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UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

PORTLAND DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. **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.	Case No. 3:16-cv-00438-PK **MOTION OF DEFENDANTS BRIAN A. OLIVER AND N. SCOTT GILLIS FOR RELIEF FROM RECEIVERSHIP ORDER, TO THE EXTENT NECESSARY, TO PERMIT PAYMENT OF DEFENSE COSTS** **EXPEDITED HEARING REQUESTED** **ORAL ARGUMENT REQUESTED** Complaint Filed: March 10, 2016

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LOCAL RULE 7-1(a) COMPLIANCE

Pursuant to LR 7-1(a), counsel for Defendants Brian A. Oliver and N. Scott Gillis ("Individual Defendants") met and conferred in good faith through telephone conferences with Plaintiff's counsel and counsel for Aequitas Management, LLC, Aequitas Holdings, LLC, Aequitas Commercial Finance, LLC, Aequitas Capital Management, Inc., and Aequitas Investment Management, LLC (collectively, "Aequitas") regarding this Motion, but Plaintiff and Aequitas declined to stipulate to the proposed order. In addition, pursuant to LR 7-1(g), counsel for the Individual Defendants conferred in good faith through telephone conferences and via email with Plaintiff's counsel and counsel for Aequitas regarding the Individual Defendants' request for an expedited hearing on this Motion. Plaintiff takes no position on the Individual Defendants' request for an expedited hearing, but Aequitas opposes the Individual Defendants' request.

MOTION

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 for Aequitas and freezing Aequitas's assets. Dkt. No. 156, ¶¶ 1-2. On May 23, 2016, this Court entered an Order permitting the first tier of insurance covering the Individual Defendants, issued by Catlin Specialty Insurance Company ("Catlin"), to advance past and future Defense Costs to or on behalf of the Individual Defendants in connection with an investigation by the United States Securities and Exchange Commission (the "Investigation") and this subsequently filed civil action, *SEC v. Aequitas Management, LLC,* et al., Case No. 3:16-cv-00438-PK (D. Or.) (the "Litigation") and other Claims. Dkt. No. 185. The first tier of

insurance has now been fully paid out. Accordingly, the Individual Defendants now seek relief from the Receivership Order for the purpose of allowing the second tier of insurance, Forge Underwriting Ltd ("Forge"), to advance past and future Defense Costs to or on behalf of the Individual Defendants in connection with the Litigation and/or the Investigation and other Claims. The Individual Defendants request oral argument and an expedited hearing on this Motion. An expedited hearing is appropriate here because the Individual Defendants face substantial prejudice in their ability to prepare their defenses while past Defense Costs continue to be withheld and future Defense Costs are not advanced, which prejudice only continues to increase with each passing day.

MEMORANDUM OF LAW

I. INTRODUCTION

The Individual Defendants respectfully move this Court for an order confirming that Forge, the second tier of insurance covering the Individual Defendants, may advance Defense Costs on their behalf under an Excess Claims Made Private Equity Liability Insurance Policy issued by Forge to defendant Aequitas Holdings, LLC (the "Forge Policy"). This Court has already entered a similar Order permitting the first tier of insurance, Catlin, to advance such costs. Dkt. No. 185. Forge has indicated that it is willing to advance on a current basis certain defense costs as defined by the Forge Policy ("Defense Costs"), subject to a mutual reservation of rights, subject to confirmation from this Court that advancement does not violate the Court's April 14, 2016 Receivership Order.

II. BACKGROUND

A. The SEC Litigation and the Receivership Order

After commencing the Investigation, the SEC initiated this Litigation against Aequitas and the Individual Defendants by Complaint dated March 10, 2016. 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.

B. The Policies

Catlin issued Private Equity Management Liability Insurance Policy No. MFP-686757-0714 (the "Catlin Policy") to Aequitas Holdings, LLC (the "Company"), for the Policy Period of July 1, 2014 to November 1, 2015, as amended by Endorsement 8. A copy of the Catlin Policy is attached as Exhibit A to the Declaration of Jason P. Cronic in Support of Motion of Defendants Brian A. Oliver and N. Scott Gillis for Relief from Receivership Order ("Cronic Declaration"). The Catlin Policy has a $5 million Aggregate Limit of Liability, inclusive of Defense Costs. Cronic Decl., Exhibit A, Policy Declarations, Item 3. Catlin has paid out $5 million pursuant to the Catlin Policy and thus the Catlin Policy "has been fully exhausted." Cronic Decl., ¶ 3; Receiver's Report Dated July 31, 2017 (Dkt. No. 491) at 18-19.

Forge issued Excess Claims Made Private Equity Liability Insurance Policy No. B0146ERUSA1400543 to the Company for the Policy Period of July 1, 2014 to July 1, 2015

(subject to extension). The Forge Policy has a limit of $5 million, to begin once the initial $5 million in coverage provided by Catlin is exhausted. A copy of the Forge Policy is attached as Exhibit A to the Declaration of Larisa A. Meisenheimer in Support of Motion of Defendants Brian A. Oliver and N. Scott Gillis for Relief from Receivership Order ("Meisenheimer Declaration"). The Forge Policy provides that it follows the form of the primary Catlin Policy, except as specifically provided otherwise, and relies on the terms and conditions outlined in the Catlin Policy. Accordingly, the Catlin and Forge policies together shall be hereinafter referred to as the "Policy."

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).

The insuring agreement at issue in this Motion, Insuring Agreement A of the Policy, provides that Forge "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." Cronic Decl., Exhibit A, Section I(A). Oliver and Gillis are Insured Persons in their capacity as current or former executives of the Company. Cronic Decl., Exhibit A, Sections III(S) & (Z).

Other Insured Persons have sought coverage under the Policy in connection with the Investigation and may do so in the future. 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 . . . ." Cronic Decl., Exhibit A, Sections III(DD) & (K). Pursuant to Section VII of the Policy, Catlin and Forge "shall advance Defense Costs . . . no later than ninety (90) days after the receipt by the Insurer of such defense invoices." Cronic Decl., Exhibit A, Section VII.B.

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." Cronic Decl., Exhibit A, Section XIII(C). Given the magnitude of the Defense Costs that will likely be incurred by the multiple firms representing insured persons during this ongoing Litigation (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.

III. RELIEF REQUESTED

The Individual Defendants seek an order authorizing Forge to advance on a current basis Defense Costs incurred by or on behalf of the Individual Defendants in connection with the Litigation and/or the Investigation and other Claims. The Individual Defendants have incurred and continue to incur Defense Costs in connection with the Litigation and Investigation. If they are not able to access insurance proceeds, they face immediate, extreme prejudice, including but not limited to the possibility that their counsel will seek to withdraw and leave them unrepresented and that they will be unable to retain vendors or third-party professionals, such as experts, that they need for their defense.

IV. BASIS FOR RELIEF REQUESTED

To the extent necessary, the Individual Defendants respectfully submit that sufficient

cause exists to modify the Receivership Order to permit Forge to advance Defense Costs on behalf of the Individual Defendants 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, Forge should be able to advance those proceeds on behalf of the Individual Defendants in accordance with the terms of the Policy. First, while the Policy itself may be an asset of the Aequitas receivership estate subject, Policy *proceeds* due to Insured Persons like the Individual Defendants are not assets of that estate subject to an asset freeze. The Policy provides that Forge 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. Second, the Policy's Priority-of-Payments provision requires that payment first go directly to the insured directors and officers like the Individual Defendants before they can go to the covered corporate entity (here, the Receiver). Third, even if neither of these facts was true, the Court has authority to and should permit the disbursement of insurance proceeds to the Individual Defendants as Insured Persons.

In the bankruptcy context, courts have long recognized that although a liability insurance policy is the property of an estate in bankruptcy, policy *proceeds* paid "on behalf" of the insureds to third parties such as defense counsel or underlying claimants are not. That is because liability policy proceeds (like those at issue here) are not paid to the Receivership estate, and so never become a part of that estate. For that reason, bankruptcy courts frequently authorize the payment of policy proceeds for defense and indemnity for the insured directors and officers of an insolvent business. *See, e.g., In re La. World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987); *see also Matter of Edgeworth*, 993 F.2d 51, 56 (5th Cir. 1993); *First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993); *In re Endoscopy Ctr. of S. Nev., LLC*, 451 B.R. 527,

547 (Bankr. D. Nev. 2011).

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., SEC v. Narayan*, No. 3:16-CV-1417-M, 2017 WL 447205, at *5 (N.D. Tex. Feb. 2, 2017) (finding "compelling reasons to permit the advancement of defense costs" to insured individuals notwithstanding stay imposed by receivership order); *SEC v. Morriss*, No. 4:12-CV-80 CEJ, 2012 WL 1605225, at *4 (E.D. Mo. May 8, 2012) (granting insureds' motion for relief from receivership order to permit insurer to advance defense costs despite SEC's and receiver's opposition); *SEC 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 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"); *Exec. 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).

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-Payments provision. *Id*. at *4 ("[T]he policy includes a 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.*

On similar facts, the court in *Narayan* found "compelling reasons to permit the advancement of defense costs" to two officers of a company that had been placed in receivership after the SEC sued the company for securities fraud, also naming the two officers as defendants. 2017 WL 447205, at *1. Relying on the "general rule … that a receiver acquires no greater rights in property than the debtor had," the court first concluded that any potential benefit to the receivership estate under the insurance policy did not "negate [the officers'] contractual rights" to coverage under the insurance policy, finding "no basis to expand [the company's] rights under the contract simply because the Court imposed a receivership." *Id.* at *5. Second, the court found that the potential harm to the officers in withholding defense costs far outweighed any harm to the estate, as the officers were experiencing "clear, immediate, and ongoing defense expenses arising from" the SEC litigation and a related derivative action. *Id.* at *6. Third, even if the receivership estate had a current claim for coverage on the company's behalf, the court reasoned,

a Priority-of-Payments provision in the insurance policy "appears to subordinate any claim that the Receiver may have for [the company's] defense costs or derivative investigation expenses to the coverage" for the officers. *Id.* at *7. Finally, the court rejected the Receiver's argument that any covered defense costs must be evaluated for reasonableness because "it is [the insurer's] responsibility to determine the reasonableness of any fees incurred by" the officers—not the Receiver's. *Id.* at *9.

In administering a receivership, as the courts in *Morriss* and *Narayan* explained, courts may look to bankruptcy law when deciding the treatment of a particular issue, including examining the ownership of insurance policy proceeds. *See Morriss*, 2012 WL 1605225 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 . . . ."); *Narayan*, 2017 WL 447205, at *4 (same). 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]

For example, in *In re Downey Fin. 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

[1] The bankruptcy cases cited supra page 6 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.").

bankruptcy code "is not intended to expand the debtor's rights against others beyond what rights existed at the commencement of the case," the policy proceeds were not 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*, No. 07-10279-BKC-AJC, 2008 WL 1766637 (Bankr. S.D. Fla. Mar. 13, 2008) (not reported in B.R.), 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. The court therefore held that the policy proceeds were not part of the estate and not subject to an automatic stay. *See also In re Adelphia Comms. Corp.*, 298 B.R. 49, 53-54 (S.D.N.Y. 2003) (former employer of directors and officers had no property interest in proceeds of insurance policies in bankruptcy).

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 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:

> D&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.

Ochs v. Lipson (In re First Cent. Fin. 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).

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., Groshong v. Sapp (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 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).

Where, as here, the Individual Defendants face substantial prejudice if Forge is not allowed to advance Defense Costs, the Court, in its discretion, should allow advancement of Defense Costs pursuant to the Individual Defendants' 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, the Individual Defendants respectfully request 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 Forge to advance past and future Defense Costs to or on behalf of the Individual Defendants in connection with the Litigation and/or the Investigation and other Claims.

DATED: August 22, 2017 SHARTSIS FRIESE LLP

By: */s/ Larisa A. Meisenheimer*
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DATED: August 22, 2017 COVINGTON & BURLING LLP

By: */s/ W. Douglas Sprague*
W. DOUGLAS SPRAGUE (*Pro Hac Vice*)

Attorneys for Defendant N. Scott Gillis

LR 11-1(D)(2) CERTIFICATION

I hereby attest that all other signatories listed, on whose behalf this filing is submitted, concur in the filing's content and have authorized this filing.

/s/ Larisa A. Meisenheimer
LARISA A. MEISENHEIMER (*Pro Hac Vice*)

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