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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. RALPH T. IANNELLI and ESSEX CAPITAL CORP., Defendants.	Case No. 2:18-cv-05008-FMO-AFM NOTICE OF FILING AND FORENSIC AND INVESTIGATIVE ACCOUNTING REPORT OF RECEIVER, GEOFF WINKLER Date: NO HEARING REQUIRED Ctrm: 6D Judge Hon. Fernando M. Olguin

TO ALL INTERESTED PARTIES AND THEIR COUNSEL OF RECORD, AND THIS HONORABLE COURT:

PLEASE TAKE NOTICE THAT, on June 11, 2020 and by this Notice, Geoff Winkler (the "Receiver"), the Court-appointed permanent receiver for Defendant Essex Capital Corporation and its subsidiaries and affiliates (collectively, the "Receivership Entities"), hereby submits his Forensic and Investigative Accounting Report (the "Report"), in accordance with Civil Local Rule 66-6 and this Court's prior orders. The Receiver's Report is appended hereto as **Exhibit A**, and details conclusions drawn from the Receiver's extensive review and forensic analysis of records relating to the business and financial activities of the Receivership Entities.

The Receiver's Report may also be viewed at https://essex-receivership.com.

Dated: June 11, 2020

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP
DAVID R. ZARO
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By: */s/ David R. Zaro*
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FORENSIC AND INVESTIGATIVE ACCOUNTING REPORT
SEC V. IANNELLI, ET AL.

This Forensic and Investigative Accounting Report (the "Report") expands upon, and, in some cases supplements or modifies, the preliminary observations and conclusions presented in the Report of Preliminary Accounting of Defendant Essex Capital Corporation and Recommendations of Court-Appointed Monitor Geoff Winkler [ECF No. 60], and the First, Second, Third, and Fourth Interim Reports and Petitions For Further Instructions of Receiver, Geoff Winkler [ECF Nos. 78, 103, 123, 149] (collectively, the "Prior Reports"), each of which is incorporated herein by this reference.

INTRODUCTION AND EXECUTIVE SUMMARY

Essex Capital Corporation ("Essex") was founded in 1996 by Ralph Iannelli, who managed Essex exclusively until the appointment of the Receiver, with the stated purpose of "act[ing] as a financing source and lessor to credit worthy companies on a nationwide basis, leasing all assets except vehicles and commercial aircraft." While initially described as an equipment finance and leasing company, Essex also managed dozens of other private equity investments. Until the appointment of Geoff Winkler (the "Receiver") as the permanent receiver for Essex and its subsidiaries and affiliates (collectively, the "Receivership Entities"), Mr. Iannelli was the sole owner and operator of Essex and the Receivership Entities.

Typically, once Essex identified a customer seeking financing, Essex's equipment leases, bridge loans, and related endeavors would be funded through two sources: (1) private investment capital memorialized by promissory notes issued to individual investors (either in the investor's name, personally, or through a partnership entity); and (2) bank loans through traditional and non-traditional financial institutions. The interest rate paid to investors averaged 8% on 24-36 month notes, while the interest rate paid on the bank loans typically averaged 5.5%. The customer/lessee side of the lease transaction was typically made up of the lease value amount plus interest amortized over its term, its residual value and, in some instances, warrants, which formed the basis of Essex's operational investments. The operative leases typically ran between 24 and 36 months, and generally carried an interest rate of 9.75% to 10.25%. Total returns were represented to have an effective rate of 13% to 15% when including the residual values of the leases.

From approximately 1996 through 2018 (the "Accounting Period"), Essex took in $143.1 million in gross revenue from lease and residual payments and paid bank loan interest, principally to Montecito Bank and Trust ("MBT"), totaling $14.3 million. Essex's overall net income from its leasing operations during the Accounting Period was a loss of $4.5 million. However, Essex's investment operations lost $10.2 million in the aggregate over this period as well, so its total overall 22-year operational loss was over $14.7 million.

During the Accounting Period, Essex paid $8.0 million to professionals, principally attorneys and accountants. Essex paid employees, contractors and consultants $2.5 million; $1.9 million was

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paid in office rent; $787,137 in taxes; and $2.0 million in all other expenses. In total, Essex expended $15.2 million for these services.

Likewise, during the Accounting Period, Mr. Iannelli caused Essex to transfer a total of $42 million from its accounts into Mr. Iannelli's. Over the same period, Mr. Iannelli transferred a total of $21 million from his personal accounts into Essex. In other words, Mr. Iannelli appears to have received net transfers from Essex in the amount of at least $21 million.

Given the unprofitability of the Receivership Entities' operations, and the substantial amounts of money transferred from Essex to Mr. Iannelli, the best recovery for the Receivership Entities' investors would have been a return of 85.1% of their principal investments.[1] Notwithstanding this, the Receiver has confirmed that more than 80 investors received all of their principal investments (plus promised payments, totaling more than $38.9 million) while the balance of investors received substantially less (with 59% receiving between 0% and 48% of their original investments). As detailed below, and in certain of the Prior Reports, based on the materials obtained to date, the Receiver believes that $25 million of these payments to investors may be recoverable as false profits.

The Receiver has identified at least 65 investors, who together are owed at least $39.9 million from the Receivership Entities, on a net investment basis.[2] The Receiver's pending and proposed claims procedures could result in greater claims, as he has encountered indications of missing and incomplete files.

The Receiver's investigation and forensic analysis of the business and financial operations of the Receivership Entities have confirmed that, among other things:

- The Receivership Entities were not profitable and their operations were unsustainable absent large, additional infusions of funding from investors and lenders;
- The Receivership Entities' books and records are marked by questionable accounting practices, including: (1) a significant amount of adjusting journal entries reflecting highly speculative and ultimately inaccurate adjustments to major assets and liabilities; (2) keeping lease assets booked as fixed assets after the disposition of the underlying lease and assets; (3) under-depreciating individual assets to inflate total assets; (4) high-dollar adjustments with accounting notes from the bookkeeper reflecting a notation to the effect of "Per Mr. Iannelli's otherwise unsubstantiated word"; and (5) Mr. Iannelli's acceptance of investor funds, personally, and subsequent transfers to Essex, paired with instructions to the bookkeeper to the effect that such transfers represented payments from Mr. Iannelli, personally, against his shareholder loan;

[1] $240.2 million in investor funds were received overall, less $21 million paid to Mr. Iannelli, less $14.7 million lost in operations yields $204.5 million, or 85.1%, on average.

[2] Allocating loss using a net investment approach is the most common and equitable method of allocating loss among victims of an allegedly fraudulent scheme. A "Money-In-Money-Out" or "MIMO" approach to victim cash flows is employed under the assumption that since The Receivership Entities' overall return on investment was no greater than zero, the amount therefore due to any investor is the net amount of his or her aggregate principal investment, functionally as a loan to Essex at 0% interest.

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- Mr. Iannelli took at least $21 million out of Essex notwithstanding the Receivership Entities' overall lack of profitability and operational unsustainability;
- While a number of Receivership Entity investors were paid 100% of their principal investment amounts, plus interest payments due under their associated notes with Essex, many other investors suffered significant or complete losses; and
- The Receivership Entities did not generate funds sufficient to make complete principal repayment or interest payments to investors, and those payments were made, at least in part, by funds obtained from later investors.

REVIEW OF RECEIVERSHIP ENTITIES' BUSINESS AND FINANCIAL OPERATIONS

The Receiver has completed a comprehensive analysis of the Receivership Entities' business and financial operations roughly during the Accounting Period, via a detailed review of bank records, financial statements, partnership and joint venture agreements, investment and ownership agreements, and other materials. The Receiver identified and analyzed 121 bank and brokerage accounts, along with 62,358 verified transactions, which were compared to the over 70,000 accounting entries made in the books and records principally maintained (and later turned over by) Mr. Iannelli. As a result of this effort, the Receiver has been able to identify each of the Receivership Entities' investors and creditors, and complete a cash flow analysis for each of them Although the bulk of this work has recently focused on those Essex investors who profited, those who did not, and in what amounts, some details of the main creditors and broader operations are in order.

Through its equipment leasing business, Essex generally provided fixed asset capital options to early stage companies in the form of leases. After the fixed payments terms on the leases ended, lessees were generally authorized to purchase the leased assets for a depreciated amount and, in certain instances, Essex received warrants or other investments in the lessee company. Mr. Iannelli raised money from investors and borrowed money from banks in order to run the business, as well as to make numerous capital, brokerage, and private equity investments on behalf of the Receivership Entities and, on at least one occasion, himself, personally.

The critical failures that contributed to Essex's operational losses included:

- Two of Essex's lessors, Passaic Healthcare Services, LLC ("Passaic") and Beamreach Solar, Inc. ("Beamreach"), petitioned for bankruptcy mid-lease, resulting in large losses. (*See In re Passaic Healthcare Servs., LLC*, Bankr. D. N.J. Case No. 3:14-BK-36129-CMG and *In re Beamreach Solar, Inc.*, Bankr. N.D. Cal. Case No. 5:17-BK-50307.) Both bankruptcies resulted in leases that were abruptly cut off in mid-repayment and whose underlying assets ended up being not recovered by Essex. The Passaic bankruptcy resulted in a loss of $5.3 million; the Beamreach bankruptcy resulted in a loss of $3.3 million. These loses resulted, in part, because Essex was not properly secured, and the underlying leased assets were not recovered. Both investments were funded with money obtained from MBT and investors. MBT's loans were cross-collateralized, and had to be repaid, in-full and with interest, resulting in additional losses. Essex likewise made complete repayments, including of promised interest, to all associated investors. Given that funds were not

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available from these leases to make these repayments, payments were necessarily made from other sources, raising the prospect of recoverable false profits to investors.

- Essex lost $10.2 million on $40.6 million in private equity and other investments. Most of Essex's major investments originated from its leases, but Essex also invested heavily in its lessees once they went public. By way of example, Essex held Neos Therapeutics, Inc. shares commencing in or around 2015, at which point each share was valued in excess of $28. At the time of the Receiver's appointment, the stock traded for approximately $2 a share. This investment alone accounts for an $11.9 million loss to Essex.
- Essex paid approximately $7 million in legal fees for Essex and Mr. Iannelli.
- Essex's total operating cash losses reached at least $14.7 million.

INVESTOR ACTIVITY

During the Accounting Period, Essex raised over $240.2 million from 152 investors, and made over $225 million in repayments to these investors. This includes 51 investors that were paid, in full along with, in many cases, significant interest. From 2012 through the date of the Receiver's appointment, Essex paid $25,033,431 in interest to investors. The schedule below summarizes (in millions) the investor funds raised, repaid, and those potentially subject to disgorgement as false profits:

	Investor Funds Raised	Investor Funds Returned	Possible Disgorgement Profits
2009 and Prior	$64.2	($51.2)	$0.0
2010	$14.6	($10.0)	$0.0
2011	$17.2	($11.0)	$0.0
2012	$11.8	($10.0)	($1.2)
2013	$18.2	($8.6)	($1.0)
2014	$25.0	($26.4)	($4.5)
2015	$42.3	($25.1)	($4.3)
2016	$33.9	($29.2)	($4.9)
2017	$11.2	($34.8)	($6.9)
2018	$1.8	($18.9)	($2.2)
TOTAL	$240.2	($225.1)	($25.0)

MR. IANNELLI'S USE OF ESSEX FUNDS

As noted above, and despite the fact that the operations did not yield a profit overall, Mr. Iannelli paid himself at least net $22.7 million in salaries, bonuses, and loans over the 22-year period preceding notice of the SEC's investigation.[3] Between that time and the Receiver's appointment, Mr. Iannelli paid down his shareholder loan by $1.7 million. These flows of funds to and from Mr. Iannelli are summarized below:

[3] The SEC's notice of investigation was sent to Essex and Mr. Iannelli on March 8, 2017, via overnight delivery.

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	Flows To RTI	Flows From RTI	Net RTI Flows
2009 and Prior	(13,729,117)	5,768,500	(7,960,617)
2010	(1,977,293)	375,000	(1,602,293)
2011	(2,373,265)	550,000	(1,823,265)
2012	(1,931,434)	5,000	(1,926,434)
2013	(2,116,380)	2,000,000	(116,380)
2014	(4,739,679)	1,770,000	(2,969,679)
2015	(4,017,913)	2,299,875	(1,718,038)
2016	(8,090,818)	4,725,000	(3,365,818)
1/1/17 - 3/8/17	(1,310,868)	-	(1,310,868)
3/8/17 TOTAL	(40,286,767)	17,493,375	(22,793,392)
3/9/17 - 12/31/17	(1,056,724)	3,194,484	2,137,760
2018	(737,001)	391,000	(346,001)
3/9/17 - 2018 TOTAL	(1,793,725)	3,585,484	1,791,759
12/21/18 TOTAL	(42,080,492)	21,078,859	(21,001,633)

Again, Mr. Iannelli returned $1.7 million to Essex before December 21, 2018, reducing his shareholder loan balance to $21 million at the time of the Receiver's appointment. In the 14 years before 2009, Mr. Iannelli received an average of $568,615 a year from Essex. From 2010-2018, that average amount increased to $1.4 million per year.

In the 3 years between the time the Passaic bankruptcy was filed and the SEC notified Essex of its then-pending investigation, during which time the Receivership Entities were experiencing substantial losses, as detailed above, Mr. Iannelli took over $9.3 million out of the company. It is inconceivable that Mr. Iannelli did not know at this time that Essex was unprofitable and in dire financial straits, so any extraction of funds by himself as principal would diminish the working capital available to the company.

Transfers

Included in the above, a total of $11,160,456 was transferred from Essex's bank accounts to accounts owned by Mr. Iannelli personally. $4,368,392 of Essex's funds were used to pay Mr. Iannelli's personal credit card bills, along with other direct personal bills and invoices. In addition, Mr. Iannelli received $1,789,753 in Essex funds via checks drawn on Essex accounts and either made out to "cash" or to him, personally.

Essex also facilitated Mr. Iannelli's purchase of a personal interest in an LLC (915 Elm Avenue CVL, LLC or "CVL") established to purchase and operate Carpinteria Valley Lumber Co. Among other things, Essex executed a note to the seller for $1.5 million in July 2016, on which. Essex had paid the seller at least $453,683 in the pre-receivership period. Essex funded 100% of more than $643,000 that Mr. Iannelli transferred to CVL as partner capital on January 13, 2016, July 12, 2016, and October 13, 2016. Mr. Iannelli was also responsible for depositing CVL's remittances to Essex for inventory loans but, on February 1, 2018 Mr. Iannelli deposited a $21,733.84 remittance intended for Essex into his personal account at MBT, and failed to transfer those funds on to Essex.

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Comingled Accounts

Mr. Iannelli also commingled his personal funds with funds derived from Essex investors. Mr. Iannelli received a total of $6,622,189 in direct deposits of investor proceeds into his personal bank accounts, including over $2.8 million in the 12 months following the date of notice of the SEC's investigation. If funds received from investors were not then transferred to Essex, Mr. Iannelli would make a manual entry in Essex's books to credit the investors' account for the payment(s) to Mr. Iannelli. In instances where some of these investor funds were ultimately transferred to Essex, these deposits were booked as repayment of shareholder loans in Essex's books, never as a transfer of investor funds. This is a critical mischaracterization of these transactions because the money coming in was in fact taking cash and creating a new liability for Essex, not taking cash and reducing another asset (Shareholder Loan Receivable). The cumulative effect being that the ending account balance in Shareholder Loan Receivable was falsely presented as $6.6 million below what it should have been. The same is true for the Investor Loans Payable category.

Below is a list of 33 payments from investors directly to Mr. Iannelli:

Date	Amount	Investor	Funds Transferred to Essex?	Essex Accounting Action
6/19/2000	100,000	113	No	Unknown
7/14/2000	25,000	117	No	Unknown
1/5/2006	50,000	102	No	Unknown
2/1/2006	618,000	102	No	Unknown
12/26/2008	400,000	102	Yes	Due From Shareholder on Transfer; Journal Entry For Investor
3/2/2009	100,000	114	No	Journal Entry For Investor
12/23/2009	300,000	106	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
1/3/2012	160,000	110	No	Journal Entry For Investor
1/20/2012	15,000	119	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
1/26/2012	45,000	118	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
8/1/2013	40,237	110	No	Journal Entry For Investor
11/21/2013	1,000,000	101	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
12/10/2013	159,000	111	No	Journal Entry For Investor
12/31/2013	500,000	103	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
2/12/2014	200,000	104	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
7/15/2016	109,879	110	No	Journal Entry For Investor
5/10/2017	50,000	117	No	Journal Entry For Investor
6/2/2017	25,000	117	No	Journal Entry For Investor
7/3/2017	25,073	117	No	Journal Entry For Investor
10/11/2017	500,000	104	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
10/16/2017	300,000	107	No	Journal Entry For Investor
12/28/2017	100,000	106	No	Journal Entry For Investor
1/18/2018	500,000	105	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
2/12/2018	25,000	119	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
2/28/2018	175,000	108	No	Money to Essex Woodlands
3/8/2018	200,000	109	No	None
3/23/2018	150,000	106	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
3/27/2018	250,000	108	Yes	Due From Shareholder on Transfer; Journal Entries For Investor
4/2/2018	50,000	111	No	Journal Entry For Investor
4/9/2018	100,000	108	Yes	Due From Shareholder on Transfer; No Entries For Investor
4/16/2018	150,000	112	Yes	Due From Shareholder on Transfer; No Entries For Investor
5/30/2018	100,000	115	Yes	Due From Shareholder on Transfer; No Entries For Investor
5/30/2018	100,000	116	Yes	Due From Shareholder on Transfer; No Entries For Investor
TOTAL	**6,622,189**			

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The above-described activity and all associated accounting entries suggest that Mr. Iannelli knowingly appropriated investor funds for personal use.

Anecdotally, but as also reflected in some of Essex's executed promissory notes, Mr. Iannelli would typically raise more money than he had leases to fund and would therefore effectively promise more than 100% ownership in Essex's leases, with MBT receiving the highest level of repayment security. The Receiver understands that Mr. Iannelli has previously asserted that all bank loans ($66.9 million borrowed) and all investor funds ($240.2 million) went to fund leased assets ($124.4 million). If this is true, then the banks funded the first 53.7% of the assets (as they were generally secured and cross-collateralized). That means that only 23.9% of the investor funds could have possibly been used to purchase lease assets and that the remaining $182.7 million of investor funds were never used for their stated purpose.

Charitable Donations

Mr. Iannelli donated at least $1,125,543 to 47 regional charities from 2013-2017, including 10 organizations which received at least $50,000. Based on the information available to the Receiver, it appears that funds derived from Receivership Entity investors may have been used for some of these donations.

CONCLUSION

The operations of Essex and the Receivership Entities were unprofitable an unsustainable. Despite this fact, Mr. Iannelli took millions of dollars of investor money over the years and paid out millions more in purported profits to investors. Operational losses and cash shortfalls caused old investor debts as well as bank loans on defaulted leases to be paid directly with funds obtained from new investors. These actions forced Essex to pick winners and losers.

In his capacity as the Receivership Entities' principal, Mr. Iannelli told investors and banks that he needed capital to fund leases, and ultimately raised a combined $307.1 million. However, Essex only ever purchased $117.0 million in leasable equipment. Of the more than $190 million remaining, $21 million was paid to directly to Mr. Iannelli, $14.7 million was used to cover significant operational losses, and the balance was used to make payments to investors, including via the use of money from new investors to pay existing obligations to older investors.

Dated this 10th day of June, 2020.

Geoff Winkler, Receiver
Essex Capital Corporation

PROOF OF SERVICE

Securities and Exchange Commission v. Ralph T. Iannelli and Essex Capital Corporation
USDC, Central District of California – Case No. 2:18-cv-05008-FMO-AFM

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 865 S. Figueroa Street, Suite 2800, Los Angeles, California 90017-2543.

On **June 11, 2020**, I caused to be served on all the parties to this action addressed as stated on the attached service list the document entitled: **NOTICE OF FILING AND FORENSIC AND INVESTIGATIVE ACCOUNTING REPORT OF RECEIVER, GEOFF WINKLER**.

☒ **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 the firm'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.

☐ **OVERNIGHT DELIVERY**: I deposited in a box or other facility regularly maintained by express service carrier, or delivered to a courier or driver authorized by said express service carrier to receive documents, a true copy of the foregoing document(s) in sealed envelope(s) or package(s) designed by the express service carrier, addressed as indicated on the attached service list, with fees for overnight delivery paid or provided for.

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

☐ **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 that I am employed in the office of a member of the Bar of this Court at whose direction the service was made. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on **June 11, 2020** at Los Angeles, California.

/s/ *Martha Diaz*
Martha Diaz

SERVICE LIST

Securities and Exchange Commission v. Ralph T. Iannelli and Essex Capital Corporation
USDC, Central District of California – Case No. 2:18-cv-05008-FMO-AFM

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