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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re MF GLOBAL INC., Debtor.	Bankruptcy Case No. 11-2790 (MG) SIPA
CONOCOPHILLIPS COMPANY, et al., Plaintiffs, v. JAMES W. GIDDENS, Trustee for the SIPA Liquidation of MF Global Inc. Defendant.	Case No. 12-CV-6014 (KBF)

TRUSTEE'S MEMORANDUM OF LAW IN OPPOSITION TO CONOCOPHILLIPS' MOTION TO WITHDRAW THE REFERENCE

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

BACKGROUND & PROCEDURAL POSTURE 2

ARGUMENT 6

I. WITHDRAWAL OF THE REFERENCE IS NOT REQUIRED BECAUSE THE PART 190 REGULATIONS IMPLEMENT AND ARE EFFECTIVELY PART OF TITLE 11, NOT "OTHER LAWS." 6

A. The Regulations Congress Authorized The CFTC To Draft To Implement The Commodity Broker Liquidation Provisions Of Chapter 7 And That Are Referred To In Title 11 Itself Are Not "Other," Non-Bankruptcy Laws Under Section 157(d). 6

B. ConocoPhillips' Reading Of Section 157 Cannot Be Correct. 10

II. THE TRUSTEE'S DETERMINATION INVOLVES A STRAIGHTFORWARD APPLICATION OF THE PART 190 REGULATIONS. 12

A. The Plain Language Of The Part 190 Regulations And The CFTC's Enacting Commentary Make Clear That The Trustee's Determination Of ConocoPhillips' Claims Is Correct. 13

B. ConocoPhillips' Efforts To Broaden The Scope Of This Case Beyond The Part 190 Regulations Should Be Rejected. 16

1. ConocoPhillips' U.C.C. And State Contract Law Arguments Are Irrelevant To This Case. 17

2. The Part 190 Regulations' Customer Property Definition Has Nothing To Do With The Regulation Of Bank Products. 18

3. There Is No Conflict Between The Part 190 Regulations And Chapter 5 Of The Bankruptcy Code. 19

III. IF THE REFERENCE WERE TO BE WITHDRAWN, THE DISTRICT COURT SHOULD REMAND THIS MATTER TO THE BANKRUPTCY COURT FOR PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW. 20

CONCLUSION 23

TABLE OF AUTHORITIES

Page(s)

CASES

Barton v. SIPC,
185 B.R. 701 (D.N.J. 1994) 12

In re Drexel Burnham Lambert Grp.,
151 B.R. 684 (Bankr. S.D.N.Y. 1993) 18

Enron Corp. v. J.P. Morgan Sec., Inc. (In re Enron Corp.),
388 B.R. 131 (S.D.N.Y. 2008) 13

Gredd v. Bear, Stearns Sec. Corp. (In re Manhattan Inv. Fund Ltd.),
343 B.R. 63 (S.D.N.Y. 2006) 7

Grede v. Fortis Clearing Americas LLC,
No. 09 C 138, 2009 U.S. Dist. LEXIS 100299
(N.D. Ill. Oct. 28, 2009) 9

Houbigant, Inc. v. ACB Mercantile, Inc. (In re Houbigant, Inc.),
185 B.R. 680 (S.D.N.Y. 1995) 6

HSBC Bank USA, N.A. v. Fane (In re MF Global Inc.),
466 B.R. 244 (Bankr. S.D.N.Y. 2012) 10, 22

Keller v. Blinder (In re Blinder, Robinson & Co., Inc.),
162 B.R. 555 (D. Colo. 1994) 11

In re Lehman Bros. Inc.,
462 B.R. 53 (Bankr. S.D.N.Y. 2011) 14

In re MF Global, Inc.,
No. 11-2790 (MG) SIPA, 2012 Bankr. LEXIS 3701
(Bankr. S.D.N.Y. Aug. 10, 2012) 10

In re MF Global Inc.,
No. 11-2790 (MG) SIPA, 2012 Bankr. LEXIS 1801
(Bankr. S.D.N.Y. Apr. 24, 2012) 9, 22

In re MF Global Inc.,
467 B.R. 726 (Bankr. S.D.N.Y. 2012) 10

O'Connell v. Terranova (In re Adelphia Institute, Inc.),
112 B.R. 534 (S.D.N.Y. 1990) 7

Oneida Ltd. v. Pension Benefit Guar. Corp.,
372 B.R. 107 (S.D.N.Y. 2007)....13

Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.),
4 F.3d 1095 (2d Cir. 1993), cert. denied, 511 U.S. 1026 (1994)....21

Pension Benefit Guar. Corp. v. Official Parent Creditors' Comm. of the LTV Corp. (In re Chateaugay Corp.),
108 B.R. 27 (S.D.N.Y. 1989)....21

Pension Benefit Guar. Corp. v. Pan Am Corp. (In re Pan Am Corp.),
133 B.R. 700 (S.D.N.Y. 1991)....21

Picard v. Flinn Invs., Inc.,
463 B.R. 280 (S.D.N.Y. 2011)....11

SEC v. Goren,
No. 00-CV-970-TCP, 800-8178-288-TCP, 2002 WL 32963582 (E.D.N.Y. Mar. 6, 2002)....12

Shugrue v. Air Line Pilots Ass'n Int'l (In re Ionosphere Clubs, Inc.),
922 F.2d 984 (2d Cir. 1990), cert. denied, 502 U.S. 808 (1991)....7, 12

Shugrue v. Pension Benefit Guar. Corp. (In re Ionosphere Clubs, Inc.),
142 B.R. 645 (S.D.N.Y. 1992)....21

SIPC v. Bernard L. Madoff Inv. Sec. LLC,
401 B.R. 629 (Bankr. S.D.N.Y. 2009),
aff'd sub nom. Rosenman Family, LLC v. Picard, 420 B.R. 108 (S.D.N.Y. 2009)....14

SIPC v. Bernard L. Madoff Inv. Sec. LLC,
Nos. 11 Civ. 4505, 11 Civ. 4937, 11 Civ. 8018, 2012 U.S. Dist. LEXIS 92231 (S.D.N.Y. Jun. 25, 2012)....11

SIPC v. Lehman Bros. Inc.,
433 B.R. 127 (Bankr. S.D.N.Y. 2010)....14

Stern v. Marshall,
131 S. Ct. 2594 (2011)....6

United States v. Johns-Manville Corp. (In re Johns-Manville),
63 B.R. 600 (S.D.N.Y. 1986)....7, 13

STATUTES AND RULES

7 U.S.C. § 24....8

7 U.S.C. § 24(a)....3, 19

11 U.S.C. §§ 761-767 .... *passim*

15 U.S.C. §§ 78aaa et seq. .... *passim*

28 U.S.C. § 157(a) 10, 11, 12

28 U.S.C. § 157(b)(2) 5

28 U.S.C. § 157(c)(1)..20, 21

28 U.S.C. § 157(d) .... *passim*

Fed. R. Bankr. P. 9014..5, 21

REGULATIONS

17 C.F.R. §§ 190.01 et seq.. *passim*

LEGISLATIVE AND ADMINISTRATIVE MATERIALS

48 Fed. Reg. 8716 (Mar. 1, 1983)..8, 15

146 Cong. Rec. 27078 (2000)..19

146 Cong. Rec. 27237 (2000)..19

H.R. Rep. No. 95-595 (1977), reprinted in 1978 U.S.C.C.A.N. 5963..8, 20

H.R. Rep. No. 95-746 (1977)..9

S. Rep. No. 95-763 (1978), reprinted in 1978 U.S.C.C.A.N. 764 9

S. Rep. No. 95-989 (1978), reprinted in 1978 U.S.C.C.A.N. 5787 ....8, 20

James W. Giddens (the "Trustee"), as Trustee for the liquidation of MF Global Inc. ("MFGI") under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa et seq., by and through his undersigned counsel, respectfully submits this memorandum of law in opposition to the Motion to Withdraw the Reference and accompanying Memorandum of Law (ECF No. 2 (the "CP Mem. of Law")) filed by ConocoPhillips Company and ConocoPhillips Canada Marketing & Trading ULC (together, "ConocoPhillips") and states as follows:

PRELIMINARY STATEMENT

The Trustee's duties include the marshaling and equitable distribution of customer property to all of MFGI's former customers. Like tens of thousands of other former MFGI customers, ConocoPhillips posted margin with MFGI to support its trading in commodity futures contracts. But instead of posting cash, securities, or other assets, ConocoPhillips was among a small handful of former MFGI customers that posted margin in the form of letters of credit.

While the Trustee has made significant progress in marshaling customer property, there currently remains a shortfall, such that property of former MFGI customers is currently being returned at a rate significantly less than 100%. ConocoPhillips argues, in the face of this substantial shortfall in customer property, that its use of letters of credit entitles it to a return of its margin at a 100-cents-on-the-dollar rate, while MFGI's other customers share equitably in the shortfall and receive only a portion of the margin they had posted. ConocoPhillips is not entitled to such preferential treatment. Instead, the fair approach, and the approach supported by the plain language of the governing regulations, is for ConocoPhillips' letters of credit to be part of the normal pro rata distribution process.

Currently before the Court is ConocoPhillips' motion to withdraw the reference from the bankruptcy court overseeing the SIPA liquidation of MFGI. The SIPA case has been pending before Judge Martin Glenn since October 31, 2011, when District Judge Paul A.

Engelmayer's order removed the case from district court to the bankruptcy court pursuant to the congressional mandate that SIPA proceedings be so removed immediately upon the appointment of a trustee. ConocoPhillips argues that withdrawal of the reference is mandatory because this case involves application of Commodity Futures Trading Commission ("CFTC") regulations that implement the bankruptcy code and govern the liquidation of a commodity broker like MFGI.

ConocoPhillips is incorrect. First, mandatory withdrawal is triggered only when the case requires substantial and material consideration of federal laws outside of the title 11 bankruptcy regime. The CFTC regulations do not fit this description; in fact, they implement and are intimately connected with the portion of title 11 that governs commodity broker liquidations. Second, this case does not involve "substantial and material consideration" of the CFTC regulations; rather, it requires a straightforward application of the regulations' plain language, bolstered by its promulgation history. Finally, even if the Court were to determine that withdrawing the case from the bankruptcy court were appropriate, a remand to the bankruptcy court for proposed factual findings and legal conclusions would be most efficient in light of the bankruptcy court's extensive experience with the MFGI liquidation and its specific procedure for resolving claims disputes like this one.

BACKGROUND & PROCEDURAL POSTURE

The SIPA Proceeding

Prior to its liquidation, MFGI was a futures commission merchant ("FCM") subject to regulation by the CFTC and a registered securities broker-dealer subject to SIPA and regulation by the Securities and Exchange Commission ("SEC"). (Report of the Trustee's Investigation and Recommendations (the "Investigation Report") at 26, 31-32, attached in part to the Declaration of Marlena C. Frantzides sworn to on August 23, 2012 (the "Frantzides Decl.") at Ex. A.)

The liquidation of MFGI was commenced pursuant to the provisions of SIPA. On October 31, 2011, the Honorable Paul A. Engelmayer, United States District Court for the Southern District of New York, entered an order (the "MFGI Liquidation Order," Frantzides Decl. at Ex. B) commencing the liquidation in the case captioned Securities Investor Protection Corp. v. MF Global Inc., Case No. 11-CIV-7750 (PAE). The MFGI Liquidation Order, inter alia: (i) appointed James W. Giddens as Trustee for the liquidation of the business of MFGI pursuant to 15 U.S.C. § 78eee(b)(3); and (ii) removed the case to the bankruptcy court, before the Honorable Martin Glenn, for all purposes as required by 15 U.S.C. § 78eee(b)(4) (the "SIPA Proceeding").

Title 11 (the "Bankruptcy Code") includes a specific subchapter governing the liquidation of a FCM like MFGI — subchapter IV of chapter 7 codified at 11 U.S.C. §§ 761-767. SIPA provides that this subchapter governs the duties of a trustee when a FCM is liquidated pursuant to SIPA and states:

> To the extent consistent with the provisions of this chapter or as otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of Title 11, including, if the debtor is a commodity broker . . . the duties specified in subchapter IV of such chapter 7 . . . .

15 U.S.C. § 78fff-1(b). Congress directed that subchapter IV of chapter 7 of the Bankruptcy Code be implemented by certain CFTC regulations that are specifically applicable to a FCM liquidation. See 7 U.S.C. § 24(a); 17 C.F.R. §§ 190.01 through 190.10 (the "Part 190 Regulations"). The Part 190 Regulations implement the Bankruptcy Code to provide detailed rules for the liquidation of a FCM, with a special focus on the identification, marshaling, and equitable pro rata distribution of the property of the FCM's former customers.

Upon entry of the MFGI Liquidation Order, the commodity futures accounts of tens of thousands of customers, and the property in those accounts, came under the Trustee's control and were subject to the FCM liquidation statutes and regulations. (Trustee's First Interim Report (the "Interim Report") at ¶ 15, Frantzides Decl. at Ex. C.) The ConocoPhillips entities are two of these customers.

The Letters of Credit

Prior to MFGI's liquidation, ConocoPhillips traded commodity futures contracts through MFGI and, like all other customers who actively traded through MFGI, was required to post margin. (CP Mem. of Law at 5-6; Trustee's Motion for an Order Confirming the Trustee's Determination of ConocoPhillips' Claims to Customer Accounts Margined with Letters of Credit (the "Trustee's Motion") at ¶ 13-17, attached to the Declaration of Emil. A. Kleinhaus in Support of ConocoPhillips' Motion to Withdraw the Reference (ECF No. 3 (the "Kleinhaus Decl.")) at Ex. A.) Nearly every MFGI customer posted margin in the form of cash or securities. The ConocoPhillips entities, however, were two of a small handful of MFGI customers (nine in total) that instead posted margin in the form of letters of credit.[1] (See Trustee's Motion at ¶ 16.) Six of these irrevocable standby letters of credit (the "CP LOCs") are the subject of the current dispute between the parties. (See Trustee's Motion at ¶ 17.)

The Contested Matter

On December 16, 2011, ConocoPhillips Company and ConocoPhillips Canada each timely asserted a customer claim in the SIPA Proceeding seeking return of property from MFGI. (Trustee's Motion at ¶ 24.) The current disagreement between the parties stems from the

[1] Koch Supply & Trading, LP, the only other former MFGI commodity futures customer that disputes the Trustee's position on letters of credit, initiated an adversary proceeding against the Trustee in the bankruptcy court (Koch Supply & Trading, LP v. James W. Giddens, Trustee for the SIPA Liquidation of MF Global Inc., Adv. Proc. No. 12-1754 (MG)) and also made a motion to withdraw the reference (Koch Supply & Trading, LP v. Giddens, Case No. 12-CV-5596 (NRB)), which has been assigned to the Honorable Naomi Buchwald. The briefing schedule in that case is the same as the briefing schedule here.

Trustee's determination of ConocoPhillips' customer claims. Specifically, the Trustee determined that ConocoPhillips' customer property included the face amount of the CP LOCs in accordance with 17 C.F.R. § 190.08(a)(1)(i)(E) and that the CP LOCs should therefore be part of the pro rata distribution to ConocoPhillips. ConocoPhillips, on the other hand, takes the position that the CP LOCs are not customer property and that they therefore should be returned in full outside of the normal pro rata distribution process.

On May 22, 2012, the Trustee allowed the claims of ConocoPhillips Company and ConocoPhillips Canada as customer claims and included the face amount of the CP LOCs as customer property as described above. (See Notices of the Trustee's Determination of Claims, Kleinhaus Decl. at Exs. N and O.) Because the Trustee had already returned in full all but two of the CP LOCs to ConocoPhillips, and because the remaining two CP LOCs had already expired, the Trustee included the face amounts of the CP LOCs under the heading "Amount Already Transferred to You," and deducted those amounts from the total amount owed to ConocoPhillips. (Id.) On June 22, 2012, ConocoPhillips filed a joint objection disputing the Trustee's determination. (Kleinhaus Decl. at Ex. P.)

On July 30, 2012, the Trustee filed a motion in the bankruptcy court for confirmation of his application of the Part 190 Regulations to his determination of ConocoPhillips' claims. (See Trustee's Motion.) In accordance with the "MFGI Claims Procedure Order" issued by the bankruptcy court, the Trustee's Motion initiated a "Contested Matter" subject to the streamlined procedures in Rule 9014 of the Federal Rules of Bankruptcy Procedure. (Frantzides Decl. at Ex. D.) The Contested Matter is substantively a claims dispute and is also a core bankruptcy proceeding that does not raise an issue of the bankruptcy court's constitutional authority to enter a final judgment. 28 U.S.C. § 157(b)(2) (including the "allowance or disallowance of claims against the estate" as a core proceeding.); see also Stern v. Marshall, 131 S. Ct. 2594, 2618 (2011) (acknowledging bankruptcy court authority to adjudicate a dispute that would "necessarily be resolved in the claims allowance process"). ConocoPhillips nonetheless filed a motion to withdraw the reference with respect to the Contested Matter.

ARGUMENT

I. WITHDRAWAL OF THE REFERENCE IS NOT REQUIRED BECAUSE THE PART 190 REGULATIONS IMPLEMENT AND ARE EFFECTIVELY PART OF TITLE 11, NOT "OTHER LAWS."

Section 157(d) of title 28 requires the Court to withdraw the reference to the bankruptcy court if it "determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." 28 U.S.C. § 157(d). ConocoPhillips argues that the Part 190 Regulations were not technically promulgated pursuant to title 11 — and that they are therefore "other laws of the United States" regulating commerce — such that a strict reading of section 157(d) mandates withdrawal. This argument ignores the history and purpose of the Part 190 Regulations, as well as the cautions from the Second Circuit against over-applying the mandatory withdrawal statute. It also ignores the fact that if the mandatory withdrawal statute were truly read as strictly as ConocoPhillips advocates, it would not apply to a SIPA proceeding like this one at all.

A. The Regulations Congress Authorized The CFTC To Draft To Implement The Commodity Broker Liquidation Provisions Of Chapter 7 And That Are Referred To In Title 11 Itself Are Not "Other," Non-Bankruptcy Laws Under Section 157(d).

If applied literally, section 157(d) would effectively "eviscerate much of the work of the bankruptcy courts." Houbigant, Inc. v. ACB Mercantile, Inc. (In re Houbigant, Inc.), 185 B.R. 680, 683 (S.D.N.Y. 1995). To avoid this result, courts in the Second Circuit have consistently held that section 157(d) must be "construed narrowly." See Shugrue v. Air Line Pilots Ass'n Int'l (In re Ionosphere Clubs, Inc.), 922 F.2d 984, 995 (2d Cir. 1990), cert. denied, 502 U.S. 808 (1991); O'Connell v. Terranova (In re Adelphia Institute, Inc.), 112 B.R. 534, 536 (S.D.N.Y. 1990) (District courts "[a]re admonished by the legislative history to construe this sentence narrowly.") (internal quotation omitted). Mandatory withdrawal is not an "escape hatch through which most bankruptcy matters [can] be removed to a district court." Gredd v. Bear, Stearns Sec. Corp. (In re Manhattan Inv. Fund Ltd.), 343 B.R. 63, 66 (S.D.N.Y. 2006) (internal quotation omitted).

Section 157(d) ensures that federal district courts resolve those issues that "Congress . . . intended to have decided by a district court judge rather than a bankruptcy judge." United States v. Johns-Manville Corp. (In re Johns-Manville), 63 B.R. 600, 602 (S.D.N.Y. 1986). ConocoPhillips argues that the Part 190 Regulations should be considered by the district court rather than the bankruptcy court because they were promulgated under title 7, not title 11. (See CP Mem. of Law at 11-12.) But an examination of congressional intent makes clear that Congress considered these regulations to be bankruptcy regulations, and they are referred to in title 11 itself. There is no indication that Congress intended that they be considered in the first instance outside of the bankruptcy court.

Specifically, Congress gave the CFTC the power to promulgate the Part 190 Regulations as part of the Bankruptcy Reform Act of 1978 when it was modernizing the Bankruptcy Code to specifically address the liquidations of FCMs like MFGI. Congress added subchapter IV of chapter 7 of the Bankruptcy Code to govern these FCM liquidations and simultaneously stated that more detailed regulations governing commodity broker liquidations would be promulgated by the CFTC:

> The commodity broker subchapter provides only a framework within which commodity broker liquidations are to be administered . . . the subchapter does not provide detailed rules to cover every contingency. Instead general rulemaking authority has been delegated to the CFTC . . . .

Bankruptcy Reform Act of 1978, S. Rep. No. 95-989, at 8 (1978), reprinted in 1978 U.S.C.C.A.N. 5787. In giving the CFTC this statutory authority, Congress did so under the Commodity Exchange Act ("CEA"), pursuant to which the CFTC was created in 1974, rather than the Bankruptcy Code itself. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, tit. III, § 302, 92 Stat. 2549 (1978) (codified at 7 U.S.C. § 24). But this bit of statutory organization does not detract from the obvious fact that the regulations the CFTC was directed to promulgate as part of the Bankruptcy Reform Act are bankruptcy regulations, as closely connected to the Bankruptcy Code as federal regulations can be. See H.R. Rep. No. 95-595 (1977), reprinted in 1978 U.S.C.C.A.N. 5963 ("A final distinction [between a commodity and stockbroker liquidation] concerns the creation of a rule-making power in the [CFTC] to carry out the provisions [of subchapter IV of chapter 7 of the Bankruptcy Code].") It is not a normal reading of the statutory langauge to conclude that regulations promulgated at the direction of Congress to implement parts of title 11 should be considered "other laws of the United States" regulating interstate commerce.

In addition, the CFTC itself made clear when it was promulgating the Part 190 Regulations that it was "implement[ing] subchapter IV [the commodity broker subchapter] of Chapter 7 of the Bankruptcy Act which applies only to commodity broker liquidations." 48 Fed. Reg. 8716 (Mar. 1, 1983). Subchapter IV of the Bankruptcy Code also references the CFTC's implementation of rules and regulations in congressional contemplation of the CFTC's involvement. See, e.g., 11 U.S.C. § 761(17). ConocoPhillips did not cite, and the Trustee is not aware of, any case withdrawing the reference because the case required interpretation of the

CFTC's bankruptcy regulations. (See CP Mem. of Law at 11-12.) ConocoPhillips does cite Grede v. Fortis Clearing Americas LLC, but Grede is irrelevant here because it involved CFTC regulations that were not the Part 190 Regulations and therefore had no relationship to the Bankruptcy Code. No. 09 C 138, 2009 U.S. Dist. LEXIS 100299, at *9-11 (N.D. Ill. Oct. 28, 2009); see id. at 11.

ConocoPhillips relies on a number of cases arising from the Madoff liquidation, but those cases turn on an application of SIPA rather than the Part 190 Regulations drafted pursuant to a congressional directive to implement title 11. See CP Mem. of Law at 11-12. It is also worth noting that decisions to withdraw the reference in Madoff-related cases have resulted in over 400 motions to withdraw the reference in that case, not a result that Congress likely contemplated when it made clear its intent that SIPA liquidations be handled by bankruptcy courts. S. Rep. No. 95-763, at 10 (1978), reprinted in 1978 U.S.C.C.A.N. 764 (amending section 78eee(b)(4) to clarify "[a]uthority for the existing practice of referring all or part of a liquidation proceeding to a referee in bankruptcy, thereby in many cases expediting liquidation proceedings"); see also H.R. Rep. No. 95-746, at 27 (1977).

These points are all reinforced by consideration of the ultimate ramifications of ConocoPhillips' argument. The Part 190 Regulations govern all aspects of the liquidation of a commodity broker, just as Congress intended. Therefore, if a district court were in fact required to withdraw the reference whenever a case required significant consideration of the Part 190 Regulations, the bankruptcy court would have virtually no role left to play in commodity broker liquidations. For example, matters that the bankruptcy court has routinely and efficiently handled in the MFGI liquidation would, according to ConocoPhillips, be subject to mandatory withdrawal. See, e.g., In re MF Global Inc., No. 11-2790 (MG) SIPA, 2012 Bankr. LEXIS 1801, at *15-19 (Bankr. S.D.N.Y. Apr. 24, 2012) (determining that the Part 190 Regulations require a separate account class for delivery property); In re MF Global Inc., 467 B.R. 726, 728-29 (Bankr. S.D.N.Y. 2012) (approving the liquidation of specifically identifiable property as defined in the Part 190 Regulations); HSBC Bank USA, N.A. v. Fane (In re MF Global Inc.), 466 B.R. 244, 248 (Bankr. S.D.N.Y. 2012) (interpreting the Part 190 Regulations that "guide trustees and assist courts in implementing the CEA and subchapter IV of title 11 of the Bankruptcy Code" as applied to specifically identifiable property); In re MF Global Inc., No. 11-2790 (MG) SIPA, 2012 Bankr. LEXIS 3701, at *19-20 (Bankr. S.D.N.Y. Aug. 10, 2012) (discussing the potential interaction of the Part 190 Regulations and Exchange Rules in the context of approving a settlement agreement). Over 26,000 timely commodity claims have been submitted in the MFGI liquidation and determined by the Trustee. To date, nearly 450 objections to claim determinations have been filed, and these customers are entitled to and could potentially have their day in court. The objections deadline for several hundred other claimants' objections has not yet expired. Certainly no rational Congress would remove all this litigation from the specialized courts created for this purpose to already over-burdened district courts.

B. ConocoPhillips' Reading Of Section 157 Cannot Be Correct.

ConocoPhillips relies heavily on a narrow and technical reading of section 157(d). Specifically, ConocoPhillips reads the phrase "title 11" in section 157(d) to exclude regulations that were promulgated by a federal agency at the specific direction of Congress as part of the Bankruptcy Reform Act to implement title 11. But if section 157(d) were truly to be read that narrowly and technically, it would not apply to this case at all. This is because, read strictly, section 157(d) mandates withdrawal only when cases are referred to the bankruptcy court pursuant to section 157(a) of title 28. And section 157(a) refers only title 11 bankruptcy cases. This case, however, was not referred to the bankruptcy court under title 11, but instead pursuant to the mandatory removal provision in SIPA. See 15 U.S.C. § 78eee(b)(4).

Specifically section 157(d) states:

> The district court may withdraw, in whole or in part, any case or proceeding referred under this section [28 U.S.C. 157], on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

28 U.S.C. § 157(d) (emphasis added). The "this section" to which the statute refers is section 157(a), which states that "[e]ach district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." 28 U.S.C. § 157(a). SIPA liquidations, in contrast, are not referred to the bankruptcy court pursuant to the referral provision in section 157(a) but instead are removed under the mandatory removal section in SIPA that states:

> Upon the issuance of a protective decree and appointment of a trustee, or a trustee and counsel, under this section, the court shall forthwith order the removal of the entire liquidation proceeding to the court of the United States in the same judicial district having jurisdiction over cases under title 11. The latter court shall thereupon have all of the jurisdiction, powers, and duties conferred by this chapter upon the court to which application for the issuance of the protective decree was made.

15 U.S.C. § 78eee(b)(4). Thus, when section 157(d) says it applies to "any case or proceeding referred under this section," a literal reading would limit its application to cases referred under section 157(a), not cases removed to the bankruptcy court pursuant to SIPA.

To be sure, to date, courts have not given the statute such a strict reading. See Picard v. Flinn Invs., Inc., 463 B.R. 280, 282-83 (S.D.N.Y. 2011); SIPC v. Bernard L. Madoff Inv. Sec. LLC, Nos. 11 Civ. 4505, 11 Civ. 4937, 11 Civ. 8018, 2012 U.S. Dist. LEXIS 92231, at *5-7 (S.D.N.Y. Jun. 25, 2012); Keller v. Blinder (In re Blinder, Robinson & Co., Inc.), 162 B.R.

555, 559 (D. Colo. 1994); Barton v. SIPC, 185 B.R. 701, 703 (D.N.J. 1994); SEC v. Goren, No. 00-CV-970-TCP, 800-8178-288-TCP, 2002 WL 32963582, at *2 (E.D.N.Y. Mar. 6, 2002). But even if the broader reading of section 157(a) is correct and title 11 encompasses SIPA removals, then a broader reading of the same language in another section of the same statute (section 157(d)) must also be correct and would encompass regulations that implement title 11. Any FCM liquidation involving a broker-dealer may well proceed under SIPA. Congress could not have intended in such circumstances that two interrelated sections of the same statute would be read in an illogical and inconsistent fashion. Either section 157 has no application to the case because it was removed pursuant to SIPA, not title 11, or title 11 as used in the statute must include implementing regulations.

Either reading of the statute compels the same conclusion. Congress could only have meant that the core issue of customer claim treatment under the regulations implementing the Bankruptcy Code for FCM liquidations would be determined by the court created for that purpose: the bankruptcy court.

II. THE TRUSTEE'S DETERMINATION INVOLVES A STRAIGHTFORWARD APPLICATION OF THE PART 190 REGULATIONS.

Even if the Part 190 Regulations had no connection to the Bankruptcy Code at all, which is plainly not the case, withdrawal of the reference would still be inappropriate because a straightforward application of the regulations is all that is required. The Second Circuit has held that mandatory withdrawal "is reserved for cases where substantial and material consideration of non-Bankruptcy Code federal statutes is necessary for the resolution of the proceeding." In re Ionosphere Clubs, Inc., 922 F.2d at 995 (emphasis added). Mandatory withdrawal "is not available merely whenever non-Bankruptcy Code federal laws will be considered in the bankruptcy court proceeding." Id. "Substantial and material consideration" requires a bankruptcy judge to engage in "significant interpretation of federal [non-bankruptcy] laws . . . as opposed to . . . the straightforward application of a federal statute." Enron Corp. v. J.P. Morgan Sec., Inc. (In re Enron Corp.), 388 B.R. 131, 136 (S.D.N.Y. 2008) (emphasis in original) (internal citations omitted). The "substantial and material consideration" standard excludes those cases that involve only the routine application of federal, non-bankruptcy laws to a particular set of facts. See id.; see also In re Johns-Mansville Corp., 63 B.R. at 602.

A. The Plain Language Of The Part 190 Regulations And The CFTC's Enacting Commentary Make Clear That The Trustee's Determination Of ConocoPhillips' Claims Is Correct.

This case is about whether the Trustee is correct in his determination of ConocoPhillips' claims when he includes the full amount of the CP LOCs as customer property in ConocoPhillips' net equity and then determines that the return or expiration of the CP LOCs acted as a transfer or distribution of that property to ConocoPhillips. The answer to this question involves a simple and straightforward application of the Part 190 Regulations, which specifically address the treatment of letters of credit used to margin commodities contracts — exactly like the CP LOCs in this case.

The Part 190 Regulations state that "[t]he full proceeds of a letter of credit if such letter of credit was received, acquired or held to margin, guarantee, secure, purchase or sell a commodity contract" are customer property. 17 C.F.R. § 190.08(a)(1)(i)(E). There is no dispute that the CP LOCs were held by MFGI to margin a commodity contract. (See Trustee's Motion at ¶ 28.) So the only question left is how to apply this on-point Part 190 Regulation to the determination of ConocoPhillips' claims. See Oneida Ltd. v. Pension Benefit Guar. Corp., 372 B.R. 107, 110-11 (S.D.N.Y. 2007) ("Bankruptcy judges are well qualified to apply the language of a federal statute to the Bankruptcy Code's definition of a 'claim,' a definition which they interpret and apply in most bankruptcies.").

And this is really not a question at all. ConocoPhillips takes the position that when the CFTC explicitly included the "full proceeds" of a letter of credit used as margin collateral for commodities trades as customer property, it meant only the amount that the failed FCM would have been permitted contractually to draw down prior to the liquidation. This interpretation defies common sense: the CP LOCs were collateral, and before MFGI's liquidation, by definition neither MFGI nor anyone else was permitted to access that collateral absent a default by ConocoPhillips. But once a liquidation occurs, everything changes. The Trustee is charged with the duty of marshaling all customer property, including collateral that the debtor would have had no right to access prior to the liquidation, so that it can be distributed equitably to customers in a pro rata fashion. There is simply no reason that letters of credit should be treated any differently from any other form of collateral in this regard. It is also worth noting that decisions about what is and is not customer property are commonly made by bankruptcy courts. See In re Lehman Bros. Inc., 462 B.R. 53, 57-58, 61-68 (Bankr. S.D.N.Y. 2011) (confirming SIPA trustee's determination that counterparties on to-be-announced contracts are not customers and that the contracts themselves are not customer property under SIPA); SIPC v. Lehman Bros. Inc., 433 B.R. 127, 132-33 (Bankr. S.D.N.Y. 2010) (finding that short securities positions constitute customer property under SIPA); SIPC v. Bernard L. Madoff Inv. Sec. LLC, 401 B.R. 629, 635-36 (Bankr. S.D.N.Y. 2009) (holding that funds entrusted to the debtor constituted customer property under SIPA), aff'd sub nom. Rosenman Family, LLC v. Picard, 420 B.R. 108 (S.D.N.Y. 2009).

But even this common-sense reasoning is unnecessary because the CFTC made clear what it meant when it used the term "full proceeds": it meant the full face value of the letter of credit, regardless of any contractual term that might have limited the failed commodity broker's ability to draw on the letter prior to the liquidation. Specifically, the CFTC received requests to amend its proposed regulation "to provide that letters of credit be drawn upon only in accordance with their terms and only to the extent of the margin owing by the depositor." 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983). As the commentators requesting the amendment noted, the "proposed rule would require a trustee to draw the full proceeds of letters of credit irrespective of their terms even though they 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." Id.

The CFTC rejected any amendment to its proposed rule, explaining that including the full proceeds of the letter of credit as customer property, instead of some lesser amount, would "assure that customers using a letter of credit to meet original margin obligations would be treated no differently than customers depositing other forms of non-cash margin or customers with excess cash margin deposits." 48 Fed. Reg. 8716, 8718 (Mar. 1, 1983). The CFTC reasoned that customers of a FCM that post cash or other forms of collateral (and whose accounts were not in default) are subject to pro rata distribution for the full amount of their margin collateral upon a FCM's liquidation even if they were over margined. Id. The CFTC concluded that customers like ConocoPhillips who posted letters of credit should not be treated any differently or escape from the pro rata distribution scheme, and it enacted the regulation as proposed. Id.; see Trustee's Motion at ¶ 31.

This administrative history is fatal to ConocoPhillips' arguments in two ways: first, contrary to ConocoPhillips' assertion that the CFTC guidance "dramatically alters the regulation," it makes clear that both commentators and the CFTC interpreted the regulation to mean exactly what the Trustee believes it means today; and second, it shows that the CFTC considered the identical position that ConocoPhillips advances today and flatly rejected it as inconsistent with the equitable distribution principles that govern a liquidation. It could hardly be more clear that the full face amount of the CP LOCs are customer property pursuant to the governing Part 190 Regulations. No substantial and material interpretation is required.

ConocoPhillips is then left to argue that, even if the full proceeds of the CP LOC were customer property, the fact that two of the CP LOCs expired prior to their identification by the Trustee means that no distribution occurred — and ConocoPhillips thereby receives a windfall. This result is not supported anywhere in the Part 190 Regulations or elsewhere in the Bankruptcy Code, which is not surprising since there is no reason why former customers whose margin "expires" prior to its identification should be preferred over any other customers. But in any event, the substantive issue need not be decided at this stage, because ConocoPhillips does not and cannot argue that this question involves the interpretation of any federal law other than the Bankruptcy Code and the Part 190 Regulations.

B. ConocoPhillips' Efforts To Broaden The Scope Of This Case Beyond The Part 190 Regulations Should Be Rejected.

To support its motion to withdraw the reference, ConocoPhillips also seeks to broaden the scope of the dispute unnecessarily to include the Uniform Commercial Code (the "U.C.C."), federal versus state law preemption analysis, and Bankruptcy Code conflict. (CP Mem. of Law at 13-14, 17-22.) But this case is not about how letters of credit are treated under state contract law outside of the liquidation context, nor is it about the creation of the debtor's estate in a title 11 bankruptcy. The question here is much simpler and narrower: how are letters of credit that were posted as margin collateral by a FCM's former customers treated when the FCM enters liquidation? The answer is in the Part 190 Regulations that govern exactly this issue in a commodity broker liquidation. The other issues raised by ConocoPhillips are red herrings and certainly do not require withdrawal of the case from the bankruptcy court.

1. ConocoPhillips' U.C.C. And State Contract Law Arguments Are Irrelevant To This Case.

ConocoPhillips makes much of the fact that misrepresentations and fraudulent draw downs on letters of credit are prohibited by the U.C.C. and other state laws, and further argues that unlawful conduct is not "good market practice" as used in the Bankruptcy Code. The Court can rest assured that these propositions are common ground between the parties. But these arguments also have nothing whatsoever to do with this case.

ConocoPhillips' citation to the U.C.C. fraud provisions is based on an incorrect framing of the question in this case. If the question were whether the pre-liquidation MFGI would have had the right to draw down on the CP LOCs that ConocoPhillips posted as margin collateral absent a default by ConocoPhillips, the answer is unquestionably no, just as MFGI would have been prohibited from accessing any customer's collateral absent a default. But all of that changes once a FCM like MFGI goes into liquidation. When a FCM files for bankruptcy, a trustee is charged under the Part 190 Regulations with marshaling assets for the benefit of the FCM's former customers, who each share ratably in the fund of customer property. 17 C.F.R. §§ 190.02-04, 08. Under the Part 190 Regulations, the Trustee is directed to undertake a host of actions, like the liquidation of commodity contracts, the liquidation of specifically identifiable property, and the transfer of customer accounts, that would of course be inappropriate in the context of an operational, non-liquidating FCM. 17 C.F.R. § 190.02(e)-(f). If pre-liquidation contractual agreements with general terms regarding margin collateral and default prevented the Trustee from taking control of margin, then the Part 190 Regulations would have no meaning and nearly all customers' margin would be excluded from pro rata distribution. (See Kleinhaus Decl. at Exs. C at 2 ¶ 3 and I at 11 ¶ 2 (illustrating that the form customer agreements make no distinction between letters of credit and other forms of collateral).) The fact that customers who, pre-liquidation, had contractual or other rights governing property held at the debtor might now receive less than 100-cents-on-the-dollar is one of the unfortunate consequences of a commodity broker liquidation. Whether the Trustee's marshaling of property would have been permissible under the U.C.C. or any other state law before the liquidation is irrelevant.

ConocoPhillips' arguments that this case requires a complex decision about preemption are incorrect for the same reason. The only preemption that is occurring here is the typical overriding of non-liquidation state law contract rights that occurs in any bankruptcy. That a trustee could not, under pre-liquidation state law, marshal and distribute customer property (including margin) pro rata, but that a trustee is both permitted and required to do so in a liquidation, is non-controversial. See 11 U.S.C. §§ 761, 766(f) (directing a trustee to distribute customer property pro rata and specifically including margin in the definition of customer property). And even if there were a meaningful question for consideration here, bankruptcy courts routinely consider and decide issues that involve the interplay between state law and federal bankruptcy laws. See, e.g., In re Drexel Burnham Lambert Grp., 151 B.R. 684, 691 (Bankr. S.D.N.Y. 1993) (holding that "the distribution scheme of the Federal Bankruptcy Laws pre-empts the further application" of a state law). Certainly no preemption questions require withdrawal of the case from the bankruptcy court.

2. The Part 190 Regulations' Customer Property Definition Has Nothing To Do With The Regulation Of Bank Products.

ConocoPhillips also argues that this Court must hear this case because there is a conflict between the CFTC's definition of customer property in the Part 190 Regulations and the Legal Certainty for Bank Products Act, which states that the CFTC may not regulate bank products. This purported conflict does not exist.

The Legal Certainty for Bank Products Act has nothing to do with the treatment of customer property in a FCM liquidation. The Act's legislative history makes clear that Congress intended to exempt certain banking products, including letters of credit, from regulation as futures contracts. See 146 Cong. Rec. 27237 (2000) ("This legislation provides certainty that products offered by banking institutions will not be regulated as futures contracts."); 146 Cong. Rec. 27078 (2000) ("The purpose of title IV . . . is clear: to clarify what is already the current state of the law that the CFTC does not regulate the traditional array of products that banks have been offering for years.").

The Part 190 Regulations do not regulate letters of credit or any other bank products. Instead, the regulations were promulgated pursuant to the congressional mandate to "provide, with respect to a commodity broker that is a debtor under chapter 7 of Title 11 of the United States Code, by rule or regulation . . . that certain . . . property . . . be included in . . . customer property." 7 U.S.C. § 24(a). The argument that the CFTC can only include in customer property items that it has the specific authority to regulate is absurd. The CFTC does not exercise regulatory authority over securities, or cash, or a host of other assets that are unquestionably within the definition of customer property under the Part 190 Regulations. Letters of credit are no different. There is no conflict at all between the limits on the CFTC's regulatory powers and its explicit authority to define customer property in a FCM liquidation.

3. There Is No Conflict Between The Part 190 Regulations And Chapter 5 Of The Bankruptcy Code.

ConocoPhillips also argues that the Part 190 Regulations conflict with chapter 5 of the Bankruptcy Code, which details the procedures and rules applicable to the general estate in an ordinary bankruptcy. As an initial matter, even if there were merit to this argument, it would not trigger the mandatory withdrawal provision because chapter 5 is part of title 11 — it is not "other laws of the United States" as that term is used in section 157(d).

But in any event, reference to chapter 5 of the Bankruptcy Code is misplaced here because it deals with the creation of the debtor's estate, not the marshaling and distribution of customer property that is at issue here. Congress specifically enacted "subchapter IV of chapter 7 [to] set forth a special procedure that applies only to the liquidation of commodity brokers." H.R. Rep. No. 95-595 (1977), reprinted in 1978 U.S.C.C.A.N. 5963. Chapter 5 of the Code makes no mention of customer property because the concept of customer property does not exist in an ordinary bankruptcy. See id. ("Commodity brokers may not proceed under chapter 11 or chapter 13 because the special protections provided for customers under the liquidation chapter are inapplicable . . . ."). Subchapter IV was enacted because at that time "bankruptcy laws [had] never specifically addressed the unique problems raised by commodity broker bankruptcies." S. Rep. No. 95-989, at 7 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5793. It is subchapter IV and the Part 190 Regulations implementing that subchapter that are at issue here, and no consideration of chapter 5 is required.

III. IF THE REFERENCE WERE TO BE WITHDRAWN, THE DISTRICT COURT SHOULD REMAND THIS MATTER TO THE BANKRUPTCY COURT FOR PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW.

Even if the Court, contrary to the above arguments, determines that mandatory withdrawal is appropriate, the Court should authorize continued jurisdiction before the bankruptcy court for the purpose of issuing proposed findings of fact and conclusions of law. Section 157(c)(1) of title 28 provides that "a bankruptcy judge may hear a proceeding . . . [and] shall submit proposed findings of fact and conclusions of law to the district court." 28 U.S.C. § 157(c)(1). District courts have used this provision to remand cases back to bankruptcy courts, even after withdrawing the reference, where the bankruptcy court has developed "familiarity with the . . . bankruptcy . . . over considerable time." See Shugrue v. Pension Benefit Guar. Corp. (In re Ionosphere Clubs, Inc.), 142 B.R. 645, 649 (S.D.N.Y. 1992) (finding withdrawal mandatory but remanding case to the bankruptcy court for proposed findings fact and conclusions of law); see also Pension Benefit Guar. Corp. v. Official Parent Creditors' Comm. of the LTV Corp. (In re Chateaugay Corp.), 108 B.R. 27, 28-29 (S.D.N.Y. 1989) (same). Although by its terms section 157(c)(1) allows the bankruptcy judge to "hear a proceeding that is not a core proceeding" and submit findings of fact and conclusions of law, this section can also be applied to core proceedings like the claims dispute at issue here. See Pension Benefit Guar. Corp. v. Pan Am Corp. (In re Pan Am Corp.), 133 B.R. 700, 703-04 (S.D.N.Y. 1991) (requiring mandatory withdrawal and remanding to bankruptcy court reasoning that 157(c)(1) is applicable in a core proceeding concerning allowance and disallowance of claims).

The dispute between the Trustee and ConocoPhillips is a dispute about the Trustee's determination of ConocoPhillips' claims and should be resolved as a contested matter before the bankruptcy court. The MFGI Claims Procedure Order, which was supported by both the Securities Investor Protection Corporation ("SIPC") and the CFTC, was implemented specifically to provide a fair and efficient means for resolving claims as contested matters pursuant to Bankruptcy Rule 9014, which provides for streamlined adjudication of certain disputes in bankruptcy courts. (See MFGI Claims Procedure Order at 5, Frantzides Decl. at Ex. D.) As a general principle, "hearing core matters in a district court could be an inefficient allocation of judicial resources given that the bankruptcy court generally will be more familiar with the facts and issues." Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1101 (2d Cir. 1993), cert. denied, 511 U.S. 1026 (1994). This is especially true where the bankruptcy court has issued a number of opinions interpreting the Part

190 Regulations and has already considered the enacting CFTC guidance that ConocoPhillips' argues amounts to a substantial and material interpretation in other MFGI disputes. The bankruptcy court has developed an expertise regarding these provisions in resolving the issues presented to it. See In re MF Global Inc., 2012 Bankr. LEXIS 1801, at *19-20 n.11 (relying on the CFTC's guidance to establish a delivery account class); see also In re MF Global Inc., 466 B.R. at 249-50.

If the Court finds that withdrawal is appropriate, the bankruptcy court should be authorized to issue findings of fact and conclusions of law in the Contested Matter for review by this Court.

CONCLUSION

For the foregoing reasons, the Trustee respectfully requests that this Court deny ConocoPhillips' Motion to Withdraw the Reference and that this action remain in the bankruptcy court.

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