

1 GARY Y. LEUNG (Cal. Bar No. 302928)
Email: leungg@sec.gov
2 DOUGLAS M. MILLER (Cal. Bar No. 240398)
Email: millerdou@sec.gov
3 YOLANDA OCHOA (Cal. Bar No. 267993)

4 Attorneys for Plaintiff
Securities and Exchange Commission
5 Michele Wein Layne, Regional Director
Alka N. Patel, Associate Regional Director
6 Amy J. Longo, Regional Trial Counsel
444 S. Flower Street, Suite 900
7 Los Angeles, California 90071
Telephone: (323) 965-3998
8 Facsimile: (213) 443-1904

9 **UNITED STATES DISTRICT COURT**
10 **CENTRAL DISTRICT OF CALIFORNIA**
11 **Western Division**

12 **SECURITIES AND EXCHANGE**
13 **COMMISSION,**

14 Plaintiff,

15 vs.

16 **RALPH T. IANNELLI and ESSEX**
17 **CAPITAL CORPORATION,**

18 Defendants.

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

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

1 The court-appointed monitor, Geoff Winkler, has prepared the enclosed
2 Response to Defendants' Objection and Response to Monitor's Report and
3 Recommendations (Dkt. No. 63). Because the court-appointed monitor has not yet
4 retained counsel, and in an effort to minimize the cost and expense of the
5 monitorship, Plaintiff Securities and Exchange Commission is electronically filing
6 the monitor's response on his behalf. *See* Exhibit 1.

7 Dated: December 18, 2018

8 */s/ Gary Y. Leung*

9 GARY Y. LEUNG
10 DOUGLAS M. MILLER
11 YOLANDA OCHOA
12 Attorneys for Plaintiff
13 Securities and Exchange Commission
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EXHIBIT 1

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**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
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SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

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RALPH T. IANNELLI and ESSEX
CAPITAL CORPORATION,

Defendants.

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

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

1 **I. INTRODUCTION**

2 The Monitor was appointed on October 1, 2018 under the Order Regarding
3 Preliminary Injunction (the “Order”), and was tasked with, among other things,
4 submitting to the Court a written report containing a preliminary accounting of Essex
5 Capital Corporation (“Essex”) for the limited purpose of determining the assets and
6 liabilities of Essex and making a recommendation as to whether the monitorship
7 should be terminated, limited, continued, expanded, or converted to a permanent
8 receivership. In order to carry out his duties, the Monitor met with dozens of
9 interested parties, reviewed thousands of pages of documents and contracts,
10 investigated hundreds of assets and liabilities, and carefully examined Defendants’
11 accounting system.

12 The Monitor filed his report on December 6, 2018 (the “Report”), which
13 contained a preliminary accounting of the assets and liabilities of Essex and
14 recommended that the Court appoint a Receiver due to the dire financial condition of
15 Essex and the need for an orderly and neutral distribution of assets.

16 On December 14, 2018, Defendants’ filed Defendants’ Objection and
17 Response to Monitor’s Report and Recommendations (the “Objection”). In the
18 Objection, Defendants’ lay out a handful of issues they believe are inaccurate and
19 argues that the Monitor should file a revised report. Before discussing these issues, it
20 is important for the Court to note that the Defendants do not take issue with the vast
21 majority of the Report, including the appointment of a receiver, and the areas where
22 the Defendants have taken issue appear to be more about preserving the reputation of
23 Defendants than it does protecting the investors involved.

24 **II. DISCUSSION**

25 **A. The Duty of a Monitor**

26 A court-appointed monitor is a neutral party tasked with providing oversight
27 and other specified tasks on behalf of the court in which they are appointed. Despite
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1 the Defendants' assertions of bias on the part of the Monitor in their Objection,¹ the
2 Monitor has provided the Court with the information he believed the Court needed to
3 make an informed decision on the appropriate next steps in this case and not in order
4 to bolster the Plaintiffs' case.^{2,3} All of the findings in his Report are based on analysis
5 completed by the Monitor and his team and were not influenced by any other party.

6 **B. The Monitor's Report**

7 **1. The Financial Condition of the Essex Capital Corporation**

8 Despite significant evidence to the contrary, Defendants appear to dispute the
9 financial condition of Essex in suggesting that the Monitor did not understand Essex
10 financial statements and that Essex had, in fact, been profitable from 2014-2017.
11 Essex's 4-year net income from 2014-2017, according to its own accounting records,
12 was negative \$12,237,284. Considering this operating loss alongside the increased
13 capitalized net lease purchases of \$18,579,955 during this time, a total \$30,917,239
14 operational cash shortfall is estimated. This shortfall was funded through additional
15 loans from banks, limited partnerships, and secured and unsecured lenders, which
16 increased \$19,101,047 over this timeframe, and through the liquidation or sale of
17 certain investments to cover the balance (Report, Section III.A).

18
19 ¹ Defendants suggest that sharing the Report with Plaintiffs gives them reason to
20 question the Monitor's impartiality. The Monitor couldn't hire counsel due to fee
21 restrictions in the Order, so he requested Plaintiffs review it.

22 ² The fact that both Plaintiff and the Monitor have identified instances of Ponzi-like
23 payments in Defendants' accounting does not illustrate bias on the Monitor's part,
24 especially since the Monitor cites separate instances. The Monitor included this
25 analysis, as he has done in similar cases, since he believes the presentation of this
26 information is necessary for the Court to make a fully informed decision.

27 ³ In the Objection, Defendants include statements made by the Monitor about his
28 belief that Defendant Iannelli started Essex as a legitimate business and that he
intended to use Defendant Iannelli as an advisor due to his experience and knowledge
about Essex, which are still true. The Monitor has no recollection, nor would it be
appropriate, for the Monitor to have opined as to whether Defendant Iannelli
committed fraud.

1 It is not only the Monitor that has expressed concern about financial condition
2 of Essex. Note 17 from 2015 and 2016 consolidated financials from Essex's CPA,
3 Damitz, Brooks, Nightingale, Turner & Morrisset, states:

4 "[a]s shown in the accompanying financial statements, the
5 Company incurred a net loss of approximately
6 \$7,042,213 during the year ended December 31, 2015, and
7 as of that date, the Company's current liabilities exceeded
8 its current assets by approximately \$21,984,000 and its total
9 liabilities exceeded its total assets by approximately
10 \$12,362,000. ***Those factors create a substantial doubt
11 about the Company's ability to continue as a going
12 concern for the year following the date the financial
13 statements are available to be issued.***" (emphasis added)

14 Over the past ten years, Essex's assets on its balance sheet incorrectly inflated
15 the value of the lease assets and certain major investments. But it is clear that, from at
16 least the point of the Passaic Healthcare Services bankruptcy in December 2014, that
17 had Essex ceased accepting new capital investments, an underlying cash insolvency
18 would emerge very quickly and assure the actual insolvency of the company in short
19 order (Report, Section III.A).

20 The current total assets of Essex as represented in the company's accounting
21 file are overstated by at least \$23,703,800. This is principally due to an 83%
22 overstatement of the value of the leased fixed assets by at least \$22,561,278.
23 Additionally, there are 17 other equity investment assets on the balance sheet totaling
24 \$6,276,292 that have either been transferred away but not booked or are worthless but
25 not written down (Report, Section III.C.1-2).

26 While Defendants want to argue about whether Essex was profitable at various
27 points in time to refute assertions that Ponzi-like payments were made, the key
28 takeaway from the Report is that Essex is currently in significant financial trouble
with liabilities exceeding assets by over \$50 million. Regardless of whether
Defendants were profitable during some prior periods, none of the issues that

1 Defendants raise in their Objection will have any significant effect on the current
2 reality.

3 **2. Shareholder Distributions**

4 Outside of providing what Defendants claim to be corrected calculations of the
5 shareholder distributions⁴ that Defendant Iannelli received from Essex, Defendants
6 did not provide explain why they believe the Monitor's calculations are incorrect.
7 However, based upon the Monitor's reading of the Objection, it appears that
8 Defendants are not disputing the total amount of money that Defendant Iannelli
9 received, only the amount he still owes after the payments Defendant Iannelli claims
10 to have made to Essex.

11 The Monitor has reviewed the payments that Defendant Iannelli claims against
12 the amount due from shareholder and in some cases was unable to determine the
13 source of the funds used to make these payments. In many cases, the payments made
14 by Defendant Iannelli to Essex come after a similar sized deposit into Defendant
15 Iannelli's bank account. The Monitor requested the underlying detail on these
16 deposits in order to determine the actual source of these payments but was never
17 provided the copies of checks and deposits requested.⁵ Given that the Monitor has yet
18 to determine the source of the payments, and the fact that Defendant Iannelli only had
19 limited income outside of Essex for the past 25 years, the Monitor was left to assume
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21 _____
22 ⁴ The Defendants dispute the proper terminology for these payments. The
23 Defendants' accounting records list these as loans due from shareholder. However,
24 Defendant Iannelli stated that he is currently being audited by the Internal Revenue
25 Service because they believe that these payments are shareholder distributions and
26 not loans. The Monitor, based upon his study of federal tax law, also believes that
27 these would ultimately be classified as shareholder distributions, but will reserve that
28 discussion for another time.

⁵ See the Declaration of Jorge deNeve in Support of Defendants' Objection and
Response to Monitor's Report and Recommendations for a discussion of the missing
records.

1 that these payments must have been made using Essex or other related entities funds.⁶

2 Even if the Defendants were correct about the amount of money paid back by
3 Iannelli, or the amount was reduced after additional records are received, it still does
4 not change the fact that Essex is in serious financial trouble and a receiver needs to be
5 appointed to protect remaining assets and ensure investors are treated equitably.

6 **3. Preferential Payments**

7 Defendants also take exception to the Monitor's reference to the three
8 examples of potential preference payments. During his investigation, the Monitor
9 uncovered many examples of what appear to be preference payments and decided that
10 it was important to provide the Court with underlying details to help the Court
11 understand the potential issues and the need to act quickly in this case. These
12 examples were chosen due to the parties involved, their size relative to others during
13 the same time period, and the fact that these transactions were not standard cash
14 payments (Report, Section III.C.5). If the Court determines that a receiver should be
15 appointed, that person will need to investigate and analyze all payments made over
16 the last few years to determine what is in the best interest of all parties to the case.

17 **C. Next Steps**

18 Outside of suggesting that the Monitor needs to file a corrected report, the
19 Defendants do not provide the Court with a recommendation of how it should
20 proceed. The Defendants have not suggested that Defendant Iannelli should continue
21 to operate Essex nor have they withdrawn their recommendation on the appointment
22 of a receiver. The Monitor continues to believe that the timely appointment of a
23 receiver is crucial to ensure maximum recovery for investors in this case.

24 **III. CONCLUSION**

25 The purpose of the Objection appears to have been filed only to try and protect
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27 ⁶ The calculations provided in the Report may be revised in the future once additional
28 records become available.

1 the Defendants' reputation and not for the preservation of assets or the benefit of
2 investors involved in this case. Essex is in a dire financial condition and further
3 delays will only serve to deepen these issues. Therefore, Defendants' Objection
4 should not further delay the appointment of a receiver.

5 DATED this 18th day of December, 2018.

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11 Geoff Winkler, Monitor
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PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

U.S. SECURITIES AND EXCHANGE COMMISSION,
444 S. Flower Street, Suite 900, Los Angeles, California 90071
Telephone No. (323) 965-3998; Facsimile No. (213) 443-1904.

On December 18, 2018, I caused to be served the document entitled **MONITOR’S RESPONSE TO DEFENDANTS’ OBJECTION AND RESPONSE TO MONITOR’S REPORT AND RECOMMENDATIONS** on all the parties to this action addressed as stated on the attached service list:

OFFICE MAIL: By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency’s practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

PERSONAL DEPOSIT IN MAIL: By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

EXPRESS U.S. MAIL: Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

HAND DELIVERY: I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

UNITED PARCEL SERVICE: By placing in sealed envelope(s) designated by United Parcel Service (“UPS”) with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

ELECTRONIC MAIL: By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

E-FILING: By causing the document to be electronically filed via the Court’s CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.

FAX: By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: December 18, 2018

/s/ Gary Y. Leung
GARY Y. LEUNG

