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UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

PORTLAND DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. **AEQUITAS MANAGEMENT, LLC; AEQUITAS HOLDINGS, LLC; AEQUITAS COMMERCIAL FINANCE, LLC; AEQUITAS CAPITAL MANAGEMENT, INC.; AEQUITAS INVESTMENT MANAGEMENT, LLC; ROBERT J. JESENIK; BRIAN A. OLIVER; and N. SCOTT GILLIS**, Defendants.	Case No. 3:16-cv-00438-PK **DEFENDANT ROBERT J. JESENIK'S (1) REPLY TO RECEIVERSHIP ENTITY'S OPPOSITION AND INVESTOR OBJECTIONS [DKT. NOS 527 & 533] TO MOTION FOR RELIEF FROM RECEIVERSHIP ORDER AND (2) RESPONSE TO RECEIVERSHIP ENTITY'S EVIDENTIARY OBJECTIONS TO DECLARATION OF JASON P. CRONIC [DKT. NO 535]** **ORAL ARGUMENT REQUESTED** Complaint Filed: March 11, 2016

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I. INTRODUCTION

Despite the vitriolic tone of the Receiver's Opposition to this Motion, there are very few issues in dispute here. First, there is no dispute that Defendant Jesenik is entitled to coverage for his Defense Costs in connection with this case. Second, there is no genuine dispute that the first layer of insurance coverage, from Catlin, is exhausted. Third, there is no dispute that Catlin reviewed the invoices submitted by Mr. Jesenik's counsel and advanced fees for the tasks it determined were reasonable and necessary to his defense – and refused payment for others. Fourth, there is no dispute that there is another policy, from Forge, that covers Mr. Jesenik's and his co-defendants' continued costs in defense of this litigation. And fifth, there is no dispute that the Receiver has no current claim to any proceeds from insurance from Catlin or Forge, and may never have any such claim.

The policy at issue here is a standard directors and officers liability policy. Its primary purpose is to cover the costs to defend a lawsuit like this one brought against Aequitas executives. It does not contemplate payments directly to those executives or to Aequitas in any instance – it exists to make payments to third parties in the event that an officer or the company is liable to them. It prioritizes payment for just this sort of case – where an officer is sued in a regulatory action. The policy expresses that preference in a number of ways. For instance, the policy excludes coverage for Aequitas for this sort of regulatory enforcement proceeding, but includes and prioritizes payments on behalf of covered individual for such proceedings.

The Receiver's Opposition does not credibly dispute any of these facts. Nonetheless, the Receiver asserts, with no proof, that excessive costs *may* have been approved by Catlin. Based on that specious claim, the Receiver asks the Court to intervene to deny Mr. Jesenik the coverage he has a contractual right to under the Forge policy. Because Mr. Jesenik is entitled to the

coverage that is the basis of this motion, and because the Receiver has provided no legal or equitable justification to gut Mr. Jesenik's contractual rights under the insurance policy, much less evidence to support his questions about Catlin's determination that all Defense Costs that it advanced on behalf of Mr. Jesenik were reasonable and necessary, the motion should be granted and the Receiver's objection overruled.

II. THE RECEIVER'S "SUBSTANTIAL QUESTIONS" ARE MISDIRECTED AND MISGUIDED.

The stated basis for the Receiver's Opposition is Mr. Jesenik's failure to justify, to the Receiver's satisfaction, the Defense Costs he incurred defending this case. Receivership Entity's Opposition to Robert J. Jesenik's Motion for Relief From Receivership Order ("Opposition" or "Opp.") Dkt. No. 527 at 2. The Receiver evidently believes that being a secondary insured under the Private Equity Management Liability Policy (the "Catlin Policy") authorizes his demand that Mr. Jesenik justify the cost of his legal defense in a matter for which the Receiver itself is not covered, has already settled, and is effectively adverse to Mr. Jesenik.

The Receiver's belief is incorrect in at least three ways. First, the Receiver has no right to demand justification from Mr. Jesenik concerning his manner of defending this case. Second, any questions regarding the propriety of advancement of covered Defense Costs should be directed to Catlin, the insurance company that advanced them, not to Mr. Jesenik. Third, Mr. Jesenik's Defense Costs are entirely reasonable for a complex securities enforcement matter like this one.

A. The Receiver is Entitled Neither to Audit Mr. Jesenik's Legal Defense Costs Nor Demand an Explanation of His Defense.

The Receiver's chief complaint and the only basis for its opposition here is that the Insurer's payments for Mr. Jesenik's Defense Costs are larger than the payments to his co-

defendants' counsel. *See, e.g.,* Opp. at 2-3; Declaration of Stanley H. Shure in Support of Receivership Entity's Opposition to Defendants' Motion for Relief ("Shure Decl."), Exh. 2 at 5 ("Based upon the large deviation between the amounts paid by Catlin/XL to Jesenik's counsel, as compared to counsel for Gillis and Oliver, it appears that uncovered Defense Costs were paid by Catlin/XL to Jesenik's counsel."). The Receiver demanded a "detailed explanation" from Mr. Jesenik for his higher Defense Costs and, in particular, that he "establish the reasonableness and necessity of the entire $1,435,034.06 paid to [Schulte Roth & Zabel LLP]" under the Catlin Policy. *Id*. at 5. These requests demonstrate the Receiver's belief that it has the authority to control Mr. Jesenik's defense, including even his choice of counsel. *See* Opp. at 11, n. 6.

Undersigned counsel for Mr. Jesenik, in a good faith effort to resolve this issue, provided a narrative explanation of the work performed for Mr. Jesenik, including an explanation of the additional work done by Mr. Jesenik's counsel explaining why his Defense Costs were greater than those of his co-defendants. Even if the Receiver were entitled to it (and he is not), a detailed comparison of each party's Defense Costs was not possible for Mr. Jesenik to provide as he lacks a complete understanding of what work counsel for his co-defendants had performed in defense of their own clients. No party has the right to demand such information from another party, and the Policy does not grant the Receiver such a right. Though Mr. Jesenik requested that the Receiver provide authority for the extraordinary proposition that it has the right to evaluate and determine how a co-insured under the same policy conducts his defense (*see* Shure Decl., Exh. 4 at 1-2), the Receiver provided none to Mr. Jesenik, and now provides none to the Court.

B. All Compensated Defense Costs for Mr. Jesenik Have Been Appropriately Determined to be "Reasonable and Necessary" by Catlin.

The Receiver repeatedly falsely accuses Mr. Jesenik of utilizing the Policy proceeds unreasonably or improperly.[1] As salacious as they may be, none of these accusations is supported by any evidence of unreasonable or unnecessary billing practices. As such, the Receiver's opposition is meritless.

The Receiver cannot dictate how Mr. Jesenik defends himself.[2] Mr. Jesenik's legal strategies and decisions are not subject to review by any party other than Mr. Jesenik and his counsel. The *only* potentially relevant question is whether payments under the Policy were for covered Defense Costs. Catlin, an independent third party with an incentive to be skeptical about any claims for coverage, has already answered that question, determining that all payments it advanced to Mr. Jesenik's counsel were reasonable and necessary to his defense. *See* Supplemental Declaration of Jason P. Cronic in Support of Motions for Relief From Receivership Order, to the Extent Necessary, to Permit Payment of Defense Costs ("Cronic Decl."), at ¶¶ 13-16**.** Catlin, not Mr. Jesenik, determined that its payments reflect covered "Defense Costs" under the Policy. As such, any questions about those payments are not properly

[1] *See, e.g.*, Opp. at 2 ("have Jesenik's counsel justify the extraordinary amount of defense costs"); 7 ("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"); 10 ("Receiver is aware of specific instances of legal services being performed on Jesenik's behalf…which did not involve defending Jesenik in the SEC Action"); 28 ("Jesenik's and his counsel's profligate use of policy proceeds").

[2] In an awkward attempt to deflect criticism, the Receiver states at one point that it wants "*to make clear that they are not attempting to deprive Jesenik of his ability to prepare his defenses in the SEC Action*." *See* Opp. at 7 (emphasis in original). Given the Receiver's objection to Mr. Jesenik's continued access to Policy proceeds to fund his defense, this statement is false. Put simply, the exact opposite is true here – the Receiver's objective is to deny Mr. Jesenik the coverage he is entitled to, depriving him of his ability to prepare his defense to this case.

directed at Mr. Jesenik who, in any event, is powerless to resolve any complaints from a co-insured about Catlin's payments for covered Defense Costs.

As the Receiver is well aware, the Insurer – not the Insured – makes coverage decisions. *See, e.g.,* Receivership Entity's Opposition to Brian A Oliver's and N. Scott Gillis's Motion for Relief from Receivership Order ("Response in Opposition to Oliver and Gillis"), Dkt. No. 536, at 1 (asserting "Catlin's apparent shirking of its duty to analyze the Defense Costs"); Declaration of James P. Schratz in Support of Receivership Entity's Opposition to Motions for Relief from Stay ("Schratz Decl"), Dkt. No. 530 at ¶ 1 (asserting "very serious issues concerning the competence and adequacy of the so called audit conducted by" Catlin regarding its payments of Defense Costs); *see also SEC v. Narayan*, No. 3:16-CV-1417-M, 2017 WL 447205, at *9 (N.D. Tex. Feb. 2, 2017) ("it is [the insurer's] responsibility to determine the reasonableness of any fees incurred by[the insureds.]").

The Receiver has known for at least two months that the Catlin Policy was nearly exhausted. *See* Opp. at 2. While professing to be "[a]larmed" by this fact and undertaking "intense efforts" and an "investigation," the Receiver offers no evidence of any effort to contact Catlin, regarding any purported concerns, despite the Receiver's insurance counsel having promised to do so. *See* Shure Decl., Dkt. No 531 Exh. 2, at 6. Neither the Receiver nor the "expert" it hired to opine about Catlin's payment of Mr. Jesenik's Defense Costs has any first-hand or even second-hand knowledge of Catlin's review of invoices from Mr. Jesenik's counsel. Rather, they baldly assert, with no proof, that Catlin may have violated the Policy by paying Mr. Jesenik's Defense Costs.

Even assuming a basis for a purported breach of contract claim by the Receiver against Catlin, the Receiver is attempting to convert Catlin's coverage determinations (about which the

Receiver has seemingly requested no information) into an allegation about *Mr. Jesenik's* "unclean hands." *See* Response in Opposition to Oliver and Gillis, Dkt. No. 536, at 1.

The Receiver's argument is baseless and inappropriate. Mr. Jesenik has done nothing but defend himself and seek reimbursement for the Defense Costs to which he is entitled under the Policy. He has engaged in no unlawful or inequitable conduct in this regard and the Receiver offers no evidence to the contrary. In defending Mr. Jesenik in the SEC Litigation, as in any case of this type, his counsel submitted invoices to the Insurer for advancement under the Policy. *See* Cronic. Decl. at ¶ 13. The Insurer reviewed those invoices and made an independent determination about which invoiced items were "reasonable and necessary," and thus properly covered Defense Costs, and which were not. *See id*. The Insurer then advanced payments on behalf of Mr. Jesenik for work it determined to be covered. *See id.* at ¶ 14. The Receiver cites *no reason* to believe that the process by which Mr. Jesenik's requests for payment were reviewed differs from the process for invoices submitted by anyone else covered by the Policy. If the Receiver had suffered any Loss covered by the Policy, its claims would be reviewed the same way. There is nothing inequitable or improper about Mr. Jesenik's requests for advancement of his covered Defense Costs under the Policy.

Even if Catlin had neglected to review Mr. Jesenik's advancement requests *at all*, that would not suggest unclean hands by Mr. Jesenik. The Receiver has *no rights* related to Mr. Jesenik or his defense – the only potential rights cited in the Receiver's pleading relate to its status as a party to an insurance contract issued by Catlin and so are only exercisable against Catlin.[3]

[3] Similarly, the Receiver provides no basis – even if Catlin had breached some sort of contractual obligation – for its attempt to prevent Forge from performing its duties under the Policy. The prior decisions of Catlin are not the equivalent of any future decisions of Forge.

C. Mr. Jesenik's Defense Costs To Date Are Reasonable Given The Nature Of This Lawsuit.

Given the nature of this lawsuit, the seriousness of the allegations pending against Mr. Jesenik, his alleged role in the transactions at issue in this lawsuit, and complex financial transactions that form the basis of the SEC's claims, Mr. Jesenik's Defense Costs to date have been appropriate and the Receiver has provided no basis for challenging Catlin's determination that all compensated Defense Costs were reasonable and necessary to his defense.

First, all Defense Costs advanced on Mr. Jesenik's behalf were approved by Catlin. Both the Policy and this Court's prior order prohibit Catlin from paying anything other than covered Defense Costs incurred to defend the SEC Litigation. *See* Catlin Policy, § III(K) ("'Defense Costs' means reasonable and necessary fees and expenses incurred in the defense or appeal of a Claim"); Stipulation and Order Granting Relief from Receivership Order to Permit Limited Payment of Defense Costs, Dkt. No. 185 at 5 (authorizing Catlin "to make payments under the Policy to or for the benefit of the [Individual Defendants] for covered Defense Costs incurred in connection with" the SEC Litigation).

Had the Receiver bothered to ask Catlin about its advancement of Mr. Jesenik's Defense Costs, it could have verified that Catlin carefully reviewed the underlying invoices to determine which fees and expenses it determined were reasonable and necessary. Cronic. Decl. at ¶ 13. The Receiver also could have confirmed that Catlin rejected substantial fees and expenses incurred by Mr. Jesenik's counsel for various reasons, including Catlin's conclusion that they were not sufficiently related to the SEC Litigation, duplicated work by Mr. Jesenik's prior counsel, did not comply with Catlin's Billing Guidelines, or were otherwise ineligible for coverage under the Policy. Cronic. Decl at ¶¶ 14-15 (demonstrating that Catlin deducted over $200,000 in costs it determined were not covered Defense Costs under the Policy).

Of course, understanding the *facts* related to Catlin's approval of Mr. Jesenik's Defense Costs was never the Receiver's objective. The Receiver's failure to offer evidence that he made such an inquiry, despite the Receiver's insurance counsel promising to do so, confirms that the reasons for his failure were tactical. But the Receiver cannot benefit from its conscious avoidance of facts, especially when discoverable facts completely undermine the Receiver's uninformed speculation. *See, e.g.,* Schratz Decl. at ¶ 15 (offering "opinion that there is no indication" that Catlin scrutinized the invoices). Regardless, the Receiver's specious claims are definitively refuted by Catlin's determination that Mr. Jesenik's Defense Costs were reasonable and necessary to defend a covered Claim pursuant to the Policy and the Defense Costs Order—all of which is proven by Catlin's payments.

Second, the Defense Costs Catlin approved for Mr. Jesenik are no more "facially unreasonable" than the Receiver's $13 million in total professional fees to date.[4] For instance, Pepper Hamilton LLP, one of the law firms representing the Receivership in the SEC Litigation, incurred fees of roughly $230,000 per month until the Receivership agreed to settle the SEC Litigation.[5] Those fees are almost identical to the average monthly Defense Costs that Mr. Jesenik incurred during the period of time the Receiver selected—the most active period to date—to support its allegation that Mr. Jesenik's Defense Costs are unreasonable. Opp. at 3 n.2.

[4] Notice Of Filing Receiver's Report Dated July 31, 2017 Dkt. No. 491 at 44 (professional fees totaling $2,342,470.04); Notice Of Filing Receiver's Report Dated April 30, 2017, Dkt. No. 444 at 42 (professional fees totaling $2,629,729.76); Notice Of Filing Receiver's Report Dated January 31, 2017 Dkt. No. 365 at 59 (professional fees totaling $2,518,374); Notice Of Filing Receiver's Report Dated November 10, 2016 Exh. 1 Dkt. No. 298.1 at 41(professional fees totaling $2,340,008); Notice Of Filing Receiver's Report Dated September 14, 2016 Dkt. 246 at 83 (professional fees totaling $3,278,188)

[5] Notice Of Filing Receiver's Report Dated September 14, 2016 Dkt. 246 at 83 (Pepper Hamilton fees totaling $701,476).

Third, Mr. Jesenik's Defense Costs are actually much lower than those incurred to defend executives in similarly complex financial fraud cases. For example, a defendant facing similar SEC and related allegations projected his defense costs would be $20 million. *See* Memorandum in Support of Motion to Modify Preliminary Injunction Order, *SEC v. Stanford Int'l Bank, Ltd.*, No. 3:09-CV-298 2009 WL 8707814 (N.D. Tex. Oct. 9, 2009), at *9; *see also United States v. Stein*, 495 F. Supp. 2d 390, 424 (S.D.N.Y. 2007) (citing examples of substantial defense costs in similarly complex matters including, "$14.9 million (Kumar—Computer Associates), $17.7 million and $8 million for each of two trials (Kozlowski—Tyco), $24 million (Shelton—Cendant), $25 million (Rigases—Adelphia), $32 million (Scrushy— HealthSouth), and $25 and $70 million (Lay and Skilling, respectively—Enron)"). Beyond the totals, the defense costs ranging from $8 to $70 million for these cases underscores that defendants in analogous cases do not employ identical defense strategies. This obvious fact of defending complex securities fraud cases undermines the Receiver's assertion that one defendant's costs are unreasonable simply because they are larger than those of another defendants'. Defense costs in these examples vastly exceed the amounts advanced to Mr. Jesenik's counsel under the Catlin Policy. Moreover, through trial, Mr. Jesenik's Defense Costs are projected to remain well within the lower end examples offered by other courts.

Fourth, in addition to defending a complex case, Mr. Jesenik has been saddled with defending claims of attorney-client and joint defense privileges directly resulting from the Receiver's decisions in this case. The Receiver's waiver of privilege shifted the burden of preserving privilege to the Individual Defendants. Mr. Jesenik took the lead on this effort, in part based on his former position at Aequitas and frequent interactions with counsel while at Aequitas. Mr. Jesenik's privilege review costs increased further due to the need to not just

identify privileged documents, but also to ascertain, document by document, whether privilege survived the Receiver's waiver. The increased costs were exacerbated by the Receiver's failure to appreciate the existence of joint defense arrangements, personal privileges, technical issues throughout the review, and limitations of the Receiver's privilege database—all of which culminated in a prolonged and costly privilege dispute.

III. NEITHER THE ORDER APPOINTING THE RECEIVER NOR THE UNDERLYING POLICY SUPPORTS THE RECEIVER'S OPPOSITION.

The Receiver contends that this Court's Order Appointing Receiver (Dkt. No. 156 (the "Order")) "completely undermines" Mr. Jesenik's argument that the proceeds of the Policy are not property of the estate subject to a freeze. *See* Opp. at 19. The Receiver is incorrect.

A. The Order Appointing the Receiver Does Not Establish A Property Right Where None Existed Before.

The Receiver's claim that the Order defines what is and is not property of the Receiver through judicial fiat is meritless. The appointment of a receiver, regardless of the language of the underlying order, does not create property rights that did not exist previously. *See, e.g., Javitch v. First Union Sec., Inc.*, 315 F.3d 619, 625 (6th Cir. 2003) ("The general rule is that a receiver acquires no greater rights in property than the debtor had."); *Narayan*, WL 447205, at *5 ("Thus, if [the entity's] interest in the proceeds would have been limited under the terms of the Policy, the Receiver's right in the proceeds asserted on behalf of the Receivership Estate should be similarly limited."); *Caesars Entm't Operating Co., Inc. v. BOKF, N.A., et al.* (*In re Caesars Entm't Operating Co., Inc.*), 533 B.R. 714, 735 (Bankr. N.D. Ill. 2015), *vacated and remanded on other grounds*, 880 F.3d 1186 (7th Cir. 2015) ("allowing the debtors to hold up payments for [co-insured's] losses in favor of the debtors' own, would give the debtors rights under the policy they did not have before these cases were filed. It is a truism that the [Bankruptcy] Code does not grant debtors rights greater than they had outside of bankruptcy."). The Court's Order

appointing the Receiver did not—and could not—grant any property to the Receivership Estate that did not previously exist.

In support of its contrary position, the Receiver simply quotes "in pertinent part" two passages from the Order that it believes are fatal to Mr. Jesenik's request. Opp. at 19-20. Those passages, however, do not address whether any particular item *actually is* property of the estate. Rather, they establish the Receiver's duty "[t]o use reasonable efforts *to determine* the nature, location and value of all property interests of the Receivership Entity," which for purposes of the remainder of the Order, are referred to as "Receivership Property." *Id*. (emphasis added).[6]

B. Because Payments Under the Policy Can Only Be to Third Parties "On Behalf" of an Insured, They Are Not Property of the Receivership Estate.

The plain language of the Policy further undermines the Receiver's position that Policy proceeds are property of the Receivership Estate. The Policy makes clear that *any* payments made under the Policy (regardless of the particular Insuring Agreement under which the payment is made[7]) are made "on behalf of" the Insured. *See* Catlin Policy, §§ I(A)-I(C). Though the Receiver may now have a "Claim" under the Policy based on the demand letters the Receiver has identified,[8] a Claim that may be subject to coverage under the Policy (in the event of Loss) does

[6] Even if the Court's Order had explicitly stated that the proceeds of any and all insurance policies were property of the Receivership Estate, such an order would conflict with established precedent governing receiverships and trusts.

[7] The Receiver argues that Mr. Jesenik's focus on Insuring Agreement A is somehow "misleading." Opp. at 20. This allegation is puzzling and baseless, as advances of covered Defense Costs incurred on his behalf are governed by Insuring Agreement A and no other clause.

[8] Several aspects of the sudden appearance of these "Claims" are troubling. For example, they all arrived within a short time period of one another after Mr. Jesenik's meet-and-confer letter to Receiver's insurance counsel and all use essentially the same language even though they come from separate law firms. Also, despite the claimants' requests that the Receiver inform the Insurers that the claimants would be also be asserting claims against Mr. Jesenik, Mr. Jesenik was not copied on any of this correspondence or made aware of its existence until the Receiver filed its Opposition. Moreover, the notice from the Receiver's insurance counsel to the Insurer regarding the SYK Claim did not disclose that SYK asserted a claim against Mr. Jesenik or the other Individual Defendants. *See* Shure Decl., Exh. 6.

not create a property interest in the Policy proceeds. Just as Insuring Agreement A obliges the Insurer to pay Loss "on behalf of" Mr. Jesenik to third parties, Insuring Agreement C obliges the Insurer to pay any Loss that may in the future occur "on behalf of" the Receivership Entity. Neither Insuring Agreement provides for payment directly to Mr. Jesenik or to the Recievership Entity. Neither provision grants the party asserting the claim a property interest in the Policy proceeds.

After recitation of the terms of the Policy, the Receiver states in conclusory fashion, absent any citation to authority, that "[p]ayments that are made on behalf of the Receivership Entity constitute Receivership Property." Opp. at 20-21. The Receiver's analysis is intentionally perfunctory because the law regarding property interests of receivers or trustees does not support this position.

C. The Receiver's Inconsistent Interpretation of "Loss" Undermines Its Own Argument.

The Receiver's discussion of "Loss" under the Policy relies upon a shifting definition of that term. The Receiver *first* construes "Loss" under the Policy as the *potential loss* represented by the damages asserted in demand letters from a group of potential future civil litigants. Opp. at 6 ("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."). Later, the Receiver objects to Mr. Jesenik's arguments concerning the Priority of Payment provision in the Policy by arguing that "[o]n its face, Catlin's Priority-of-Payments provision is implicated *if, and only if*, Loss is incurred that exceeds the remaining Limits of Liability." *Id*. at 26.

The Receiver cannot have it both ways. If Loss under the Policy includes *potential liability*—that is, the total amount claimed—then Mr. Jesenik (with the other Individual

Defendants) has a Claim for Loss of more than $350 million based solely on the SEC allegations in this case. The SEC's demand—also leveled against the Receivership Estate, but for which the Receiver lacks coverage under the Policy—is more than 30 times the remaining proceeds under the Policy.[9] Further, although the Receiver's Opposition neglects to mention this fact, the demand letters submitted by the Receiver also state claims against Mr. Jesenik, thereby exposing him to the *exact same hypothetical loss* calculated by the Receiver.[10] If mere demands for payment from the Receiver qualify as Loss, then those same demands for payment from the Individual Defendants, on top of the SEC's claims, must likewise qualify as Loss for the Individual Defendants. If that is the case, then the Policy limits are exceeded, and the Individual Defendants "Loss" must be fully paid before any payments are made on behalf of the Receiver as required by the Priority of Payment provision of the Policy. *See* Defendant Robert J. Jesenik's Motion for Relief from Receivership Order, to the Extent Necessary, to Permit Payment of Defense Costs, Dkt. No. 499 at 11-14.

Even if Loss is limited to amounts that are actually due and owing, rather than demanded but not due and owing, the Receiver's position is untenable. Insuring Agreement C, on which the Receiver relies, is unambiguous: "The Insurer shall pay *on behalf* of an Insured Organization all Loss which the Insured Organization *becomes legally obligated to pay*." Catlin Policy § I(C) (emphasis added). The Receiver is not currently "legally obligated to pay" *any* Loss. Therefore, the Receiver has *no right to demand* that the Insurer issue any payments under Insuring

[9] *See* Complaint, Dkt. No. 1 at ¶ 45 (asserting that the Aequitas entities raised approximately $350 million based on allegations of materially false and misleading representations); *see also id.* at 28-29 (seeking disgorgement, plus interest, and civil penalties from defendants).

[10] *See, e.g.*, Declaration of Troy D. Greenfield in Support of Receivership Entity's Opposition to Motion of Robert J. Jesenik, Exh. 1 ("[O]ur clients are asserting their claims against Aequitas Holdings and its subsidiaries, *as well as* the officer and directors of Aequitas, including but not limited to Robert Jesenik, Brian Oliver, and Scott Gillis.") (emphasis added).

Agreement C, much less prioritize them over payment of Mr. Jesenik's real and ongoing covered Defense Costs. While the Receiver may be facing valid *Claims* against it, absent a legal obligation to pay a *Loss*, there is no basis for any payment under the Policy. By contrast, the Individual Defendants' Claim under Insuring Agreement A need not be a legal obligation to pay. All that is required to trigger the Insurer's obligation to pay on behalf of the Individual Defendants is that the Loss—including Defense Costs—not be reimbursed by the Receivership Estate. *See* Catlin Policy § I(A).

IV. EXISTING PRECEDENT ALSO SUPPORTS MR. JESENIK'S RIGHT TO ACCESS THE PROCEEDS OF THE POLICY.

The only property relative to this Motion that the Receiver possesses is *the Policy*. The Policy grants the Receiver (and formerly Aequitas) the right to have its property protected from exposure by means of the insurance coverage, according to the terms of the Policy. *See In re Endoscopy Center of Southern Nevada, LLC*, 451 B.R. 527, 545 (Bankr. D. Nev. 2011) ("*Endoscopy Center*"). The issue at hand, however, is "whether the Policy ***proceeds*** that are potentially going to be paid to injured third-parties are property of the [Receiver's] estates. The Ninth Circuit has not yet resolved this issue." *Id*. at 542.

The directors and officers policy at issue here is titled as a "Private Equity Management *Liability Insurance*" policy. Catlin Policy, at 9 (emphasis added). It is designed primarily to protect the managers of the business, like the defendants here, in the event that actions like this are brought against them. The Policy is *not* an indemnity policy, as Mr. Jesenik and the Receiver agree. *See, e.g.*, Opp. at 23 ("here the proceeds from these mixed 2014-2015 policy-year D&O and Professional Liability policies); 24 n.15 ("Jesenik concedes that the Policies at issue here are liability policies"). This is a liability only policy which, by its unambiguous terms, only

contemplates payments to third parties. This fact is dispositive of this Motion in Mr. Jesenik's favor under the most recent applicable case law.

A. *Minoco* Supports Mr. Jesenik's Request – Not the Receiver's Opposition.

The Receiver's reliance on *In re Minoco Group of Cos.*, 799 F.2d 517 (9th Cir. 1986), is misplaced. *Minoco*, a thirty-year-old Ninth Circuit decision, holds that liability insurance *policies* held by the entity are property of that entity's estate. *Id*. at 519.[11] Mr. Jesenik does not claim a personal property interest in the Policy and so takes no position in conflict with *Minoco*'s holding. However, as numerous courts have noted in the interim – including cases the Receiver's Opposition cites – *Minoco* does not resolve whether the estate also owns the *proceeds* of those policies, which is the only item in dispute here. *See, e.g., Endoscopy Center*, 451 B.R. at 542 ("However, the principal threshold question in this case revolves around whether the Policy ***proceeds*** that are potentially going to be paid to injured third-parties are property of the Debtors' estates. The Ninth Circuit has not yet resolved this issue.") (emphasis in original); *Metro. Mortg. & Sec. Co., Inc. v. Cauvel*, (*In re Metro. Mortg. & Sec. Co., Inc*)., 325 B.R. 851, 855 (Bankr. E.D. Was. 2005) ("The applicability of § 541 to proceeds of insurance policies is not yet a settled question in the Ninth Circuit."); *In re Daisy Sys. Sec. Litig.*, 132 B.R. 752, 755 (Bankr. N.D. Cal.

[11] Notably, while urging this Court to rely on *Minoco*, the Receiver completely ignores another decision of the Ninth Circuit (cited in the Individual Defendants' motion at p. 11) that expressly rejected the same argument the Receiver presents here. *See Groshong v. Sapp (In re Mila, Inc.)*, 423 B.R. 537 (B.A.P. 9th Cir. 2010) ("it does not appear that *Minoco* compels the outcome Trustee suggests: that a D & O policy's proceeds … are property of the policy owner's bankruptcy estate"). In reaching that conclusion, the Ninth Circuit relied on the *Minoco* court's supposition that proceeds paid to the insured debtor to satisfy indemnification claims by officers and directors might constitute property held in trust by the debtor for the directors and officers, "and thus would not constitute property of the estate. 423 B.R. at 543 (emphasis added). This suggests that even proceeds paid *directly* to the insured debtor to satisfy indemnification claims by directors and officers are not property of the estate. Thus, to the extent *Minoco* has any application here, it bolsters the *Individual Defendants'* argument that proceeds paid to *third parties* on behalf of the insured debtor are not property of the estate, while simultaneously undermining the Receiver's reliance on inapposite cases involving indemnity policies.

1991) ("In this case, however, the DOL policies are not threatened; only the proceeds are. Thus, *Minoco*, does not control."). As such, there is no "controlling Ninth Circuit authorit[y]" with which Mr. Jesenik's position conflicts, contrary to Receiver's assertions. *See* Opp. at 5.

The Receiver is likewise wrong to argue that Mr. Jesenik's request is inconsistent with *Minoco*'s intent – it is not, as more recent decisions within the Ninth Circuit demonstrate. The Receiver argues that, under *Minoco*, the Policy proceeds are the Receiver's property because "the estate is worth more with them than without" (*see id.* at 5), even though numerous courts recognize that *Minoco* does *not* apply to the question of whether insurance policy *proceeds* are property of the estate.[12] Even if the *Minoco* test applied, it is not, as the Receiver asserts, "easily met here." *See id.*

The Receiver's argument concerning *Minoco* appears to be that, if the Court awards the proceeds of the Policy to the Receiver, the Receivership Estate will be "worth more than if these million [*sic*] in proceeds were not there." *See id*. at 22. Thus, the Receiver concludes, the proceeds of the Policy are property of the Receivership Estate. *See id*. That this is such an obvious tautology is a "red flag" that the Receiver has misunderstood the test. The Receiver can reach this conclusion only by ignoring the terms of the Policy itself.

Even if *Minoco* applied, an actual analysis of the ownership of the Policy proceeds requires the Court to consider whether the proceeds of the Policy have the potential to increase the value of the Receiver's estate, *under the terms of that Policy*. *Cf. In re Circle K Corp.*, 121 B.R. 257, 261 (Bankr. D. Ariz. 2003) ("[T]he end result is consistent with *Minoco*: In certain instances, debtor can *make a claim for reimbursement* for indemnification claims paid.")

[12] The Receiver's argument concerning constructive trusts is inapposite. Mr. Jesenik makes no argument concerning *his* ownership of either the Policy or its proceeds. While the Receiver's owns the Policy, it does not own the *proceeds* of that Policy which can be used to pay third party claimants under the Policy.

(emphasis added). The *Minoco* test is not whether the estate would worth more with than without the proceeds. That is not a test – there is no case in which that "test" would *not* be met. The appropriate analysis, if *Minoco* applied, would be whether *under the terms of the Policy*, the proceeds are in fact payable directly to the insured entity, such that they would have the potential to increase the value of the estate.

The other cases cited by Mr. Jesenik do not conflict with *Minoco*, but rather appropriately apply principles not in conflict with *Minoco* to the proceeds of a policy rather than the policy itself. *See, e.g., Houston v. Edgeworth* (*In re Edgeworth)*, 933 F.2d 51, 55-56 (5th Cir. 1993) ("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. When payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate."). Despite the Receiver's arguments, *Edgeworth* is consistent with *Minoco* by explaining that an estate *can be neither* "enhance[d] nor decrease[d]" (an equivalent standard to *Minoco's* inquiry about whether an estate is "worth more with…than without" (799 F.2d at 519)) by proceeds that cannot inure to the debtor's pecuniary benefit. Likewise, the court in *Endoscopy Center* cited to *Edgeworth* to determine that liability policy proceeds like those at issue here were not property of the estate. *See* 451 B.R. at 542-47. The *Endoscopy Center* court also cited *Minoco* in its opinion and so was aware of *Minoco*'s holding and either did not find that holding to be in conflict with its own or concluded that it did not apply in determining the ownership of policy *proceeds*.

B. Recent Decisions Concerning Liability Insurance Proceeds Support Mr. Jesenik.

Endoscopy Center engaged in a thorough analysis, cognizant of Ninth Circuit law and undertaken more recently than the cases the Receiver believes support his position, concerning whether liability policy proceeds were property of a bankruptcy estate. 451 B.R. 527.

Endoscopy Center recognizes that appointing a receiver or trustee as custodian of an entity "does not expand or change a debtor's interest in an asset; it merely changes the party who holds that interest." *Id*. at 542. "To the extent an interest in property is limited in the hands of the [original entity], it is equally limited as property of the estate." *Id*. *Endoscopy Center* also notes that the law in this area, while not entirely consistent, "seems to depend in large part upon the type of policy involved, and whether the [entity] has or will receive any of the proceeds from the policy." *Id*. at 543. It notes, however, that "one concept is clear from these decisions: cases determining whether the proceeds of a liability insurance policy are property of the estate are controlled by the language and scope of the specific policies at issue." *Id*. (internal quotation marks omitted).

The *Endoscopy Center* court divides insurance policies into two categories: liability and indemnity. *Id*. Liability policies "provide for payments only to third parties on behalf of the insured," while indemnity policies "permit payments of proceeds to the insured to reimburse the insured itself for, among other things, costs incurred in defending claims or suits." *Id*.

The Policy at issue in this case is unambiguously a liability policy. *See* Catlin Policy, §§ I(A), I(C). "The Insurer shall *pay on behalf of*…" is the opening description of all three types of coverage available under the Policy. *Id*., §§ I(A)-(C). On this, the Receiver agrees. *See, e.g.*, Opp. at 23 ("here the proceeds from these mixed 2014-2015 policy-year D&O and Professional Liability policies); 24, n. 15 ("Jesenik concedes that the Policies at issue here are liability

policies"). So does the Ninth Circuit. *See Okada v. MGIC Indem. Corp.*, 823 F.2d 276, 280 (9th Cir. 1986) ("The policy here, based on loss incurred and not as loss paid out by insureds is a liability policy."); *see also 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.").

This distinction is key because, unlike an indemnity policy, the proceeds of liability policies like the one at issue here *can never paid to the Insured* – not to the Receiver or to any other covered person like Mr. Jesenik.

Each of the factors identified in *In re Endoscopy* demonstrate why the proceeds of liability insurance policies distributed to third parties are not the property of the estate. All eight of those factors are also present here and weigh universally in favor of Mr. Jesenik's position:

> A. "[Receivership Entity] ha[s] no claim to the proceeds paid by [the Policy] for a covered claim, as they are paid directly to [third parties]."[13] Any monies paid out by the Policy are paid directly to a third party without ever passing to or through the Receiver.
>
> B. "[Receivership Entity] cannot ask [Insurer] to distribute Policy proceeds to [the Receiver]." There is no mechanism in the Policy that would allow the Receiver to demand that the Insurer pay the estate directly.
>
> C. "[Receivership Entity] cannot determine on [his] own how the Policy proceeds will be distributed." The Policy does not permit the Receiver to determine on his own how Policy proceeds will be distributed. The *only exception* is that the Receiver could delay payments under Insuring Agreements B and C *in favor of* Mr. Jesenik's and the other Individual Defendant's rights under Insuring Agreement A. Catlin Policy, § XIII(C)(2).

[13] Under Ninth Circuit law, the identity of the third party is irrelevant. *See Minoco*, 799 F.2d at 519 ("For the purposes of the automatic stay, we see no significant distinction between a liability policy that insures the debtor against claims by consumers and one that insures the debtor against claims by officers and directors.").

D. "[Receivership Entity's] creditors cannot seize the Policy proceeds from [the Insurer] to satisfy a claim that is outside the scope of the Policy coverage." The Policy does not permit payments for anything other than for Loss incurred to defend a covered Claim, and Mr. Jesenik is aware of no mechanism by which creditors of the Receivership Entity could seize Policy proceeds outside of the satisfaction of a covered Claim.

E. "Policy proceeds can only be distributed to the creditors who have claims under the Policy." This is also true here. The Policy does not contemplate a payment or distribution to creditors without covered claims.

F. "When a covered claim arises, the [Receivership Entity] ha[s] in interest in having [the Insurer] pay for [the Receivership Entity's] wrongdoing; [Receivership Entity's] interest is the contractual right to have its own assets protected from exposure by means of the insurance coverage, according to the terms of the Policy." Just as in *Endoscopy Center*, the Receiver's interest here is not in the proceeds themselves, but in the contractual right provided by the Policy. Mr. Jesenik's co-existing contractual right does not damage the right held by the Receiver and indeed has existed since the signing of the Policy. Likewise, the risk that the proceeds would not be distributed equally to all co-insureds or that the Policy could at some point be exhausted and be unavailable to a co-insured at a later date is a risk that has been present since the signing of the Policy. That risk was assumed by the entity whose shoes the Receiver now fills, as well as by the co-insureds about whom the Receiver now complains. The parties could have, through contract and negotiation, bargained around that risk or distributed it in a different way (such as contractual coverage limits on individual claims, separate policies for the entity and the officers, or indemnity-specific language), but they did not. It is not appropriate for the Court to now, extra-contractually, re-apportion that risk. *See* Opp. at 34 ("Nor can this Court or any other Court rewrite the terms of the policy.").

G. "[Receivership Entity's] estates are not enriched by the existence of coverage of the payment by a liability insurer to a [third party]." The size of the Receivership Estate cannot increase by virtue of the payments made by the Insurer to *any* third party. If the Receiver controls $100 million in assets, and faces $200 million in claims, and a liability insurer pays $10 million towards those claims *on behalf of* the Receiver, the Receiver still controls $100 million in assets – no more, no less.

I. "The size of the [Receivership Entity's] estate never changes; the underlying claim base against the estate is affected. Because of insurance, the estate property is liable for a smaller amount of claims." The Policy terms make this true by definition. The Receiver's conflation of the size of the estate with the size of the claims arrayed against that estate is the root of its entire objection – and fatal to its logical and legal appeals.

Endoscopy Center, 451 B.R. at 546 (source of all quotes in the above alphabetical list unless otherwise attributed).

These factors also illustrate the principles behind *Minoco* and *Edgeworth* as applied here—the use of Policy proceeds, according to Policy terms, can *never* increase the value of the estate because no use of the proceeds in accordance with the Policy can ever result in money coming into the estate. The value of the assets in the possession of the estate, their monetary worth, can never change as a result of the Policy proceeds.

C. The Receiver's Diminution Argument Does Not Create a Property Right.

Decreasing the pool of claims against the estate is not equivalent to increasing the value of the estate for three reasons.

First, *Minoco* does not support this diminution argument. Nowhere in *Minoco* does the Ninth Circuit hold that payments of insurance proceeds to third parties are rendered property of the Receivership Estate because they may decrease the size of the claims made against the Receivership Estate. Moreover, *Minoco* addressed whether the policies could be canceled – not utilized. *See* 799 F.2d at 518. It reasoned that cancelling the policies would harm the estate because it would increase the likelihood that the now-uninsured officers and directors of Minoco would seek payment of their legal fees in the form of indemnity from the estate. *See id*. at 518-19. The exact opposite is true here: the existence of the Policy and the contractual rights it guarantees are preventing and delaying any indemnification claims on behalf of the Individual Defendants. Moreover, the Policy also prevents the Receiver from wasting estate assets litigating the Individual Defendants' entitlement to indemnity or the terms of that indemnity. While the Receiver's attempt to deny the Individual Defendants access to the Policy and its proceeds has diminished the value of the Receivership Estate, it has not, and cannot, enhance the estate's value.

Second, as *Endoscopy Center* explained:

> [T]o hold that the debtor has a legal or equitable interest in property used to pay the covered claims because payment of the covered claims by some other party with that party's property may decrease the debtor's overall liability, is utterly backward.
>
> Property, however, does not become property of the estate merely because such property has the effect of reducing the estate's liability, or because of some other beneficial effect such property has on the estate. **The estate must have a legal or equitable interest in the property which benefits the estate.**

451 B.R. at 546-47 (quoting *Landry v. Exxon Pipeline Co.*, 260 B.R. 769, 787-89 (Bankr. M.D. La. 2001) (emphasis in *Landry* and *Endoscopy Center*); *see also SEC v. Morriss*, No. 4:12-CV-80 CEJ, 2012 WL 1605225 at *4 (E.D. Mo. May 8, 2012) (holding that, where the insurer is "required to advance defense costs on a current basis without regard to the potential for other future payment obligations" the secondary impact rational does not apply because "there is no basis for concluding that the policy actually protects the estate's other assets from diminution.") (internal quotation marks omitted).

It is not enough for the Receiver to claim a property interest in an asset because that asset has the potential to reduce the Receiver's overall liability. The logic of this is obvious: former Aequitas investors (including those investors who recently submitted demand letters to the Receiver) are seeking recovery for the same series of transactions from third parties *other than* the Receivership Estate. Successful recovery from such third parties, paid with assets held by those entities, will reduce the Receiver's overall liability. That does not transform the assets of those third-party entities into property of the Receiver and thereby subject them to the stay. The Receiver must demonstrate an ownership interest that is *separate* from an asset's ability to decrease the value of claims outstanding against the Receiver.

Third, the bankruptcy cases the Receiver cites to support his "diminution" theory are easily distinguishable. The Receiver cites to both *In re Circle K Corp.* and *Metro. Mortg. & Sec. Co., Inc.* in support of his position. Despite noting that the courts in those decisions engaged in a "fact-specific analysis" concerning the policies at issue, the Receiver did not.

The policy at issue in *In re Circle K Corp.* was unambiguously an *indemnity policy* which provided for payment *directly* to the insured entity. *See* 121 B.R. at 261. ("Underwriter *will reimburse the Company*…") (emphasis added). As such, there were circumstances in which the "debtor [could] *make a claim for reimbursement* for indemnification claims paid" and receive payment directly. *Id*. (emphasis added). Indeed, another case the Receiver cites makes exactly this point: "The [*Circle K*] court reasoned that since the policies at issue were indemnity policies and not just liability policies, the debtor had a right to the proceeds." *In re Metro. Mortg.*, 325 B.R. at 856. Those circumstances are not present here as the Policy at issue is unambiguously a liability policy. Further, unlike liability-only policies, the proceeds of indemnity policies might constitute estate property under *Minoco* (the estate is without a doubt worth more when it is directly reimbursed for an expense), *Edgeworth* (the insured in *Circle K Corp.* had the right to receive and keep the proceeds paid by the insurer), and *Endoscopy Center* (the insured had a claim to the proceeds, could ask the insurer to pay the proceeds directly to the estate, could determine how to distribute those proceeds once it had received them, etc.).

In *In re Metropolitan Mortgage*, the policy likewise contained an indemnity provision: "The D & O policies insure. . . payment *to the debtors* for any indemnification claims which may be made against them by their directors and officers"; "The debtors also have a non-derivative right *to receive proceeds to compensate for the cost* of responding to certain investigations by regulatory agencies." *See* 325 B.R. at 853, 856-57 (emphasis added). As noted above, the *In re*

Metro court noted that the *Circle K* decision turned on the distinction between indemnity and liability policies, and opted to follow that court's analysis. *Id*. at 855, 857.

V. THE COURT SHOULD PERMIT PAYMENT OF DEFENSE COSTS EVEN IF THE POLICY PROCEEDS ARE A PART OF THE RECEIVERSHIP ESTATE.

A. Conditions to Access Are Appropriate Only Where the Court Has Ruled the Proceeds are the Property of the Receiver.

Contrary to the Receiver's mischaracterization, Mr. Jesenik's position is *not* that the Court should permit the Insurer to pay his Defense Costs "regardless of how it rules on the receivership property…issue[]." *See* Opp. at 27. If the Court rules that the Policy proceeds are *not* property of the Receiver, this inquiry is over and Mr. Jesenik (and any other party with valid claims under Insuring Agreement A) will exercise his contractual rights under the Policy without further intervention from the Court. *See, e.g. In re Laminate Kingdom, LLC*, No. 07-10279-BKC-AJC, 2008 WL 1766637, at *1 (Bankr. S.D. Fla. Mar. 13, 2008) ("As set forth below, this Court agrees that the Policy is not an asset of the Debtor's estate and, therefore, this Court's approval for Carolina's advancement of Costs of Defense is not necessary.") (internal quotations omitted).

Rather, Mr. Jesenik argues that this Court can allow him and the other Individual Defendants to access Policy proceeds even if it does not rule on the issue of whether the proceeds are property of the estate. *See, e.g., Groshong v. Sapp (In re Mila, Inc.)*, 423 B.R. 537, 543-44 (B.A.P. 9th Cir. 2010) (holding that regardless of whether policy proceeds are considered property of the estate, courts have discretion to permit advancement of defense cost payments in light of the harm if insured persons are "prevented from *executing their rights* to defense costs" (emphasis added)).

The only way the Court can impose conditions on the Individual Defendants' ability to seek advancement from the Insurer for covered Defense Costs is to find that the proceeds

requested are property of the estate. *See, e.g., Narayan*, 2017 WL 447205, at *9 (rejecting receiver's request that various conditions, including judicial review of defense costs and the provision of a security for reimbursement, where the court had not ruled on the ownership of the policy proceeds). As such, the Receiver's request for such conditions should *only* be considered if the Court determines—notwithstanding authority to the contrary—that the Policy proceeds are property of the estate.

B. Good Cause Exists to Allow Defendants Access to the Proceeds Under the Policy Even If the Proceeds Are Deemed To Be Property of the Receivership Estate.

Even if the Court rules that Policy proceeds are the Receiver's property, the Court can and should allow the Individual Defendants to seek advancement of their Defense Costs pursuant to the Policy for three reasons.

First, denying Mr. Jesenik access to the proceeds of the Policy would undermine the essential and primary purpose of such policies. *See In re MF Global Holdings Ltd.*, 469 B.R. 177, 193-94 (Bankr. S.D.N.Y. 2012) ("The MFGA Policies provide equal status to the Individual Insureds and the Debtors. However, in essence and at their core, the MFGA Policies were obtained for the protection of the Individual Insureds and are not a vehicle for corporate protection.") (internal quotation marks omitted); *SEC v. Stanford Int'l Bank, Ltd.*, Civ. A. No. 309-CV-298-N, 2009 WL 8707814, at *4 (N.D. Tex. Oct. 9, 2009) ("[T]he directors and officers, many of whom deny any knowledge of fraudulent activities, relied on the existence of coverage. They expected D & O proceeds would afford them a defense were they to be accused of wrongdoing in the course of duty."); *In re First Central Financial Corp.*, 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999) ("D & O policies are obtained for the protection of individual directors and officers…[i]n essence and at its core, a D & O policy remains a safeguard of officer and director

interests and not a vehicle for corporate protection.").[14] The primary purpose of obtaining insurance like that provided by the Policy here is to ensure that directors and officers will be able to mount a vigorous defense in the precise situation presented here: where the full force and limitless resources of an agency of the federal government are arrayed against them. Indeed, that primary purpose is evidenced by the fact that the Policy provides coverage for the SEC Litigation for the Individual Defendants while expressly *excluding* coverage for the Receivership Estate for the identical Claim. *See* Catlin Policy, Regulatory Exclusion, Endorsement No. 7.

Second, the prejudice to the Individual Defendants' rights if they are prohibited from seeking the advancement of Defense Costs they are entitled to under the Policy is self-evident.[15] The Receiver's position that Mr. Jesenik's request should be denied as he has "failed to provide the Court with any ***evidence*** of prejudice" (Opp. at 28) (emphasis in original) is disingenuous. Obviously, the Receiver, this Court, and everyone else is well aware that an inability to fund a defense in a case like this is highly prejudicial to a defendant. Moreover, the Individual

[14] Indeed, in every single case cited by the parties (on both sides) that involved a liability policy with proceeds payable solely to third parties, the court permitted the advancement of defense costs—either because the proceeds were not property of the estate or in the exercise of the court's discretion.

[15] *See XL Specialty Ins. Co. v. Level Global Investors, L.P.*, 874 F. Supp. 2d 263, 272-73 (S.D.N.Y. 2012) (recognizing that failure to receive defense costs under a professional liability policy when they are incurred satisfies the rigorous "irreparable harm" standard required for injunctive relief); *see also In re Worldcom, Inc., Sec. Litig.*, 354 F. Supp. 2d 455, 469 (S.D.N.Y. 2005); *In re CyberMedica, Inc.*, 280 B.R. 12, 18–19 (Bankr. Ct. D. Mass. 2002) (granting relief from automatic stay in bankruptcy because directors and officers would suffer irreparable harm if prevented from exercising rights to legal defense payments under D&O policy); *Great Am. Ins. Co. v. Gross*, No. 05-cv-159, 2005 U.S. Dist. LEXIS 8003, at *13–14 (E.D. Va. May 3, 2005) (granting preliminary injunction compelling insurer to resume advancement of defense costs, because insured faced prospect of "massive civil liability due to the complex, fact intensive actions" and "[t]he practical effect of Plaintiff's failure to advance costs of defense to Moving Defendants would be to cause [insureds' counsel] to withdraw"); *Emons Indus., Inc. v. Liberty Mutual Ins. Co.*, 749 F. Supp. 1289, 1293 (S.D.N.Y. 1990) (finding irreparable harm where insurer sought to force insured whose policy covered defense costs to replace his attorney of a decade); *Nu-Way Envtl., Inc. v. Planet Ins. Co.*, No. 95-cv-573, 1997 U.S. Dist. LEXIS 11884, at *7 (S.D.N.Y. Aug. 5, 1997).

Defendants are not required to demonstrate actual prejudice from a violation of their contractual rights; their obligation, which is easily met here, is to show a risk of *future* prejudice from such a violation. *See, e.g.*, *In re Arter & Hadden, LLP*, 335 B.R. 666, 674 (Bankr. N.D. Ohio 2005) ("[T]here is cause to lift the automatic stay because the [executive insureds] *may* suffer substantial and irreparable harm if prevented from exercising their rights to defense payments to fund their defense.") (emphasis added); *In re MF Global Holdings, Ltd.*, 469 B.R. 177, 193-94 (Bankr. S.D.N.Y. 2012) (granting individuals access to insurance proceeds after listing various harms that denial would cause including future failure to pay defense costs, deprival of settlement opportunities, and an increase in out-of-pocket costs). Evidencing the disingenuous nature of the Receiver's position on this issue, both of these cases are cited by the Receiver on the very page that its Opposition argues the Court should deny Mr. Jesenik's request for allegedly failing to demonstrate prejudice. *See* Opp. at 28.

Here, based on nothing more than the Receiver's unsupported allegations, Mr. Jesenik is currently being denied the ability to exercise his contractual rights to advancement of his Defense Costs. *Cf. In re MF Global Holdings Ltd.*, 469 B.R. at 194. Mr. Jesenik risks being deprived of fair and efficient settlement opportunities and losing his counsel and damaging the quality of his defense. *Cf. Stanford*, 2009 WL 8707814 at *4. Mr. Jesenik risks his ability to retain *any counsel at all* as civil actions do not guarantee court-appointed counsel. *Id*. He also risks suffering increased out-of-pocket costs to mount a defense despite having satisfied the Policy's contractual coverage requirements. *See In re MF Global Holdings Ltd.*, 469 B.R. at 194. Mr. Jesenik also faces personal disgorgement risks as well as the risk of SEC-imposed penalties, the severity of both of which depend on his ability to defend himself. In short, the risk of prejudice to from any curtailment of his access to the Policy proceeds is overwhelming.

By contrast, any prejudice to the Receiver in allowing Mr. Jesenik to exercise his contractual rights under the Policy is potentially non-existent and, in any event, drastically less than Mr. Jesenik faces. There are no circumstances under which the Policy proceeds can be paid to the Receivership itself, so there are no circumstances under which they will become an asset of the estate to be distributed as the Receiver sees fit. *See* Catlin Policy, § I.(C) ("Loss" resulting from a "Claim" paid "on behalf" of the Insured to a third-party). As noted above, the Receiver currently has no insurable Loss. If it did, it would make a claim for it just as Mr. Jesenik has. The Receiver is at no risk of being unable to pay its own attorneys or of being unable to receive his own fees. The Receiver is at no risk of being unable to settle a claim against it. The Receiver is facing pre-litigation demands for payment from third-parties, but makes no representations as to the validity or merits of those demands. In fact, the Receiver has taken the position that those demands are insurable under the Policy (Opp. at 3-4), which excludes coverage for fraud or intentional misconduct. Catlin Policy, Endorsement No. 2. If there is no fraud or intentional misconduct, there is little or no basis for the claims asserted against the Receiver, completely undermining the amount claimed. Moreover, Mr. Jesenik is subject to every demand to which the Receiver has been subject.

That any prejudice to the Receiver is dwarfed by the risks facing Mr. Jesenik is underscored by the fact that the Receiver *currently* controls $150 million in liquid assets, with the potential for that amount to increase. *See* Opp. at 13. Mr. Jesenik is asking that he and the other Individual Defendants, be able to exercise their contractual rights to utilize a pool of $5 million in insurance proceeds. Even if those proceeds *could* be given to the estate, which they cannot, they would not meaningfully decrease the entirely hypothetical "Loss" to the estate about which the Receiver complains. Despite the Receiver's disingenuous claim that he is "not

attempting to deprive Jesenik of his ability to prepare his defenses in the SEC Action" (Opp. at 7), it asks that the Court to undercut Mr. Jesenik's contractual rights under the Policy in favor of reducing the hypothetical exposure to the Receivership Estate by less than one percent. *See id*. at 13 (noting Forge Policy limit of $5 million and purported demand letters seeking more than $600 million); *Cf. In re Allied Digital*, 306 B.R. 505, 514 (Bankr. D. Del. 2004) ("Without funding, the Individual Defendants will be prevented from conducting a meaningful defense to the Trustee's claims and may suffer substantial and irreparable harm. The directors and officers bargained for this coverage.").

Third, allowing Mr. Jesenik and the Individual Defendants access to Policy proceeds under the terms of the Policy may *reduce* the actual diminution of estate assets as well as the universe of potential claims against those assets. For example, the Individual Defendants' use of the proceeds of the Policy to defend themselves may reduce the claims for indemnification they hold against the Receivership Estate. A successful defense by the Individual Defendants would also reduce the overall exposure of the estate's property by eliminating claims against the estate, dissuading additional prospective claimants, or convincing certain claimants to settle their claims for smaller amounts. Further, the Individual Defendants' defense against the SEC may assist the Receiver in establishing that there was no wrongdoing by the corporate entities, resulting in a more accurate and just dispensation of the property of the estate if such a dispensation is ultimately required. *See In re MF Global Holdings, Ltd.*, 469 B.R. at 194.

C. The Receiver's Proposed Conditions Are Inappropriate and Unnecessary.

The Receiver lays out four "conditions" that it believes this Court should impose against Mr. Jesenik. Even if the Court were to find that the proceeds of the Policy were property of the Receivership Estate, all of the suggested conditions are unprecedented, inappropriate given the

relative prejudice to the parties and the Receiver's improper motives, and unnecessarily burdensome on Mr. Jesenik, the Individual Defendants, the Insurer, and this Court.

(1) *Request that the Court Determine the Reasonableness of Mr. Jesenik's Defense Costs*. The Receiver's first condition is unnecessary. While counsel for Mr. Jesenik will provide the Court with any billing or other information it requests, it would be a waste of the Court's time to review decisions made by the Insurers here. An *in camera* review of "all of [Mr. Jesenik's] counsel's billing and communications with [the Insurer]" would force this Court to engage in an entirely duplicative process to one which has already been carried out by Catlin, and to substitute its judgment concerning the applicability of coverage under the Policy for that of the Insurer. Courts have rejected similar requests from co-insureds for exactly this reason. *See Narayan*, 2017 WL 447205 at *9 (The Court finds that it is [Insurer's] responsibility to determine the reasonableness of any fees incurred by [Insureds]."). Indeed, a case cited by the Receiver notes that courts have been *explicitly* reluctant to engage in the process Receiver requests. *See In re MF Global Holdings*, 469 B.R. at 197 ("The Court is therefore very reluctant to constrain the usual claim submission, determination and payment process dictated by the Policies.").

This requested condition is designed to delay a ruling on the merits. The Receiver's own witness notes that, in his opinion, proper analysis of the fees would take someone *experienced in doing just that* more than 100 hours. *See* Schratz Dec. at 6-7 (claiming that a legal fee audit would require "50 to 75 hours per $1 million in fees" to "properly analyze fees"). The Receiver admits that it does not know whether Catlin performed such an analysis and presents no evidence of even asking Catlin or its counsel what analysis they performed. For all the supposed concern about the Insurer's review of Mr. Jesenik's legal invoices and its enforcement of the Policy terms and conditions, the Receiver has seemingly not written a letter, made a phone call, sent an email,

or had one meeting with Catlin about this issue. Finally, whatever the Receiver's concerns about Catlin may be, there is no basis for imputing those concerns or any additional burden onto Forge. The Receiver's desire is that the Court substitute the Receiver's judgment for the Insurer's to limit Mr. Jesenik's contractual right to coverage under the Policy.

(2) *Request to Apportion Remaining Policy Proceeds Among the Insureds*. This request is inappropriate for multiple reasons. First, the Receiver asks this Court to apportion proceeds that *no one* yet has a right to access. *See* Opp. at 30 (requesting apportionment of coverage provided under the Starr Policy, which is triggered only after exhaustion of Forge Policy). Second, the Receiver's request is disproportionate to the risks and harms as outlined above. Third, the Receiver has not incurred any "Loss" for which the Policy provides coverage. Fourth, the Receiver has not shown the merits and validity of even the hypothetical risks to which it is exposed. Finally, the Receiver's desire to preemptively apportion the proceeds of the Policy completely writes out the Policy's Priority of Payment provision. It is irreconcilable for the Receiver to concede that the Priority of Payment provision must be given effect in certain circumstances as a valid, bargained-for contractual right under the Policy and then request that this Court impose conditions on Mr. Jesenik and the other Individual Defendants designed to ensure that they *can never trigger that right*.

(3) *Request to Allocate Limited Insurance Proceeds Among the Individual Defendants, and to Subrogate Mr. Jesenik's Rights*. Without citation to any contractual authority or legal precedent, the Receiver requests that, as a "condition" of Mr. Jesenik's access to the Policy proceeds he is entitled to by contract, the Court both implement a "soft cap" on the proceeds that have *already* been set aside for the Individual Defendants, and apportion proceeds under that "soft cap" between parties *other than the Receiver*. The Receiver makes this request even though

it does not appear that anyone has asked that it do so and there is no reason why these parties could not make this request of the Court themselves if they wanted to do so.

The Receiver also seeks – again without no reference to the Policy terms – to *subrogate* any rights Mr. Jesenik has to utilize the proceeds of that Policy to those of the other Individual Defendants despite the fact that both Mr. Jesenik and the Individual Defendants have perfected rights and are drawing proceeds under the same Insuring Agreement. The Receiver provides no basis in contract or law for its asserted right to determine the apportionment of proceeds between third parties. This "condition" is unsupportable and demonstrates that the Receiver's Opposition is not meritorious. Rather, the Receiver's motive is to limit in any way possible Mr. Jesenik's access to the defense funds he is entitled to under the Policy.

(4) *Request that Mr. Jesenik Meet and Confer Regarding Monitoring*. The Receiver believes that *after* the Court has (1) conducted an *in camera* review in excess of 100 hours of counsel for Mr. Jesenik's invoices and correspondence, (2) reserved $7.5 million in funds ($5 million of which no one has a contractual right to yet) for the Receiver, and (3) apportioned the remaining $2.5 million between the Individual Defendants and discovery vendor in accordance with the Receiver's wishes, the Court should then *compel* counsel for Mr. Jesenik and the Insurer to engage in a meet and confer with the Receiver to justify how Mr. Jesenik intends to utilize whatever proceeds remain. At the conclusion of the obviously-designed-to-fail meet-and-confer process, the Receiver intends to request a hearing on Mr. Jesenik's failure to accede to its wishes.

The Receiver's purported cause for concern does not match its proposed method of remediation. Decisions about how Mr. Jesenik defends the SEC Litigation rest solely with him and his counsel. The Receiver cannot determine which documents his attorneys review, whom they speak with, when and how frequently they meet, or how they prepare to defend him.

Nonetheless, the Receiver seeks to use its status as a co-insured under the Policy to do just this. In essence, the Receiver is attempting to transform questions about what Defense Costs Catlin advanced under the Policy and whether it scrutinized his legal bills with a sufficiently sharp eye, into claims of "unclean hands" by Mr. Jesenik.

However, the Receiver also states "the Receivership Entity has advised Oliver's and Gillis's counsel that the Receiver *has no objection at this time to the amounts the primary-level insurer (Catlin) paid to them."* Opp. at 7, n. 5 (emphasis added). Of course, this creates a logical conundrum for the Receiver. If Catlin was not sufficiently diligent in reviewing the bills of counsel for Mr. Jesenik, why would it have been *more diligent* reviewing the lower invoices provided by counsel for Oliver or Gillis? The Receiver does not address this logical inconsistency because its purported concerns about the thoroughness of Catlin's review are simply a baseless pretext with no evidentiary foundation – not to mention the complete lack of any basis to support its allegation that Forge will do the same. The Receiver is not seeking to ensure that the terms of the Policy are being adhered to. Rather, the Receiver's motivation is to stop Mr. Jesenik's counsel from defending him aggressively and thoroughly.

CONCLUSION

In light of the foregoing, Mr. Jesenik respectfully request that the Court grant his Motion and enter an order to permit Forge to advance on his behalf past and future Defense Costs in connection with the SEC Litigation.

DATED: September 28, 2017 SCHULTE ROTH & ZABEL LLP

By: */s/ Peter H. White*
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