

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

UNITED STATES SECURITIES)	
AND EXCHANGE COMMISSION,)	
)	
Plaintiff,)	Civil Action No. 18-cv-5587
)	
v.)	Hon. John Z. Lee
)	
EQUITYBUILD, INC., EQUITYBUILD)	Mag. Judge Young B. Kim
FINANCE, LLC, JEROME H. COHEN, and)	
SHAUN D. COHEN,)	
)	
Defendants.)	

RECEIVER’S DISCLOSURE

Pursuant to Section 11 of the Court’s Order Regarding Claims Resolution Process No. 2 (Dkt. No. 941), the Receiver hereby discloses his position that the security interest given by EquityBuild, Inc. (“EquityBuild”) to BC57 LLC (“BC57”) in the Group 1 properties (3074 Cheltenham Place, 7625-33 S East End, 7635-43 S East End, 7750-58 S Muskegon, and 7201 S Constance) constitutes a voidable fraudulent transfer under the Illinois Uniform Fraudulent Transfer Act, 740 ILCS 160 (“the Act”).

As a preliminary matter, the Receiver submits that if the investor-lenders’ mortgages are deemed to be in first position, then the fraudulent conveyance issue to which this disclosure relates will essentially be moot and neither the participants nor the Court should devote time or expense to the matter. For this reason, the Receiver’s Disclosure is provided in the alternative and asserted herein only insofar as the Court determines that BC57’s mortgage interest is superior in position to the investor-lenders’ mortgage interests. The legal and factual basis for

the avoidance of the BC57 mortgage lien, and the documents relied upon (drawn either from BC57's files or from deposition testimony in Group 1 discovery), are set forth herein.¹

A. Legal Basis of Fraudulent Transfer Claim

Section 5 of the Act, 740 ILCS 160/5, provides in relevant part as follows:

Sec. 5. (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

- (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; . . . and the debtor:
- (B) intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due.

A Ponzi scheme is “an investment scheme in which returns to investors are not financed through the success of the underlying business venture, but are taken from principal sums of newly attracted investments.” *In re M & L Business Mach. Co., Inc.*, 84 F.3d 1330, 1332 n.1 (10th Cir. 1996). Proof of a Ponzi scheme is sufficient to establish actual intent to hinder, delay or defraud creditors. *See, e.g., In re Bernard L. Madoff Investment Securities LLC*, 12 F.4th 181, 196 (2d Cir. 2021) (“Under the so-called ‘Ponzi scheme presumption,’ the existence of a Ponzi scheme demonstrates actual intent as a matter of law because transfers made in the course of a Ponzi scheme could have been made for no purpose other than to hinder, delay or defraud creditors.”); *In re Agricultural Research and Technology Group, Inc.*, 916 F.2d 528, 535-36 (9th Cir. 1990) (“the mere existence of a Ponzi scheme, which could be established by circumstantial evidence, has been found to fulfill the requirement of actual intent on the part of the debtor”).

¹ Documents produced by BC57 in discovery are identified by Bates number.

The evidence that EquityBuild and the Cohens were operating a Ponzi scheme is a matter of record and incontrovertible. (*See, e.g.*, Dkt. Nos. 40, 492)

The Act does, however, recognize a “good faith” defense for creditors who accept a pledge of assets in good faith and for reasonably equivalent value:

Sec. 9. (a) A transfer or obligation is not voidable under paragraph (1) of subsection (a) of Section 5 against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee.

740 ILCS 160/9. *See also* 11 U.S.C.A § 548(c). The transferee/obligee carries the burden of demonstrating good faith. *See, e.g., Agricultural Research and Technology Group, Inc.*, 916 F.2d at 539; *Madoff*, 12 F.4th at 196.

In the context of fraudulent conveyance law, “inquiry notice” is the appropriate standard for determining lack of good faith. *In re Sentinel Management Group, Inc.*, 809 F.3d 958 (7th Cir. 2016) (bank which accepts pledge of assets is not acting in good faith if it had “inquiry notice” of possible fraud); *Madoff*, 12 F.4th at 186-88 (2d Cir. 2021). “Inquiry notice” is the awareness of suspicious facts that would have led a reasonable firm, acting diligently, to investigate further and by doing so discover wrongdoing. *In re Sentinel Management Group, Inc.*, 809 F.3d 958 (7th Cir. 2016). Actual knowledge of the Ponzi scheme or fraud is not necessary to a finding that a creditor lacked good faith. *Id.* at 962 (“inquiry notice is not knowledge of fraud or other wrongdoing but merely knowledge that would lead a reasonable, law-abiding person to inquire further—would make him in other words suspicious enough to conduct a diligent search for possible dirt”); *In re Nieves*, 648 F.3d 232, 242 (4th Cir. 2011) (finding no actual knowledge but affirming finding that mortgagee did not take in good faith where numerous facts known to mortgagee would have led a reasonable person to inquire further as to the voidability of the transfer). Even if the transferee gave reasonably equivalent value in

exchange for the transfer, the transferee may not recover such value if the exchange was not in good faith because good faith is “indispensable” for the transferee who would recover any value given pursuant to 11 U.S.C. § 548(c) or state Uniform Fraudulent Transfer statutes. *Agricultural Research and Technology Group, Inc.*, 916 F.2d at 535.

A finding of inequitable conduct on the part of the transferee is also unnecessary. Instead, “mere negligence—or ineptitude” suffices for inquiry notice. *Sentinel Management Group, Inc.*, 809 F.3d at 962-63 (“Notice that because of the recipient’s obtuseness fails to trigger suspicion is nevertheless sufficient to create inquiry notice because all that is required to trigger it is information that would cause a *reasonable* person to be suspicious enough to investigate.”) (emphasis in original).

The first step in the inquiry notice analysis thus looks to the facts which a transferee knew. *Id.*; see also *Madoff*, 12 F.4th at 191-92. The second and third steps of the inquiry are whether the facts known by the transferee would have led a reasonable person to conduct further inquiry into the transferor’s possible fraud, and whether diligent inquiry by the transferee would have discovered the fraudulent purpose of the transfer. *Id.* Thus, the “good faith” inquiry includes both subjective and objective components. *Id.*; see also *M & L Business Mach. Co.*, *Inc.*, 84 F.3d at 1332 n.1.

B. Facts and Documents Supporting Fraudulent Transfer Claim

Documents in the possession of BC57 at the time EquityBuild granted it security interests in the Group 1 properties demonstrate that BC57 was aware of numerous facts that would have led a reasonable person to inquire further into the validity of the grants and that any such inquiry would have revealed that EquityBuild was engaged in fraud, including by fraudulently releasing mortgages without the authority of the mortgagees. Those facts include the following:

- When Tyler DeRoo of EquityBuild first approached BC57 regarding a potential refinancing, BC57 was aware based on DeRoo's statements and the information he provided to BC57 that EquityBuild was seeking to borrow an amount that well exceeded the acquisition cost of the properties plus the capital expenditures, which representatives of BC57 found unusual. (BC570000921-23)

- At the inception of the loan process, EquityBuild represented that the refinancing would facilitate the buyout of equity owners with whom it had a falling out (BC570000940-42) (explaining that EquityBuild "bought [the properties] with a partner and have since had a falling out"). BC57 acknowledged at the time that "we need to understand what happened with their partner." *Id.* Information that Mr. DeRoo subsequently shared with BC57 indicated that there were, in fact, no equity partners and that EquityBuild instead needed the funds to pay off group mortgages recorded in favor of investor-lenders who were expressly disclosed on the face of the mortgage instruments (BC570000998) (acknowledging that these "investors actually came in as private lenders in effect" and noting that "Cohen is representing that they have the right to remove them").

- Kasturi Bagchi, who acted as transaction counsel for BC57 for this loan, reviewed a title commitment with special exceptions reflecting the original principal amounts of the existing mortgages, which totaled \$10,009,398 in the aggregate. (BC570006661-73) She also printed the actual mortgage instruments (which were hyperlinked in the title commitment) "in order to see what the dollar amounts were." (Bagchi Dep. at 24-30) The payoff letters, however, reflected that the outstanding principal loan balances totaled only \$4,944,850, suggesting that more than half the aggregate principal balances had been repaid over periods ranging from 12 to 30 months, which would be unusual enough for amortizing loans, but extremely rare for interest-

only loans, which the payoff letters revealed them to be. The typical explanation for the outstanding loan balances would be substantial principal paydowns, but BC57 was informed and understood that the properties were operating at a loss (Jarjosa Dep., 109:1-5), thus the net income from the properties could not have produced cash sufficient to curtail such a substantial amount of principal.

- BC57 neither compared the original mortgage balances to the payoffs nor inquired as to why the payoffs were so steeply discounted. (Jarjosa Dep., 110:10-111:22). A corporate representative of BC57 testified that BC57 does not review payoff correspondence because “it’s someone else’s job to make sure that [BC57 will obtain] a senior secured mortgage.” (*Id.*, 111:23 -112:7) BC57 delegated this to persons who acted as agents of BC57 relative to such matters (including but not limited to its transaction counsel and title insurer).

- Publicly recorded documents, available to BC57 and its delegated agents at the time, showed that the prior mortgages associated with the five properties being refinanced were nearly double the purchase prices of the properties. These mortgage instruments were contained in BC57’s files. (BC570009566-74; BC570017332-40; BC570017363-70; BC570012935-42; BC570012919-26)

- The personal financial statement submitted to BC57 by Jerry Cohen attached a schedule of real estate owned in which he listed the existing debt as of August 3, 2017, on the five properties pledged to BC57 as collateral in the aggregate amount of \$5,234,375. And while that amount in the aggregate is only about 6% higher than the payoff figures provided approximately a month later, on the individual properties the debt balances provided to BC57 a few weeks later, on September 11, 2017 differed (either higher or lower) by 11%, 20%, 24%, and 28%, respectively. (BC570001836-40; BC570013938-51) These statements also reflected

that Cohen personally (as the “sponsor”) had \$6,460,388 equity in these five properties, an assertion belied by facts within BC57’s possession. (BC570001840)

- BC57 and its counsel were aware that the security being pledged as collateral consisted of five separate properties with five different parcel ID’s, and encumbered by five separate mortgages requiring five separate releases. (BC570006238-39)

- Although there were five properties being refinanced, EquityBuild supplied proposed payoff letters and releases for only four properties to transaction counsel for BC57, who sent them to BC57 and the title company, asking the title agent to “please also let us know from a title perspective if these draft releases are satisfactory.” (BC570012880-92) The releases in question were prepared for signature by Jerry Cohen, the principal of the borrowing entity (EquityBuild), and not for signature by the lenders (c/o EquityBuild Finance).

(BC570013938-51). Transaction counsel for BC57 specifically noticed this irregularity and admonished that “[a]ll releases must be signed by EquityBuild Finance LLC and not Jerome Cohen individually.” (BC570013027-28)

- After a representative of BC57 asked EquityBuild why only four payoff letters were submitted for five properties (BC570001877-89), Mr. DeRoo claimed that one of them was "mis-labeled" and that the outstanding loan balance associated with the two properties at 7625 South East End and 7635 South East End should have been reflected on a single payoff letter. (BC570001902-03) Mr. DeRoo then supplied BC57 with two new payoff letters, changing the address on one of them to the fifth property and treating 7625 and 7635 South East End as a single property for loan repayment purposes. (BC57001989-91) BC57 was aware at that time that separate mortgages in favor of different groups of mortgagees were recorded against these

two properties; in fact, transaction counsel for BC57 found it “notable” that “we received only 4 payoffs and releases but 5 mortgages are showing up.” (BC570006615-18)

- Original drafts of the payoff letters directed the payoff funds to EquityBuild (the borrower), so Mr. DeRoo instructed that those payoff letters be amended:

"We need Payoffs to be remitted to [EquityBuild Finance] not [EquityBuild], **the optics aren't good**. Can you change the account name? It references [EquityBuild] in the top half and [EquityBuild Finance] in the bottom half, need it all to be EBF." (Emphasis added.)

This e-mail, including the remark that the "optics [weren't] good," was forwarded to transaction counsel for BC57. (Nielsen Dep. Ex. 6) The same email chain forwarded to counsel indicates that EquityBuild told EquityBuild Finance the dollar amounts to use for the payoff quotes. *Id.*

- Each of the prior mortgages recorded against the properties in the Group 1 tranche identified every individual mortgagee (BC570009566-74; BC570017332-40; BC570017363-70; BC570012935-42; BC570012919-26), but the corresponding payoff letters did not identify the individual mortgagees or specify the principal balances of their respective loans (BC570017297, BC570017313, BC570017318, BC570017323), and the purported releases of the mortgages were not executed by the mortgagees. (BC570017283-92)

- Neither the payoff letter nor release provided for the mortgage of record on 7752 S Muskegon referenced the Lenders identified on the mortgage or Hard Money Company LLC. (BC570017323; BC570017291-92)

- The mortgage releases ultimately accepted in connection with the refinance reflected that EquityBuild (the borrower) was releasing its own mortgages, except that a borrower cannot release its own mortgage – only the lender can. (BC570017283-92)

* * * *

The Receiver reserves the right to rely upon or cite to other evidence supporting its positions in this Disclosure in its later submissions including but not limited to any information and documents cited by other claimants that is presented in their position statements.

Dated: January 7, 2022

Respectfully submitted,

s/ Michael Rachlis

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CERTIFICATE OF SERVICE

I hereby certify that I provided service of the foregoing Receiver's Disclosure, via ECF filing, to all counsel of record on January 7, 2022.

I further certify that I caused true and correct copies of the foregoing to be served upon the following individuals or entities by electronic mail:

- All known individuals or entities that submitted a proof of claim in this action (sent to the e-mail address each claimant provided on the claim form).

I further certify that the Receiver's Disclosure will be posted to the Receivership webpage at: <http://rdaplawnet.com/receivership-for-equitybuild>

/s/ Michael Rachlis _____

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