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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

PORTLAND DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v.	No. 3:16-cv-00438-PK RECEIVERSHIP ENTITY'S OPPOSITION TO ROBERT J. JESENIK'S MOTION FOR RELIEF FROM RECEIVERSHIP ORDER

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.

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

Defendant Robert J. Jesenik's ("Jesenik") Motion for Relief from the Receivership Order to Permit Payment of Defense Costs (the "Motion") (Dkt. 499) asks this Court to allow Forge Underwriting Ltd. ("Forge") to pay Jesenik's Defense Costs incurred in connection with his defense of the action entitled *Securities And Exchange Commission v. Aequitas Management, LLC, et.al.*, (the "*SEC* Action"). (Dkt. 1). Jesenik is one the three individual defendants in the *SEC Action*, along with Brian Oliver ("Oliver") and N. Scott Gillis ("Gillis"), who were involved in the management of the various Aequitas entities which the SEC asserts were responsible for Aequitas's financial collapse. As discussed herein, and putting it charitably, the Motion is disingenuous, lacks candor, and is rife with factual and legal misstatements.

To begin, Jesenik's Motion suffers from a lack of admissible evidence on a crucial issue. Jesenik asserts in his Motion, *inter alia,* that Forge has agreed to pay his Defense Costs in the *SEC* Action based upon his assertion that the primary-level liability carrier, Catlin Specialty Insurance Company ("Catlin"), had paid out its $5 million in limits of liability in Defense Costs in connection with the *SEC* Action and asks this Court to allow Forge to do so as well. Yet, the declaration purportedly supporting this assertion lacks foundation showing personal knowledge and constitutes inadmissible hearsay. Indeed, the declarant, Jason Cronic, an attorney from an unidentified law firm, states that he represents Catlin, but he provides no facts whatsoever involving his: (i) review and analysis of the contents of any invoice submitted in connection with the *SEC* Action or the SEC's prior investigation, let alone invoices seeking payment of $5 million in attorneys' fees and expenses; (ii) conclusion that these invoices contained $5 million in covered Defense Costs; or (iii) payment of $5 million in Defense Costs on Catlin's behalf to the Insured Persons or telling Catlin to do so. (*See* Receiver's Objection to Declaration of Jason P. Cronic). Nor has Jesenik provided a single shred of admissible evidence of Forge's positions on Catlin's supposed exhaustion or Forge's willingness to pay Defense Costs to Jesenik. These evidentiary omissions on the issue of exhaustion are fatal to Jesenik's Motion.

Even if Cronic's assertions were admissible (and they are not), the problems detailed below concerning Jesenik's Defense Costs in the *SEC* Action are so significant that they call into doubt whether Catlin's $5 million in policy limits were legitimately exhausted and/or whether Catlin shirked its duty to analyze the Defense Costs despite the presence of numerous red flags. (*See also* Declaration of James P. Schratz ¶¶ 14-16). Besides Jesenik's inability to prove that Catlin's policy limits were legitimately exhausted, as described below, there are a number of other problems with Jesenik's Motion.

A. Jesenik's Motion Ignores The Existence of Substantial Questions About Whether The Legal Fees and Expenses Incurred By Him Qualify As Defense Costs.

Jesenik's Motion critically fails to mention that the factual landscape has substantially changed since this Court entered the May 20, 2016 Stipulation and Order Granting Relief from Receivership Order to Permit Limited Payment of Defense Costs.[1] (Dkt. 185). Jesenik's Motion notably omits any discussion of the Receiver's intense efforts over the last month and a half or so to have Jesenik's counsel justify the extraordinary amount of defense costs in the *SEC* Action, which Jesenik has largely failed to answer. The legal fees and costs incurred by counsel for Jesenik and the other Individual Defendants qualify as Defense Costs only if they were incurred in defending the subject Claim, here the *SEC* Action, and were reasonable and necessary. Questions about the amount of fees and costs being incurred by Jesenik, and Catlin's payment of them, first came to light during the latter part of June 2017, when the Receivership was first informed by a representative for the Individual Defendants that the Catlin policy's $5 million in limits of liability were fully exhausted, less than three months after it was informed that only a little over $2 million had been paid out through the end of the first quarter of 2017.

[1] The factual landscape has also changed (and continues to change) given Jesenik's repeated changes in counsel and the tremendous costs associated therewith. Jesenik has gone from Gibson Dunn/Stoel Rives to Schulte Roth & Zabel/The Rose Law Firm, and most recently, he has replaced The Rose Law Firm with the Mahler Law Group and the Jonak Law Group.

The Receivership's subsequent investigation has led to a number questions, mostly involving fees and expenses billed by Jesenik's counsel. The Receiver, for example, questioned Jesenik about: (i) how the combined amounts billed by Jesenik's lead and local counsel starting in early November 2016, after Jesenik had replaced Gibson Dunn & Crutcher ("Gibson Dunn") and local counsel Stoel Rives with new counsel, through the end of July 2017, are close to $2.5 million,[2] and are 270% ($1,565,905) and 435% ($1,914,655), respectively, greater than the amounts billed by Jesenik's co-defendants over this same period[3]; (2) how one of Jesenik's ***local*** counsel, the Rose Law Firm, in a case that does not involve any issues of Oregon law, incurred legal fees and expenses totaling in excess $207,000 for just five months' worth of work; and (3) whether the insurers paid for legal services unrelated to the *SEC* Action that the Receivership knows were performed on Jesenik's behalf by Gibson Dunn and the Rose Law Firm. Jesenik's silence in response to these, as well as a number of other issues, speaks volumes.

B. The Receivership Entity Has Received Claims Seeking Damages Significantly In Excess of The Remaining 2014-2015 Policy Limits, Which Trigger Coverage for The Receivership Entity Under the 2014-2015 Policies.

The factual landscape has also dramatically changed after numerous Aequitas investors have sent Claims to counsel for the Receiver, Troy Greenfield of Schwabe, Williamson & Wyatt, P.C. ("Schwabe"). For example, on August 10, 2017, counsel for many Aequitas Investors, Robert Banks of Samuels Yoelin Kantor, LLP ("SYK"), wrote Mr. Greenfield to demand payment of $45 million plus interest from, *inter alia*, Aequitas Holdings and its various subsidiaries. (Greenfield Decl., Exh. 1). The SYK correspondence constitutes a Claim as that term is defined in the Catlin policy (the "SYK Claim") and is covered under, *inter alia*, the Forge and Starr policies that

[2] For this nine (9) month period running from November 2016 through the end of July 2017, this equates to roughly $277,778 per month in legal fees and expenses being charged by Jesenik's counsel.

[3] Gibson Dunn and local counsel, Stoel Rives, separately were paid by Catlin $1,015,673.05 and $55,375.10, respectively, for work those firms performed on behalf of Jesenik before they were replaced in early November 2016.

incorporate the terms of the underlying Catlin policy. The Receivership gave Notice to both the 2014-2015 policy-year carriers (Catlin, Forge and Starr) and the 2015-2016 policy-year carriers (Forge, Aspen and Starr). There are no material coverage questions that currently exist for the SYK Claim under the 2014-2015 policy-year policies since the so-called "personal profit" and "deliberate fraud" exclusions of those policies apply only if there is a "final adjudication" of such conduct. (See Catlin Policy, Section IV.B.1 & 2). The existence of the SYK Claim undercuts one of (if not the) central argument Jesenik makes in his Motion that the Receivership has no right to the proceeds of any of the 2014-2015 policies, since no Claim against the Receivership triggering coverage under the same 2014-2015 policies existed. (Motion at 9, 10-11, 16).[4]

More recently, additional Claims have been sent to Mr. Greenfield. On September 7, 2017, additional Aequitas investors sent a demand of payment of more than $72 million from various Aequitas entities ("Miller Claim"). (Greenfield Decl., Exh. 2). On September 11, 2017, counsel for the plaintiffs in the lawsuit captioned *Ciuffitelli et al. v. Deloitte & Touche LLP et al.*, No. 16-CV-00580-AC (D. Or.), sent a demand of $450 million or more from various Aequitas companies ("Stoll Claim"). (Greenfield Decl., Exh. 3). Then on September 12, 2017, counsel for additional Aequitas investors sent a demand for $38 million plus interest and attorneys' fees ("LVK Claim"). (Greenfield Decl., Exh. 4).

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[4] The absence of any prior active litigation against the Receivership is due solely to the stay provided for in the Order Appointing Receiver. As the Court will recall, objections to the stay were filed by counsel representing the Investors, who wanted to bring suit against the Receivership Entity and Aequitas' former management, including Jesenik. (Dkt. 52). This should be distinguished from the situation presented in bankruptcy, upon which Jesenik heavily relies, where adversary proceedings can be brought against a bankrupt organization and its management or former management, as the case may be. *In re Teerlink Ranch Ltd.*, 886 F.2d 1233, 1237 (9th Cir. 1989) (automatic stay inapplicable to suit commenced in same court where bankruptcy pending).

C. **<u>The Proceeds Of The 2014-2015 Policies, Under Either The Receivership Order Or Controlling Analogous Ninth Circuit Bankruptcy Case Law, Are Property of the Receivership Estate.</u>**

Jesenik's Motion also fails to address the fact that the Court's April 14, 2016 Order Appointing Receiver contains a very broad definition of Receivership Property that encompasses policy proceeds as property of the Receivership Estate (Dkt. 156). The Receivership Property definition provides that monies, rights, or other income which the Receivership Entity owns, possesses, has a beneficial interest in, or controls directly or indirectly constitute Receivership Property. The 2014-2015 policy-year policies, including Forge's obligation to pay Loss under Insuring Agreement C – which includes Defense Costs, damages, settlements, or judgments an Insured Company is legally obligated to pay – is triggered here, subject to available limits of liability, by the above-mentioned Claims. The 2014-2015 policies' obligation to pay Loss under Coverage C on behalf of the Insured Companies, which includes Aequitas Holdings and all its subsidiaries, constitutes monies, rights or other income the Receivership owns, possesses, or has a beneficial interest in, and therefore qualifies as Receivership Property. Jesenik has not, and cannot, legitimately argue otherwise.

Moreover, even if bankruptcy law were relevant here for determining whether insurance proceeds are property of the estate (and it is not), Jesenik's argument is inconsistent with controlling Ninth Circuit authorities which have held that (a) the test of whether insurance proceeds are property of the bankruptcy estate is whether the estate is worth more with them than without (which is easily met here); and (b) liability policies (such as those at issue here) are not held in constructive trust by the insured for the benefit of potential claimants; rather, they are held by the insured as protection against claims that may be asserted against the insured. *In re Minoco Group of Cos.*, 799 F.2d 517, 519 (9th Cir. 1986).

Further, even if the Fifth Circuit bankruptcy authorities upon which Jesenik relies applied (and they do not) and payments made "on behalf of" a debtor do not constitute estate property, cases within the Fifth Circuit hold that insurance proceeds are still property of the estate if the amount of loss exceeds the available limits of liability. *Schmidt v. Villarreal (In re OGA Charters,* *LLC)*, 2017 Bankr. LEXIS 2056, at *65 (Bankr. S.D. Tex. July 24, 2017) (citations omitted). Here, the amount of Loss from the SYK Claim, the Miller Claim, the Stoll Claim, and the LVK Claim, which total in excess of $600 million, exceed the available limits of liability.

D. Catlin's Priority of Payments Provision is Very Narrowly Drafted And Under Oregon Law Does Not Transform The Policy Proceeds Into Jesenik's or The Other Individual Defendants' Property.

Jesenik also unreasonably misinterprets the priority-of-payments provision of the Catlin policy, asserting it provides that all ***potential*** Loss under the 2014-2015 policies (which includes Defense Costs) are solely the property of Jesenik and other Insured Persons, to the exclusion of the Receivership. (Motion at 11-12). Catlin's Priority-Of-Payments provision says no such thing.

When interpreting insurance provisions under Oregon law, absent a writing to the insurer(s) from the Named Insured (here Aequitas Holding) stating that all Loss should be first paid to Insured Persons under Coverage A, Insured Persons have priority over Loss under Coverage C, *if, and only if*, their incurred **Loss** under Coverage A exceeds the remaining Limits of Liability. *Hoffman Constr. Co. v. Fred S. James & Co.*, 313 Ore. 464, 469-70 (1992) (if provision is not ambiguous, then policy is interpreted in accordance with that unambiguous meaning). Since Aequitas Holding never wrote any of the 2014-2015 policy-year insurers telling them to pay Loss under Coverage A first, any priority-of-payments rights Jesenik and the other Individual Defendants may have are limited in scope to the situation where the available Limits of Liability are insufficient to pay all Loss, and therefore pays incurred Loss under Coverage A first. By contrast, the cases upon which Jesenik relies (Motion at 11-14) contain priority-of-payments provisions with different, much more broadly written priority-of-payments provisions that require an insurer to pay individual insureds ahead of corporate entities.

E. Assuming Jesenik Establishes Exhaustion of the Catlin Policy, The Court In Exercising Its Discretion Should Not Grant Him Any Relief At This Time Since Any "Prejudice" He Supposedly Will Suffer Is of His Own Making And Without Evidentiary Support.

The Receivership Entity and each of the three Individual Defendants in the SEC Action are insureds under the 2014-2015 policy-year policies and have an undivided, unliquidated interest in the same assets, the 2014-2015 policy proceeds. *In re Metro. Mortg. & Sec. Co.,* 325 B.R. 851, 857 (Bank. E.D. Wash. 2005). The continued diminution of the 2014-2015 proceeds adversely affects the Receivership Entity's interest in and right to recover them. *Id.*

Assuming, *arguendo,* that Jesenik establishes that the Catlin policy is exhausted and liability under the Forge policy is therefore triggered, this Court will be faced with the question of whether it should exercise its discretion – taking into consideration the impact of further diminution of the 2014-2015 policy-year proceeds available to the Receivership to address the SYK Claim, the Miller Claim, the Stoll Claim, and the SVK Claim – to allow further payment of Defense Costs to Jesenik and, if so, to what extent and under what conditions.

While the evidentiary deficiencies in Jesenik's moving papers warrant the denial without prejudice, *the Receivership Entities want to make clear that they are not attempting to deprive Jesenik of his ability to prepare his defenses in the SEC Action.*[5] However, as discussed at some length herein, a large portion of the legal fees and expenses Jesenik and his counsel have so far incurred, at least facially, cross the line as to whether they properly qualify as Defense Costs.

Finally, as set forth below in greater detail in Section IV.C, if this Court is inclined to exercise its equitable power to allow Forge to pay **Loss** incurred by or on behalf of Jesenik, then it should also use its equitable powers to impose a number of basic safeguards to protect against the unreasonable diminution of Receivership Property which is attributable to Jesenik's out-of-control Defense Costs. Alternatively, the Court can avoid supervising each payment by tentatively partitioning the remaining limits of liability in the 2014-2015 policies under its equitable powers between the Individual Defendants and the Receivership Entity, subject of course to any coverage

[5] Notably, by contrast, the Receivership Entity has advised Brian Oliver's and N. Scott Gillis's respective counsel that the Receiver has no objection at this time to the amounts the primary-level insurer (Catlin) paid to them. The questions at issue in Oliver's and Gillis's Motion involve other issues such as whether the Catlin policy is exhausted, whether the Forge policy proceeds are property of the estate and whether, under all the facts presented they are entitled to payment out of the policy proceeds.

issues that Forge and Starr may raise (but only in their capacity as 2014-2015 policy-year insurers) and which the Court can later rule on if necessary.

II. RELEVANT BACKGROUND FACTS

A. The Stipulated Order Permitting Relief from the Receivership Order and the Payment of Defense Costs

On April 14, 2016, this Court entered an Order appointing Ronald Greenspan as the Receiver for the Receivership Defendants. (Dkt. 156). On May 12, 2016, Defendants Jesenik, Oliver, and Gillis filed a joint Motion for Relief from Receivership Order "for the purpose of allowing Catlin to advance past and future Defense Costs to or on behalf of the Executives and other Insured Persons in connection with the Litigation and/or the Investigation and other Claims." (Dkt. 176). Subsequently, however, the Aequitas Entity and moving parties negotiated and filed a Stipulation and proposed Order granting relief from the Order Appointing Receiver to permit limited payment of defense costs. (Dkt. 184). Unlike the relief Jesenik had sought in his original motion, the Stipulation and Order made clear that, among other things, Defense Costs could only be paid pursuant to the terms and conditions of the Catlin Policy, the Receivership Entity stated that it had rights to a portion of the policy proceeds, the Receivership had a right to information about expenditures, no policy proceeds were allowed for other claims or unidentified insured persons, and the parties had entered into the Stipulation pursuant to a mutual reservation of rights. This Court entered an Order on the Stipulation, which required the Executives to submit a quarterly report to the Receiver reflecting the aggregate amount of Defense Costs paid by the Insurer on behalf of the Executives during the prior quarter. (Dkt. 185). Jesenik's Motion fails to mention this procedural history and, instead, misleadingly states that "this Court has already ruled on the issue . . . ." (Motion at 2).

B. The Recent Inexplicable Acceleration of Payments to Jesenik's Counsel

In April 2017, counsel for the Aequitas Entity, Ivan Knauer, received an email from Jesenik's new lead counsel, Jeffrey Robertson of Schulte Roth & Zabel ("Schulte"), regarding fees paid through Q1 of 2017. Robertson wrote:

> According to its counsel, Catlin advanced $763,924.11 during the quarter ending 12/31/16, $685,818.89 during the quarter ending 3/31/17, and $2,020,842.59 in total. . . . [T]hese amounts include payments to the e-discovery vendor we're using.

(Knauer Decl. ¶3 & Exh. 1 thereto). This amount, while significant, did not appear unreasonable on its face, especially given that it was inclusive of the investigation.

In late June 2017, counsel for Brian Oliver ("Oliver"), Larisa Meisenheimer of Shartsis Friese LLP, communicated with Mr. Knauer and Stanley Shure (coverage counsel for the Receivership Entity), supposedly on behalf of all Individual Defendants, asserting that the Catlin Policy was exhausted. (Shure Decl. ¶2). Mr. Shure asked Ms. Meisenheimer for evidence of exhaustion, and she subsequently provided a spreadsheet on July 13, 2017, purportedly showing exhaustion of Catlin's $5 million in policy limits. (*Id*. ¶3 & Exh. 1). *Notably, in between the time of Mr. Shure's request for evidence and Meisenheimer's production of the spreadsheet, Catlin made additional payments on July 7, 2017, totaling in excess of $1.4 million.* (*Id*.)

The Individual Defendants provided no explanation for the extraordinary jump from $2 million in Defense Costs at the end of Q1 of 2017 to an additional $3 million paid out during Q2 of 2017 (and one week of Q3 of 2017). Further, the Receivership learned that an additional $1,421.522.45 million of Defense Costs incurred as of July 31, 2017. (*Id*. ¶6, Exh. 3). Incredibly, as of July 31, 2017 – in a case involving one motion to dismiss (Gillis); document review (not yet finished); no depositions; and a motion for a protective order (which Jesenik's counsel was the driving force behind) – the Individual Defendants have incurred close to $7 million in fees and expenses.

C. The Receiver Conveys His Concerns about Jesenik's Extraordinary Defense Costs in the *SEC* Action

Alarmed by the sudden, significant increase in defense costs, on August 3, 2017, Mr. Shure wrote to counsel for the Individual Defendants to convey the Receiver's concerns regarding the apparent exhaustion of the Catlin Policy. (Shure Decl., Exh. 2). Among other things, after pointing out the relatively minimal amount of motion practice in the *SEC* Action, Mr. Shure noted that the amounts purportedly paid by Catlin – as reflected in the spreadsheet provided – to Jesenik's counsel to defend the *SEC* Action *dwarfed* the amounts paid to Oliver's or Gillis's counsel.

> Catlin/XL made payments to Oliver's attorneys totaling $814,382.07, of which $15,238.20 was paid to local counsel. Catlin/XL paid Gillis's attorneys a total of $905,070.25, of which $29,150.09 was paid to local counsel. Catlin/XL, in contrast, paid Jesenik's counsel a total of $2,713,683. The $2,713,683 in fees and costs paid to Jesenik's counsel is 333% higher than the $814,382 paid to Oliver's counsel and 300% higher than the $905,070 paid to Gillis' counsel.

Mr. Shure further noted that the fees paid to Jesenik's counsel have greatly increased once Schulte Roth & Zabel ("SRZ") and new local counsel, the Rose Law Firm ("Rose"), substituted into the *SEC* Action:

> The payments made by Catlin/XL to SRZ and Rose, in contrast, were significantly higher than those made to their predecessors. SRZ received payments totaling $1,435,034.06 based upon five fully paid invoices and the partial payment on a sixth invoice. Using 5.5 invoices, SRZ was paid by Catlin/XL on average $260,915.27 in legal fees and costs per invoice. This is the equivalent of a 282% per invoice increase in the amounts paid by Catlin/XL to SRZ as compared to the amount paid to Gibson.
> Rose, Jesenik's local counsel, received a total of $207,600.68 in payments from Catlin/XL based upon the five invoices it submitted to Catlin/XL. This translates to an average payment of $41,520.14 per invoice. Rose's average monthly invoice of $41,520.14 reflects a 600% increase as compared to Stoel Rives' average monthly invoice of $6,921.89.

In addition, Mr. Shure pointed out in his correspondence that the payments to and/or amounts incurred by SRZ and Rose ($1,642,634.74) also dwarfed those made to Oliver's ($597,654.69) and Gillis's defense counsel ($344,839.50) for the same time frame.

Mr. Shure also told the Individual Defendants' counsel that the Receiver is aware of specific instances of legal services being performed on Jesenik's behalf by Gibson Dunn, primarily, and later by Rose, to some extent, which did not involve defending Jesenik in the SEC Action. (*See, e.g.*, Dkt. 264 (Jesenik's Motion to Continue Hearing on Sale of CCM Interests); Dkt. 265 (Declaration of Marc Fagel)). Mr. Shure added that if Jesenik asserts these legal services were not submitted to Catlin/XL or Forge for payment, he should provide evidence supporting this position. Further, Mr. Shure inquired how it was possible for Rose, as local counsel for Jesenik, to incur legitimate Defense Costs totaling $207,600 for a five (5) month period.

On August 9, 2017, Peter White, counsel for Jesenik, responded in part to Mr. Shure's August 3rd letter. (Shure Decl. Exh. 4). More specifically, after asserting that the Receiver lacked standing to object to the improper payment of defense costs to the Individual Defendants, Mr. White raised a number of strawman arguments and otherwise misconstrued the August 3rd request for information. Unfortunately, Mr. White also failed to supply much of the requested information,[6] and instead decided to try and ride roughshod over the meet-and-confer process and file his request for relief on an expedited basis.

On August 12, 2017, Mr. Shure wrote Mr. White addressing the main issues raised in his response. These included the Receiver's standing to object to the legal fees and costs incurred on Jesenik's behalf, as well as Mr. White's straw man arguments to try and justify the reasonableness and necessity of the Defense Costs paid to or incurred by his firm. (Shure Decl. Exh. 5). There has been no response to Mr. Shure's August 12, 2017 letter. Instead, Jesenik and his co-defendants filed motions for relief from the Receivership Order to permit the payment of Defense Costs and sought an expedited hearing.

There are also substantial questions about the relief sought by Jesenik. As reflected in Jesenik's [Proposed] Order (Dkt. No. 503), he seeks payment for Jesenik and other undisclosed individuals for, *inter alia*, the SEC's Investigation – which ended in March 2016 when the SEC

[6] Thus, although Mr. White's letter purportedly was on behalf of Jesenik, he provided none of the requested information regarding work performed by Gibson Dunn (and the Rose Law Firm) outside the defense of the SEC Action. Nor did he provide any explanation about how local counsel (Rose) spent approximately $207,000 in five months when no Oregon law issues were contested and the activity in the case has been *de minimus*. In fact, Mr. White made it clear in his letter that his firm (not local counsel) was performing the document review and interviewing witnesses. If so, it certainly raises a question about what the Rose Law Firm was doing during that time period. Additionally, Mr. White failed to explain why the Rose Law Firm has been replaced by two law firms: the Mahler Law Group and the Jonak Law Group.

filed this action – and other unidentified claims, all without any oversight by this Court or the Receiver.

As set forth in the concurrently filed Declaration of James P. Schratz, the Receiver's concerns are well-founded. Mr. Schratz is an expert both in matters involving billing disputes and the duties and obligations of insurance companies. (Schratz Decl. ¶¶3-12). Indeed, it is Mr. Schratz's opinion that "there are serious questions about whether certain of the law firms representing the individual defendants unreasonably billed fees in this case." (Schratz Decl. ¶ 17). Among other things, Mr. Schratz points out that, the fact that Jesenik's counsel was paid approximately three times more than Gillis's counsel or Oliver's counsel raises questions which need to be investigated and answered. (*Id.*). Mr. Schratz also notes that, based on his preliminary review, there is no indication that Catlin spent time to analyze the bills looking for red flags or that Forge is properly performing its duties and obligations as to whether the Catlin policy is, in fact, properly exhausted. (Schratz Decl. ¶¶ 14-16).

D. SYK's $45 Million Claim against Aequitas Holdings Is The Tip Of The Iceberg.

On August 10, 2017, counsel for numerous Aequitas Investors, Robert Banks of Samuels Yoelin Kantor, LLP ("SYK"), wrote counsel for the Receiver and Receivership Entity, Troy Greenfield of Schwabe, Williamson & Wyatt, PC, ("Schwabe") to demand payment of $45 million plus interest from, *inter alia*, Aequitas Holdings and its various subsidiaries. (Greenfield Decl. Exh. 1). The Investors' claims are based on, among other things, Aequitas's failure to disclose the true nature of the relationship between Aequitas Holdings and its subsidiaries, on the one hand, and the Registered Investment Advisors ("RIA") firms that sold Aequitas investments to many of SYK's clients, on the other hand; numerous misrepresentations and omissions in private placement memoranda for Aequitas investments; and the failure to disclose the existence and dire financial conditions of entities owned by Aequitas affiliates that were losing money year after year.

The SYK August 10th correspondence (the "SYK Claim"), of which the Receivership Entity has provided notice to the insurers (*see* Shure Decl. ¶9 & Exh. 6), qualifies as a "Claim" under the Forge and Starr Indemnity 2014/2015 policy-year policies and the Forge, Aspen, and Starr 2015/2016 policy-year policies. Certain allegations of the SYK Claim trigger coverage and "relate back" to the 2014/2015 policies and other allegations "relate back" to the 2015/2016 policies. The existence of a Claim that contains some matters that are covered by a given policy and some matters that are not covered is contemplated by both the 2014/2015 policies and the 2015/2016 policies.[7]

The $45 million in damages sought as part of the SYK Claim is well in excess of the approximately $10 million (assuming the Catlin Policy is fully exhausted) in combined limits currently available under the 2014/2015 policy-year D&O/Professional Liability policies.[8] Putting aside the liability insurance assets discussed above, as of July 31, 2017, the Receivership Entity has assets in the amount of $150 million. Moreover, as noted above, Mr. Greenfield has recently received a number of additional Claims – the Miller Claim, the Stoll Claim, and the LVK Claim – which total in excess of $600 million. (Greenfield Decl., Exhs. 2-4).

III. RELEVANT POLICY LANGUAGE

The Forge Policy has a limit of $5 million, which is triggered once the $5 million of Catlin's policy limits are exhausted. *See* Forge Policy – WNM Professional Indemnity, Item 1 ("Liability to pay under this Policy shall not attach unless and until the Underwriters of the Underlying Policy(ies) shall have paid or have admitted liability or have been held liable to pay, the full amount

[7] Both the 2014/2015 policy-year and the 2015/2016 policy-year primary level policies contain identical Allocation provisions that provides "[i]f the **Insureds** incur **Loss** that is only partially covered by this Policy because a **Claim** includes *both covered and uncovered matters* . . . then the **Insurer** and the **Insureds** shall use their best efforts to allocated such **Loss** based upon: . . . ." (*Italics* added.)

[8] Assuming, *arguendo*, that the all the fees paid to Jesenik's various counsel properly constitute Defense Costs, it is the Receivership's understanding that there are slightly in excess of $8 million in unimpaired limits left of the original $15 million of combined limits of the 2014/2015 policy-year D&O/Professional Liability policies.

of their indemnity inclusive of costs and expenses."). The Forge Policy follows the form of the Catlin primary policy, except as provided otherwise, including its terms and conditions.

The Catlin Policy provides, in pertinent part, as follows:

I. Insuring Agreements

A. Insured Person Liability

The **Insurer** 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**.

C. Insured Organization Liability
The **Insurer** shall pay on behalf of an **Insured Organization** all **Loss** which the **Insured Organization** becomes legally obligated to pay resulting from a **Claim** . . . first made against such **Insured Organization** during the **Policy Period** . . . for a **Wrongful Act**.

III. DEFINITIONS

E. "**Asset Management Services**"[9] means:

(1) any advisory or other services, including without limitation, any management, investment, financial, monitoring, operational or financial advisory or other services: (i) for or on behalf of or for the benefit of any **Insured Organization**;or (ii) for or on behalf of any **Portfolio Company**;

(2) investment or asset management services, administrative services, portfolio management and asset allocation services;

(3) financial, economic, or investment advice regarding investment in securities or investment vehicles;

(4) the formation, capitalization, operation, management, administration, marketing, solicitation or dissolution of, or

[9] As amended by the "Amended Definition of Asset Management Services Endorsement."

raising capital for, any Investment Fund, including but not limited to the preparation of any offering documents . . . .

F. "**Claim**" means any:

1. written demand or notice for civil monetary or non-monetary relief (including, but not limited to, injunctive relief) commenced by an **Insured's** receipt of such demand or notice;

2. civil proceeding . . . commenced by the service upon an **Insured** of a written notice of complaint, demand for arbitration, request for mediation or similar document . . .

.[10]

K. "**Defense Costs**" means reasonable and necessary fees and expenses incurred in the defense or appeal of a **Claim** . . . .

DD. "**Loss**" means **Defense Costs**, compensatory and other damages, settlements, judgments, pre- and post-judgment interest, and legal fees and costs awarded pursuant to judgments and appeals. . . .

OO. "**Wrongful Act**" means:

1. regarding an **Insured Person**, any actual or alleged:

   a. act, error, omission, statement, misstatement, misleading statement, neglect or breach of duty by an **Insured Person** in his or her capacity as such, including, without limitation:

      (i) in rendering of, or failure to render, **Asset Management Services**; . . .

2. regarding an **Insured Organization**, any actual or alleged act, error, omission, statement, misstatement, misleading statement, neglect or breach of duty by an **Insured Organization**:

   a. in rendering, or failing to render, **Asset Management Services** . . . .

[10] Pursuant to the Securities Claims Endorsement, the term **Claim** also includes a **Securities Claim**. A **Securities Claim** means any **Claim** that a security holder of the **Company** brings in his or her capacity as a security holder of the **Company**.

IV. **LIMIT OF LIABILITY**

A. The Limit of Liability specified in Item 3. of the Declarations is the maximum aggregate amount that the **Insurer** shall pay for all **Loss** under this Policy. . . If the Limit of Liability is exhausted, the premium for this Policy shall be fully earned.

B. **Defense Costs** shall be part of, and not in addition to, the Limit of Liability. Payment of **Defense Costs** by the **Insurer** shall reduce the Limit of Liability.

XIII. **GENERAL CONDITIONS**

C. Priority of Payments

1. If **Loss** is incurred that exceeds the remaining Limits of Liability for this Policy, the Insurer shall pay **Loss** under **Insuring Agreement A**. before paying any other **Loss**.

2. If **Loss** is incurred other than under **Insuring Agreement A** the **Named Insured** shall have the right to direct the **Insurer** to delay payment of such **Loss** until such time as the **Named Insured** specifies. . . .

IV. JESENIK'S ARGUMENTS ARE WITHOUT MERIT.

Jesenik essentially advances three substantive arguments in support of his request for relief: (1) the Policy proceeds – presumably those paid pursuant to "entity" coverage provided by Insuring Agreement C are not assets of the Aequitas receivership estate subject to an asset freeze because they are paid "on behalf of" the Receivership Entity; (2) the Policy's Priority-of-Payments provision requires that payments first be made directly to or on behalf of the insured directors and officer, like Jesenik, before they go to the covered corporate entity (*i.e.*, the Receivership Entity); and (3) in any event, the Court has authority to permit the disbursement of insurance proceeds to Jesenik to ensure the orderly processing of this matter. *See* Motion at 6. Jesenik's first two arguments are plainly wrong for the reasons set forth below. As for his third argument, while the Court has discretion to permit the insurers to make additional payment of defense costs to and on behalf of Jesenik, such payments should be permitted only under the conditions set forth below in Section IV.D of this memorandum.

A. Jesenik's Motion Is Not Supported By Admissible Evidence And Fails On This Ground Alone.

Again, the Forge Policy has a limit of $5 million, which is triggered once the $5 million of Catlin's policy limits are exhausted. *See* Forge Policy – WNM Professional Indemnity, Item 1 ("Liability to pay under this Policy shall not attach unless and until the Underwriters of the Underlying Policy(ies) shall have paid or have admitted liability or have been held liable to pay, the full amount of their indemnity inclusive of costs and expenses."). However, as noted above, and in the concurrently filed Evidentiary Objections to Jason Cronic's Declaration, Jesenik's moving papers do not include admissible evidence to support the conclusion that Catlin has in fact paid $5 million in Loss on behalf of Insured Persons through the advancement of "Defense Costs." (Dkt. No. 500). Specifically, Cronic's statement lacks foundation and constitutes inadmissible hearsay. As for Jesenik's assertion in his brief that "Forge has indicated that it is willing to advance certain defense costs as defined by the Policy," there is no declaration supporting this assertion, and this statement is inadmissible hearsay.[11] Fed. R. Evid. 801(c). Absent the foregoing admissible evidence, Jesenik has failed to satisfy his burden that he is in fact entitled to relief *vis-à-vis* the Forge Policy.

B. The Court Need Not Look Beyond The Receivership Order And The Policy Language To Determine Whether Insurance Proceeds Are Receivership Property.

Jesenik concedes that a debtor's insurance policies are property of the estate. *See* Motion at 7. Jesenik argues, however, that in the bankruptcy context (and, by analogy, the receivership context), insurance policy *proceeds* are not assets of the estate subject to an asset freeze. *Id.* at 7. According to Jesenik, this is because the policy proceeds are paid "on behalf of" the insureds to

[11] Additionally, based upon the scope of the Order that Jesenik seeks from the Court here, there seem to be significant but unstated agreements between Jesenik and others, including perhaps Forge. The Order proposed by Jesenik asks for payments to "other" unidentified Insured Persons, payments for unidentified Investigations, and unspecified "claims." Jesenik should be required to disclose the identity/ies of the unidentified Insured Persons and what other Investigation(s) or Claims he is referring to in his proposed Order.

third parties, rather than directly to the Receivership estate itself, and so never become part of the estate. *Id.* Notably, in advancing this argument, Jesenik relies on Insuring Clause A of the Policy, rather than Insuring Clause C. *Id.* ("[T]he Receiver has no entitlement to the proceeds of a claim paid under Insuring Agreement A (sometimes called a 'Side A claim') on behalf of Jesenik when those proceeds are paid."). Jesenik is wrong for a number of reasons.

1. Jesenik's Reliance On Bankruptcy Law Is A Red Herring. The Unambiguous Order Appointing Receiver And Policy Make Clear That The Monies The Insurers Pay On Behalf Of The Receivership Entity Constitute Receivership Property. This Ends The Inquiry.

a. *There Is No Requirement To Apply The Bankruptcy Code In A Federal Equity Receivership Proceeding.*

Rather than attempting to address the language in the governing Order Appointing Receiver, Jesenik turns instead to bankruptcy law. *See* Motion at 6. While he correctly notes that it is *permissible* for a court in a receivership proceeding to look to bankruptcy law for guidance (*see* Motion at 6-8), he cites no authority (and there is none) *requiring* a court to do so. Indeed, the case law is clearly to the contrary. *See, e.g.*, *Qulling v. Trade Partners, Inc.*, 2006 U.S. Dist. LEXIS 101381, at *6 (W.D. Mich. Dec. 1, 2006) ("This proceeding is a federal equity receivership and the Bankruptcy Code does not apply. Instead, when appropriate, courts can consider bankruptcy provisions for guidance but are not generally required to apply the Bankruptcy Code."); *SEC v. Capital Consultants LLC*, 453 F.3d 1166, 1170 n.4 (9th Cir. 2006) (noting differences between bankruptcy and receivership proceedings).

Not surprisingly, Jesenik cites no authority (and, again, there is none) suggesting that a court in a federal equity receivership proceeding is bound to follow bankruptcy law especially where (as here) the Court's own Order Appointing Receiver is instructive on the disputed issue.[12]

[12] In *SEC v. Morriss*, 2012 U.S. Dist. LEXIS 64465, at *8 & n.7 (E.D. Mo. May 8, 2012), the decision upon which Jesenik relies, the court does not discuss whether the receivership order it had entered contained a definition of receivership property and, if so, the nature and scope of the definition. Thus, it is unclear why the *Morriss* court turned to bankruptcy law for guidance in its analysis rather than its own order. Speculation as to that court's unwritten reasoning is unnecessary

Indeed, such a decision would be completely inconsistent with a district court's "broad powers and wide discretion" to fashion appropriate relief in federal receivership proceedings. *See SEC v. Capital Consultants*, LLC, 397 F.3d 733, 738 (9th Cir. 2005). These broad powers "extend to allocating the priority of distributions from the receivership estate." *Quilling, supra*, 2006 U.S. Dist. LEXIS, at *11. Moreover, "[i]n receivership proceedings arising out of securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud." *Id*. at *12; *see also SEC v. HKW Trading LLC*, 2009 U.S. Dist. LEXIS 77215, at *7-8 (M.D. Fla. Aug. 14, 2009) (same). Thus, Jesenik's reliance on bankruptcy law principles is misplaced.

b. *The Application Of Basic Principles Of Contractual Interpretation To The Order Appointing Receiver And The Policy Completely Undermines Jesenik's Argument.*

The starting point for determining what is (and is not) property of the Receivership Entity is, not surprisingly, this Court's April 14, 2016 Order Appointing Receiver (Dkt. No. 156). The interpretation of the Order Appointing Receiver is governed by the basic principles of contract law. *See Fred Hutchinson Cancer Research Ctr. v. United of Omaha Life Ins. Co.*, 821 F. Supp. 644 (D. Or. 1993). Here, the first (and only necessary) interpretation step is to examine the text of the policy to determine whether it is ambiguous. If it is not, the policy is interpreted in accordance with that unambiguous meaning. *Id*. (citations omitted). A court may not rewrite the terms of a contract for the parties. *Usinger v. Campbell*, 280 Or. 751, 754 (1977).

The Order Appointing Receiver provides, in pertinent part, as follows:

> 6. Subject to the specific provisions in Sections IV through XV, below, the Receiver shall have the following general powers and duties:
>
> A. To use reasonable efforts to determine the nature, location and value of all property interests of the Receivership Entity, including, but not limited to, monies, funds, securities, credits, effects, goods, chattels, lands, premises, leases, claims, rights and other assets, together with all rents, profits,

(and inappropriate). Regardless, this Court's April 14th Order Appointing Receiver defines "Receivership Property" and, as such, there is no gap to be filled by bankruptcy law.

> dividends, interest or other income attributable thereto, of whatever kind, which the Receivership Entity own, possess, have a beneficial interest in, or control directly or indirectly ("Receivership Property" or, collectively, the "Receivership Estates");
>
> . . .
>
> G. To use reasonable efforts to determine the nature, location and value of all property interests of the Receivership Entity; . . . .

Moreover, as set forth above, under the Policy's Insuring Agreement C, "[t]he **Insurer** shall pay on behalf of an **Insured Organization** all **Loss** which the **Insured Organization** becomes legally obligated to pay resulting from a **Claim** . . . first made against such Insured Organization during the Policy Period . . . for a **Wrongful Ac**t." Further, the term "**Claim**" includes any "written demand or notice for civil monetary or non-monetary relief"; the term "**Loss**" includes "**Defense Costs**", compensatory and other damages, and settlements; and the term "**Defense Costs**" means "reasonable and necessary fees and expenses incurred in the defense or appeal of a **Claim** . . . ."

The SYK correspondence constitutes a Claim as that term is defined in the Catlin policy and is covered under, *inter alia*, the Forge and Starr 2014/2015 policies that incorporate the terms of the underlying Catlin policy. The **Claim** sets forth in general terms the **Wrongful Acts** that SYK attributes to Aequitas that are the basis of its demand (*e.g.*, Aequitas's failure to disclose the true nature of the relationship between Aequitas Holdings and its subsidiaries, on the one hand, and Registered Investment Advisory firms that sold Aequitas investments to many of SYK's clients, on the other hand. (Greenfield Decl., Exh.1). Moreover, certain allegations of the SYK Claim trigger coverage and "relate back" to the 2014/2015 polices. As such, the SYK Claim triggers coverage for the Receivership Entity under Insuring Agreement C (not Insuring Agreement A, as Jesenik misleadingly argues). Therefore, the 2014/2015 Insurers (and the 2015/2016 Insurers, subject to their coverage defenses) must pay on behalf of the Receivership Entity all **Loss,** which it becomes legally obligated to pay resulting from the SYK Claim made against the Receivership Entity during the **Policy Period(s)** for a **Wrongful Act**. Payments that are made on behalf of the Receivership Entity constitute Receivership Property.[13] Similarly, the Miller Claim, the Stoll Claim, and the LVK Claim also constitute Claims at least under the Catlin and other 2014/2015 policies and perhaps also the 2015/2016 policies, subject to those insurers coverage defenses.

2. Even Assuming Bankruptcy Law Governs (And It Does Not), Jesenik's Argument Fails.

Given Jesenik's failure to address the Order Appointing Receiver together with the plain language of the Catlin policy, there is no need for this Court to consider Jesenik's bankruptcy-based argument. Put another way, Section IV.A of Jesenik's brief (pages 6 through 11) is a red herring. Nevertheless, even if Jesenik were correct that bankruptcy law should be considered (and he is not), his bankruptcy law analysis is seriously flawed.

a. *Jesenik's Argument is Inconsistent with Ninth Circuit Authorities, All of Which Jesenik has Curiously Avoided Mentioning.*

In *In re Minoco Group of Cos.*, *supra*,799 F.2d 517, which Jesenik failed to cite in his brief, the Ninth Circuit observed that the fundamental test of whether a policy is "property of the estate" is whether the estate is worth more with it than without it. *Id*. at 519. Although the *Minoco* court did not directly address the issue of whether the insurance proceeds of the First State policies were property of the estate, the decision contains crucial observations regarding the nature of liability policies that completely undermine Jesenik's arguments to the contrary (as well as the non-Ninth Circuit authorities upon which he relies). First, the court noted: "Liability policies, however, are not held in constructive trust by the insured *for the benefit of potential claimants*; they are held by the insured as protection against claims that may be asserted against the insured."[14] *Id*. at 519

[13] Because the insurance proceeds are Receivership Property, the Receiver has standing to object to Jesenik's Motion. *See* Order Appointing Receiver at 4 (Receiver's powers include "G. To use reasonable efforts to determine the nature, location and value of all property interests of the Receivership Entity.").

[14] In *dicta*, the *Minoco* court speculated that it was "conceivable that at some point Minoco would receive money from First State for payment to officers and directors in satisfaction of indemnification claims, in which event section 541(b) might come into play," but the court stated

(Italics added). Second, the court also noted that "[l]iability insurance policies, by contrast, are not independent contractual obligations running directly to potential claimants; rather, they are direct obligations to the insured." *Id*. at 520 n.3.

While the *Minoco* court did not directly rule on the issue of whether insurance proceeds are property of the estate, several lower courts within the Ninth Circuit have considered the issue, and they have generally concluded (after conducting a fact-specific analysis) that the policy proceeds in question were part of the estate. For example, in *In re Circle K Corp*., 121 B.R. 257 (Bankr. D. Ariz. 1990), the court, relying on *Minoco*, held that D&O insurance policies and proceeds were part of the estate because the debtor had a right to the proceeds. *Id*. at 260. Moreover, relying on *In re Circle K Corp.*, the court in *Metro. Inv. Sec., Inc., supra*, also held that the proceeds of two D&O policies and two E&O policies were the property of the debtor's estate and subject to the protections of the automatic stay after conducting a fact-specific analysis:

> Lacking controlling precedent on the issue of whether or not the policies and proceeds at issue in this case are property of the estate, this Court is inclined to follow the analysis in *In re Circle K Corp*. It is this Court's opinion that not only are the insurance policies property of the estate, but that *the proceeds are also property of the estate because the estate is worth more with them than without them and because the debtors hold claims payable from the proceeds*.
>
> The debtors and all other insureds have undivided, unliquidated interests in the identical asset, i.e., the policy proceeds. Continued diminution of those proceeds affects the debtors' interests in and rights to recover the proceeds. This is consistent with and necessary to promote the fundamental bankruptcy principles of preserving estate property and ensuring ratable distribution to creditors.
>
> Under principles of insurance law, all entities or persons having an interest in the policy proceeds would engage in a race to judgment or settlement with the fleetest claimants realizing upon their interest while the slower claimants were deprived of their interest. Such a result is contrary to the fundamental principle of bankruptcy

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that this question was not before it. *Id*. at 519-20. It is not clear from the opinion what hypothetical circumstances the court could foresee; however, it is clear from the Ninth Circuit's opinion that (a) section 541(b) "manifests Congressional concern that funds which the debtor holds in constructive trust for another should not be parceled out among the creditors"; and (b) "[l]iability policies . . . are not held in constructive trust . . . ." *Id*. at 519 (citation omitted). These conclusions undermine Jesenik's "on behalf of" argument. *See* Motion at 8.

> law that all of the debtors' interests in property are to be equitably distributed. The problem is worsened in this case by the fact that the cost of determining each claimant's interest in the policy proceeds may deplete the proceeds before all but the fleetest claimants recover.

325 B.R. at 857 (Italics added).

b. *The Receivership Estate is Worth More with the Insurance Proceeds; Thus, The Proceeds Constitute Receivership Property.*

Based on the foregoing Ninth Circuit authorities, the fundamental test for determining if an intangible asset (here the proceeds from these mixed 2014-2015 policy-year D&O and Professional Liability policies) are property of the estate turns on whether the estate is worth more with them than without them. There can be no doubt that the millions in limits of liability available under the 2014-2015 policy-year policies available to address the SYK Claim and the other claims makes the Receivership estate worth more than if these million in proceeds were not there.

Accordingly, the proceeds of the 2014-2015 policy-year policies are property of the Receivership Estate. Under Insuring Agreement C, the insurers are required to pay on behalf of the Receivership Entity all **Loss** which the Receivership Entity becomes legally obligated to pay resulting from a **Claim**. Second, the SYK August 10th demand for $45 million qualifies as a **Claim** as that term is defined in the Forge and Starr Indemnity 2014/2015 policy-year policies and the Forge, Aspen, and Starr 2015/2016 policy-year policies. Third, as of July 31, 2017, the Receivership has assets in the amount of $150 million. Any amount of proceeds that the insurers pay on behalf of the Receivership to the SYK claimants (whether contributing to a settlement, judgment, or otherwise) would necessarily reduce the diminution of the Receivership estate. Thus, under the facts of this case, the insurance proceeds are in fact property of the Receivership estate.

c. *Jesenik's Out-Of-Circuit Authorities Are Unavailing.*

While there is no need for this Court even to consider Jesenik's bankruptcy-related argument, let alone the authorities he cites from outside of the Ninth Circuit when authorities from within this Circuit are available, we provide the following analysis for the sake of completeness. Jesenik relies heavily on the Fifth Circuit's decision in *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51 (5th Cir. 1993), and its progeny for the proposition that the "overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have the right to receive and keep those proceeds when the insurer paid on a claim." *See* Motion at 7. However, *Edgeworth* (1) does not apply the Ninth Circuit's test of considering whether the estate is worth more than without the proceeds; (2) is fundamentally inconsistent with *Minoco*'s observations that liability policies are not held in constructive trust by the insured, but rather they are held by the insured as protections against the claims that may be asserted against the insured[15]; (3) is readily distinguishable on its facts because, *inter alia*, the debtor never tendered the insurance policy or any insurance proceeds into the bankruptcy estate, he specifically denied any interest in any insurance policies in his schedule of personal property, and he had obtained a bankruptcy discharge which left the plaintiff unable to pursue him except nominally in order to collect from his insurance policy; and (4) Fifth Circuit jurisprudence provides that where (as here) the proceeds of the policy are inadequate to cover all claims, the insurance proceeds are included in the bankruptcy estate. *Schmidt, supra*, 2017 Bankr. LEXIS 2056, at *65 (citing, *inter alia*, *Edgeworth*, 993 F.2d at 55-56).

Jesenik's other authorities are equally unavailing. *See, e.g., In re Louisiana World Exposition*, 832 F.2d 1391 (5th Cir. 1987) (no consideration of whether policy protected against diminution of estate assets; policy did not cover the liability exposure of the corporation at all, but only of its directors and officers and was payable only to them); *First Fidelity Bank v. McAteer*, 985 F.2d 114 (3d Cir. 1993) (court did not consider whether policy protected against diminution of estate assets; decision relied heavily on *In re Louisiana World* decision); *Executive Risk Indem.*,

[15] Jesenik concedes that the Polices at issue here are liability policies. *See* Motion at 7. *See Mt. Hawley Ins. Co. v. Fed. Sav. & Loan Ins. Corp.*, 695 F. Supp. 469, 474-75 (C.D. Cal. 1987) ("The plain meaning of 'pay on behalf of' is to disburse to a third party money owed by the insured. The policy could have promised only to indemnify the insureds against loss, but it does not. The insuring clause, setting forth the fundamental obligation of the policy, establishes this as a liability policy."); *Okada v. Mgic Indem. Corp.*, 823 F.2d 276, 280 (9th Cir. 1986) ("The policy here, based on loss as incurred and not as loss paid out by insureds, is a liability policy.").

Inc. v. Integral Equity, L.P., 2004 U.S. Dist. LEXIS 3742, at *48 (N.D. Tex. Mar. 10, 2004) (court did not consider whether policy protected against diminution of estate; decision followed *Edgeworth* and *Louisiana World Exposition* line of cases); *cf. In re Endoscopy Ctr. of S. Nev., LLC*, 451 B.R. 527, 546-47 (Bankr. D. Nev. 2011) (court concluded Ninth Circuit has not resolved issue of whether insurance proceeds are property of estate and relied heavily on *Edgeworth* and progeny instead; decision referred to "diminution of estate assets" as a "secondary impact" factor from the *Edgeworth* decision but declined to consider this factor in any event); *Morriss, supra*, 2012 U.S. Dist. LEXIS 64465, at *9, 12-13 (applying different test for determining when policy proceeds are assets of the estate; holding that insurance proceeds were not part of the receivership estate based on distinguishable priority-of-payments provision and insurer's contractual obligation to advance defense costs on a current basis without regard to the potential for other future payment obligations); *In re Adelphia Communs. Corp.*, 298 B.R. 49, 53 (S.D.N.Y. 2003) (no current insurable claims unlike here; policy readily distinguishable because it provided for reimbursement to estate if estate advanced funds and no evidence of such advances); *SEC v. Narayan*, 2017 U.S. Dist. LEXIS 14424 (S.D. Tex. Feb. 2, 2017) (followed *Edgeworth*; contained readily distinguishable priority-of-payments provision requiring the insurer, Hiscox, to first pay claims arising under Coverage A (individual insurance coverage; did not decide whether proceeds were part of the receivership estate; entity failed to submit evidence of right to payment).

C. Jesenik's Arguments Regarding The Catlin Policy's Priority-Of-Payments Provision Are Misleading And Without Merit.

Jesenik next argues that "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." Motion at 12. Unfortunately for Jesenik, the plain language of Catlin's Priority-of Payments provision is readily distinguishable from the provisions discussed in the case law upon which he relies.

Once again, since insurance policies are contractual in nature, the principles of contract interpretation must guide this analysis. Here, the only part of the three-step contract interpretation process that needs to be addressed is the first one (i.e., to examine the text of the policy to determine whether it is ambiguous and, if not, interpret the policy in accordance with its unambiguous meaning). *See Employers-Shopmens Local 516 Pension Trust, supra,* 235 Ore. App. at 582.

On its face, Catlin's Priority-of-Payments provision is implicated *if, and only if*, **Loss** is incurred that exceeds the remaining Limits of Liability. *See* Policy, Section XIII.C.1 ("If **Loss** is incurred that exceeds the remaining Limits of Liability for this Policy, the Insurer shall pay **Loss** under **Insuring Agreement A** before paying any other **Loss**."). The term "incurred," which is not defined in the Policy, commonly means "to become liable or subject to." *White v. Jubitz Corp.*, 345 Or. App. 62 (2008) (quoting Webster's Third New Int'l Dictionary 1146 (unabridged ed. 2002)), *aff'd* 2009 Or. LEXIS 500 (Or. Oct. 15, 2009). Only after the combined **Loss** of all insureds (here **Insured Persons** and **Insured Organizations**, such as Aequitas Holding and its subsidiaries) are liable for **Loss** in excess of a policy's then existing limits of liability does the Priority of Payments provision even come into play. It is only at that time that the directors and officers are entitled to priority of reimbursement of their incurred **Loss** under Insuring Agreement A, with the balance of any remaining limits in the policy being paid toward the Insured Organization's **Loss** under Insuring Agreement C.

As Jesenik notes, the Forge Policy 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. *See* Motion at 4. The Forge Policy does not provide its own Priority-of-Payments provision. Thus, the language in Catlin's Priority-of-Payments provision applies where, as here, the proceeds of the excess policies are at issue. It follows, therefore, that the Priority-of-Payments provision does not come into play, preventing payment of Loss to the Receivership Entities unless and until Jesenik and the other Individual Defendants have *incurred* **Loss** under Coverage A exceeding the then combined remaining limits of the excess policies. Jesenik has not (and cannot) make such a showing. Accordingly, based on the plain language of the Priority-of-Payments provision, Jesenik's argument must be rejected.

Moreover, unlike Catlin's Priority-of-Payments provision, all of the authorities upon which Jesenik relies in his Motion contain much broader Priority-of-Payment provisions. *See, e.g., Morriss, supra*, 2012 U.S. Dist. LEXIS, at *4 (insurer must first pay claims under Insuring Clause 1, and other claims are payable only to the extent of the remaining limit of liability); *In re Downey Fin. Corp.*, 428 B.R. 595, 599 (Bankr. D. Del. 2010) (insurer shall in all events first pay Loss for which coverage is provided under Coverage A and Coverage C [Coverage B related to organizational insurance]); *In re Laminate Kingdom LLC*, 2008 Bankr. LEXIS 1594, at*7-8 (Bankr. S.D. Fla. Mar. 13, 2008) (insurance proceeds must be used first to pay non-indemnifiable loss for which coverage is provided under Coverage A of the Policy, and 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, estate had only a contingent, residual interest in the policy's proceeds); *Miller v. McDonald* (*In re World Health Alternatives, Inc.*), 369 B.R. 805, 808 (Bankr. D. Del. 2007) (payment of damages and defense costs to the directors and officers under Coverage A before any payment is made to World Health under Coverages B and/or C).

By contrast, the Receivership's interest in the policy proceeds here is not subordinate to the coverage provided to the officers and directors. While we certainly understand why Jesenik wishes Catlin's Priority-of-Payment provision required the insurers to pay all his future potential **Loss** prior to paying any of the Receivership's Loss, the plain language of this provision does not provide for such a result. Nor can this Court or any other Court rewrite the terms of the policy. *Usinger, supra,* 280 Or. at 754. Jesenik's Priority-of-Payment provision argument is unavailing.

D. If The Court Is Inclined To Exercise Its Equitable Powers To Allow Forge To Advance Jesenik's Defense Costs, It Should Impose Reasonable Safeguards To Protect The Receivership Estate.

Alternatively, Jesenik argue that this Court has discretion – regardless of how it rules on the receivership property and priority-of-payments issues – to enter an Order allowing for the disbursement of insurance proceeds. According to Jesenik, good cause exists for the Court to proceed in this fashion because he "faces substantial prejudice if Forge is not allowed to advance Defense Costs . . . ." (Motion at 17).

The question of this Court exercising its discretion to determine if good cause exists to allow Forge to advance Jesenik's Defense Costs, however, arises only if Jesenik establishes that the Catlin policy is properly exhausted and liability under the Forge policy attaches. The Receivership as discussed *infra* does not believe he has met this burden. Assuming, for sake of argument Jesenik meets this burden the question then involves the exercise of the Court's discretion balancing the "prejudice" that Jesenik asserts he will suffer if his Defense Costs are not paid, with the harm the Receivership Entity will sustain by the reduction of the policy proceeds, which are property of the estate. In exercising its discretion the Court should keep in mind that Jesenik has failed to provide this Court with any ***evidence*** of prejudice that would establish good cause[16] for paying his legal fees and expenses. In contrast, as discussed throughout significant amounts of evidence are before this Court establishing Jesenik's and his counsel's profligate use of policy proceeds, to the prejudice of other insureds. Simply put, the evidence before this Court runs against Jesenik and would strongly support the Court's exercise of its discretion to deny Jesenik request to allow Forge to pay Jesenik's Defense.

That said, if this Court is inclined to grant such equitable relief to Jesenik, then this Court should also use its equitable powers to impose a number of basic safeguards to protect against the further unreasonable diminution of Receivership Property attributable to Jesenik's out-of-control Defense Costs. Indeed, there is ample support for this Court to do so. *See, e.g., In re Laminate, supra*, 2008 U.S. Bankr. LEXIS at *13-14 (conditioning the granting of stay relief to pay attorney's fees on court approval upon the filing of an application for compensation or reimbursement); *In re Arter & Hadden, L.L.P.*, 335 B.R. 666, 674 (Bankr. N.D. Ohio 2005) (imposing fees submission requirements as condition of relief from automatic stay); *In re MF Global Holdings, Ltd., supra*,

[16] For example, Jesenik fails to present any evidence regarding his financial ability to fund the defense of the *SEC* Action or the terms upon which his attorneys have agreed to represent him.

469 B.R. 177, 197 (Bankr. S.D.N.Y. 2012) (imposing "soft cap" for defense costs and reporting requirements).

As set forth above, Jesenik has burned through an extraordinary amount of attorney's fees in purportedly defending the SEC Action, despite having taken no depositions through July 31, 2017, and having only one borderline specious motion for a protective order to show for it. The amounts paid to Jesenik's counsel to defend the SEC Action *dwarf* the amounts paid to Oliver's or Gillis's counsel. Besides the sheer excessive total amount of the fees for both his lead and local counsel, the Receiver is seriously concerned about the following particularly egregious items:

(1) Legal services have been performed on Jesenik's behalf by Gibson, primarily, and later by Rose, to some extent, which did not involve defending Jesenik in the SEC Action. (*See, e.g.*, Dkt. 264 (Jesenik's Motion to Continue Hearing on Sale of CCM Interests); Dkt. 265 (Declaration of Marc Fagel)).

(2) The Rose Law Firm, local counsel for Jesenik, has incurred Defense Costs totaling $207,600 for a five (5) month period. (Shure Decl. Exh. 2).

(3) Between March and July 2017, the combined ***payments*** made by Catlin/XL to SRZ and Rose total over $1.6 million. By contrast, Catlin/XL paid Gillis's lead and local counsel a combined $344,839.50 in **Defense Costs** and paid Oliver's lead and local counsel a combined $597,654.69 in **Defense Costs**. (*Id.*).

(4) When SRZ's and Jesenik's various local counsel (Rose, Mahler and Jonak) unpaid invoices through the end of July 2017 (already submitted to Forge for payment) are added the total attributable to SRZ and Jesenik's local counsel total close to $2.5. By contrast, for the same time frame the amounts paid and incurred by Gillis's lead and local counsel total $571,904 and for Oliver's lead and local counsel total $920,655. (Shure Decl., Exh. 5)

As set forth in the Schratz Declaration, the Receiver's concerns about Jesenik's Defense Costs, as well as Catlin's and Forge's apparent unwillingness to scrutinize the bills, are well founded. (Schratz Decl. ¶¶ 14-16). Unfortunately, Jesenik's counsel has failed to supply much of the requested information and, instead, decided to file the instant Motion. The message is clear: Jesenik and his counsel do not intend to cooperate by justifying the fees in dispute. They undoubtedly will not agree to any rigorous safeguards to prevent abuse.

Given the unwillingness of Jesenik and his counsel to cooperate in good faith thus far, the speed by which Jesenik has (and undoubtedly will continue) to burn through attorneys' fees, and the Receivership Entity's significant interest in the insurance proceeds, we respectfully submit that the Court should impose the following conditions if it is inclined to exercise its equitable powers and permit Forge to advance Defense Costs:

- Require Jesenik to submit all of his counsel's billing and communications with carrier to this Court *in camera* for purposes of determining reasonableness of all Jesenik's fees and/or amounts billed and paid for non-defense work.
- Subject to the Individual Defendants establishing exhaustion of the Catlin policy, tentatively partitioning, under its equitable authority, the remaining $10 million in limits of liability available under the 2014-2015 policy-year Forge and Starr Indemnity policies, with $2.5 million going to the Individual Defendants and $7.5 million to the Receivership. The $7.5 million portioned for the Receivership would be subject to the Receivership establishing coverage for the SYK Claim and any other claims made against the Receivership triggering coverage under these 2014-2015 policies.
- Subject, to the items discussed above, imposing a "soft cap" of $1.25 million (combined total) for Defense Costs, with Oliver, Gillis and Discovia paid in full for unpaid invoices reflecting work through July 31, 2017, with the balance going to pay Jesenik invoices.[17]

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[17] Additionally, any Order the Court may issue allowing Forge to pay **Defense Costs** to Jesenik and/or the other Individual Defendants in the *SEC* Action, to the extent the remaining 2014/2015 policy proceeds are not allocated between the Individual Defendants and the Receivership Entities, *must* provide the Receivership Entities the ability to contemporaneously monitor the amount of **Defense Costs** and, if necessary intervene. This is because the amounts incurred by the Individual Defendants are arguably reducing the amount of Receivership Property, the policy proceeds, the Receivership Entities can recover. The Receivership Entities propose that

- Direct counsel for Jesenik, the Receiver, and the Insurers to confer within twenty-one (21) days of the entry of this Court's Order on the instant Motion to attempt to agree to procedures to monitor future Defense Costs subject to protection of the attorney-client privilege, with disclosure limited to the insurers and Receiver. If the parties cannot stipulate to agreed-upon procedures, the Receiver will promptly request a hearing on the matter.

V. CONCLUSION

For the foregoing reasons, the Receivership Entity respectfully submits that if this Court is inclined to grant equitable relief to Jesenik, then it should also use its equitable powers to impose a number of basic safeguards to protect against the unreasonable diminution of Receivership Property.

Dated this 14th day of September, 2017.

Respectfully submitted,

SCHWABE, WILLIAMSON & WYATT, P.C.

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Forge is required every month to provide written reports to the Receivership, setting forth by counsel (and discovery vendor, such as Discovia) each invoice, by invoice number submitted for payment, the total amount sought in each invoice, with subcategories respectively for the amount of fees and expenses being sought. These reports would also set forth the amounts later paid by Forge broken down by invoice and the amounts paid on each invoice for fees and expenses.

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