STEVEN J. OLSON (S.B. #182240)
solson@omm.com
JORGE DENEVE (S.B. #198855)
jdeneve@omm.com
O'MELVENY & MYERS LLP
400 South Hope Street
18th Floor
Los Angeles, California 90071-2899
Telephone: +1 213 430 6000
Facsimile: +1 213 430 6407

Attorneys for Defendants
Ralph T. Iannelli and
Essex Capital Corporation

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

Securities and Exchange Commission,

Plaintiff,

v.

Ralph T. Iannelli and Essex Capital Corporation,

Defendants.

Case No. 2:18-cv-05008-FMO-AFM

DEFENDANTS' OBJECTION AND RESPONSE TO MONITOR'S REPORT AND RECOMMENDATIONS

Judge: Hon. Fernando M. Olguin
Courtroom: 6D

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Other Authorities

I. INTRODUCTION

On October 1, 2018, through a stipulated order, the Court appointed Geoff Winkler as a Monitor for Defendant Essex Capital Corporation ("Essex") with a limited reporting mandate: prepare "a written report containing a preliminary accounting for Defendant Essex for the limited purpose of determining the assets and liabilities of Defendant Essex, and a recommendation as to whether the monitorship should be converted to a permanent receivership [or otherwise]." (Dkt. No. 53 at 7.) On December 6, 2018, the Monitor filed a report (the "Report") that significantly exceeds his mandate, contains numerous unsupported, inaccurate, and materially misleading statements, and demonstrates a clear and improper partiality for the SEC. In fact, the Monitor shared a draft of the Report with the SEC over a week before filing it but extended no such courtesy to Defendants.[1] For these reasons, Defendants object to the filing of the Report and request that the Court strike the Report and require that, prior to the appointment of any receiver, the Monitor file a revised, corrected report that is consistent with his mandate and his role as an impartial Court-appointed officer.

Critically, the Monitor misrepresents the nature of Essex's business by claiming that he has found "indicia of a Ponzi-Like Scheme." (Dkt. No. 60-1 ("Report") at 19.) To come to this conclusion, the Monitor ignores evidence demonstrating that Essex did not operate such a scheme, uses a definition of "Ponzi-like scheme" that is unsupported by the case law, and contorts facts to tarnish Essex's reputation with the scandalous and derogatory term "Ponzi." Essex is not and has never been a Ponzi or Ponzi-like (whatever that means) scheme. In fact, the SEC's own analysis confirms that Essex is not a Ponzi-like scheme—it shows that from 2014 to 2017 Essex generated more than enough revenue to pay

[1] Declaration of Jorge deNeve In Support of Defendants' Objection and Response ("deNeve Decl.") ¶ 8, filed concurrently herewith.

back its noteholders. Although Defendants shared this analysis with the Monitor, his Report ignores it. And while the Monitor acknowledges that Essex reported over $75 million in leased equipment and could have been profitable, he somehow concludes that Essex was not "operationally profitable." (*Id.* at 6-7.) The Monitor comes to this conclusion only by ignoring the significant amount of cash Essex's equipment leases generated and disregarding the effects depreciation and other non-cash items had on Essex's business. Taking into account depreciation and other non-cash items (which provide a significant benefit to equipment leasing companies), Essex's income exceeded expenses in 2014, 2015, and 2016. The Monitor's conclusions are further undermined by his misconception of a Ponzi scheme as any business that does not generate an "operating profit" and pays back noteholders. Under that definition, virtually any company that pays back debt using new debt without showing a profit on its income statement is a Ponzi-like scheme. Case law, however, establishes that such activity does not make a Ponzi scheme. The Monitor, therefore, takes a pejorative, scandalous term ("Ponzi") to define legitimate and acceptable conduct and then seeks to apply it to Essex even though the evidence shows that Essex did not operate as a Ponzi scheme.

The Report also makes a number of other serious errors. For example, the Monitor overstates the amount of funds transferred by Essex to its founder and CEO Ralph T. Iannelli by at least $8.4 million and potentially by more than $13.4 million. The Monitor also omits and misstates relevant details of transactions with noteholders who he calls Essex "insiders" without any basis. None of those individuals are employees or shareholders of Essex or fit any generally understood definition of an insider. The Monitor, however, relies on these errors and the use of the word "insider" to insinuate—without citing any actual evidence—that Defendants engaged in wrongful conduct.

Finally, the Report is inconsistent with representations the Monitor made during the monitorship. The Monitor told Defendants' counsel that (1) he did not

think Mr. Iannelli engaged in fraud, (2) he believed Essex was started as a legitimate business, and (3) he wanted Mr. Iannelli to serve as an advisor to him because of Mr. Iannelli's experience. (deNeve Decl. ¶ 5.) He also stated that he understood that his mandate did not include reaching the disputed question of scienter. (*Id.*) Those statements are inconsistent with his eagerness to embrace the SEC's allegations and label Essex a Ponzi scheme. The Monitor also decided to share his Report only with the SEC. Finally, the Monitor sought the support of Greg Van Wyk, an investment adviser to a number of the Essex lenders, for his appointment as a receiver, without disclosing that he intended to accuse one of Mr. Van Wyk's clients in his Report. As a result, Mr. Van Wyk is withdrawing his letter supporting the appointment of Mr. Winkler as the receiver.

A court-appointed monitor or receiver needs to act in an objective and impartial manner. A receiver or monitor also cannot appear to be partial to one party over another. "Failure to do so undermines the faith placed by the public in the fairness of the judicial system." *SEC v. Schooler*, 2015 WL 1510949, at *7 (S.D. Cal. Mar. 4, 2015) (discussing receivers). The Monitor's conduct in preparing the Report and the statements made in the Report raise serious questions about his impartiality. The Court should, therefore, require the submission of a corrected, revised report before considering his appointment as a receiver.

II. DISCUSSION

A. The Facts and Evidence Confirm That Essex Is Not a Ponzi Scheme.

Essex is not a Ponzi scheme and did not engage in "Ponzi-like" conduct. But in an attempt to unfairly tarnish Defendants, the Monitor adopts the SEC's strategy of presenting a contorted and false picture of Essex to fit it into a novel definition of "Ponzi-like" scheme. But the facts and evidence establish that Defendants did not engage in a Ponzi scheme. The Monitor ignored the evidence and, instead, submitted a scandalous Report that is not "determined fairly, objectively and

impartially, and based on relevant evidence," as required by the Monitor Standards promulgated by the American Bar Association.[2] By advocating for the disputed position of the SEC, he also disregarded the ethical standard applicable to court-appointed receivers, and by extension to court-appointed monitors, under which he "is obligated to remain unbiased between the parties in the litigation and must not take positions or advocate for actions primarily for the benefit of one party unless such positions or actions are consistent with the receiver's fiduciary duties." *Schooler*, 2015 WL 1510949, at *7. The Court should, therefore, reject the Report submitted by the Monitor.

1. The Evidence Shows That Essex Generated Sufficient Funds to Cover Payments to Noteholders and Undermines the Monitor's "Ponzi-like" Theory.

The Monitor defines a "Ponzi-like scheme" as "an illegal business practice in which new investors' money is used to make payments to earlier investors." (Report at 19.) The Monitor then concludes that Essex engaged in Ponzi-like transactions because it appears that it never generated an "operating profit"—a term the Monitor never defines—and therefore Essex "likely" must have used new noteholder funds to pay off old noteholder debt. (*Id.* at 20.) Even assuming that the Monitor has correctly defined "Ponzi-like scheme" (which as discussed below he did not), the Monitor only can argue that Essex is a Ponzi-like scheme by ignoring critical information within his possession. First, he fails to address that from 2014 through 2017, Essex generated more than enough revenue from operations to pay back the noteholders, as shown by the analysis conducted by the SEC.[3] Second, he fails to consider that the loss he reports for Essex includes a

[2] ABA Criminal Justice Standards, Monitors Standards, Standard No. 24-4.3.5, at https://www.americanbar.org/groups/criminal_justice/standards/MonitorsStandards/.

[3] The Monitor decided that he should go back and analyze the financial operations of Essex as far back as 2007, even though Essex does not have reviewed or compiled financial statements prior to 2013. Further, the SEC has focused on the period 2014 forward and Defendants do so as well. Nonetheless, Defendants

number of non-cash items that have no bearing on whether Essex could pay back its noteholders.

In its motion for injunctive relief, the SEC attempted to show "Ponzi-like" payments by pointing to specific payments to noteholders that were made *at a time* that Essex did not have sufficient funds that the SEC had traced to "Non-Investor Funds." The Monitor takes that a step further and concludes that merely because Essex had a loss from operations, it must have been a Ponzi-like scheme. Both the SEC and the Monitor failed to consider—or disclose to the Court—that the SEC's own financial analysis shows that Essex had enough non-noteholder revenue to *fully cover* payments made to noteholders from 2014 to 2017. In her declaration in support of the SEC's preliminary injunction motion, Staff Accountant Rhoda Chang makes several assumptions in order to calculate funds that came from "Investors" (*i.e.*, noteholders)[4] as opposed to "Non-Investors" from 2014 to 2017. (Dkt. No. 6 ("Chang Decl.") ¶ 9.) Even adjusting these assumptions *to favor* the SEC's theory, Essex generated sufficient revenue from Non-Investor sources, as defined by the SEC, to fully cover all the amounts returned to noteholders. (deNeve Decl. ¶¶ 10-13.) Defendants provided this analysis to the Monitor, but he does not even mention it in his Report. (*Id.* ¶ 14.)

Additionally, the Report makes no reference to how much cash was generated by Essex's numerous leases. But without this basic information about Essex's primary revenue source, the Monitor has no basis to conclude that Essex used new noteholder funds to pay old noteholder debt or was otherwise making "Ponzi-like" payments. As explained above, from 2014 to 2017 incoming non-noteholder funds—which included nearly $55 million in lease payments—exceeded

---

believe that the Monitor's errors in his analysis of 2014 forward also infect his analysis of the period before 2014.

[4] Although the SEC and the Monitor refer to Essex's lenders as "investors," Defendants refer to the lenders as "noteholders."

incoming noteholder funds.

The Monitor's conclusion that Essex was never "operationally profitable" also fails to recognize the nature of the equipment-leasing business. Because he relies on Essex's consolidated financial statement, the Monitor appears to equate "operationally profitable" with the net loss shown on Essex's financial statements. (*See* Report at 12.) Specifically, the Monitor points to the net losses shown for the years 2014 through 2016: $2.1 million, $7.0 million,[5] and $22.8 million, respectively. (*Id.*) The Monitor, however, neglects to mention that such net losses are a result of non-cash expenses including depreciation. A significant advantage of lease financing, as with any business relying on capitalized assets, is the tax benefit from depreciation. (Dkt. No. 20-2 (Iannelli Decl.) ¶ 14.) Depreciation costs increase expenses and generally result in a lower tax liability without resulting in any outlay of cash for that depreciation expense. (*Id.*) The Monitor's focus on the net loss metric shows that he ignored Essex's actual use of cash, as shown by the SEC's cash-based analysis.[6] (*See* deNeve Decl. ¶¶ 10-13.)

When adjusting Essex's net loss for non-cash items, the financial statements confirm that Essex generated positive earnings. For 2014 through 2016, Essex reported about $11 million, $9 million, and $8 million in depreciation. (Dkt. No. 20-2 (Iannelli Decl.) ¶ 15, Ex. 3 at 26, Ex. 4 at 44, Ex. 5 at 62.) Excluding just the

---

[5] The Monitor lists the loss for 2015 as $10.49 million. The revised 2015 financial statements, however, show a net loss of $7.0 million. The Report's amount for 2015 appears to be erroneous as there is no entry in the 2015 financial statements for $10.49 million. (Dkt. No. 20-2 (Iannelli Decl.), Ex. 4.)

[6] The Monitor may not have recognized the impact of non-cash items on Essex because of his apparent lack of accounting or lease financing experience. (*See* Dkt No. 4-3 (SEC's Receiver Recommendation) at 12-13.) In fact, in his proposal for the role of receiver, the Monitor identified Steve Daughters as the subject matter expert in the area of equipment lease financing. (*Id.* at 6, 16.) Mr. Daughters also may have provided accounting expertise as he apparently is a CPA with experience at Ernst & Young. (*Id.* at 14-15.) Mr. Daughters, however, was not actually part of the Monitor's review team. (deNeve Decl. ¶ 7.)

depreciation "cost" more than wipes out the net loss for 2014 and 2015, and reduces the 2016 net loss by more than one-third, to $14.6 million. Excluding unrealized gains and losses from investments—which, as with depreciation, do not result in any actual cash income or expense—Essex's income for 2014, 2015, and 2016 *exceeded* its expenses after taxes by $5.1 million, $4.5 million, and $1 million, respectively. (*See id.*) Essex's financial statements reveal that Essex's revenues from operations consistently covered its expenses, including interest payments to lenders, throughout 2014, 2015, and 2016. Given these facts, the Monitor cannot credibly maintain that Essex engaged in Ponzi-like activity.

2. The Monitor's Overbroad Definition of "Ponzi-like" Activity Is Contrary to Case Law.

The Monitor defines "Ponzi-like scheme" as "an illegal business practice in which new investors' money is used to make payments to earlier investors" without citing any case law or other authority. Relevant case law shows that the Monitor's definition is plainly incorrect. In *SEC v. Narayan*, 2017 WL 4652063, at *11 (N.D. Tex. Aug. 28, 2017), the court rejected the SEC's attempt to characterize payments made to investors as a Ponzi scheme giving rise to scheme liability. Although the defendants "used funds from a later investor to pay an earlier investor," that payment "d[id] not, in and of itself, establish deceptive conduct. [The defendants' company] had, and continues to have, assets; the fact that [the company] may have been cash poor does not sufficiently support the inference that [the defendants] made these payments to deceive investors about the true state of [the company's] business." *Id.* By merely looking at whether a company generated an "operating profit," the Monitor's definition of Ponzi scheme would convert any company that has acquired new debt and at the same time paid off old debt into an illegal Ponzi-like scheme, unless the company could show a profit on paper.

As in *Narayan*, here, Essex's use of some noteholder funds to pay back other noteholders does not make it an illegal Ponzi or Ponzi-like scheme, because those

payments were not deceptive. Essex ran a legitimate business. Essex's promissory notes generally did not put any restrictions on Essex's use of lender funds. (*See, e.g.*, Dkt. No. 20-2 (Iannelli Decl.), Ex. 1.) It was entitled to use the funds for any general business purpose, which would include satisfying debt obligations. Further, like the company in *Narayan*, Essex "had, and continues to have, assets." *Narayan*, 2017 WL 4652063, at *11.

All the Monitor has shown is that Essex may have paid some noteholders with other noteholders' funds at a period in time when Essex was "cash poor," which is insufficient to demonstrate an illegal Ponzi or Ponzi-like scheme. *Id.* at *11. Calling such activity "Ponzi-like" is a gross mischaracterization of Essex's business and far exceeds the Monitor's Court-ordered mandate to provide a "preliminary accounting" of Essex for the "limited purpose" of determining its assets and liabilities.

3. The Monitor Misrepresents the Facts To Claim That He Encountered Indicia of a Ponzi-Like Scheme.

The Monitor contorted facts and ignored case law in an attempt to tarnish Essex with a scandalous term "Ponzi," that he vaguely defined. To fit his narrative, he also claims—without providing any factual or evidentiary support—that he "encountered [other] indicia of a Ponzi-Like Scheme." (Report at 19.) This unsupported and inaccurate statement should be disregarded.

First, the Monitor writes that Essex was "[m]asquerading as some type of investment - The investments offered by Essex have been advertised as a loan program 'secured and backed by actual equipment leases.'" (*Id.* at 20.) In fact, Essex did not advertise a loan program. (Dkt No. 20-2 (Iannelli Decl.) ¶ 3.) Neither the SEC nor the Monitor has provided or pointed to any evidence to the contrary.

Second, the Monitor claims that Essex's return rate was "abnormally high" because the rate of return "averaged 2.5 percent higher than traditional bank

financing." (Report at 20.) As the Report points out, the average rate to noteholders was 8% annually. (*Id.* at 4.) The Monitor provides no support for his claim that such a rate, which was slightly better than the bank rate, was in fact abnormally high. In fact, the only example provided by the Monitor of a Ponzi scheme with abnormally high returns was a scheme in which investors were promised about a 160% annual return compared to a bank return of 5%. (*Id.* at 19 n.18.) Such a return—where one is told they can more than double their money in less than a year—is abnormally high. There is nothing abnormal, however, with a rate of return that is modestly higher than what a bank would offer.

Third, the Monitor erroneously, and without support, concludes that "Payoffs [were] made from the pool of investor funds while the remainder is used for the operators' personal gain." (*Id.* at 21.) Again, in his desire to use the term "Ponzi," the Monitor mischaracterizes Essex's activities. As the Report points out, Essex funded "equipment leases," "bridge loans," and "other private equity investments." (*Id.* at 3-4.) The Report further notes that:

- "From February 2007 through June 2017, Essex booked $75,000,697 in leased equipment fixed asset purchases," (*id.* at 7);
- "From 2007 through now, Essex's books reflect $37,592,491 in payments for investments in partnerships, private equity investments, bridge loans to lessees, and other non-lease assets," (*id.*); and
- "Essex typically operated with a small staff of two or three employees and/or consultants in addition to Iannelli," (*id.* at 6).

The Report itself, therefore, confirms that the Monitor's statement that funds were used to pay back investors and "the remainder [was] used for the operators' personal gain" is false.

A monitor, like a receiver, is appointed by the Court and "is still an 'officer of the court' and not an arm of the SEC." *Schooler*, 2015 WL 1510949, at *3; *see also SEC v. Private Equity Mgmt. Grp., Inc.*, 2009 WL 2019747, at *2 (C.D. Cal.

Jul. 2, 2009) ("A court-appointed receiver is 'appointed on behalf and for the benefit of all the parties having an interest in the property, not for the plaintiff or defendant alone.'"). A monitor should, therefore, "be *impartial between the parties and avoid the appearance of impropriety*." *Schooler*, 2015 WL 1510949, at *3 (emphasis added). Here, the Monitor exceeded his mandate and decided to assist the SEC's effort to tarnish Defendants by the use of the term "Ponzi," even though Defendants contested the use of the term and have shown that Essex was not engaged in a Ponzi scheme. Because of the Monitor's decision to adopt the use of the scandalous phrase "Ponzi-like scheme," the Court should strike the Report and require the Monitor to file a report addressing only his mandate of providing a preliminary accounting of Essex's assets and liabilities.

B. The Monitor's Report Is Replete with Other Inaccurate, Unsubstantiated, and Misleading Statements.

In addition to erroneously characterizing the nature of Essex's business and exceeding its mandated scope, the Report is filled with inaccurate, unsubstantiated, and misleading statements, further supporting the need for the Monitor to file a corrected and revised report.

1. The Monitor Incorrectly Calculated Amounts Received By Mr. Iannelli From Essex.

For example, the Monitor appears to miscalculate the funds exchanged between Essex and Mr. Iannelli in a way that makes it appear that Mr. Iannelli received a much larger amount from Essex. In terms of the amounts borrowed by Mr. Iannelli (which as discussed below, the Monitor mischaracterizes as distributions), the Monitor makes the following errors:

//

//

//

//

//

Year	Monitor's Calculation[7]	Correct Calculation[8]	Monitor's Error
2014	$1,634,500	$3,322,800	($1,688,300)
2015	$4,458,979	$1,770,679	$2,688,300
2016	$4,131,219	$2,131,219	$2,000,000
2017	$1,490,825	$(2,047,175)	$3,538,000
2018	$519,721	$(1,418,334)[9]	$1,938,055
Totals	$12,235,244	$3,759,189	**$8,476,055**

Therefore, at a minimum, the Monitor overstates the amounts that Mr. Iannelli purportedly received from Essex from 2014 through the present ***by over $8.4 million***. Given these errors, it appears likely that the Monitor also erroneously calculated amounts that predated 2014.

The Monitor also wrote, "The vast majority of the funds Iannelli took from Essex are likely to be classified as distributions under Internal Revenue Service rules." (Report at 6 n.2.) This comment appears to refer to the loans that Essex provided to Mr. Iannelli. The Monitor, however, is not a licensed attorney and does not appear to have tax experience. Indeed, in his initial proposal to be a receiver, he stated that he would need assistance to evaluate tax-related issues: "In the event that I … need tax advice, I anticipate retaining Miller Kaplan Arase LLP to assist me." (Dkt No. 4-3 at 7.) The Court should therefore disregard the Monitor's

---

[7] Report at 17.

[8] The calculation of these amounts is described in the concurrently filed Declaration of Ralph Iannelli In Support of Defendants' Objection and Response ("Third Iannelli Decl.") at ¶¶ 4-10.

[9] Defendants believe that even this amount is understated by $5 million because it does not include interests in Mr. and Mrs. Iannelli's personal real estate that Mr. Iannelli provided to certain noteholders in exchange for cancellation of notes obligating Essex. (Third Iannelli Decl. ¶ 10.) Although Defendants believe those transactions were in the best interest of Essex and its noteholders, they also acknowledge that the Monitor takes a different view of those transactions.

interpretation of Internal Revenue Service rules.

2. The Monitor Mischaracterizes Transactions With Certain Noteholders.

The Monitor asserts that Defendants made "preferential transfers" to "a small, select group of 'insider' investors." (Report at 17.) Even though the Monitor stated that he "made the decision to redact or withhold the name of certain customers and investors to minimize any unintended harm it may cause," he identified these purported "insiders." (*Id.* at 3, 18.) He fails, however, to explain why he refers to these three individuals as "insiders." Not one of them is a shareholder of Essex (Essex is owned 100% by Mr. Iannelli), has served as a director of Essex, was an employee of Essex or Mr. Iannelli, is a blood relative of Mr. Iannelli, or otherwise fits under any generally accepted definition of insider. The Monitor also fails to acknowledge that the transactions benefitted other noteholders by permitting Essex to continue using cash to make payments to noteholders. Finally, the Monitor fails to describe completely or accurately the transaction with Geoff Grant and points to a ***non-existent*** transaction with Paul Wolansky.

The Grant Transaction. In April 2018, Essex entered into a transaction that permitted it to restructure $10 million owed by Essex to Mr. Grant. The original debt was initially due in July 2017, based on an agreement that required Essex to buy out Mr. Grant and his wife in July 2017 for an amount exceeding $10 million. (Third Iannelli Decl. ¶ 14.) Essex, however, restructured the obligation by converting the $10 million payment into three promissory notes of $5 million, $2.5 million, and $2.5 million due in July 2017, July 2018, and July 2019, respectively. (*Id.* ¶ 15.) Around April 2018, Mr. Iannelli had further discussions with Mr. Grant about these promissory notes and the upcoming payment due in July 2018. (*Id.* ¶ 16.)

At that point, Mr. Grant agreed to exchange the $5 million note due on July

19, 2018, for an interest in certain illiquid, private-held securities owned by Essex. Specifically, Essex and Mr. Grant formed a limited liability corporation (the "LLC") to hold the assets. (*Id.* ¶ 16, Ex. A.) Essex owns 51% of the LLC and Mr. Grant owns the rest. (*Id.* ¶ 18.) In his Report, the Monitor misrepresents the value of the assets to be transferred by claiming they were worth $5 million. (*See* Report at 18.) But the value of the illiquid assets, as of December 31, 2017, was approximately $4.5 million. (Third Iannelli Decl. ¶ 17.) And both Essex and Mr. Grant recognized that a sale of those assets at that time would generate significantly less than that amount because the assets were privately held and illiquid. (*Id.*) Furthermore, Essex was unable to transfer two of the private equity investments, which means that the LLC holds assets that are worth less than $3.9 million. (*Id.* ¶ 19.) Yet Mr. Grant has not sought additional assets for the LLC or to reverse the transaction. (*Id.*)

The deal with Mr. Grant also provides additional benefits to Essex which the Monitor fails to mention. Any proceeds from the assets (by sale, for example) exceeding $5 million will be split 75% to Essex and 25% to Mr. Grant. (*Id.* ¶ 18.) Mr. Grant also agreed to restructure the remaining $5 million in notes. The restructured note will carry a 5% interest rate (whereas the current notes have an 8% interest rate) and repayment will not be due until July 19, 2021. (*Id.*) For all these reasons, Mr. Iannelli believed in good faith that the transaction was beneficial to Essex. (*Id.* ¶ 20.)

The Wolansky Transaction. In June 2018, Mr. Iannelli began negotiating with Mr. Wolansky to address an obligation that was coming due. (*Id.* ¶ 21.) The parties eventually reached an accord that prevented any action against Essex by Mr. Wolansky. (*Id.*) The accord included providing Mr. Wolansky with an interest in Mr. Iannelli and his wife's New York apartment. (*Id.*) The Monitor further asserts that: "In September 2018, Defendants transferred 83,333 shares of Neos Therapeutics stock to a transfer agent to hold as additional security. The insider

investor is entitled to as much as $9.60 per share with anything above that going back to Essex." (Report at 18.) Those statements are false. (Third Iannelli Decl. ¶¶ 22-23.) Essex never provided the shares as "additional security" to Mr. Wolansky and did not ever discuss the structure described by the Monitor. (*Id.*)

C. The Statements and Actions of the Monitor During the Monitorship Undermine His Report.

Finally, the statements in the Report cannot be squared with the statements the Monitor made during his investigation and raise questions about Mr. Winkler's appreciation of the receiver's role as "an 'officer of the court' and not an arm of the SEC." *Schooler*, 2015 WL 1510949, at *3.

For example, the Monitor made several representations to Defendants' counsel at odds with the contents of the Report. He informed Defendants' counsel that (1) he did not believe Mr. Iannelli engaged in fraud, (2) he believed that Essex was started as a legitimate business, and (3) he wanted Mr. Iannelli to serve as an advisor to him because of Mr. Iannelli's experience. (deNeve Decl. ¶ 5.) The Monitor also stated that he understood that addressing the issue of scienter was not part of his mandate. (*Id.* ¶ 5.) These statements are simply at odds with the Report's statements that Essex made Ponzi-like payments. In fact, Mr. Winkler adopted the term "Ponzi-like," a term that the SEC has used repeatedly in its complaint and its initial request for a preliminary injunction. Defendants challenged the use of the term, and provided evidence contradicting the SEC's position. Defendants also provided the Monitor with evidence showing that Defendants did not engage in a Ponzi scheme. The Monitor merely ignored it while stating that he viewed Essex and Mr. Iannelli favorably.[10]

[10] The Monitor also confirmed that he was satisfied receiving documents and information from 2007 which is when Essex began using QuickBooks. (*See* deNeve Decl. ¶¶ 2-4, Exs. A & B.) These statements from the Monitor and his team are simply inconsistent with the Report's claim that they have "unsatisfied records requests." (Report at 2.)

Defendants, however, could not address these issues with the Monitor because he refused to provide a copy of the Report to Defendants, even though he was negotiating with Defendants the terms of the proposed order that he attached as Exhibit 3 to his Report. (deNeve Decl. ¶ 6.) At the same time, he appears to have favored the SEC by providing a draft of the Report no later than November 30, 2018—almost a week before the Report was filed. The Monitor's favoritism to the SEC is reinforced by his own marketing material, in which he claims that he "has conducted investigations ***on behalf of*** the Securities and Exchange Commission…." (*Id.* ¶ 9, Ex. C (emphasis added).)

Finally, the Monitor's efforts to obtain a letter of support from Greg Van Wyk raises concerns about the tactics he is employing. The Monitor sought Mr. Van Wyk's support for his appointment as a receiver by disclosing that Defendants' counsel expressed the view that a receiver would be beneficial for Essex and its noteholders. (Second Declaration of Greg Van Wyk (filed concurrently herewith) ¶ 3.) Mr. Van Wyk, however, was deeply troubled when he saw the Monitor's Report referenced one of his clients, Mr. Wolansky, potentially damaging Mr. Wolanksy's reputation. (*Id.* ¶ 6.) Mr. Van Wyk believes that the mischaracterization of events involving Mr. Wolansky, including the reference to him as an insider, was unnecessary, imprudent, and a violation of Mr. Wolansky's privacy. (*Id.* ¶ 7.) Mr. Van Wyk is also greatly concerned with the general strategy of seeking a clawback from his client or any other noteholder. (*Id.* ¶ 8.) The Monitor did not provide Mr. Van Wyk with specific information about this strategy prior to filing the Report. (*See id.*) Without understanding the details, Mr. Van Wyk believes his endorsement of the Monitor was premature and that the information he provided to his clients to assist them in making a decision whether to endorse the Monitor as a receiver is incomplete and lacking. (*Id.*) Accordingly, Mr. Van Wyk suspends his endorsement of Mr. Winkler to serve as a receiver. (*Id.* ¶ 9.)

The Monitor's conduct is inconsistent with the ethical standards that will apply if he is appointed as a receiver. His conduct as a Monitor has failed to live up to the following two standards:

- "The receiver … is obligated to remain unbiased between the parties in the litigation and must not take positions or advocate for actions primarily for the benefit of one party unless such positions or actions are consistent with the receiver's fiduciary duties;" and
- "The receiver must also avoid the appearance of impropriety so as to maintain confidence in the impartiality of the judiciary."

Schooler, 2015 WL 1510949, at *3-4 (citations omitted).

By his own admission, Mr. Winkler has "not previously served as a receiver." (Dkt. No. 4-3 (SEC's Receiver Recommendation) at 9.) It is important that he understand that, as a receiver, he will serve as an officer of the court and must abide by applicable ethical standards. Because the Court appointed the Monitor and would appoint any receiver in this case, it has "extremely broad authority to supervise and determine the appropriate action to be taken in a federal equity receivership." *Schooler*, 2015 WL 1510949, at *1. Given its broad supervisory power, the Court should address the Monitor's lack of impartiality and evidence in his Report, as well as the factual errors, by striking the current Report and requiring that the Monitor submit a revised, corrected report.

III. CONCLUSION

The Monitor's Report raises serious concerns about the appointment of Mr. Winkler as a receiver. For the reasons discussed herein, the Court should strike the Report and require that he file a revised, corrected report that is consistent with the mandate established by the Court before appointing him as a receiver.

Dated: December 14, 2018

STEVEN J. OLSON
JORGE DENEVE
O'MELVENY & MYERS LLP

By: */s/ Jorge deNeve*
Jorge deNeve
Attorneys for Defendants
Ralph T. Iannelli and Essex Capital Corporation