)-(B);

(iv) "restitution to persons who have sustained losses proximately caused by such violation (in the amount of such losses)," *id.* § 13a-1(d)(3)(A); and

(v) "disgorgement of gains received in connection with such violation," *id*. § 13a-1(d)(3)(B).

3. On August 21, 2012, the CFTC timely filed Proof of Claim forms setting forth contingent, unliquidated claims against each of the six debtors in this Chapter 11 proceeding. (*Declaration of Robert A. Schwartz in Support of the Limited Opposition of the Commodity Futures Trading Commission to the Amended Thirteenth Omnibus Objection of Plan Proponents Seeking to Reclassify Certain Claims* ("Schwartz Decl.") Exs. A-F.) Item 2 of each Proof of Claim form requests the "Basis for Claim." In response, on each form, the CFTC referenced an Attachment. (*Id*.) The Attachments submitted with each Proof of Claim form explain that each claim was filed to preserve the Commission's rights to bring litigation against each debtor for violations, if any, of the CEA or CFTC regulations, in the event the Commission determines that that such law was violated:

> On October 31, 2011, the Commission's Division of Enforcement opened an investigation into whether the Commodity Exchange Act or Commission regulations were violated. It is possible that this investigation may lead to litigation involving [the debtor]. The Commission is filing this protective proof of a contingent unliquidated claim to preserve the Commission's rights in that event.

(*Id.* (Attachments).)

Item 5 of each Proof of Claim form asks the claimant to indicate, by checking a box, whether "any part of the claim" includes "Taxes or penalties owed to governmental units." (Schwartz Decl. Exs. A-F.) The CFTC checked that box on each of the six Proof of Claim forms, indicating that "part of the claim" includes penalties. (*Id*.)

4. On March 6, 2013, the Plan Proponents filed the *Thirteenth Omnibus Objection of Plan Proponents Seeking to Reclassify Certain Claims*. (ECF Doc. 1163.) The Plan Proponents stated that the CFTC's six claims are "on account of tax penalties" and sought an order subordinating them pursuant to 11 U.S.C. § 726(a)(4). In support, the Plan Proponents submitted the *Declaration of Scott A. Rinaldi in Support of the Thirteenth Omnibus Objection of Plan Proponents Seeking to Reclassify Certain Claims*. (ECF Doc. 1163 at 11.) The declarant, Scott A. Rinaldi of FTI Consulting Inc., stated that "I, or employees of FTI under my supervision and direction, personally reviewed" the CFTC's claims and others and "[b]ased upon such review, I believe that each of" the CFTC's claims (along with the other listed claims) "is a claim on account of a non-pecuniary tax penalty." (ECF Doc. 1163 at 12.)

5. On April 9, 2013, counsel for the CFTC communicated by email to counsel for the Plan Proponents, informing them that their characterization of the CFTC's claims as "claims 'on account of a non-pecuniary tax penalty" was erroneous. (Schwartz Decl. ¶ 8.) On April 12, 2013, counsel for the CFTC spoke by telephone with counsel for the Creditor Co-Proponents (ECF Doc. 1317 at 3 n.5) and informed them that the claims covered by the CFTC's Proof of Claim forms include claims not only for civil penalties, but also for restitution and disgorgement, and that these latter two categories of claims are not subject to subordination under the Bankruptcy Code (Schwartz Decl. ¶ 9).

6. On April 16, 2013, the Plan Proponents filed the Amended Objection.

ARGUMENT

The CFTC's claims may only be subordinated to the extent they include a "fine, penalty, or forfeiture." 11 U.S.C. § 726(a)(4). To the extent the CFTC's claims include restitution and disgorgement under 17 U.S.C. § 13a-1(d)(3)(A) and (B), they may not be subordinated.

Whether a claim is for a "fine, penalty, or forfeiture" depends on whether it is punitive or remedial, *i.e.*, whether it seeks to punish the wrongdoer or merely to restore the status quo before the wrongdoing. *SEC v. Lorin*, 869 F. Supp. 1117, 1122-23 (S.D.N.Y. 1994); *accord Meeker v. Lehigh V. R. Co.*, 236 U.S. 412, 423 (1915); *In re Schaffer*, 515 F.3d 424, 428 (5th Cir. 2008); *Johnson v. SEC*, 87 F.3d 484, 491 (D.C. Cir. 1996); *HUD v. Cost Control Mktg. & Sales Mgmt.*, 64 F.3d 920, 928 (4th Cir. 1995); *In re Schultz Broadway Inn, Ltd.*, 89 B.R. 43, 44 (Bankr. W.D. Mo. 1988), *aff'd*, 912 F.2d 230 (8th Cir. 1990).[1] The CEA provides for both types of sanction – punitive sanctions in the form of civil penalties under 7 U.S.C. § 13a-1(d)(1), and remedial sanctions including "restitution to persons who have sustained losses" and "disgorgement of gains" under 7 U.S.C. § 13a-1(d)(3)(A) and (B), respectively.

Non-criminal restitution is presumptively remedial. *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971) ("Restitution of the profits on these transactions merely deprives the appellants of the gains of their wrongful conduct."); *accord Johnson*, 87 F.3d at 491 (holding that sanction was remedial, not punitive, "where the effect … is to restore the status quo ante, such as through a proceeding for restitution"); *SEC v. DiBella*, 409 F. Supp. 2d 122, 127 (D. Conn. 2006) (following *Johnson*). For example, in *In re Seneca Oil Company*, 906 F.2d 1445 (10th Cir. 1990), the Department of Energy ("DOE") alleged that the debtor overcharged purchasers of crude oil, and DOE therefore sought restitution on behalf of those customers. *Id.* at 1456. Plan proponents sought to subordinate DOE's claim, arguing that they were claims for a "fine, penalty, or forfeiture" under section 726(a)(4). The Tenth Circuit held that DOE's restitution claim was not penal and could not be subordinated because "(1) the claim [wa]s based

[1] Certain of the cited cases concern section 523(a)(7) rather than 726(a)(4), but "the phrase 'fine, penalty, or forfeiture' as it appears in § 726(a)(4) must have the same meaning as in § 523(a)(7)." *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 561-62 (1990).

solely on actual pecuniary loss, (2) the purpose of the claim [wa]s restitutionary rather than penal, and (3) the statutory scheme support[ed] the restitutionary nature of the claim." *Id.* at 1455. As to the "statutory scheme," the court found it persuasive that the relevant sections provided for restitution *as well as* civil penalties, making clear that a "restitution" claim under the statute was distinct and remedial. *Id*. at 1456.

The restitution remedy under the CEA, 7 U.S.C. § 13a-1(d)(3)(A), shares each of these characteristics. First, the claim is based solely on actual pecuniary loss because the statute explicitly ties the recovery to "the amount of such losses." *Id.* § 13a-1(d)(3)(A). Second, a "restitutionary rather than penal" purpose is explicit in the statute—to compensate "persons who have sustained losses proximately caused" by the violation. *Id.* Finally, the statutory scheme, like the statute at issue in *Seneca Oil*, separately provides for "a civil penalty," confirming that the restitution remedy is distinct and non-punitive. *Id.* § 13a-1(d)(1).

The remedial, non-punitive purpose of disgorgement under the CEA is equally clear. "It is well established that disgorgement is remedial rather than punitive, since a fundamental policy underlying disgorgement is to prevent the unjust enrichment of the wrongdoer rather than to punish him." *SEC v. Robinson*, No. 00-cv-7452, 2002 WL 1552049, at *7 (S.D.N.Y. Jul. 16, 2002). Indeed, "disgorgement may not be used punitively." *SEC v. First City Financial Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989); *see also Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) ("[D]isgorgement orders are not penalties, at least so long as the disgorged amount is causally related to the wrongdoing."); *SEC v. Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994) ("[W]e conclude that the disgorgement order is remedial in nature and does not constitute punishment within the meaning of double jeopardy."); *CFTC v. British Am. Commodity Options Corp.*, 788 F.2d 92, 93 (2d Cir. 1986) ("[T]he party seeking disgorgement must distinguish

between the legally and illegally derived profits."). It "merely deprives one of wrongfully obtained proceeds" and thus "returns the wrongdoer to the status quo before any wrongdoing had occurred." *Lorin*, 869 F. Supp. at 1122; *see also DiBella*, 409 F. Supp. 2d at 127 ("Disgorgement … merely dispossesses the wrongdoer of the profits earned from illegal conduct.").

None of the Plan Proponents' arguments to the contrary have merit.

First, Plan Proponents' statement that the CFTC "concedes that its claims are for 'taxes or penalties'" (ECF Doc. 1317 at 7 (citing proofs of claim)) lacks a good-faith basis. The cited claim forms ask whether "*any part* of the claim" is for "[t]axes or penalties." (Schwartz Dec. Exs. A-F. (emphasis added).) The CFTC's affirmative responses indicates that "part of the claim" against each debtor is for penalties. As the Plan Proponents state in a footnote, prior to the filing of the Amended Objection, "counsel for the Creditor Co-Proponents conferred with counsel for the CFTC to discuss the CFTC Claims and the Plain Proponents' position that the CFTC Claims should be reclassified as Subordinated Claims." (ECF Doc. 1317 at 3 n.3.) In that conference, counsel for the CFTC informed counsel for the Plan Proponents that only a portion of each of the CFTC's claims relates to penalties, and that each claim also includes restitution and disgorgement, which may not be subordinated. (Schwartz Decl. ¶ 9.)

Second, Plan Proponents misconstrue section 726(a)(4) of the Bankruptcy Code in arguing that a claim is "considered a penalty" if it is "not intended to compensate *the claimant*," but an injured third-party. (ECF Doc. 1317 at 6 (emphasis added); *see also id.* at 7 (arguing for subordination "because the CFTC itself has not suffered any loss").) That is not what section 726(a)(4) says. Rather, it states that a claim is subordinated if it is: "for any fine, penalty, or forfeiture … *to the extent* that *such* fine, penalty, forfeiture" is "*not* compensation for actual

pecuniary loss suffered by the holder of such claim." 11 U.S.C. § 726(a)(4) (emphases added). In other words, *if* a claim is for a fine, penalty, or forfeiture, it is subordinated *unless* it intended to compensate the claimant. If the claim is *not* for a fine, penalty, forfeiture, it is not covered by section 726(a)(4) and is therefore not subordinated.[2] The court in *Seneca Oil* correctly rejected the same argument the Plan Proponents assert here:

> The language of Section 726(a)(4) does not provide that a claim is a fine, penalty, or forfeiture unless the holder of the claim is seeking recovery for actual loss to the holder. Rather, the language provides that a fine, penalty, or forfeiture will be accorded fourth priority only "to the extent that such fine, penalty, [or] forfeiture … [is] not compensation for actual pecuniary loss suffered by the holder of such claim." Thus, *the language makes actual pecuniary loss to the holder of the claim relevant only if a fine, penalty, or forfeiture is involved*. That language does not state that if a claim is not for pecuniary loss to the holder of the claim the claim automatically is a fine, penalty, or forfeiture.

906 F.2d at 1455-56 (emphasis added; alterations in *Seneca Oil*).

Texas American Oil Corp. v. U.S. Department of Energy, 44 F.3d 1557 (Fed. Cir. 1995) (ECF Doc. 1317 at 6-7), cited by the Plan Proponents, is not to the contrary. In *Texas American Oil*, while DOE sought a claim it termed "restitution," it was "undisputed that no significant restitution ha[d] been made or [wa]s expected to be made to any person who actually suffered a pecuniary loss." *Id*. at 1569. Instead, recovered funds would be "retained for government use." *Id*. The court held that true restitution requires "some relationship between the person injured and the recipient of the recovery." *Id*. Because the government intended to retain the money although it had "expended no funds and suffered no actual loss," the claims were, for purposes of section 726(a)(4), "non-compensatory penalties and forfeitures," which must be subordinated.

[2] Section 726(a)(4) provides for the same treatment of "multiple, exemplary, or punitive damages." 11 U.S.C. § 726(a)(4). Plan Proponents do not assert that the CFTC's claims are for multiple, exemplary, or punitive damages.

Id. at 1571. Here, by contrast, the CEA limits the CFTC's restitution claims to "restitution to persons who have sustained losses." 7 U.S.C. § 13a-1(d)(3)(A).

Finally, it is irrelevant that these equitable remedies appear in a section with the heading "civil penalties." *See Bhd. of R.R. Trainmen v. Balt. & Ohio R.R.*, 331 U.S. 519, 528 (1947) ("That the heading … fails to refer to all the matters which the framers of that section wrote into the text is not an unusual fact."). Section headings "cannot limit the plain meaning of the text." *Id.* at 528-29. "[N]or are they necessarily designed to be a reference guide or a synopsis." *United States ex rel. Thistlethwaite v. Dowty Woodville Polymer, Ltd.*, 110 F.3d 861, 866 (2d Cir. 1997). Here, because the statute text provides for "civil penalt[ies]," 7 U.S.C. § 13a-1(d)(1), separately from the provisions for restitution and disgorgement, *id*. § 13a-1(d)(1), "a plain reading of the text suggests that" the latter "are not a fine, penalty, or forfeiture," *Schaffer*, 515 F.3d at 428. The Court "should not interpret the statute in a way that erases that distinction." *Comm. to Stop Airport Expansion v. FAA*, 320 F.3d 285, 289 (2d Cir. 2003) (rejecting reliance on a section heading where "Congress distinguished between … two types of agency power").

The legislative history of 7 U.S.C. § 13a-1(d)(3)(A) and (B) confirms their remedial character. Both provisions were added to the CEA in Section 744 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Dodd-Frank, Pub. L. No. 111-203, § 744, 124 Stat. 1376, 1735 (July 21, 2010). Prior to Dodd-Frank, courts held that the CFTC's power under 7 U.S.C. § 13a-1(b) to obtain an "injunction" included the power to obtain equitable remedies. *See, e.g.*, *British Am. Commodity Options Corp.*, 788 F.2d at 94. However, in *CFTC v. Wilshire Investment Management Corp*., 531 F.3d 1339 (11th Cir. 2008), the U.S. Court of Appeals for the Eleventh Circuit held that such relief must be limited to the amount of the defendant's unjust enrichment. *Id.* at 1345. If victims' losses were greater than that amount, the

Wilshire court held that the CFTC could not seek complete redress on their behalf. *Id.* Dodd-Frank Section 744, sometimes called the "*Wilshire* fix," reversed that outcome, confirming that the CFTC has the power not only to pursue fines and disgorge profits, but to make victims whole:

> **SEC. 744. RESTITUTION REMEDIES**
>
> Section 6(c)(d) of the Commodity Exchange Act (7 U.S.C. 13a-1(d)) is amended by adding at the end the following:
>
> "(3) EQUITABLE REMEDIES.—In any action brought under this section, the Commission may seek, and the court may impose, on a proper showing, on any person found in the action to have committed any violation, equitable remedies including—
>
> "(A) restitution to persons who have sustained losses proximately caused by such violation (in the amount of such losses); and
>
> "(B) disgorgement of gains received in connection with such violation.".

Dodd-Frank, Pub. L. No. 111-203, § 744, 124 Stat. 1376, 1735.

Congress thus clarified that *in addition* to the express authority to seek civil penalties for wrongdoing, the CFTC may also seek a full range of equitable remedies, including restitution and disgorgement, to restore the status quo *ex ante*—quintessentially non-punitive functions, giving rise to claims that are not subject to subordination under 11 U.S.C. § 726(a)(4). Thus, the purpose of the CFTC's filing claims here, in accordance with 7 U.S.C. § 13a-1, is to protect its ability in the event it determines that the law was violated, to make victims whole, disgorge wrongdoers of the gains received, *and* to pursue such punitive sanctions as the Commission determines are appropriate.

CONCLUSION

For the foregoing reasons, the Amended Objection should be overruled to the extent it seeks to subordinate the CFTC's claims for restitution or disgorgement under 7 U.S.C. § 13a-1(d)(3).

Respectfully submitted,

COMMODITY FUTURES TRADING COMMISSION

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Dated: May 9, 2013

CERTIFICATE OF SERVICE

I hereby certify that on May 9, 2013, I caused the foregoing document to be served on all counsel via the Court's CM/ECF system.

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