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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 BRIAN A. OLIVER'S AND N. SCOTT GILLIS'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.

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Defendants Brian A. Oliver ("Oliver") and N. Scott Gillis ("Gillis") jointly move this Court to allow Forge Underwriting Ltd. ("Forge") to pay their Defense Costs incurred in connection with their defense of the action entitled *Securities And Exchange Commission v. Aequitas Management, LLC, et.al.*, (the "*SEC* Action"). (Dkt. 1). As discussed below, Defendants' Motion should be denied for several reasons.

As a preliminary matter, however, the Receivership Entity would like to point out to the Court that there is a tremendous amount of overlap between the Defendants' Motion (Dkt. 496) and Defendant Robert J. Jesenik's ("Jesenik") motion for the same relief. (Dkt. 499). Not surprisingly, therefore, the Receivership Entity opposes both Motions for many of the same reasons. Thus, for the sake of brevity and the convenience of the Court, the Receivership Entity incorporates by reference many of the arguments advanced in its Opposition to Jenenik's Motion for Relief from the Receivership Order. That said, the Receivership Entity's Opposition to Jesenik's Motion is also based, to a large extent, on its argument that Jesenik's Defense Costs are grossly excessive and warrant the denial of equitable relief on the grounds of unclean hands, which the Receivership Entity does not assert against Oliver and Gillis at this time.

Unfortunately for Oliver and Gillis, even though their respective Defense Costs do not appear unreasonable at this time, Jesenik's Defense Costs are so extraordinarily high that they negatively affect Oliver's and Gillis's current Motion for at least two reasons.

First, even assuming Defendants submitted admissible evidence establishing that Catlin's $5 million in policy limits have been exhausted (and they have not, *see infra*), there is a reasonable basis for concluding that the policy limits were not properly exhausted given Catlin's apparent shirking of its duty to analyze the Defense Costs despite the presence of numerous red flags. Indeed, James Schratz – an expert both in matters involving billing disputes and the duties and obligations of insurance companies (*see* Schratz Decl. ¶¶3-12) – agrees that the Receiver's concerns are well founded. 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." (*Id.* ¶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. (*Id.* ¶¶ 14-16). Absent proper exhaustion, of course, there is no basis for this Court to allow Forge to pay Defendants' Defense Costs because the obligation to pay their counsel has not been triggered according to the plain language of the Policy.

Second, and relatedly, Jesenik's counsel has been reluctant to justify the fees in dispute. This lack of cooperation will undoubtedly cause delay in resolving the exhaustion issue which, in turn, will likely cause delay of payment of the Defense Costs of Oliver and Gillis. While it is possible that Oliver's and Gillis's counsel could help persuade Jesenik's counsel to provide immediate cooperation, counsel for the Receiver has not seen any evidence of such influence thus far in the proceedings.

A. There Is No Admissible Evidence Supporting Defendants' Assertion That The Catlin $5 Million Policy Limits Have Been Exhausted.

Defendants' Motion suffers from a lack of admissible evidence on a crucial issue. Defendants assert in their Motion, *inter alia,* that Forge has agreed to pay their Defense Costs based upon the contention that the primary-level liability carrier, Catlin Specialty Insurance Company ("Catlin"), has paid out its $5 million policy limits in Defense Costs, 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 have Defendants 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 Defendants. These evidentiary omissions on the issue of exhaustion are fatal to Defendants' Motion.

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

It is also important to keep in mind 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. (Dkt. 185). This is because numerous Aequitas investors have sent Claims to counsel for the Receiver and Receivership Entity, 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 incorporate the terms of the underlying Catlin policy. The Receivership Entity 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 an argument Defendants appear to make in their

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.[1]

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).

C. 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

Defendants' 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

[1] 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 as a matter of right without court approval *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).

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. Defendants have 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), Defendants' 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 Defendants rely 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

Defendants also unreasonably misinterpret 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 Defendants and other Insured Persons, to the exclusion of the Receivership. Catlin's Priority-Of-Payments provision says no such thing.

The Priority-Of-Payments provision does not provide, as Defendants suggest, that insurance proceeds automatically belong to the Insured Persons:

> 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. . . .

When the language of the Catlin Priority-Of-Payments provision is interpreted under Oregon law it becomes clear that an Insured Person's "priority" rights are very limited in scope. The Catlin Priority-Of-Payments provision provides that where there is no 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 is limited in scope to the situation where the available Limits of Liability are insufficient to pay all Loss, whether under Coverages A, B or C and the insurer therefore pays *incurred* Loss under Coverage A first. Under the Catlin Priority-Of-Payments provision at issue here, that in the future "potential" Loss may be payable under Coverage A is simply put completely irrelevant. By contrast, the cases upon which Defendants rely (Motion at 8-11) contain priority-of-payments provisions with different, much more broadly written priority-

of-payment provisions that have been interpreted as requiring an insurer to pay individual insureds ahead of corporate entities.

E. Assuming Defendants Establish Exhaustion of the Catlin Policy, The Court In Exercising Its Discretion Should Not Grant Them Any Relief At This Time Since Any "Prejudice" They Supposedly Will Suffer Is of Their Own Making And Without Evidentiary Support.

Here, the claims made against the Receivership Entity trigger, subject to the exhaustion and attachment of liability provisions of the various 2014-2015 policy-year policies, the obligation of the 2014-2015 insurers to pay on behalf of the Receivership Entity Loss under Coverage C. The Individual Defendants in the SEC Action have also triggered under the same policies the obligation, under Coverage A, to pay Loss on their behalf. In these circumstances, 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 Defendants establish 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 Entity to address the SYK Claim, the Miller Claim, the Stoll Claim, and the SVK Claim – to allow further payment of Defense Costs to Defendants and, if so, to what extent and under what conditions.

If this Court is inclined to exercise its equitable power to allow Forge to pay **Loss** incurred by or on behalf of Defendants, 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 are set forth below. 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 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

The background facts relevant to Defendants' Motion are set forth in the Receivership Entity's Opposition to Jesenik's Motion for Relief from the Receivership Order and, for the sake of brevity, are incorporated herein.

III. RELEVANT POLICY LANGUAGE

The relevant policy language for the Forge and Catlin Policies (collectively, the "Policy") is set forth in the Receivership Entity's concurrently filed Opposition to Jesenik's Motion for Relief from the Receivership Order and is hereby incorporated by reference.

IV. DEFENDANTS' LEGAL ARGUMENTS ARE WITHOUT MERIT.

Like Jesenik, Defendants advance two substantive legal arguments in support of their 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 Entities; and (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 Oliver and Gillis, before they go to the covered corporate entity (*i.e.*, the Receivership Entity). As the Receivership Entity explained in its concurrently filed Opposition to Jesenik's Motion, these arguments are without merit. For the sake of brevity, the Receivership Entity hereby incorporates by reference those arguments as if fully set forth herein.

V. IF THE COURT IS INCLINED TO EXERCISE ITS EQUITABLE POWERS, IT SHOULD IMPOSE REASONABLE SAFEGUARDS TO PROTECT THE RECEIVERSHIP ESTATE.

In the alternative, Defendants 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 Defendants – without any evidentiary support – good cause exists for the Court to proceed in this fashion because they "face substantial prejudice if Forge is not allowed to advance Defense Costs . . . ." (Motion at 12).

The question of this Court exercising its discretion to determine if good cause exists to allow Forge to advance Defendants' Defense Costs, however, arises only if Defendants establish that the Catlin policy is properly exhausted and liability under the Forge policy attaches. The Receivership Entity, as discussed above and in the concurrently filed Opposition to Jesenik's Motion, does not believe they have met this burden. Assuming, for sake of argument Defendants meet this burden, the question then involves the exercise of the Court's discretion balancing the "prejudice" that Defendants assert they will suffer if their 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 Defendants have failed to provide this Court with any ***evidence*** of prejudice that would establish good cause[2] for paying their legal fees and expenses.

That said, if this Court is inclined to grant such equitable relief to Defendants, the Receivership Entity encourages this Court to also use its equitable powers to impose a number of basic safeguards to protect against the further unreasonable diminution of Receivership Property. Indeed, there is ample support for this Court to do so. *See, e.g., In re Laminate Kingdom LLC*, 2008 Bankr. LEXIS 1594, at*13-14 (Bankr. S.D. Fla. Mar. 13, 2008) (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);

[2] For example, Defendants fail to present any evidence regarding their financial ability to fund the defense of the SEC Action or the terms upon which their attorneys have agreed to represent them.

In re MF Global Holdings, Ltd., supra, 469 B.R. 177, 197 (Bankr. S.D.N.Y. 2012) (imposing "soft cap" for defense costs and reporting requirements).

Given the current circumstances – which include Jesenik's extraordinarily high Defense Costs, his counsel's unwillingness to justify such expenses, and Catlin's apparent unwillingness to scrutinize the bills (see Schratz Decl. ¶¶ 14-16) – the Receivership Entity respectfully submits 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 the carriers 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.[3]

[3] 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 Forge is required every month to provide written reports to the Receivership, setting forth by

- 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.

VI. CONCLUSION

For the foregoing reasons, the Receivership Entity respectfully submits that if this Court is inclined to grant equitable relief to Defendants, 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,

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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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