

MF Global U.S. bankruptcy first day hearing leaves questions unanswered

Author: [Elizabeth A. McGovern](#), Associate, Philadelphia & London

Author: [Victoria Thompson](#), Associate, London

Publication Date: November 03, 2011

The first day hearings in the Chapter 11 cases of MF Global Holdings Ltd and MF Global Finance USA Inc (together the "**Debtors**") were held on 1 November 2011 before Judge Martin Glenn in the U.S. Bankruptcy Court for the Southern District of New York (the "**Bankruptcy Court**").

- Question of whether money was swept from the UK entities to the U.S. entities prior to the insolvency proceedings remains unclear
- Debtors allowed to continue to make inter-company payments within the U.S.
- Debtors allowed to use US\$5 million of cash collateral held with JP Morgan for ordinary course business expenses within the U.S.

At the hearing, Debtors' counsel cited the recent downgrading of MF Global's credit rating and overall lack of liquidity as the reasons for its bankruptcy filings. Further, and in contrast to recent news reports, Debtors' counsel denied that any money was misapplied/misdirected and stated that all money was accounted for with MF Global Inc. (the MF Global broker-dealer entity) and the various clearing houses. Counsel was unable, however, to provide any further detail about the funds in question or shed light on any transfers done by the Debtors in the days leading up to the bankruptcy filings. Concerns were raised at the hearing about money from MF Global UK entities being transferred to the Debtors or other U.S. entities, but no clear answer was given with regards to what transfers, if any, took place prior to the bankruptcy filings.

At the hearing the Bankruptcy Court, in addition to various procedural motions, considered motions filed by the Debtors seeking (i) to continue to use existing bank accounts and cash management systems and engage in intercompany transfers (the "**Bank Account Motion**"); and (ii) authority to use cash collateral (the "**Cash Collateral Motion**").

Bank Account Motion

In the Bank Account Motion, the Debtors requested permission to, among other things, continue to maintain certain of their existing bank accounts and to fund intercompany loans among the various MF Global entities. The Bankruptcy Court granted the Bank Account Motion, but specified in its order that while the Debtors could continue to pay intercompany payables, extend intercompany credit, and otherwise transfer funds by and among the Debtors and their affiliates, the Debtors could not receive moneys from the entities that are, or become, the subject of administration in the United Kingdom or the subsidiaries of any such entities, unless the Debtors are otherwise legally permitted to do so. The Bankruptcy Court specifically noted that nothing in its order should be deemed to adjudicate the

respective rights of the Debtors, on the one hand, and the UK administration entities, on the other hand, with respect to claims against, interests in, or assets of their affiliates.

Cash Collateral Motion

In the Cash Collateral Motion, the Debtors sought permission to use cash collateral and provide adequate protection to JP Morgan, in its capacity as agent under its pre-petition loan facility. On 2 November the Bankruptcy Court entered an interim order authorizing the Debtors to use up to US\$8 million in cash collateral for the period through 14 November 2011. The interim order further provides that any cash collateral may only be used for ordinary course purposes, and shall not be used to fund (i) MF Global, Inc.; (ii) any foreign non-Debtor entity unless JP Morgan consents; or (iii) any other non-Debtor entity unless the Debtors determine in good faith that such funding is necessary to avoid irreparable harm to the Debtors' estates, and may not exceed US\$5 million. In exchange for use of cash collateral, JP Morgan was granted a superiority claim and a first priority lien on unencumbered assets, and a junior lien on assets subject to an existing security interest as of the date of the bankruptcy filing. Notably, JP Morgan's first priority lien extends to avoidance actions, although the Bankruptcy Court stated it would reconsider the grant of liens on avoidance actions at the final cash collateral hearing. In addition to adequate protection, the Debtors are also required to reimburse JP Morgan for all fees incurred by it and its counsel relating to the use of cash collateral. A final hearing on cash collateral is currently scheduled for 14 November 2011.

We have a dedicated team, with expertise in insolvency, financing, financial markets and commodities trading advising clients with assets, positions and other dealings with MF Global. If you have dealings with or exposures to MF Global and would like help with this evolving situation, please contact Kyri Evagora, Georgia Quenby, Brett Hillis, Andrew Cross or Andrea Pincus.

About Reed Smith

Reed Smith is a global relationship law firm with more than 1,600 lawyers in 23 offices throughout the United States, Europe, Asia and the Middle East.

The information contained herein is intended to be a general guide only and not to be comprehensive, nor to provide legal advice. You should not rely on the information contained herein as if it were legal or other professional advice.

The business carried on from offices in the United States and Germany is carried on by Reed Smith LLP of Delaware, USA; from the other offices is carried on by Reed Smith LLP of England; but in Hong Kong, the business is carried on by Reed Smith Richards Butler. A list of all Partners and employed attorneys as well as their court admissions can be inspected at the website <http://www.reedsmith.com/>.

© Reed Smith LLP 2011. All rights reserved.