

New York Commercial Division Round-Up

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[Brokerage Firm Can Recover \\$141 Million in Trading Losses from Insurers Because An "Associated Person" Is An Employee Under New York Law](#)

By *Jane Qin*

In *New Hampshire Insurance Co., et al., v. MF Global, Inc.*, Index No. 601621/09 (Sup Ct, NY County, Oct. 5, 2010), Justice Bernard J. Fried granted summary judgment to MF Global, Inc. ("MF Global"), formerly one of the world's largest non-bank futures brokerages, paving the way for it to collect on an insurance claim covering a \$141.5 million loss it suffered when a rogue broker made unauthorized overnight wheat trades in 2008. The court found that the broker, Evan Dooley ("Dooley"), was an "associated person" to MF Global, and, thus, was an employee of MF Global by law. Therefore, insurers could not refuse to cover MF Global's loss based on the contention that Dooley was not actually an employee covered under the primary insurance policy (the "Policy"). The court further found the losses sustained by MF Global as a result of Dooley's unauthorized trades were "direct losses" as required under the Policy.

The case stemmed from a situation that shook investor confidence in MF Global and resulted in heavy losses and an overhaul of management. Dooley executed large, unauthorized overnight trades on wheat futures contracts through the Chicago Mercantile Exchange ("CME"). During the evening of February 26, 2008, Dooley built up a large and unauthorized position in wheat commodities in anticipation of a fall in prices, trading well in excess of his margin. He entered into a large number of "sell contracts" for various commodities, thus creating an "open position" that could be liquidated by entering into corresponding "buy contracts." If the market price for the commodity drops, Dooley could purchase the commodity for less than the price of the sell contracts and, thus, the difference would be booked as a trading gain.

The next day, when trading resumed, the price of wheat began to rise quickly and sharply, ultimately resulting in a total loss of \$141,024,494. This loss was charged to MF Global, which, as a clearing house member of the CME, was primarily obligated to cover losses incurred on its accounts as a result of Dooley's trades. In reaction to these heavy losses, MF Global's share price fell 93%.

When MF Global sought indemnification for the trading loss through an insurance claim on the Policy, which had a total limit of \$150 million, insurers resisted, and sought from the court a ruling that the loss was not covered because MF Global did not sustain a "direct loss" as required by the Policy, and because Dooley was not an employee of MF Global as the Policy required. The insurers moved for summary judgment.

The Policy required that the primary insurer:

indemnif[y Global] 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 [Global] 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 [Global] during the *bond period* or the *discovery period*.

Policy § 1 (emphasis in original policy).

The court held that based on the plain language of the Policy, it was clear that Dooley, as a broker for MF Global, was a covered employee. The court reasoned that Dooley was clearly an “associated person” of MF Global. The New York Stock Exchange as well as the Financial Industry Regulatory Authority define an “associated person” as “any partner, or branch manager of such member, or any employee of such member.” Moreover, mere status as an “associated person” is deemed sufficient for courts to compel such persons to engage in mandatory employee arbitration. *See, e.g., Steinberg v. W.J. Nolan & Co.*, 6 Misc 3d 1003(A), 2004 NY Slip Op 51709(U) (Sup Ct, NY County 2004), *aff’d as mod*, 18 AD 3d 244 (1st Dep’t 2005).

The Policy provided that an employee is a “natural person under an implied contract of employment or service.” Because “associated persons” have an implied contract with their applicable exchange member, and because Dooley was an “associated person”, the Court held that he was an employee of MF Global at the time of the trades and, thus, was covered under the Policy.

The court further found that the losses incurred by MF Global as a result of Dooley’s trades were “direct losses” such that they were covered under the Policy. The insurers attempted to analogize the losses incurred by MF Global to those in a series of cases in which the alleged loss incurred to another party first, and only subsequently, to the insured, thus making the insured’s loss indirect. In contrast, the court found that the exact opposite situation occurred here: MF Global incurred a direct loss, and Dooley incurred an indirect loss, because MF Global was primarily liable for the debt incurred. The court reasoned that because the CME went directly to MF Global to collect on the excessive open position, it would be inaccurate to attribute the debt directly to Dooley.

This case demonstrates that for the purposes of insurance claims of brokerage firms, or companies with similar organizational structures, where the relevant policy requires the covered action to be that of an “employee”, brokers who have implied contracts with their firms meet the requirements for an “employee” and are thus covered. This case further demonstrates brokerage firms that are members of an exchange that requires the members to be liable for any losses may recover losses attributed to unauthorized trading as a "direct loss" under an insurance policy.

For further information, please contact [Jane Qin](#) at (212) 634-3093.