

UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS  
EASTERN DIVISION

IN RE:	)	CHAPTER 11
	)	
EQUIPMENT ACQUISITION	)	Case No. 09 B 39937
RESOURCES, INC.	)	
	)	Hon. Timothy A. Barnes
Debtor.	)	
_____	)	
	)	
	)	
WILLIAM A. BRANDT, JR., solely in his	)	Adv. No. 11-02231
capacity as Plan Administrator for Equipment	)	
Acquisition Resources, Inc.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
PENTECH FINANCIAL SERVICES, INC.,	)	
	)	
Defendant.	)	

**SECOND AMENDED COMPLAINT**

William A Brandt, Jr., solely in his capacity as Plan Administrator for Equipment Acquisition Resources, Inc. ("**EAR**"), by his attorneys, Diamond McCarthy LLP, brings this adversary proceeding against Pentech Financial Services, Inc. ("**Pentech**" or "**Defendant**").

**INTRODUCTION**

1. This suit seeks the recovery of almost \$1.8 million that was fraudulently transferred from EAR to Pentech. These transfers were part of a fraudulent equipment lease and financing scheme that caused the loss of tens of millions of dollars.

2. After EAR began to experience financial difficulties in late 2009, EAR employed turnaround specialists and restructuring counsel to assist the company. During the rehabilitation efforts, it became clear that EAR engaged in a Ponzi scheme utilizing equipment financing and

leases. As a result of the issues at EAR, Brandt was appointed as Chief Restructuring Officer to replace the then current directors and officers. Brandt filed a voluntary bankruptcy petition on behalf of EAR on October 23, 2009.

3. Prior to EAR's bankruptcy filing, Pentech, entered into lease agreements with EAR related to certain equipment. Under the terms of the agreements, EAR made monthly payments to Pentech from the inception of the agreement through at least July of 2009. The underlying equipment leases and funds transferred to Pentech were a part of and furthered the Ponzi scheme, serving to hinder, delay, and defraud EAR's creditors.

4. Brandt requests that this Court grant relief that will return the funds that were transferred to Pentech as part of the scheme. Specifically, Plaintiff seeks: (a) the avoidance and recovery of \$1,791,298.59 million in fraudulent transfers under 11 U.S.C. § 548 or 740 ILCS 160/5.

## **PARTIES, JURISDICTION & VENUE**

### **I. Nature of the Proceeding**

5. This is an adversary proceeding, pursuant to Fed. R. Bankr. P. 7001, which relates to the Chapter 11 proceeding captioned *In re Equipment Acquisition Resources, Inc.*, Case No. 09-B-39937 (Bankr. N.D. Ill., Eastern Div.).

### **II. Plaintiff**

6. On October 23, 2009, EAR filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in this Court (the "Petition Date"). This Court confirmed the Plan on July 15, 2010 [DE #322]. Pursuant to the terms of the Plan, EAR executed the Plan Administrator Agreement, appointing Brandt as Plan Administrator.

7. The Plan expressly retains the EAR's Litigation Claims, as defined in Plan ¶1.43. Under the terms of the Plan and the Plan Administrator Agreement, Brandt has the responsibility and right to pursue the Litigation Claims on behalf of the Estate, including EAR's claims against Pentech.

### **III. Defendant**

8. Defendant Pentech is a corporation formed under the laws of the state of California. Defendant was cited to appear through its registered agent, CT Corporation Systems at 208 South LaSalle Street, Suite 814, Chicago, Illinois 60604 and has appeared in this action.

### **IV. Jurisdiction and Venue**

9. This Court has subject matter jurisdiction over this action pursuant to 28 U.S.C. § 1334 in that this action arises in, arises under, and/or relates to EAR's bankruptcy proceeding.

10. This action is, at least in part, a core proceeding under 28 U.S.C. §§ 157. In the alternative, Plaintiff consents to entry of a final order or judgment by this Court.

11. This Court has venue over this proceeding pursuant to 28 U.S.C. § 1409.

## **FACTUAL BACKGROUND**

### **I. EAR's Formation and Operations**

12. EAR was incorporated in 1997 under the laws of Illinois. Under its purported business model, EAR operated as a refurbisher of special machinery, a manufacturer of high-end technology parts, and a process developer for the manufacturing of high-technology parts. EAR allegedly purchased high-tech equipment near the end of its life-cycle at low prices relative to the cost of a new unit and then refurbished the equipment for sale to end-users at substantial gross margins using a propriety process. In 2009, EAR's operations came to an abrupt end when it could no longer repay its financing and lease obligations, despite its purported net income of

almost \$35 million in 2008. Subsequent investigations by Brandt would uncover a massive fraudulent scheme involving the equipment purportedly in EAR's possession.

## **II. The Ponzi Scheme at EAR**

13. Beginning at least as early as 2003, EAR systematically and repeatedly entered into unnecessary and harmful financing and lease agreements for over-valued machinery. EAR's fraudulent scheme involved high-tech machinery near the end of its life cycle. As part of this fraudulent scheme, EAR entered into financing and lease agreements with numerous entities (the "**Financial Entities**") for equipment that was allegedly owned by Machine Tools Direct, Inc. ("**MTD**"). However, the equipment was actually owned by EAR, and MTD was a mere straw-man in EAR's scheme.

14. Many, if not all, of MTD's sale prices grossly overstated the value of the underlying equipment. MTD "purchased" the underlying equipment from EAR around the same time MTD sold the equipment either to the Financial Entity (in the case of a lease) or to EAR (in the case of financing). Once MTD received funds from the Financial Entities, MTD transferred the proceeds to EAR, less a cut for MTD's role in the transaction (which was regularly calculated as 1 to 2% of the purchase price).

15. EAR paid far more for the equipment under the financing or lease agreements than it ever received via the sale to MTD. As a result, EAR entered into an increasing number of these transactions in order to have sufficient funds to repay its current obligations. Of course, EAR had to make all required payments under its lease and financing obligations or risk having the scheme collapse. First, EAR needed to have a clean credit history to induce Financial Entities to enter into new leases and financing arrangements. Second, defaulting on any given obligation could cause a cascade of defaults that would cripple EAR's Ponzi scheme. EAR's

misconduct amounted to a Ponzi scheme where funds from later Financing Entities were used to repay EAR's obligations under earlier financing and lease obligations, including the transfers made to Pentech. The Ponzi scheme rendered EAR insolvent at least as early as December 31, 2005.

16. Further evidence of the fraud indicates that EAR either sold the same piece of equipment to MTD multiple times to further the scheme. For instance, a physical count of equipment performed in 2009 demonstrated that EAR possessed less than half of the pieces of equipment reflected in the financial statements. This was consistent with EAR's practice of altering serial numbers on equipment to facilitate leasing one piece of equipment from multiple financial institutions. As a result, the Financial Entities have been unable to determine what, if any, security interest they hold in EAR's equipment.

### **III. EAR's Revenues**

17. As discussed above, MTD acted as the straw-man in EAR's Ponzi scheme. Although any potential legitimate revenues were commingled with funds derived from the fraud, Brandt's investigation indicates that fraudulent transactions with MTD constituted the vast majority of all revenues throughout the period in question:

- **2005** – Approximately 86% of EAR's cash receipts in 2005 were received from MTD. The total receipts associated with MTD were approximately \$30.2 million, while receipts from other entities totaled approximately \$4.9 million;
- **2006** – Approximately 87% of EAR's sales in 2006 (or \$43.4 million) were to MTD, corresponding to sales to other entities of no more than \$6.6 million;
- **2007** – Approximately 92% of EAR's sales in 2007 (or \$50.5 million) were to MTD, with corresponding sales to other entities of approximately \$4.4 million;
- **2008** – Approximately 97% of EAR's sales in 2008 (or \$82.9 million) were to MTD, with corresponding sales to other entities of approximately \$2.8 million; and
- **2009** – Approximately 92% of EAR's sales in 2009 (or \$18.2 million) were to MTD, with corresponding sales to other entities of approximately \$1.5 million.

Although this analysis plainly indicates that EAR had little funding available through potentially legitimate avenues, it does not paint the full picture. The sheer volume of EAR's leasing obligations required EAR to use funds from the Ponzi scheme to pay its financing and lease obligations, including those obligations to Pentech.

**IV. EAR's Lease and Financing Obligations Were Funded By the Scheme**

18. Because of the nature of the Ponzi scheme, EAR entered into an increasing number of equipment transactions each year to meet its current obligations. By December 31, 2005, EAR had capital lease payment obligations of approximately \$37.8 million and equipment loan obligations of at least \$693,132. By December 31, 2008, capital lease payment obligations had risen to \$91.3 million and equipment loan obligations had risen approximately \$17.8 million. In addition to capital leases and equipment loans, EAR's expense for equipment operating leases rose from \$295,496 in 2005 to \$15,900,485 in 2008.

19. Funds derived from potentially legitimate transactions were grossly insufficient to pay EAR's obligations under the equipment leases and financing arrangements. EAR's financial statements, including its statement of cash flows provide evidence:

- **2005** – EAR paid approximately \$12.7 million on equipment lease obligations and long-term debt. These payments exceeded the amount of income from potentially legitimate operation by approximately \$7.8 million. Despite the fact that EAR's potentially legitimate revenues were dwarfed by capital lease expenses, EAR's cash balances increased by \$4,431,917 during 2005.
- **2006** – EAR paid approximately \$23.0 million on equipment lease obligations and long-term debt.. This exceeded the amount of income from potentially legitimate operations by about \$16.4 million. Notwithstanding this significant shortfall, EAR's cash balance only fell by \$461,034.
- **2007** – EAR paid approximately \$21.2 million on equipment lease obligations. These payments exceeded the amount of income from potentially legitimate operations by approximately \$16.9 million. Despite the significant outflows and minimal potentially-legitimate operations, EAR's cash balance rose by over \$11.7 during 2007.

- **2008** – EAR paid approximately \$36.2 million on equipment lease obligations. These payments exceeded the amount of income from potentially legitimate operations by approximately \$33.4 million. Nevertheless, EAR's cash balances rose by over \$9 million.

Put simply, any potentially legitimate operations at EAR did not fund the liability associated with the equipment leases and financing arrangements from the Ponzi scheme, including the payments to Pentech.

20. Furthermore, EAR's other expenditures and shareholder distributions depleted any funds available from legitimate operations, establishing that money received from the Ponzi scheme was used to repay existing obligations. First, EAR had other paid expenses, such as taxes, employee wages, utilities, and rent, that depleted the amount of funding available to the company. For instance, EAR reported tax payments of \$2.3 million in 2005 and \$4.7 million in 2006. Second, massive shareholder distributions and other payments stripped the company of its assets. For 2007 and 2008 alone, shareholder distributions were approximately \$23 million. As a result, little (if any) funding was available from legitimate operations to pay for the enormous expenses associated with EAR's lease and financing obligations. EAR's expenses, distributions, and increased cash reserves exceeded the amount of any potentially legitimate revenues.

#### **V. EAR's Eventual Collapse**

21. In 2009, after receiving numerous notices of default from its creditors, EAR sought the assistance of outside counsel and turn-around specialists in order to help in the company's rehabilitation. During its investigation, EAR's outside counsel and consultants discovered evidence of EAR's fraud in equipment leasing and financing activity.

22. Once it became apparent that EAR had engaged in this fraudulent activity, EAR's officers and directors resigned from their positions at EAR on October 8, 2009. Brandt was then elected as sole member of the board of directors and as the Chief Restructuring Officer

(“**CRO**”). The CRO was vested with the power to assume full control of all operations of EAR and all the powers and duties of its President, Chief Executive, and Treasurer. Pursuant to these powers, the CRO filed EAR’s voluntary Chapter 11 bankruptcy petition to manage EAR’s assets for the benefit of all creditors. Under the Plan, Brandt was appointed as the Plan Administrator for EAR.

23. With this Court’s permission, Brandt abandoned EAR’s equipment and inventory to its lenders in late 2009. At the time of the abandonment, the inventory and equipment had a net book value of over \$130 million. In February 2011, an auction of EAR’s inventory and equipment was conducted, and the reconciliation report shows that the gross proceeds were approximately \$6.9 million. EAR’s creditors are currently engaged in litigation concerning the auction proceeds, with multiple parties claiming liens over the same equipment. The results of the auction and related litigation are consistent with the nature of the fraud, whereby the equipment subject to the leases and financing transactions was vastly overvalued and pledged multiple times.

24. Since his appointment as Plan Administrator, Brandt has continued his investigation of the fraud. This continued investigation revealed evidence of the fraud at least as early as 2003. Furthermore, for the period of from 2005 through the Petition Date, there appears to be a minimal amount of potentially legitimate business activity.

#### **VI. Pentech’s Lease Agreements with EAR**

25. Pentech entered into at least two equipment leases with EAR (the “**Leases**”). Under the terms of the Leases, EAR was required to make monthly payments to Pentech with respect to the equipment which was identified in the Leases.



26. EAR entered into the Leases and made required payments in furtherance of the Ponzi scheme. As further described below, the machinery related to the Leases was purchased from MTD and was part of the Ponzi scheme. Because EAR owned the equipment in question prior to the date of the Leases, the transactions were unnecessary from a business standpoint. Rather, EAR entered into the Leases in order to generate cash for use in paying other outstanding lease obligations as part of the Ponzi scheme.

27. EAR used funds derived from the Ponzi scheme to make payments to Pentech under the Leases. As outlined in the attached exhibits, Pentech received transfers from EAR in 2005 through 2009, during which time EAR generated almost 92% of its revenues from fraudulent sales to MTD. Thus, any potential revenues from legitimate transactions were woefully insufficient to pay EAR's operating expenses and leasing and financing obligations. EAR was therefore required to use funds generated from the Ponzi scheme to pay its lease and financing obligations, including the transfers to Pentech that Brandt now seeks to recover. Moreover, EAR made payments to Pentech because failing to do so would have caused cross-defaults and damaged its perceived creditworthiness, thereby halting EAR's ability to enter into additional lease and financing transactions. Because the transfers made to Pentech were part of the Ponzi scheme, the transfers were made with the actual intent to hinder, delay, and defraud EAR's remaining creditors.

*A. Lease No. 13977*

28. On or about October 5, 2005, EAR and Priority Leasing, Inc. ("**Priority**") entered into equipment lease agreement no. 13977 ("**Lease No. 13977**"). The lease related to an Engis Backgrinder, Model DS6000. Under the terms of the lease, EAR was required to make montly

payments of \$2,616. The total value of the leased equipment was listed as \$100,000. Priority assigned its interests in Lease No. 13977 to Pentech.

29. On or about October 21, 2005, EAR received \$98,000 from MTD for the sale of equipment. The cash receipt represents 98% of the stated value of the leased equipment, thereby allowing MTD to retain 2% on the underlying sale.

***B. Lease No. 14294***

30. On or about December 1, 2005, EAR and Pentech entered into a Master Equipment Lease, which was lease number 14294. The lease related to three pieces of equipment described as Strasbaugh Polishers, Model 6DSSP. Under the terms of the lease and accompanying supplements, EAR was required to make a monthly payment of \$15,047.55 for each machine, for a total monthly payment of \$45,142.65. The total value of the leased equipment was \$1,600,000. According to the documentation submitted with Pentech's proof of claim, the underlying equipment was purchased from MTD.

31. On or about January 4, 2006, EAR received three payments of \$522,667 from MTD related to the sale of equipment. The cash receipt represents 98% of the stated value of the leased equipment, thereby allowing MTD to retain 2% on the underlying sale.

**CLAIMS FOR RELIEF**

**COUNT I—FRAUDULENT TRANSFER  
UNDER 11 U.S.C. § 548(a)(1)(A)**

32. The Plaintiff re-alleges and fully incorporates the allegations pleaded in the paragraphs above as if fully set forth herein.

33. In accordance with the requirements of the Leases, EAR made transfers to Pentech from its bank account(s) totaling \$934,640.44 from December 3, 2007 through July 1, 2009 (the "**Lease Transfers**"). The transfers are more fully described in Exhibit A, which is

attached hereto. Discovery in this matter may identify additional transfers made to Pentech under the terms of the Leases.

34. The Lease Transfers were made within two years of the Petition Date.

35. The Lease Transfers were made as a part of the Ponzi scheme at EAR. EAR entered into the Leases in furtherance of EAR's fraudulent scheme. Each of the Leases generated cash for EAR through the "sale" of the equipment to MTD. These sham transactions provided EAR with the funds it required to pay existing obligations on equipment financing and lease obligations that were part of the fraudulent scheme. Furthermore, later transactions with other Financing Entities followed the same pattern as the Leases with Pentech. These fraudulent transactions then provided EAR with the funds used to pay Pentech under the terms of the Leases. This transactional-pyramid constitutes a Ponzi scheme whereby funds received from later fraudulent transactions are used to fund prior outstanding obligations. Therefore, the Lease Transfers were made with the actual intent to hinder, delay, or defraud entities to which EAR was or became indebted to on or after the date of the transfer.

36. Pursuant to 11 U.S.C. § 548(a)(1)(A), the plaintiff is entitled to judgment avoiding the Lease Transfers.

**COUNT II – FRAUDULENT TRANSFER  
UNDER 740 ILCS 160/5(a)(1)**

37. The Plaintiff re-alleges and fully incorporates the allegations pleaded in the paragraphs above as if fully set forth herein.

38. In accordance with the requirements of the Lease, EAR made the Lease Transfers as described more fully in Exhibit A. In addition to the Lease Transfers totaling \$934,640.44, EAR made additional transfers to Pentech totaling at least \$856,658.15 under the terms of the Lease from its bank account(s) prior to November 2007. These additional transfers are more

fully described in Exhibit B (the “**Additional Lease Transfers**”), which is attached hereto. Discovery in this matter may identify additional transfers made to Pentech under the terms of the Leases.

39. The Lease Transfers and the Additional Lease Transfers were made within four years of the Petition Date.

40. The Lease Transfers and Additional Lease Transfers were made as a part of the Ponzi scheme at EAR. EAR entered into the Leases in furtherance of EAR’s fraudulent scheme. Each of the Leases generated cash for EAR through the “sale” of the equipment to MTD. These sham transactions provided EAR with the funds it required to pay existing obligations on equipment financing and lease obligations that were part of the fraudulent scheme. Furthermore, later transactions with other Financing Entities followed the same pattern as the Leases with Pentech. These fraudulent transactions then provided EAR with the funds used to pay Pentech under the terms of the Leases. This transactional-pyramid constitutes a Ponzi scheme whereby funds received from later fraudulent transactions are used to fund prior outstanding obligations. Therefore, the Lease Transfers and Additional Lease Transfers were made with the actual intent to hinder, delay, or defraud entities to which EAR was or became indebted to on or after the date of the transfer.

41. Pursuant to 11 U.S.C. § 544(b)(1) and 740 ILCS 160/5(a)(1), the Plaintiff is entitled to judgment avoiding the Lease Transfers and the Additional Lease Transfers.

**COUNT III – RECOVERY OF THE VALUE OF THE  
AVOIDED TRANSFERS UNDER 11 U.S.C. § 550**

42. The Plaintiff re-alleges and fully incorporates the allegations pleaded in the paragraphs above as if fully set forth herein.

43. For the reasons set forth above, Plaintiff is entitled to avoid the Lease Transfers and the Additional Lease Transfers.

44. Pentech was the initial transferee of the Lease Transfers and the Additional Lease Transfers as Pentech received the funds transferred from EAR.

45. Pursuant to 11 U.S.C. § 550, Plaintiff is entitled to recover the value of the Lease Transfers and the Additional Lease Transfers from Pentech.

**COUNT IV –DISALLOWANCE OF CLAIM  
UNDER 11 U.S.C. § 502(d)**

46. The Plaintiff re-alleges and fully incorporates the allegations pleaded in the paragraphs above as if fully set forth herein.

47. The Lease Transfers and Additional Lease Transfers are avoidable under 11 U.S.C. § 548 and 740 ILCS 160/5.

48. Pursuant to 11 U.S.C. § 502(d), any claims of Defendant against the Debtor must be disallowed until such time as Defendant pays the Lease Transfers and Additional Lease Transfers as provided in 11 U.S.C. § 502(d).

**PRAYER**

Wherefore, Plaintiff respectfully requests that the Court enter judgment and grant it the following relief against Pentech:

1. Entering an order of judgment avoiding the Lease Transfers under 11 U.S.C. § 548(a)(1)(A);
2. Entering an order of judgment avoiding the Lease Transfers and the Additional Lease Transfers under 740 ILCS 160/5(a)(1);
3. Entering an order of judgment in the amount of \$1,791,298.59 in favor of the Plaintiff and against Pentech;
4. Entering an order disallowing any payment or claim held by Defendant, to the extent on exists, pursuant to 11 U.S.C. § 502(d);
5. Prejudgment and post-judgment interest as allowed by law; and

6. All other relief to which it is entitled.

Dated: October 31, 2012

Respectfully submitted,

/s/ Jon Maxwell Beatty

One of the attorneys for Plaintiff  
William A. Brandt, Jr., solely in his capacity as Plan  
Administrator for Equipment Acquisition  
Resources, Inc.

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**Exhibit A to Complaint**  
*The "Lease Transfers"*

<b>Date</b>	<b>Amount</b>
12/3/2007	\$ 45,142.65
1/2/2008	\$ 45,142.65
2/1/2008	\$ 45,142.65
2/15/2008	\$ 2,616.25
3/3/2008	\$ 45,142.65
4/1/2008	\$ 45,142.65
5/1/2008	\$ 45,142.65
5/15/2008	\$ 2,616.25
6/2/2008	\$ 45,142.65
7/1/2008	\$ 45,142.65
7/15/2008	\$ 2,616.25
8/1/2008	\$ 45,142.65
9/2/2008	\$ 45,142.65
9/15/2008	\$ 2,616.25
10/1/2008	\$ 45,142.65
10/15/2008	\$ 2,616.25
11/3/2008	\$ 45,142.65
11/17/2008	\$ 2,616.25
12/1/2008	\$ 45,142.65
12/15/2008	\$ 2,616.25
1/2/2009	\$ 30,095.10
1/6/2009	\$ 15,047.55
1/15/2009	\$ 2,616.25
2/2/2009	\$ 45,142.65
2/17/2009	\$ 2,616.25
3/2/2009	\$ 45,142.65
3/16/2009	\$ 2,616.25
4/1/2009	\$ 15,047.55
4/2/2009	\$ 30,095.10
4/15/2009	\$ 2,616.25
5/1/2009	\$ 45,142.65
6/1/2009	\$ 45,142.65
6/29/2009	\$ 3,008.69
7/1/2009	\$ 45,142.65
	<u>\$ 934,640.44</u>

**Exhibit B to Complaint**  
*The "Additional Lease Transfers"*

<b>Date</b>	<b>Amount</b>
4/3/2006	\$ 45,142.65
4/17/2006	\$ 43,551.81
4/18/2006	\$ 30,351.78
5/1/2006	\$ 45,142.65
6/1/2006	\$ 45,142.65
7/3/2006	\$ 45,142.65
8/1/2006	\$ 45,142.65
9/1/2006	\$ 45,142.65
10/2/2006	\$ 45,142.65
11/1/2006	\$ 45,142.65
12/1/2006	\$ 45,142.65
1/2/2007	\$ 45,142.65
2/1/2007	\$ 45,142.65
4/2/2007	\$ 45,142.65
5/1/2007	\$ 45,142.65
6/1/2007	\$ 45,142.65
7/2/2007	\$ 45,142.65
8/1/2007	\$ 30,095.10
8/1/2007	\$ 15,047.55
9/4/2007	\$ 45,142.65
9/20/2007	\$ 15,329.51
	<u>\$ 856,658.15</u>