SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 60

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NEW HAMPSHIRE INSURANCE COMPANY, VIGILANT INSURANCE COMPANY, UNDERWRITERS OF LLOYDS OF LONDON, SUBSCRIBING TO CERTIFICATE NO. B0576MMU280, ST PAUL FIRE & MARINE INSURANCE COMPANY, FIDELITY & DEPOSIT COMPANY OF MARYLAND, CONTINENTAL CASUALTY COMPANY, LIBERTY MUTUAL INSURANCE COMPANY, GREAT AMERICAN INSURANCE COMPANY and AXIS REINSURANCE COMPANY,

Plaintiffs,

- v -

MF GLOBAL FINANCE USA INC.

Defendant.

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INDEX NO. 601621/2009

MOTION DATE

MOTION SEQ. NO. 019 020

DECISION AND ORDER

The following e-filed documents, listed by NYSCEF document number (Motion 019) 382, 383, 384, 385, 386, 387, 388, 389, 390, 391, 392, 393, 394, 395, 396, 397, 398, 399, 400, 401, 402, 403, 404, 405, 406, 407, 408, 409, 410, 411, 412, 413, 414, 415, 416, 417, 418, 419, 420, 421, 422, 423, 424, 425, 426, 427, 428, 429, 430, 431, 432, 433, 434, 435, 436, 437, 438, 439, 440, 441, 442, 443, 444, 445, 446, 447, 448, 449, 450, 451, 452, 453, 454, 455, 456, 457, 458, 459, 460, 461, 462, 463, 464, 467, 468, 469, 470, 471, 472, 473, 474, 475, 476, 477, 478, 479, 480, 481, 482, 483, 484, 485, 486, 487, 488, 489, 558, 559, 560, 561, 562, 563, 564, 565, 566, 567, 568, 569, 570, 572, 580, 581, 582, 583, 584, 585, 586, 587

were read on this motion to/for SUMMARY JUDGMENT.

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were read on this motion to/for SUMMARY JUDGMENT.

This is an action for a declaratory judgment determining that defendant-insured MF Global Finance USA Inc. (MF Global)[1] is not entitled to recover under primary and excess financial institution bonds. The primary bond was issued by plaintiff-insurer New Hampshire

[1] MF Global Finance USA Inc. was previously known as MF Global, Inc. By order dated August 20, 2014, MF Global Finance USA Inc. was "substituted as defendant in this action in place and stead of" MF Global, Inc. (See NYSCEF Doc. No. 145; see also Joint Statement of Undisputed Material Facts, ¶ 55.) In this decision, these two entities are jointly referred to as MF Global.

Insurance Company (New Hampshire Insurance). The excess bonds were issued by plaintiffs Vigilant Insurance Company, Certain Underwriters of Lloyds of London Subscribing to Certificate No. B0576MMU280, St. Paul Fire & Marine Insurance Company, Fidelity & Deposit Company of Maryland, Continental Casualty Company, Liberty Mutual Insurance Company, Great American Insurance Company, and Axis Reinsurance Company. Plaintiffs move for summary judgment, pursuant to CPLR 3212, on their sole cause of action for a declaratory judgment that MF Global's claimed loss is not covered under the terms of the bonds, and for an order dismissing MF Global's counterclaim.[2] (New Hampshire Insurance Notice of Motion [NYSCEF Doc. No. 335].) MF Global moves for summary judgment on its counterclaim, which seeks the full amount of its claimed loss under the bonds together with prejudgment interest, and for an order dismissing plaintiffs' affirmative defenses to its counterclaim. (MF Global Notice of Motion [NYSCEF Doc. No. 382].)

MF Global was a commodity derivatives broker registered as a futures commission merchant with the Commodity Futures Trading Commission. (Joint Statement of Undisputed Material Facts [Jt. St.], ¶ 32 [NYSCEF Doc. No. 572].) MF Global was a clearing member of various exchanges on which it executed futures trades, including the Chicago Mercantile Exchange (CME). (Id.) MF Global's claimed loss, for which coverage is disputed, arises out of a financial loss of approximately $141.5 million incurred on February 26-27, 2008 by Evan Brent Dooley (Dooley) in trading large quantities of commodity futures contracts on the CME. Dooley was a trader registered with the National Futures Association (NFA) as an associated

[2] Plaintiffs are collectively referred to in this decision as New Hampshire Insurance. Subsequent to the briefing of the motions, the following excess insurers reached settlements with MF Global: Certain Underwriters of Lloyds of London Subscribing to Certificate No. B0576MMU280 and Vigilant Insurance Company (NYSCEF Doc. No. 330); Fidelity & Deposit Company of Maryland (NYSCEF Doc. No. 465); St. Paul Fire & Marine Insurance Company and Continental Casualty Company (NYSCEF Doc. No. 571); and Great American Insurance Company (NYSCEF Doc. No. 573).

person of MF Global, working out of the Memphis office. (Jt. St., ¶¶ 36, 47-51; New Hampshire Insurance Am. Compl., ¶ 33; MF Global Counterclaim, ¶ 9.)

New Hampshire Insurance entered into the primary bond, dated July 24, 2007, with MAN Financial Inc. (MAN Financial), the predecessor to MF Global Inc., for the period covering April 30, 2007 through April 30, 2008 (the primary bond or bond).[3] (Jt. St., ¶¶ 29-30; see Aff. of Scott Schmookler [Atty. for New Hampshire Insurance] in Support of Motion for Summary Judgment, Bond, Exh. 2 [NYSCEF Doc. Nos. 336, 338].)

The provisions of the bond relevant to these motions are quoted at length in an appendix to this decision. In brief, the bond provides coverage for "*loss* sustained at any time for (i) any *wrongful act* committed by any *employee*, or (ii) any theft, *fraudulent act* or malicious act committed by *any other person*. . . ." (Bond, § 1 [i], [ii].) "[T]he term *employee* does not mean any independent broker. . . ." (Id., § 2.25.) Covered *loss* means "direct financial loss. . . ." (Id., § 2.38.) The bond contains Exclusions under which the insurer is not liable for loss attributable to, among other things, contractual liability (id., § 3.2) and indirect loss, including "error in programming. . . ." (Id., § 3.9 [iv].) The bond also provides for termination "in respect of any *employee* of the *insured*, as soon as the Head of Group Insurance or his designated affiliate . . . shall first learn of any *wrongful act* on the part of the *employee* whenever committed . . . ." (Id., § 6.2 [iii].) (italics in all of the above sections in original.)

The parties sharply dispute whether coverage exists—in particular, whether Dooley was an employee and whether his acts were wrongful; whether exclusions apply; and whether MF Global had knowledge of wrongful acts on Dooley's part prior to the trades on February 26 and

[3] Prior to July 2007, MAN Financial was an operating division of Man Group Plc. (Jt. St., ¶ 29.) In July 2007, Man Group Plc "spun-off" MAN Financial, which became MF Global Inc. (Id., ¶ 30.) It is undisputed that, after the "spinoff," MF Global Inc. continued to be an insured under the bond. (Id., ¶ 31.)

27, 2008 (the February trades), thus resulting in the termination of the bond. Plaintiffs also claim, and MF Global disputes, that MF Global ratified Dooley's conduct and failed to mitigate damages.

Discussion

The standards for summary judgment are well settled. The movant must tender evidence, by proof in admissible form, to establish the cause of action "sufficiently to warrant the court as a matter of law in directing judgment." (CPLR 3212[b]; Zuckerman v City of New York, 49 NY2d 557, 562 [1980].) "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the opposing papers." (Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985].) Once such proof has been offered, to defeat summary judgment "the opposing party must 'show facts sufficient to require a trial of any issue of fact' (CPLR 3212, subd [b])." (Zuckerman, 49 NY2d at 562.)

Section 1 of the Bond—Dooley's Status as an Employee, Independent Broker, or Any Other Person

As a threshold matter, the parties dispute whether Dooley was an "employee" within the meaning of the bond, as that term is defined in section 2.25. MF Global contends that Dooley was an employee to whom coverage applies under section 1 (i) of the bond. (MF Global Memo. In Supp., at 14-16 [NYSCEF Doc. No. 383].) New Hampshire Insurance argues that Dooley was not an employee and instead was an independent broker, subject to the exception to coverage in section 2.25. (New Hampshire Insurance Memo. In Opp., at 4-6 [NYSCEF Doc. No. 489].) MF Global argues that Dooley was not an independent broker and that, if he was not an employee, he must be considered "any other person," to whom coverage applies under section 1 (ii) of the bond. (MF Global Reply Memo., at 9-11.) On this record, there is conflicting documentary and testimonial evidence as to whether Dooley was an employee.

Evidence in support of the claim that Dooley was an employee includes the following: It is undisputed that Dooley was an associated person of MF Global. (Jt. St., ¶ 36.) In addition, Wanda Arnold, MF Global's Memphis branch office manager, testified that she considered Dooley to be an employee of MF Global, that Dooley was subject to the direct control and supervision of MF Global during the time that he was an associated person, and that Dooley worked under her direct control and supervision. (See Schmookler Aff., Deposition of Wanda Arnold, dated Dec. 10, 2014, Exh. 5 [NYSCEF Doc. No. 341] [Arnold Dep.], at 122-125].) Arnold further stated that she did not consider Dooley to have been independent of MF Global in his position as an associated person. (Id., at 127.) She also testified that associated persons had to follow the rules of the clearing firm and "had always been considered employees because they were under the direct supervision of the office, ultimately of the clearing firm. (Id., at 122.) Richard Crow, the most senior trader in the Memphis branch office, also supervised Dooley's activities there. (See Schmookler Aff. in Opp., Deposition of Richard Crow, dated Dec. 10, 2014, Exh. 45 [NYSCEF Doc. No. 468] [Crow Dep.], at 23-24, 115].) Crow testified that Dooley was under the direct control and supervision of MF Global (id., at 111-112), and that, in his view, Dooley was not independent of MF Global in any way. (Id., at 115.) Crow also stated that Dooley came into the office "most of the time" (id., at 63), and Dooley attended office meetings and discussions. (Id., at 113.)

In addition, there was evidence that before Dooley started working as an associated person of MF Global, Dooley was subject to pre-employment procedures with the company. He signed a document authorizing MAN Financial to conduct a background check, paid a registration fee to the NFA, and provided his fingerprints, as required by the NFA. (Id.; see Aff. of Therese M. Doherty [Atty. for MF Global] in Support of Motion for Summary Judgment, Exh.

260 [NYSCEF Doc. No. 451], at 002039-002043].) Dooley executed an account application and customer agreement to open a personal trading account at MF Global. (Jt. St., ¶ 38.) In a document dated "as of February 27, 2008," the NFA listed Dooley as an employee of MF Global's Memphis office. (See Doherty Aff., Exh. 41 [NYSCEF Doc. No. 432].) An internal document, dated February 28, 2008, lists Dooley as one of its "trade room employee's [sic]," with a phone extension adjacent to his name. (See Doherty Aff., Exh. 49 [NYSCEF Doc. No. 435].)

The evidence in support of the claim that Dooley was not an employee includes the following: It is undisputed that MF Global paid Dooley solely on a commission basis under its payroll system. (Jt. St., ¶ 37.) All payments to Dooley were recorded on a 1099 Form, not a W-2 (see Schmookler Aff., Proof of Loss, Exh. 4 [NYSCEF Doc. No. 340], at 4.) New Hampshire Insurance's expert, Ronald Filler, also appeared to take the position that, as an associated person of MF Global, Dooley was only under the company's direct supervision and control "from a regulatory point of view." (Schmookler Aff. in Opp., Deposition of Ronald H. Filler, dated Jan. 25, 2017, Exh. 48 [NYSCEF Doc. No. 471], at 92-96].)

Further, MAN Financial entered into an agreement, dated September 1, 2006, with the members of the MARSCB Division, an organization of brokers who are all registered associated persons engaged in independent client solicitation and services. (See Schmookler Aff. in Opp., MARSCB Division Agreement, Exh. 47 [NYSCEF Doc. No. 470], at 0014442.) The agreement provides, in pertinent part, that MAN Financial "shall employ all individuals designated on Exhibit A or subsequently designated by Division. The designated employees will be subject to all of [MAN Financial's] employment policies and practices, including compliance with state and federal employment laws." (Id., at 0014444.) Although MF Global hired Dooley in August

2006, the month prior to the execution of the MARSCB Division Agreement (see Doherty Aff., ¶ 9; Doherty Aff., Exh. 260 [NYSCEF Doc. No. 451], at 002039-002043]), Dooley did not sign the agreement and his name does not appear in Exhibit A. (See MARSCB Division Agreement, at 0014446-0014447.) Moreover, Dooley began trading at MF Global on September 5, 2006, only four days after the members of the MARSCB Division signed the agreement. (See Schmookler Aff., Weir Schedules, Exh. 26 [NYSCEF Doc. No. 362].) There is, however, no evidence that Dooley was ever subsequently designated an employee.[4]

The court holds that issues of fact preclude determination on this motion of whether Dooley was an employee. As discussed above, the documentary evidence as to Dooley's status is in conflict. Moreover, the testimonial evidence as to the significance of Dooley's status as an associated person and, ultimately, his status as an employee, independent broker, or any other person, raises issues of credibility which are not properly resolved on a motion for summary judgment. (See Capelin Assocs., Inc. v Globe Mfg. Corp., 34 NY2d 338, 340 [1974].)

In finding issues of fact as to whether Dooley was an employee, the court notes that plaintiffs previously made a pre-discovery motion for summary judgment in which some of the same arguments and evidence were at issue. The trial court (Fried, J.) reasoned that, under New York law, "an 'associated person' is, by definition, 'any partner, officer, director, or branch manager of such member, or any employee of such member,'" and that "'associated persons' have an implied contract with their applicable exchange member." (New Hampshire Ins. Co. v MF Global, Inc., 29 Misc 3d 1207 [A], * 3 [Sup Ct, NY County 2010].) Although plaintiffs did

[4] MF Global asserts that Crow testified that Dooley "was subsequently designated to be included in Exhibit A." (MF Global Reply Memo., at [10], citing Crow Dep. at 107:25-110-11.) Crow testified that Dooley was subject to MAN Financial's employment policies and practices, and that Dooley was not treated in a manner different than the associated persons who signed the MARSCB Division Agreement. (See Crow Deposition, at 109-110.) He did not, however, state, in the testimony cited by New Hampshire Insurance, that Dooley was ever subsequently designated.

not move for summary judgment on the status of Dooley as an employee, the court searched the record and awarded MF Global summary judgment on this issue. The Appellate Division reversed, holding that determination of Dooley's status as an employee was "premature in the absence of further discovery." (108 AD3d 463, 468 [2013].) In also holding that issues of fact existed as to whether Dooley was an employee under the definitions in the primary bond, the Appellate Division reasoned: "There is no dispute that Dooley did not receive a regular salary from MF Global, but instead was paid on a commission basis. All payments to Dooley were recorded on a 1099 Form, not a W-2 (see Belt v Girgis, 55 AD3d 645, 646-647 [2d Dept 2008] [issuance of Form 1099 was proof that individual was an independent contractor]). Thus, there are factual questions as to whether Dooley fell within the 'independent broker' exception contained in the bonds." (Id.) Notwithstanding this guidance from the Appellate Division on the prior motion, on the record of the instant motions the parties do not comprehensively address the significance of Dooley's status as an associated person and of the recording of payments to him on the Form 1099.

Further, the bond expressly provides that "[t]he term *employee* does not mean any independent broker . . . remunerated on a sales or commission basis unless specifically agreed by the *insurer* and endorsed to this bond." (Bond § 2.25.) The term independent broker is not defined in the bond. There is equivocal or inconclusive testimony as to the meaning of the undefined term independent broker. (See e.g. Arnold Dep., at 126-127 [testifying that an "independent introducing broker" "can introduce accounts to any clearing firm that they so desire," and otherwise testifying that as an "associated person," Dooley was not "independent" of MF Global]; Crow Dep., at 114-115 [testifying that "independent broker means you introduce accounts to any FCM [futures commission merchant] you so desire," and that the terms

independent broker and independent introducing broker are "synonymous"]; Filler Dep., at 92-93 [opining that "there is no such term as independent broker in the futures industry"].)

The briefing of New Hampshire Insurance and MF Global is silent as to the meaning of "independent broker" in the futures commodities trading industry. The parties do not address the above testimony. Nor do they address the legal issue of the propriety of considering evidence of industry custom and usage in construing the meaning of this specialized term. (See Lehman Bros. Intl. (Europe) v AG Fin. Prods., Inc., 60 Misc 3d 1214 [A], * 9-10 [Sup Ct, NY County 2018] [this court's decision surveying authorities on this issue].) The parties also fail to discuss whether, or in what circumstances, section 1 (ii), in providing coverage for the specified acts of "any other person," excludes independent brokers.

In sum, on this record, summary judgment may not properly be granted as to Dooley's status as an "employee," an "independent broker," or "any other person" within the meaning of the bond. The court accordingly cannot determine whether section 1 (i) or section 1 (ii) provides coverage for Dooley's acts.

Coverage for the Act at Issue

Section 1 (i) of the Bond

The court turns to the issue of whether, if Dooley was an employee, his trading on February 26 and 27, 2008 was a "wrongful act" within the meaning of section 1 (i) of the bond. As noted above, section 1 (i) of the bond provides coverage for *loss* sustained for "any *wrongful act* committed by any *employee."* Section 2.53 defines *"wrongful act"* in the context of trading as meaning "any theft, dishonest or fraudulent act committed with the intent to obtain improper financial gain for: (i) an *employee*. . . ."

In addressing the merits of this issue,[5] MF Global argues that, because Dooley pleaded guilty to exceeding speculative position limits, in violation of Titles 7 and 18 of the United States Code, his trading activity is a wrongful act. (MF Global Memo. In Supp., at 9-14; see also Doherty Aff., Plea Agreement, Exh. 294, ¶ 5 [NYSCEF Doc. No. 453].) New Hampshire Insurance contends that "[m]ere proof that Dooley committed a 'crime' does not itself establish a covered loss," and that MF Global must demonstrate that Dooley committed a "wrongful act" within the meaning of the bond. (New Hampshire Insurance Memo. In Opp., at 6-7.) New Hampshire Insurance further contends that, even if Dooley was an employee, the trading activity that was the basis for the claimed loss is not a "wrongful act" for two reasons: first, MF Global ratified Dooley's conduct and the conduct therefore cannot be considered dishonest (id., at 9-11); and, second, Dooley did not intend to obtain an "improper" financial gain when he traded on February 26-27, 2008. (Id., at 11-13.) New Hampshire Insurance also contends that Dooley's plea agreement is inadmissible hearsay. (New Hampshire Insurance Memo. In Opp., at 8-9.)

The court holds that the evidence establishes that Dooley's trading activity on February 26-27, 2008 was a dishonest act. (See Capital Bank & Trust Co. v Gulf Ins. Co., 91 AD3d 1251, 1253 [3d Dept 2012] [reasoning that where "dishonest or fraudulent acts" was not defined, "those words, when used in the context of a fidelity bond, must be given their ordinary meaning and broadly include acts that demonstrate a want of integrity, breach of trust or moral turpitude affecting the official fidelity or character of the employee"].) Here, Dooley pled guilty to

[5] The parties dispute whether the law of the case doctrine applies to this issue. (MF Global Memo. In Supp., at 9-10; New Hampshire Insurance Memo. In Opp., at 7-8.) On the prior summary judgment motion, the motion court held that "Dooley committed a wrongful act (he made unauthorized trades beyond his margin), he was an employee of Global, and he did so for financial gain." (New Hampshire Ins. Co., 29 Misc.3d 1207 [A], * 4.) The Appellate Division did not reach this issue, as it noted that "[o]n appeal, plaintiffs [did] not challenge the motion court's finding that Dooley committed a 'wrongful act' with the intent to obtain a financial gain for himself." (New Hampshire Ins. Co., 108 AD3d, at 466 n 1.) This court will nevertheless assume that the law of the case doctrine is inapplicable, as the motion court's decision did not discuss section 2.53 of the bond which, in defining *wrongful act* in connection with trading, requires "intent to obtain improper financial gain."

exceeding speculative position limits and to the additional offense of having "devised and participated in an artifice to defraud MF Global and to obtain money and property from MF Global by means of materially false and fraudulent pretenses, representations, and promises." (Plea Agreement, ¶¶ 6, 7.)[6] Under any construction, Dooley's trading activity with the intent to defraud MF Global constitutes a wrongful act under sections 1 (i) and 2.53 of the bond.

In so holding, the court rejects New Hampshire Insurance's argument that case law establishes that "a declaration from an alleged fraudster is not admissible against an insurer unless he appears for cross-examination. . . ." (New Hampshire Insurance Memo. In Opp., at 8.) In support of this contention, New Hampshire Insurance relies on Letendre v Hartford Accident and Indem. Co. (21 NY2d 518 [1968]), in which the Court reasoned that "[i]n an action by an employer to recover on a fidelity bond, an extrajudicial declaration made by his employee should be admissible as affirmative evidence against the surety, where the declaration is in writing and the declarant is available for purposes of cross-examination." (Id., at 522.) The Court of Appeals subsequently clarified that the availability of the declarant was only one basis on which the Letendre Court held the out-of-court statement sufficiently reliable to support admissibility under an exception to the hearsay rule, and that other indicia of reliability include "spontaneity, repetition, the mental state of the declarant, absence of motive to fabricate, unlikelihood of faulty recollection and the degree to which the statement was against the declarant's interest." (Nucci v Proper, 95 NY2d 597, 603 [2001].) Here, there are sufficient indicia of the reliability of the Plea Agreement to warrant its admissibility: Dooley was subject to criminal penalties as a result of

[6] Specifically, Dooley admitted to having "devised and participated in an artifice to defraud in which he intended to trade at the CBOT [Chicago Board of Trade] in futures contracts in a manner exceeding defendant' s financial ability to pay for potential trading losses resulting from such trades, with the knowledge and intent that MF Global, as the Clearing Member for these trades, would be responsible to pay the CBOT's clearing house for any losses he incurred." (Plea Agreement, ¶ 7.)

the plea; acknowledges in the Plea Agreement that "he has read this Agreement and carefully reviewed each provision with his attorney"; and "further acknowledges that he understands and voluntarily accepts each and every term and condition of this Agreement." (Plea Agreement, ¶ 29.)

Also unavailing is New Hampshire Insurance's argument that Dooley's trading activity was not dishonest because MF Global "ratified" his conduct. "[R]atification may be implied where the principal retains the benefit of an unauthorized transaction with knowledge of the material facts." (Standard Funding Corp. v Lewitt, 89 NY2d 546, 552 [1997]; accord La Candelaria E. Harlem Community Ctr., Inc. v First Am. Tit. Ins. Co. of N.Y., 146 AD3d 473, 473 [1st Dept 2017].) There is no evidence whatsoever that MF Global authorized Dooley's February trades. MF Global not only did not benefit from the February trades but was obligated to, and did, pay the losses to the CME. (MF Global Memo. In Opp., at 6; New Hampshire Insurance Memo. In Supp., at 4-5 [acknowledging that MF Global, as a clearing member, was obligated to pay any loss on a trade to the exchange]; Answer, ¶¶ 40-45.)

New Hampshire Insurance also contends that MF Global ratified Dooley's acts because it had notice of Dooley's unauthorized trading, prior to the February trades, but continued to permit him to trade. (New Hampshire Memo. In Opp., at 9-11.) In support of this contention, New Hampshire Insurance relies on the knowledge of various employees regarding the prior trades. (See id., at 10, citing e.g. Schmookler Aff., ¶ 49, citing deposition of branch manager Arnold [NYSCEF Doc. 341, at 82-83] in which she answered "Yes" to a question as to whether Dooley's January 2008 trades were excessive because the risk posed by the trades vastly exceeded his financial capacity].) As discussed further below, there are issues, which cannot be resolved on this motion, not only as to whether the knowledge of such employees binds MF

Global but also as to whether the prior trades were in fact wrongful acts. In any event, New Hampshire Insurance submits no evidence that MF Global benefitted from the prior trades.

New Hampshire Insurance's further claim that Dooley did not intend to obtain an "improper" financial gain is without merit. This claim is based on the tortured argument that because Dooley could have retained any profits earned on the February Trades, his trading was not "committed with the intent to obtain improper financial gain," as required by the definition of wrongful act in section 2.53 of the bond. (See New Hampshire Insurance Memo. In Opp., at 11-13.) Dooley's Plea Agreement admitting his intent to defraud precludes this claim.

Section 1 (ii) of the Bond

As held above, the record on these motions does not permit determination of whether Dooley was "any other person" within the meaning of section 1 (ii) of the bond. The court holds, however, for the reasons stated above in connection with section 1 (i), that if Dooley is ultimately found to qualify as "any other person," his trading on February 26 and 27, 2008 was a malicious act for which coverage is provided under section 1 (ii).

Exclusions

New Hampshire Insurance contends that MF Global's losses from Dooley's February trades fall within exclusions from coverage, even if coverage for Dooley's acts would otherwise be authorized under section 1 of the bond.

Contractual Liability (Exclusion 3.2)

Section 3 of the bond provides that "[t]he *insurer* shall not be liable to make any payment for *loss* . . . arising out of, based upon or attributable to any of the following: . . . 3.2 *Contractual Liability* Any liability assumed by the *insured* under contract or agreement. . . ." It is undisputed that "by operation of both the rules and structure of the CME," MF Global was

"directly liable for clearing and settling the[] contracts" on the trades entered by Dooley on the CME, and that it paid the losses on Dooley's February 26 and 27, 2008 trades. (Ans., ¶¶ 40-41.) New Hampshire Insurance claims that the contractual liability exclusion therefore bars coverage for these losses. (New Hampshire Insurance Memo. In Supp., at 30.) MF Global responds that this claim is barred by law of the case. (MF Global Memo. In Opp., at 6-7.)

On the appeal of the prior motion for summary judgment by New Hampshire Insurance, in determining that Dooley's conduct "was the direct and proximate cause of MF Global's loss," the Appellate Division Court expressly held:

> **"**Dooley's trading activity resulted in a near instantaneous shortfall for which MF Global, as a Clearing Member, was automatically and directly responsible. To ensure the integrity of the market, MF Global was obligated to promptly pay the CME Clearing House for the loss. In light of the immediacy of the payment, which was made only hours after the discovery of Dooley's trading, and the regulatory scheme upon which it was premised, MF Global's loss cannot be fairly viewed as simply satisfying a contractual liability to the CME. Contrary to plaintiffs' view, the payment to the CME is not a third-party loss for which MF Global is liable, but rather a direct loss to MF Global under the bonds."

(New Hampshire Ins. Co., 108 AD3d at 466.) New Hampshire Insurance appears to contend that the Appellate Division ruled incorrectly on the meaning of the exclusion. It argues that the exclusion bars coverage for losses "arising out of" a contractual liability, and that "[t]he question therefore is not whether MFG 'simply satisf[ied] a contractual liability', but whether the loss had any 'connection' to a contractual liability." New Hampshire Insurance concludes that it did have such a connection, "as MFG bore liability solely because of its contract." (New Hampshire Insurance Memo. In Supp., at 30.)

New Hampshire Insurance ignores that the Appellate Division reached its holding after a full and fair opportunity to be heard. Indeed, in its brief to the Appellate Division, New

Hampshire Insurance expressly argued that "MF Global sustained a loss only because it satisfied a contractual liability to a third party." (See Aff. of P. Benjamin Duke [Atty. for MF Global] in Support of Motion for Summary Judgment, Exh. K, Brief for Plaintiffs-Appellants [all insurers other than St Paul Fire & Marine Insurance Company] [New Hampshire Insurance Appellate Brief], at 31; id., at 26-31 [NYSCEF Doc. No. 424]. See also Duke Aff., Exh. L, Brief for Plaintiff-Appellant St. Paul Fire & Marine Insurance Company [St. Paul Appellate Brief], at 13-15 [NYSCEF Doc. No. 425].) This court accordingly holds that the law of the case doctrine bars New Hampshire Insurance's claim that MF Global's recovery is barred by the contractual liability exclusion in the bond. (See generally Martin v City of Cohoes, 37 NY2d 162, 165 [1975], rearg denied 37 NY2d 817; Delgado v City of New York, 144 AD3d 46, 51-52 [1st Dept 2016]; Carmona v Mathisson, 92 AD3d 492, 492-493 [1st Dept 2012].)

Indirect Loss (Exclusion 3.9)

Section 3 of the bond provides that "[t]he *insurer* shall not be liable to make any payment for *loss* . . . arising out of, based upon or attributable to any of the following: . . . 3.9 *Indirect Loss* (i) Indirect or consequential loss of any nature; . . . [and, as relevant here] (iv) . . . error in design, . . . or breakdown or any malfunction or error in programming or errors or omissions in processing" (the programming exclusion). It is undisputed that, during his time at MF Global, Dooley traded commodity futures using MF Global's electronic platform, OrderXpress, which is "an electronic order routing system" that electronically routes futures contract orders placed by a user to an exchange for execution. (Jt. St., ¶¶ 39-41.) In 2007, a "position limit" control in OrderXpress was created. (Jt. St., ¶ 43.)[7] The position limit control did not, however, prevent

[7] The position limit control was "an automated pretrade risk control," and for a user subject to this control, OrderXpress "would reject an order for a contract that would cause the user's aggregate position to exceed the specified position limit." (Jt. St. ¶ 43.)

the claimed loss from Dooley's February trades. (See New Hampshire Insurance Memo. In Supp., at 13; MF Global Counterclaim, ¶ 21.) New Hampshire Insurance contends that the position limit control failed because it was not properly implemented, and that "these errors fall within the purview of 'design' or 'programming.'" (New Hampshire Insurance Memo. In Supp., at 13-14 [internal citations omitted].) MF Global does not dispute that its system administrator "failed effectively to turn on the automated pretrade risk control on Dooley as a user of OrderXpress. . . ." (MF Global Memo. In Opp., at 7.) Instead, MF Global argues that law of the case precludes New Hampshire Insurance's claim that the loss is excluded from coverage by the indirect loss or programming exclusion; that the error did not cause the loss; and that New Hampshire Insurance has not proven that the failure to turn on the position limit control was an error in programming or error in design. (See id., at 7-12.)

The court holds that the law of the case doctrine bars New Hampshire Insurance's claim that MF Global's recovery is barred by the indirect loss and programming error exclusions in the bond. As discussed above, on the appeal of the prior motion by New Hampshire Insurance for summary judgment, the Appellate Division expressly held that Dooley's conduct "was the direct and proximate cause of MF Global's loss." (New Hampshire Ins. Co., 108 AD3d at 466.) The Court noted that "[i]n moving for summary judgment, plaintiffs argued that MF Global did not sustain a 'direct financial loss' under the terms of the bonds." (Id., at 465.) The Court then discussed at length the basis for its holding that "because MF Global suffered a direct financial loss under the fidelity bonds, it is entitled to a declaration on that issue in its favor." (Id., at 467.) As the Appellate Division unquestionably determined whether MF Global's loss was direct or indirect, that issue cannot be relitigated. (See generally Martin v City of Cohoes, 37 NY2d at 165.)

In so holding, the court notes that, on its appeal to the Appellate Division, New Hampshire Insurance argued that MF Global suffered an indirect loss, not a direct loss, but did not specifically argue that there was an error in design or an error in programming. (See New Hampshire Insurance Appellate Brief, at 21-31.) One of the excess bond insurers, St. Paul Fire & Marine Insurance Company, did contend in a separate appellate brief that coverage should be denied as an indirect loss under section 3.9 (iv). (See St. Paul Appellate Brief, at 15-17.) In any event, the nature of the loss—whether direct or indirect—having been judicially determined, New Hampshire Insurance cannot now advance a new theory for setting aside the determination. Nor does it cite any authority that would permit it to do so.

6.2 (iii) Termination Provision

Section 6.2 (iii) of the bond, the termination provision, states: "This bond shall cease in respect of any *employee* of the *insured*, as soon as the Head of Group Insurance or his designated affiliate not in collusion with such person shall first learn of any *wrongful act* on the part of the *employee* whenever committed. . . ." As held above, there are issues of fact as to whether Dooley was an employee within the meaning of the bond.

On this branch of the motions, the parties also sharply dispute whether the bond ceases because New Hampshire Insurance had notice, prior to the February trades, of wrongful acts by Dooley within the meaning of the bond. New Hampshire Insurance argues that "MFG knowingly allowed Dooley to trade after uncovering his unauthorized trading, regulatory violations and excessive trading." (New Hampshire Insurance Memo. In Supp., at 16-19.) More particularly, New Hampshire Insurance contends that there were "thirty opportunities to prevent the February Trades – as those trades occurred after twenty-five incidents of unauthorized trading, six regulatory violations and trades the branch manager deemed 'excessive' and 'way

out of line.'" (Id., at 19-20 [emphasis omitted].) MF Global disputes that Dooley's pre-February 2008 trading activity constituted a wrongful act as defined by the bond. It contends that New Hampshire Insurance's claim that Dooley's pre-February trades were unauthorized is based on a misreading of the phrase "purchasing power." (MF Global Memo. In Opp., at 27-28.) Specifically, MF Global asserts that "Dooley was not required to have equity actually on deposit before initiating the trades. Rather, the margin is required to be forthcoming within a reasonable period of time following the execution of the trade (or the issuance of a margin call)." (Id., at 28.) According to MF Global, the 25 instances of allegedly unauthorized trading cited by New Hampshire Insurance were not unauthorized because the trades did not "result[] in exposure or obligations that exceeded his financial ability to pay." (Id.) MF Global also contends that the six additional trades, as to which New Hampshire Insurance claims a margin call remained unsatisfied for an unreasonable amount of time, were routine. (Id., at 28-29.)

On this record, neither party comprehensively discusses or cites definitive evidence as to whether the pre-February trades rose to the level of a wrongful act or acts under the bond. As the testimony of Ted Bohlman, MF Global's Insurance Risk Manager,[8] indicates, there are several respects in which trading by a broker may involve improper conduct: exceeding the broker's trading limits (Bohlman Dep., at 42 [NYSCEF Doc. No. 370]); exceeding the broker's purchasing power (id., at 43); conducting trades while in a deficit position (id., at 44); conducting trades while on a margin call (id., at 44-45); otherwise violating margin policies. (Id., at 45.) New Hampshire Insurance does not demonstrate the specific respects in which it claims the prior trades were analogous to the February trades. While New Hampshire Insurance

[8] Mr. Bohlman was MF Global's Insurance Risk Manager. (See MF Global Memo. In Opp., at 17; New Hampshire Insurance Memo. In Supp., at 24-25.) He assumed employment with MF Global in November 2007. (Bohlman Dep., at 13 [NYSCEF Doc. No. 370].)

claims that the trades caused loss to MF Global, this claim is based on MF Global's obligation as a clearing member to guarantee each trade and to pay the exchange for any loss in an account, regardless of whether it could recover from the trader that was the account holder. (New Hampshire Insurance Memo. In Supp., at 4-5.) New Hampshire Insurance does not, however, dispute MF Global's assertion (see MF Global Memo. In Opp., at 13) that Dooley satisfied each of the margin calls and paid all debit balances in his account prior to the February trades. New Hampshire Insurance also makes no claim that the prior trades involved losses even remotely approaching the magnitude of the losses on the February trades. New Hampshire Insurance accordingly fails to demonstrate as a matter of law that the prior trades constituted wrongful acts.

The authority on which New Hampshire Insurance relies is not to the contrary. For example, in Capital Bank and Trust Co. v Gulf Ins. Co. (91 AD3d at 1253-1254), the Court held that coverage to an employee terminated immediately upon inception of the bond because the insured employer was aware, prior to the issuance of the bond, of the dishonest employee's acts that were at issue. Similarly, in Starr Ins. Holdings, Inc. v United States Specialty Ins. Co. (2019 NY Slip Op. 30475 [U] [Sup Ct, NY County 2019], motion to vacate denied 2019 WL 2097403 [Sup Ct, NY County] affd 185 AD3d 488 [1st Dept 2020]), the Court held that the fidelity bond never covered losses sustained prior to the inception of the bond because the insured employer was aware prior to the inception "of the very acts" on which its claim under the bond was based. (2019 WL 2097403, at * 1.)

A further issue on this branch of the motions, which is also the subject of extensive dispute, is whether, if Dooley was an employee and the prior trades were wrongful acts, the "Head of Group Insurance or his designated affiliate" learned of the wrongful acts prior to the February trades, thereby precluding coverage. Resolution of this issue requires interpretation of

the term "designated affiliate" and determination of several other issues, including whether more than one employee of MF Global can qualify as a "designated affiliate," even absent express designation by the Head of Group Insurance (see New Hampshire Insurance Memo. In Supp., at 24-26; MF Global Memo. In Opp., at 17-20); whether, if employees had knowledge of wrongful acts, such knowledge may be imputed to the persons who, by the terms of the bond, were required to have learned of the wrongful acts (see New Hampshire Insurance Memo. In Supp., at 26; MF Global Memo. In Opp., at 20-23); whether senior management had knowledge of wrongful acts, and, if so, whether such knowledge terminates coverage. (New Hampshire Insurance Memo. In Supp., at 28-29; MF Global Memo. In Opp., at 25-26.)

These issues present legal and factual questions that are not properly decided on these motions, particularly given a threshold interpretive issue which the parties have not addressed. It appears to be undisputed that MF Global requested and obtained an agreement from the insurer to narrow the individuals at MF Global in the prior bond (any director or officer) whose knowledge of a wrongful act would trigger a termination of coverage, and to specify a smaller number of individuals (the Head of Group Insurance or his designated affiliate). (MF Global Memo. In Opp., at 19.) There is authority that, where a sophisticated insured negotiates a provision, ambiguities are to be construed against the insured rather than the insurer. (See e.g. Cummins, Inc. v Atlantic Mut. Ins. Co., 56 AD3d 288, 290 [1st Dept 2008]; see also Coliseum Towers Assoc. v County of Nassau, 2 AD3d 562, 565 [2d Dept 2003], lv denied 2 NY 3d 707 [2004].) The parties have not, however, addressed the countervailing principle that exclusionary provisions "are to be accorded a strict and narrow construction" and that, "before an insurance company is permitted to avoid policy coverage, it must satisfy the burden which it bears of establishing that the exclusions or exemptions apply in the particular case, and that they are

subject to no other reasonable interpretation." (Seaboard Sur. Co. v Gillette Co., 64 NY2d 304, 311 [1984] [internal citations omitted]; accord Pioneer Towers Owners Assn. v State Farm Fire & Cas. Co., 12 NY3d 302, 306 [2009].)

In conclusion, the court holds that neither party demonstrates as a matter of law that the bond ceased to provide coverage, pursuant to section 6.2 (iii), based on Dooley's trading prior to the February trades.

Mitigation

The court rejects New Hampshire Insurance's claim that MF Global is barred from recovering its claimed loss because it failed to mitigate its damages "by applying a pre-trade automated control," upon learning of Dooley's unauthorized trades prior to the February trades. (New Hampshire Insurance Memo. In Supp., at 18, 16-19.) As held above, triable issues of fact exist as to whether the prior trades were in fact unauthorized and whether the requisite persons at MF Global learned of any wrongful acts on Dooley's part prior to the February trades. More important for purposes of the viability of the mitigation defense, MF Global does not seek to recover any loss from the prior trades. New Hampshire Insurance does not cite any authority which holds, in the context of a claim under a fidelity bond, that a mitigation defense may be based on failure to prevent a loss, as opposed to failure to take steps to prevent further loss after a loss has been sustained.

Prejudgment Interest

MF Global seeks prejudgment interest on its claimed loss. (MF Global Reply Memo., at 17.) As the court cannot find as a matter of law that MG Global is entitled to its claimed loss, the request for a determination that it is entitled to prejudgment interest is denied as premature.

Affirmative Defenses to MF Global's Counterclaim

MF Global seeks to strike plaintiffs' affirmative defenses to its counterclaim. (MF Global Memo. In Supp., at 17-26.) All plaintiffs other than Liberty Mutual Insurance Company submitted an answer with seven affirmative defenses. (NYSCEF Doc. No. 5.) Liberty Mutual Insurance Company submitted an answer with the identical seven affirmative defenses and an eighth affirmative defense. (NYSCEF Doc. No. 36.)

The first affirmative defense pleads that "MF Global's claim is barred by the terms, definitions, conditions and exclusions and limitations of the Bonds that are the subject of this action. . . ." It does not specify the provisions of the bonds at issue. Rather, specific provisions are referenced in the following six affirmative defenses. The second affirmative defense pleads that "MF Global is not entitled to recover under the Bonds because MF Global did not sustain a direct financial loss as a result of Dooley's trades." The third affirmative defense pleads that "MF Global is not entitled to recover under the Bonds because Dooley was not an 'employee' as defined in the Bonds." The fourth affirmative defense pleads that "MF Global is not entitled to recover under the Bonds because they do not cover" contractual liability (citing Bond § 3.2) or indirect loss (citing Bond § 3.9). The fifth affirmative defense pleads that "MF Global is not entitled to recover under the Bonds to the extent that it failed to mitigate its damages." The sixth affirmative defense pleads that "MF Global is not entitled to recover under the Bonds, regardless of whether Dooley qualifies as an 'employee,' because Dooley's conduct does not qualify for coverage under Insuring Clause 1(i) or 1(ii)." The seventh affirmative defense pleads that "MF Global is not entitled to recover under the Bonds to the extent that it knew that Dooley engaged in dishonest conduct prior to the trades at issue in this claim."

For the reasons stated above, the second, fourth, fifth, and sixth affirmative defenses will be dismissed. The third and seventh affirmative defenses will stand.

The first affirmative defense will be dismissed to the extent based on the claims that (1) Dooley's February trades did not constitute a wrongful act within the meaning of section 1 (i) of the primary bond or a malicious act within the meaning of section 1 (ii) of the primary bond; and (2) coverage is excluded under primary bond sections 3.9 (i) or 3.9 (iv). The court is not persuaded by the authority cited by MF Global on these motions (e.g. Matter of Kowalczyk [v Village of Monticello], 107 AD3d 1365, 1366 [3d Dept 2013]) that a blanket order dismissing this affirmative defense is appropriate. Rather, in the event plaintiffs assert any defenses to coverage other than those asserted on these motions, the court at trial may more appropriately determine whether such defenses may be entertained, taking into account, among other things, whether the particular defenses have been waived and whether there is prejudice or surprise to MF Global.

The eighth affirmative defense, raised only by Liberty Mutual Insurance Company, concerns the extent to which there may be recovery under the excess bond. As this issue has not been addressed on these motions, the defense will stand.

ORDER

It is hereby ORDERED that the motion of plaintiffs New Hampshire Insurance Company, Liberty Mutual Insurance Company, and Axis Reinsurance Company (the remaining plaintiff-insurer movants) for summary judgment is denied in its entirety; and it is further

ORDERED that the branch of the motion of MF Global Finance USA Inc. for judgment on its counterclaim is denied in its entirety; and it is further

ORDERED that the branch of the motion of MF Global Finance USA Inc. for dismissal of plaintiffs' affirmative defenses is granted to the extent of 1) dismissing the second, fourth, fifth, and sixth affirmative defenses in their entirety, and 2) dismissing the first affirmative

defense to the extent based on the claims that (1) Dooley's February trades did not constitute a wrongful act within the meaning of section 1 (i) of the primary bond or a malicious act within the meaning of section 1 (ii) of the primary bond; and (2) coverage is excluded under primary bond sections 3.9 (i) or 3.9 (iv).

This constitutes the decision and order of the court.

12/21/2020
DATE

MARCY S. FRIEDMAN, J.S.C.

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
		GRANTED		DENIED	X	GRANTED IN PART	OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN				FIDUCIARY APPOINTMENT	REFERENCE

New Hampshire Insurance Company v MF Global Finance USA Inc. – 601621/2009

APPENDIX

Relevant provisions of the Primary Bond issued by New Hampshire Insurance Company to MAN Financial Inc. as insured, for the bond period April 30, 2007-April 30, 2008, are quoted below. All provisions are quoted in full unless otherwise indicated.

1. Insurance Cover

The *insurer* will indemnify the insured for their *loss* sustained at any time for:

(i) any *wrongful act* committed by any *employee*, or

(ii) any theft, *fraudulent act* or malicious act committed by *any other person*,

which is committed with the intent to cause the *insured* to sustain a *loss* or with the intent to obtain financial gain for themselves or another person or entity they intended to obtain such gain and is first *discovered* by the *insured* during the *bond period* or the *discovery period*.

2. Definitions

. . .

2.2 *Any other person* means any natural person who:

(i) is not an *employee* or any *insured*; or

(ii) does not hold any contract for services, written or implied, with any *insured*.

. . .

2.11 *Circumstance* means any circumstance brought to the attention of the *bondholder's* Head of Group Insurance, or his designated alternate, arising out of any *wrongful act* which, in the reasonable opinion of the *bondholder's* Head of Group Insurance, or his designated alternate, having regard to the facts and information then available to him, may give rise to a *loss* being suffered by the *insured*.

. . .

2.17 *Director* or *officer* means any natural person who was, now is, or shall be a director or officer of the *insured*. The terms *director* and *officer* shall also mean any equivalent position under the laws of any jurisdiction.

2.18 *Discovered* or *Discovery* means when the *bondholder's* Head of Group Insurance or his designated alternate becomes aware of any *loss* or *circumstance*.

. . .

2.25 *Employee* means any:

(i) natural person under:

(a) a contract of employment written or implied (be it full time, part-time or temporary);

(b) a contract of service written or implied;

. . .

(d) a contract for services written or implied;

. . .

with the *insured*;

. . .

(ii) natural person working under the direct control and supervision of the *insured* or a natural person who is seconded to the *insured* or a natural person who is paid by the *insured* under their payroll system;

. . .

The term *employee* does not mean any independent broker, independent financial adviser, or any similar agent or independent representative remunerated on a sales or commission basis unless specifically agreed by the *insurer* and endorsed to this bond.

. . .

2.30 *Fraudulent act* means:

(i) the *forgery*, *counterfeiting* or *fraudulent alteration* of, on or in any *money security* or *instruction* which the *insured* has acted or relied upon; or

(ii) *computer fraud*.

. . .

2.35 *Insured* means:

MAN Financial and any subsidiary company now existing or hereafter created or acquired . . .

. . .

2.38 *Loss* means the direct financial loss sustained by the *insured* as a result of any single act, single omission or single event, or a series of related or continuous acts, omissions or events. A series of related or continuous acts or omissions or events up to the time of *discovery* shall be treated as single act, omission or event. . . .

. . .

2.48 *Trading* means trading or other dealings in securities, commodities, futures, options, foreign of federal funds, currencies, foreign exchange and the like.

. . .

2.53 *Wrongful act* means any theft, dishonest, fraudulent or malicious act wherever committed, and whether committed alone or in collusion with others to also include, for the avoidance of doubt, *computer fraud*.

However, it is agreed that concerning *loans* and *trading*, *wrongful act* only means any theft, dishonest or fraudulent act committed with the intent to obtain improper financial gain for:

(i) an *employee*; or

(ii) any person or organization in collusion with such *employee* who committed the *wrongful act*.

3. Exclusions

The *insurer* shall not be liable to make any payment for *loss* under this Bond arising out of, based upon or attributable to any of the following:

. . .

3.2 Any liability assumed by the *insured* under contract or agreement except liability which would have attached to the *insured* in the absence of such contract or agreement.

. . .

3.9 *Indirect Loss*

. . .

(iv) Mechanical failure, faulty construction, error in design, latent defect, wear or tear, gradual deterioration, electrical disturbance, *electronic data processing media* failure or breakdown or any malfunction or error in programming or errors or omissions in processing;

. . .

6. General Provisions

. . .

6.2 Changes in Risk During Bond Period

. . .

(iii) This bond shall cease in respect of any *employee* of the *insured*, as soon as the Head of Group Insurance or his designated affiliate not in collusion with such person shall first learn of any *wrongful act* on the part of the

> *employee* whenever committed, but without prejudice to the loss of *money* or *securities* or other property in transit in the custody of such person at the time the *director* or *officer* of the *insured* shall so learn of such *wrongful act*. . . .

(See Primary Bond [italics in original].)