IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

3:16-CV-438-PK

v.

OPINION AND 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.

PAPAK, Magistrate Judge:

Plaintiff the Securities and Exchange Commission (the "SEC" or the "Commission") filed this securities fraud action against defendants Aequitas Management, LLC ("Aequitas Management"), Aequitas Holdings, LLC ("AH" or "Aequitas Holdings"), Aequitas Commercial Finance, LLC ("ACF"), Aequitas Capital Management, Inc. ("ACM"), Aequitas Investment Management, LLC ("AIM" and, collectively with Aequitas Management, AH, ACF, and ACM, the "Aequitas companies" or the "entity defendants"), Robert J. Jesenik, Brian A. Oliver, and N.

Scott Gillis (collectively with Jesenik and Oliver, the "individual defendants") on March 10, 2016. By and through its complaint, the SEC alleges that the entity defendants, with the knowledge and under the direction of the individual defendants (Aequitas Management CEO Jesenik, Aequitas Management executive vice-president Oliver, and former Aequitas Management CFO and COO Gillis), defrauded over 1,500 individual and entity investors nationwide into investing their assets in Aequitas business ventures with the promise of lucrative returns, when in reality defendants used the great majority of the funds they received from such investors to pay corporate expenses, including executive salaries, bonuses, and perquisites, actually investing only 15-25% of the proceeds received. Arising out of the foregoing, the SEC alleges (i) all defendants' liability under Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933 (the "Securities Act"), (ii) the liability of the individual defendants for aiding and abetting the entity defendants in their violation of Sections 17(a)(1) and 17(a)(3) of the Securities Act, (iii) all defendants' liability for violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and of Rules 10b-5(a) and 10b-5(c) promulgated under the Exchange Act, (iv) the liability of the individual defendants for aiding and abetting the entity defendants in their violation of Section 10(b) of the Exchange Act and of Rules 10b-5(a) and 10b-5(c) promulgated under the Exchange Act, (v) defendants ACF and Jesenik's liability for violation of Section 17(a)(2) of the Securities Act, (vi) the liability of the individual defendants for aiding and abetting ACF in its violation of Section 17(a)(2) of the Securities Act, (vii) defendants ACF and Jesenik's liability for violation of Section 10(b) of the Exchange Act and of Rule 10b-5(b) promulgated under the Exchange Act, (viii) the liability of the individual defendants for aiding and abetting ACF in its violation of Section 10(b) of the Exchange Act and of Rule 10b-5(b) promulgated under the Exchange Act, (ix) defendants ACM and AIM's liability for violation of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"), (x) the liability of the individual defendants for aiding and abetting defendants ACM and AIM in their violation of Sections 206(1) and 206(2) of the Advisers Act, (xi) defendants ACM and AIM's liability for violation of Section 206(4) of the Advisers Act and of Rule 206(4)-8 promulgated under the Advisers Act, and (xii) the liability of the individual defendants for aiding and abetting defendants ACM and AIM in their violation of Section 206(4) of the Advisers Act and of Rule 206(4)-8 promulgated under the Advisers Act. The SEC seeks disgorgement of the fraudulently solicited investment funds with prejudgment interest, imposition of civil monetary penalties against all defendants, and injunctive relief to prevent the individual defendants from serving as officers or directors of any public company and to prevent any of the defendants from soliciting investments or participating in securities transactions. This court has subject-matter jurisdiction over the SEC's action as expressly provided in the Securities Act, the Exchange Act, and the Advisers Act, and pursuant to 28 U.S.C. § 1331.

Judge Hernández appointed Ronald F. Greenspan to serve without bond as receiver of the Aequitas companies (and their subsidiaries and/or majority-owned affiliates) on an interim basis effective March 16, 2016; by and through that same order, Judge Hernández both froze the assets of the Aequitas entities and of certain of their subsidiaries and affiliates and stayed litigation of any ancillary proceeding involving the Aequitas entities or their past or present officers, directors, managers, agents, or partners. On April 14, 2016, these chambers confirmed Greenspan's appointment as receiver of the Aequitas companies, the freeze of the Aequitas entities' assets, and the stay of ancillary litigation on a permanent basis.

On May 23, 2016, these chambers issued an order lifting the receivership order of April 14, 2016, to the limited extent necessary to permit the Aequitas entities' primary Director and Officer liability insurance provider, Catlin Specialty Insurance Company ("Catlin"), to reimburse the individual defendants' defense costs incurred in connection with this action and the SEC's investigation only, up to the $5,000,000 limit of, and pursuant to the terms and conditions of, Catlin's policy.

Judge Hernández entered judgment of permanent injunctive relief as to the entity defendants, with their stipulation and consent, on June 15, 2016, enjoining each of them, together with their officers, agents, servants, employees, and attorneys, from violating federal securities laws, from soliciting any person or entity to purchase or sell any security (other than in connection with the receiver's fulfillment of his responsibilities under the court's receivership order), and from opposing any argument that they violated applicable securities laws in connection with any motion brought by the SEC seeking disgorgement of profits made from the foredescribed sales of securities to Aequitas investors.

On August 22, 2017, the individual defendants, asserting that they had collectively exhausted the $5 million limit of the Catlin policy, moved for further relief from the receivership order in order to permit one of the Aequitas' entities' two excess insurers (specifically, Forge Underwriting Ltd. ("Forge")) to reimburse their continuing defense costs going forward. Forge's excess policy, like Catlin's underlying Director and Officer policy, has a coverage limit of $5 million.

Now before the court are Oliver and Gillis' motion (#496) and Jesenik's motion (#499) for relief from the receivership order to the limited extent necessary to permit Forge to pay their defense costs. I have considered the motions, oral argument on behalf of the parties, and all of the pleadings and papers on file. For the reasons set forth below, both motions are granted.

MATERIAL FACTS

On April 14, 2016, I confirmed Judge Hernández' appointment of Greenspan as receiver for the Aequitas companies and froze the Aequitas entities' assets on a permanent basis. On May 23, 2016, I granted relief from the order of April 14, 2016, to the limited extent necessary to permit Catlin to pay the defense costs of the individual defendants pursuant to its Directors and Officers liability policy, up to the $5,000,000 coverage limit of that policy. I further ordered that the individual defendants submit a quarterly report to the receiver stating the amounts paid by Catlin in connection with their defense costs. My order defined property of the receivership entity as:

> including, but not limited to, monies, funds, securities, credits, effects, goods, chattels, lands, premises, leases, claims, rights and other assets, together with all rents, profits, dividends, interest or other income attributable thereto, of whatever kind, which the Receivership Entity own, possess, have a beneficial interest in, or control directly or indirectly.

In early April 2017, counsel for Jesenik submitted a report to the receiver indicating that, at that time, approximately $2.0 million of the $5 million policy had been paid out to the individual defendants. In late June 2017, counsel for Oliver reported to the receiver that the $5 million Catlin policy was exhausted in its entirety. Shortly thereafter, counsel for the receiver requested documentation of the approximately $4.9 million in payments that Catlin had reportedly made to the individual defendants. Counsel for Oliver responded on July 13, 2017, providing a spreadsheet listing all payments made by Catlin under the policy, and the dates the payments were made. According to that spreadsheet, notwithstanding Oliver's counsel's early

June 2017 report that the Catlin policy was at that time exhausted, the spreadsheet indicated that at the time of the early June 2017 report, Catlin had made approximately $2.9 million in payments to counsel for the individual defendants, approximately $0.5 million in payments to the individual defendants' discovery vendor, and approximately $0.1 million in payments to counsel for a former CFO of Aequitas Management in connection with a prior SEC investigation. The spreadsheet further indicated that another approximately $1.5 million in payments to counsel for the individual defendants had been tendered as of July 7, 2017, exhausting the policy as of that date (with approximately $4.4 million of the $5 million in payments having gone to counsel for the individual defendants, of which approximately $2.7 million, or 61% of the total payments made to counsel for the individual defendants, had been tendered to counsel for Jesenik; counsel for Oliver was paid approximately $0.8 million, and counsel for Gillis received approximately $0.9 million).

The payments of July 7, 2017, which occurred within days after counsel for the receiver requested proof of exhaustion, were not tendered according to the regular schedule that Catlin's previous payments had observed. Moreover, the payments tendered since the report of April 2017 were significantly larger than the previous payments. As of July 7, 2017, document review in this action was incomplete, no depositions had been taken, Gillis had filed an unsuccessful motion to dismiss (apparently thereby incurring approximately $90,000 in legal fees), and the individual defendants had successfully moved for a protective order. It therefore appears that the great majority of the approximately $4.9 million tendered to the individual defendants' counsel and discovery vendor was expended in connection with document review.

On August 3, 2017, counsel for the receiver wrote to counsel for the individual defendants to request a detailed explanation of the amounts billed, of the fact that 61% of the defense cost payments made to counsel for the individual defendants went to counsel for Jesenik, and of the fact that Jesenik's monthly legal fees approximately quadrupled after he hired new counsel in approximately March 2017. The receiver's counsel indicated the receiver's suspicion that uncovered costs were improperly being billed to Catlin by Jesenik's counsel, and that Catlin was improperly paying such costs. Counsel for Oliver responded on August 7, 2017, indicating that, in addition to the legal costs already paid by Catlin, as of that time an additional $1.4 million in defense costs had been incurred without having been paid. Counsel for Jesenik responded on August 9, 2017, largely refusing to provide any explanation for the legal fees incurred. Counsel for the receiver responded to Jesenik's counsel on August 12, 2017, reiterating his request for a detailed explanation and providing an explanation of the basis for the request, without eliciting any further response.

Since August 2017, the receiver has received written demands from counsel representing Aequitas investors totaling approximately $650 million. As of July 31, 2017, the receivership entity had approximately $150 million in assets.

The Forge excess insurance policy follows the form of the Catlin policy, and is the excess policy of first resort once the Catlin policy is exhausted; the Forge policy specifically provides that its coverage is triggered only after "the Underwriters of the [Catlin policy] shall have paid or have admitted liability or have been held liable to pay" an amount equal to the coverage limit under the Catlin policy. Like the underlying Catlin policy, the Forge policy has a coverage limit of $5 million, and provides coverage and an obligation to defend in connection with any "written demand or notice for civil monetary or non-monetary relief" made against certain of the Aequitas entities and their officers and directors. The Catlin policy – and therefore also the Forge policy – contains a priority-of-payments provision as follows:

> 1. If Loss [where "Loss" includes both damages a covered entity or individual is obliged to pay and "reasonable and necessary" attorney fees and costs incurred by such a party in defending against a claim for money damages] is incurred that exceeds the remaining Limits of Liability for this Policy, the Insurer shall pay Loss under [the provisions for insurance to insured directors and officers] before paying any other Loss.
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> 2. If Loss is incurred other than under [the provisions for insurance to insured directors and officers] 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. . . .

ANALYSIS

As a preliminary matter, I agree with the receiver that the receivership entity has an ownership interest in proceeds from the Forge policy, with the result that the proceeds of that policy constitute receivership assets under the receivership order subject to the asset freeze (and that a court order is therefore required before Forge can make payments to the individual defendants under its policy). Written demands for payment of money in consequence of the complained-of conduct of the defendants in this action have been made on the receivership entity, and the receivership entity will be entitled to coverage in connection with any amounts any entity within the receivership is obliged to pay in connection with those demands. Because the receivership entity has a beneficial interest (and also because the receivership entity has a direct or indirect right to control) in some portion of the proceeds of the Catlin and/or Forge policies, under the express terms of the receivership order, the proceeds of the policies are receivership assets.

As a second preliminary matter, I agree with the receiver that the Forge policy's priority-of-payments provision is without application to the individual defendants' motions now before the court. Because by its terms that provision only dictates the order in which proceeds of the policy must be paid where *incurred* losses exceed the applicable coverage limit, and because here losses have not yet been incurred that exceed the applicable coverage limit, the priority-of-payments provision is simply inapplicable to the issues raised by the individual defendants' motions.

Notwithstanding the foregoing, the parties are in agreement that this court enjoys discretion to grant or deny the relief from the asset freeze that the individual defendants request. The receiver urges the court not to exercise its discretion to grant the requested relief, in large part based on its suspicion that some of the amounts Catlin paid under its policy to counsel for the individual defendants (in particular, to counsel for Jesenik) were either not reasonably incurred, not necessary to litigating the individual defendants' defenses, or not incurred in connection with the SEC's investigation of or action against the individual defendants. It is specifically the receiver's position that, if Catlin paid out proceeds from its policy to counsel for the individual defendants that were not necessary to and reasonably incurred in connection with the SEC's investigation of or action against the individual defendants, then those proceeds were not properly paid out, with the result that the Catlin policy was not properly exhausted, such that coverage under the Forge policy is not yet triggered, and the motions now before the court should be denied as premature.

I reject the receiver's position. In so doing, I do not suggest that the receiver is wrong regarding the possibility that Catlin may have reimbursed counsel for one or more of the individual defendants for costs that were not reasonable and/or necessary to the defense of this action. However, it is clear that coverage under the Forge policy is triggered, not when judicial scrutiny has determined that the coverage limit of the Catlin policy has been properly met, but rather when Catlin has actually paid out amounts equal to or exceeding the coverage limit, has been found liable in an amount equal to or exceeding the coverage limit, or has acknowledged its own liability under the policy in an amount equal to or exceeding the coverage limit. Here, the evidence of record establishes both that Catlin has in fact paid out amounts equal to the applicable coverage limit and that it has acknowledged in writing its liability in that amount. Under the plain language of the Forge policy, its coverage is therefore triggered, without regard to the possibility that it may ultimately be determined that some of the amounts already tendered by Catlin were improperly disbursed under the terms of its policy.

In the alternative to denying the individual defendants' motions on grounds of failure to exhaust the underlying policy, the receiver urges the court, in the event it is inclined to exercise its discretion to grant the motions, to impose conditions and requirements on the individual defendants' right to access the Forge policy, so as to safeguard against the possibility that Forge might pay out policy proceeds in reimbursement for unreasonably incurred attorney fees, or for fees incurred in connection with matters outside the scope of Forge's policy. Without in any sense disregarding or minimizing the receiver's concerns regarding the rate at which Jesenik's counsel (in particular) is incurring fees in an action that has not progressed beyond the stage of document review, I do not find that the receiver has established good grounds for the court to exercise its discretion to use its inherent powers to impose the suggested conditions and requirements. First, I note that neither the Catlin nor the Forge policy, nor any agreement among any of the parties, provides either a mechanism or a justification for imposing any such conditions on the individual defendants' entitlement to access the policies. Second, as already discussed, while it is possible that it may ultimately be determined (presumably, in connection with some judicial proceeding other than this one, unless new claims or cross-claims are filed by the receiver in this action) that some of the amounts already tendered by Catlin were improperly disbursed under the terms of its policy, and possible that counsel for one or more of the individual defendants may in the future successfully attempt to receive reimbursement from Forge for unreasonably incurred attorney fees or for attorney fees incurred in connection with matters outside the scope of policy coverage, those possibilities are without impact on the individual defendants' entitlement to reimbursement of their defense costs (which, absent the asset freeze, would be undisputed and unfettered). Moreover, the receiver's suggestion that individual defendants with a legitimate need for reimbursement of reasonably incurred defense costs can seek such reimbursement from Catlin or from any individual defendant who has received policy payments from Catlin in any sense improperly applies, *mutatis mutandis*, to the receivership entity itself: to the extent that any individual defendant is receiving improper payments from any insurer to the detriment of the receivership entity, the receivership entity can make a claim against that defendant and/or his insurer seeking repayment of such payments (again, presumably but not necessarily through a separately filed action).

For the foregoing reasons, I find that good grounds do not exist for thwarting the individual defendants' legitimate expectation that their insurers will cover their attorney fees and costs reasonably incurred in the course of defending this action. The asset freeze is therefore lifted to the limited extent necessary to permit Forge to pay the reasonably incurred defense costs of any insured under its policy.

CONCLUSION

For the reasons set forth above, Oliver and Gillis' motion (#496) and Jesenik's motion (#499) for relief from the receivership order to the limited extent necessary to permit Forge to pay their defense costs are granted, and Forge is authorized to make payments under its policy to or for the benefit of the individual defendants for covered costs reasonably incurred in connection with defending this action or in connection with the underlying SEC investigation.

Dated this 23rd day of October, 2017.

Paul Papak

Honorable Paul Papak
United States Magistrate Judge