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UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

PORTLAND DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. **AEQUITAS MANAGEMENT, LLC; AEQUITAS HOLDINGS, LLC; AEQUITAS COMMERCIAL FINANCE, LLC; AEQUITAS CAPITAL MANAGEMENT, INC.; AEQUITAS INVESTMENT MANAGEMENT, LLC; ROBERT J. JESENIK; BRIAN A. OLIVER; and N. SCOTT GILLIS**, Defendants.	No. 3:16-cv-00438-PK **OLAF JANKE'S MOTION FOR RELIEF FROM RECEIVERSHIP ORDER, TO THE EXTENT NECESSARY, TO PERMIT PAYMENT OF DEFENSE COSTS** **ORAL ARGUMENT REQUESTED**

LOCAL RULE 7.1(a) COMPLIANCE

Pursuant to LR 7.1(a), counsel for Olaf Janke ("**Mr. Janke**") met and conferred in good faith through telephone conferences with counsel for the Receiver (as defined below) regarding this Motion, but counsel for the Receiver declined to stipulate to the proposed order.

MOTION

1. Plaintiff filed this lawsuit on March 10, 2016, at which time Plaintiff also filed a stipulation requesting a preliminary injunction and the appointment of a receiver. On April 14, 2016, this Court entered an Order Appointing Receiver ("**Receivership Order**"), appointing Ronald Greenspan as the receiver (the "**Receiver**") for Aequitas Management, LLC, Aequitas Holdings, LLC, Aequitas Commercial Finance, LLC, Aequitas Capital Management, Inc., and Aequitas Investment Management, LLC (collectively, "**Aequitas**") and freezing Aequitas' assets. Dkt. No. 156, ¶¶ 1-2. Mr. Janke now seeks relief from the Receivership Order for the purpose of allowing Catlin Specialty Insurance Company ("**Catlin**") to advance past and future Defense Costs (as defined below) to or on behalf of Mr. Janke in connection with the Litigation (as defined below) and/or the Investigation (as defined below) and other Claims (as defined below). Mr. Janke requests oral argument on this Motion.

MEMORANDUM OF LAW

I. INTRODUCTION

2. Mr. Janke, former Chief Financial Officer of Aequitas Holdings, LLC, respectfully moves this Court for an order confirming that Catlin may advance Defense Costs on his behalf under the Private Equity Management Liability Insurance Policy No. MFP-686757-0714 (the "**Policy**") issued by Catlin to defendant Aequitas Holdings, LLC (the "**Company**"). Catlin has indicated that it is willing to advance on a current basis certain defense costs as defined by the Policy ("**Defense Costs**"), subject to a mutual reservation of rights, in connection with the investigation (the "**Investigation**") by the United States Securities and Exchange

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Commission (the "**SEC**") and this subsequently filed civil action, *SEC v. Aequitas Management, LLC, et al.,* Case No. 3:16-cv-00438-PK (D. Or.) (the "**Litigation**"), subject to confirmation from this Court that advancement does not violate the Receivership Order.

II. BACKGROUND

A. The Investigation, the Litigation and the Receivership Order

3. After commencing the Investigation, the SEC initiated this Litigation against Aequitas and certain current and former executives of Aequitas (the "**Executives**") by Complaint dated March 10, 2016.

4. In addition, the SEC filed a stipulation requesting a preliminary injunction and appointment of a receiver. On April 14, 2016, this Court entered the Receivership Order appointing Ronald Greenspan as the Receiver for Aequitas and freezing Aequitas's assets. Dkt. No. 156, ¶¶ 1-2. The Receivership Order provides that "all persons and entities with direct or indirect control over any property of the Receivership Entity, other than the Receiver, are hereby restrained and enjoined from directly or indirectly transferring, setting off, receiving, changing, selling, pledging, assigning, liquidating or otherwise disposing of or withdrawing such assets." *Id.*, ¶ 2.

5. In connection with the Investigation and the Litigation, beginning in January 2016, the SEC has requested on multiple occasions information and interviews of Mr. Janke, as former Chief Financial Officer of the Company (both pre- and post-filing of the Litigation). Indeed, the SEC is still seeking information from Mr. Janke for purposes of the Litigation to obtain information about the Company and the purported fraudulent activities that occurred at Aequitas. Declaration of Mark Perlow ("Perlow Decl.") (filed herewith, ¶2).

6. Mr. Janke has incurred reasonable and necessary legal expenses in preparing for and responding the requests of the SEC – pre-filing of the Litigation, Mr. Janke incurred approximately $120,000 in legal fees and expenses, and post-filing, Mr. Janke has thus

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far incurred approximately $70,000 in legal fees and expenses. While Mr. Janke is not currently a Defendant in the Litigation, it is possible that he could become a defendant in the Litigation in the future. Thus, he is entitled to coverage under the Policy for all Defense Costs, both pre- and post-filing of the Litigation. Perlow Decl., ¶3.

B. The Policy

7. Catlin issued the Policy to the Company for the Policy Period of July 1, 2014, to November 1, 2015, as amended by Endorsement 8. A copy of the Policy is attached at Dkt. No. 177, Ex. A. (the "**Klaber Decl.**"). The Policy has a $5,000,000 Aggregate Limit of Liability, inclusive of Defense Costs. Klaber Decl., Ex. A, Policy Declarations, Item 3.

8. Like many director and officer ("**D&O**") liability insurance policies, the Policy contains three principal insuring agreements, generally referred to as Insuring Agreement A (payment directly to the insured directors and officers if their employer is unable or unwilling to hold them harmless); Insuring Agreement B (reimbursement to the employer for payments the employer made to hold the directors and officers harmless); and Insuring Agreement C (coverage for the named insured/employer for a more limited subset of liabilities).

9. The insuring agreement at issue in this Motion, Insuring Agreement A of the Policy, provides that Catlin "shall pay on behalf of any Insured Person all Loss for which the Insured Organization has not indemnified such Insured Person, resulting from a Claim . . . first made against such Insured Person during the Policy Period . . . for a Wrongful Act." Klaber Decl., Exhibit A, Section I(A). Mr. Janke is an Insured Person in his capacity as a former executive of the Company. Klaber Decl., Exhibit A, Sections III(S) & (Z).

10. The Policy defines "Loss" to include "Defense Costs," which is defined as "reasonable and necessary fees and expenses incurred in the defense or appeal of a Claim . . . ." Klaber Decl., Exhibit A, Sections III(DD) & (K). Pursuant to Section VII of the Policy, Catlin

"shall advance Defense Costs . . . no later than ninety (90) days after the receipt by the Insurer of such defense invoices." Klaber Decl., Exhibit A, Section VII.B.

11. The Policy contains a Priority-of-Payments provision among the three insuring agreements. That provision provides in relevant part that, "[i]f Loss is incurred that exceeds the remaining Limit of Liability for this Policy, the Insurer shall pay Loss under Insuring Agreement A before paying any other Loss." Klaber Decl., Exhibit A, Section XIII(C).

12. Certain other Insured Persons have sought coverage under the Policy in connection with the Investigation and Litigation and have received relief from this Court in order to allow advancement of past and future Defense Costs. *See Stipulated Order Granting Relief From Receivership Order to Permit Limited Payment of Defense Costs*, Dkt. No. 185. Additional other Insured Persons may do so in the future.

13. Given the magnitude of the Defense Costs that will likely be incurred by the multiple firms representing Insured Persons during this ongoing Litigation and Investigation (and potentially other Claims under the Policy), a realistic prospect exists that all potential Loss will exceed the Limit of Liability of the Policy. Thus, the Priority-of-Payments provision is triggered.

RELIEF REQUESTED

14. Mr. Janke seeks an order authorizing Catlin to advance on a current basis Defense Costs incurred by or on behalf of Mr. Janke in connection with the Litigation and/or the Investigation and other Claims. Mr. Janke has incurred and continues to incur Defense Costs in connection with the Litigation and Investigation. Additionally, should the SEC determine to commence litigation against Mr. Janke, he will be unable to retain vendors or third-party professionals, such as experts, that he will need for his defense.

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BASIS FOR RELIEF REQUESTED

15. To the extent necessary, Mr. Janke respectfully submits that sufficient cause exists to modify the Receivership Order to permit Catlin to advance past and future Defense Costs to or on behalf of Mr. Janke in connection with the Litigation and/or the Investigation and other Claims. Although the Receivership Order states that all assets and property of Aequitas are assets and property under the control of the Receiver, Catlin should be able to advance those proceeds on behalf of Mr. Janke in accordance with the terms of the Policy.

a. First, the Policy *proceeds* are not assets of the Aequitas receivership estate subject to an asset freeze. The Policy provides that Catlin will pay defense and indemnity to third parties, such as defense counsel, *on behalf of the* Insureds; the Policy does not indemnify the Insureds for payments they made.

b. Second, the Policy's Priority-of-Payments provision requires that payment go first to the Insureds.

c. Third, the Court has authority to permit the disbursement of insurance proceeds in any event.

16. In the bankruptcy context, courts have long recognized that although a liability insurance *policy* is the property of an estate in bankruptcy, the insurance policy *proceeds* are not. That is because liability policies (like the Policy at issue here) provide that the insurer will pay sums "on behalf of" the insureds to third parties such as defense counsel or underlying claimants; they do not pay money directly to the estate. For that reason, bankruptcy courts have authorized the payment of policy proceeds for defense and indemnity for the insured directors and officers of an insolvent business. *See, e.g., In re Equinox Oil Co.,* 300 F.3d 614, 618 (5th Cir. 2002); *In re McAteer,* 985 F.2d 114, 117 (3d Cir. 1993); *In re Louisiana World Exposition, Inc.,* 832 F.2d 1391, 1399 (5th Cir. 1987); *In re Endoscopy Center of Southern NV, LLC,* 451 B.R. 527 (Bankr. D. Nev. 2011).

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17. Courts have applied the same rule in the context of a receivership order, recognizing that the *proceeds* of an insurance policy are not subject to an asset freeze issued in connection with a receivership order if doing so would prejudice the ability of insureds to mount a defense to claims brought against them. *See, e.g., S.E.C. v. Morriss,* No. 4:12-CV-80 CEJ, 2012 WL 1605225, at *4 (E.D. Mo. May 8, 2012) (granting insured's motion for relief from receivership order to permit insurer to advance defense costs despite SEC's and receiver's opposition); *S.E.C. v. Stanford Int'l Bank, Ltd.,* No. 309-CV-298-N, 2009 WL 8707814, at *4 (N.D. Tex. Oct. 9, 2009) (allowing advancement of defense expenses on behalf of insured individuals notwithstanding the receiver's opposition because receivership and asset freeze orders "do not bar [the insurer] from disbursing policy proceeds to fund directors' and officers' defense costs in accordance with the D&O policies' terms and conditions," finding that "the receivership's claim to the policy proceeds is presently speculative" but the "potential harm to [the insured D&Os] if denied coverage is not speculative but real and immediate"); *Executive Risk Indem., Inc. v. Integral Equity, L.P.,* No. CIV.A. 3:03-CV-0269-, 2004 WL 438936, at *14 (N.D. Tex. Mar. 10, 2004) (insurer's payment of insureds' defense costs does not violate receivership order).

18. For example, in *Morriss,* a company's assets were frozen by way of a receivership order entered after the SEC filed suit against the company. 2012 WL 1605225, at *2. When the company's investors later filed an action against the company's directors, the directors sought coverage under a policy similar in many ways to the Policy at issue here and also containing a Priority-of-Payments provision. Citing *Louisiana World Exposition* and other cases, the court granted the directors' motion for relief from the receivership order. The court held that advancement of the directors' defense costs was appropriate in order to avoid harm to the directors by depriving them of a defense. The court found additional support under the terms of the policy, including the Priority-of-Payment provision. *Id.* at *4 ("[T]he policy includes a

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priority of payments provision requiring [the insurer] to pay claims [against insured individuals] before claims under any other insuring clause, including those of the organization. As a result, as a matter of contract, any claim that the receiver may have for defense costs is subordinate to the coverage for [the insured persons].”). In so holding, the court rejected the SEC’s argument that potential future interests of investors or others that may seek to recover under the policy should trump the insureds’ contractual right to coverage. *Id.*

19. In administering a receivership, as the court in *Morriss* explained, courts may look to bankruptcy law when deciding the treatment of a particular issue, including examining the ownership of insurance policy proceeds. *See id.* at *2 n.7 (“Because there are comparatively few cases examining the ownership of insurance proceeds in the context of a receivership, it is appropriate to consider the treatment of the issue under bankruptcy law . . . .”). In similar cases in the bankruptcy context, courts have consistently held that where a policy contains a Priority-of-Payments provision, the advancement of defense costs to an insured person does not violate the automatic bankruptcy stay.[1]

20. For example, in *In re Downey Financial Corp.*, the court held that any interest the bankruptcy trustee had in the policy proceeds was subordinate to the coverage provided to the individual insureds pursuant to the Priority-of-Payments provision. Because coverage for the debtor entity was only available under the subordinate insuring clauses prior to the bankruptcy and the Bankruptcy Code “is not intended to expand the debtor’s rights against others beyond what existed at the commencement of the cases,” the policy proceeds were not

[1] The bankruptcy cases cited *supra* did not address a “Priority-of-Payment” provision because such provisions were added to standard D&O policies more recently, to confirm that the rights of the individual directors and officers take precedence over those of the corporation or other business that is the named insured. *See* https://www.irmi.com/online/insurance-glossary/terms/p/priority-of-payments-provision.aspx (“Priority of payments provisions were added to D&O policies because in the early 2000s, numerous controversies began to arise as to whether the proceeds of a D&O policy belong to a bankruptcy trustee or to the individual insured directors and officers.”)

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property of the estate subject to the stay. 428 B.R. 595, 607-08 (Bankr. D. Del. 2010). The court in *In re Laminate Kingdom, LLC*, 2008 WL 1766637 (Bankr. S.D. Fla. Mar. 13, 2008), reached a similar conclusion. As that court noted, "[i]n determining a property interest in an insurance policy, courts are guided by the language and scope of the policy at issue," and that "[t]ypically, the proceeds of a directors and officers liability insurance policy are not considered property of a bankruptcy estate." *Id.* at *2. Like the Policy at issue here, the policy in *Laminate Kingdom* insured both the entity and its officers and directors and had a Priority-of-Payments provision. The court acknowledged that the policy did provide entity coverage, but found that interest insufficient to render the policy proceeds part of the bankruptcy estate:

> Having noted that distinction, the Court believes the depletion of proceeds to pay the Costs of Defense does not diminish the protection afforded the estate's assets under the terms of the Policy. The Policy's "Priority of Payments Endorsement" specifically requires that the proceeds be used first to pay non-indemnifiable loss for which coverage [for directors and officers] is provided under Coverage A of this Policy, which coverage includes the Costs of Defense. Then, only after such payments are made, and only if proceeds remain after payment of such Costs of Defense, will the Trustee or the estate be paid any proceeds. Thus, under the language of the Policy itself, the estate has only a contingent, residual interest in the Policy's proceeds; and, payment of the proceeds in accordance with the "Priority of Payments Endorsement" does not diminish the protection the Policy affords the estate, as such protection is only available after the Costs of Defense are paid.

Id. at *3 (emphasis in original). The court therefore held that the policy proceeds were not part of the estate and not subject to an automatic stay.

21. In these and other cases, courts consistently have refused to deprive corporate officers and directors of insurance benefits to which they are contractually entitled, particularly, as here, where there is a Priority-of-Payments provision in the policy. A contrary

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rule would undermine the very purpose of D&O coverage, which is to protect an entity's officers and directors, even when the entity is in financial distress:

> ND&O policies are obtained for the protection of individual directors and officers . . . . In essence and at its core, a D&O policy remains a safeguard of officer and director interests and not a vehicle for corporate protection.

In re First Cent. Financial Corp., 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999); *see also Miller v. McDonald (In re World Health Alternatives, Inc.),* 369 B.R. 805, 811 (Bankr. D. Del. 2007) (trustee failed to demonstrate likelihood of success on merits in establishing that policy proceeds were included in property of estate where, among other things, policy included a "Priority of Payments" provision).

22. Finally, as the court held in *Stanford International Bank*, courts have "discretion to allow disbursement of insurance proceeds [even] if they are part of the receivership estate." 2009 WL 8707814, at *3. Courts have frequently lifted automatic bankruptcy stays to allow advancement of policy proceeds where insured directors and officers would suffer prejudice if prevented from accessing coverage for defense costs, even if policy proceeds are considered property of the bankruptcy estate. *See, e.g.*, *In re Mila, Inc.*, 423 B.R. 537, 543-44 (B.A.P. 9th Cir. 2010) (holding that regardless of whether policy proceeds are considered property of the bankruptcy estate, a bankruptcy court has discretion to permit advancement of defense cost payments in light of the harm to insured persons if they are "prevented from executing their rights to defense costs"); *In re Hoku Corp.*, No. BR 13-40838-JDP, 2014 WL 1246884, at *4 (Bankr. D. Idaho Mar. 25, 2014) (permitting advancement of defense costs even under the assumption that policy proceeds are part of the bankruptcy estate because individual insured was "experiencing 'clear, immediate, and ongoing' defense costs expenses arising from the litigation in the District Court, which costs are likely covered by the Policy"); *In re Arter & Hadden, L.L.P.*, 335 B.R. 666, 674 (Bankr. N.D. Ohio 2005) ("The Court

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finds that there is cause to lift the automatic stay because the [Executive insureds] may suffer substantial and irreparable harm if prevented from exercising their rights to defense payments to fund their defense . . . ."); *In re CyberMedica, Inc.*, 280 B.R. 12, 17-18 (Bankr. D. Mass. 2002) (holding that although policy **proceeds were considered property of the bankruptcy estate, there was sufficient cause to lift the** automatic stay because the insured directors and officers "may suffer substantial and irreparable harm if prevented from exercising their rights to defense payments. [The insureds] are in need *now* of their contractual right to payment of defense costs and may be harmed if disbursements are not presently made to fund their defense . . . .") (emphasis in original).

23. Where, as here, Mr. Janke faces prejudice if Catlin is not allowed to advance past and future Defense Costs, the Court, in its discretion, should allow advancement of past and future Defense Costs pursuant to Mr. Janke's contractual right to payment under the Policy, even if the insurance proceeds are considered part of the receivership estate.

CONCLUSION

In light of the foregoing, Mr. Janke respectfully requests that the Court grant this motion and enter an order, substantially in the form of the accompanying Proposed Order, to modify the Receivership Order for the purpose of allowing Catlin to advance past and future Defense Costs

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to or on behalf of Mr. Janke in connection with the Litigation and/or the Investigation and other Claims.

DATED this 14th day of April, 2017.

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CERTIFICATE OF COMPLIANCE

This brief complies with the applicable word-count limitation under LR 7-2(b) because it contains 3,078 words, including headings, footnotes, and quotations, but excluding the caption, table of contents, table of cases and authorities, signature block, exhibits, and any certificates of counsel.

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF system, which will send notification of such filing.

DATED this 14th day of April, 2017.

s/ Lori Irish Bauman
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