UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	:	**CASE NO. 1:07-cv-4538**
Plaintiff,	:	**Hon. Elaine E. Bucklo**
v.	:	**Magistrate Judge Arlander Keys**
BRIAN N. HOLLNAGEL and BCI AIRCRAFT LEASING, INC.	:	
Defendants.	:	

PLAINTIFF UNITED STATES SECURITIES AND EXCHANGE COMMISSION'S SUPPLEMENT TO ITS MOTION FOR ORDER TO SHOW CAUSE

Plaintiff, United States Securities and Exchange Commission ("SEC"), respectfully supplements its October 5, 2007 Motion for Order to Show Cause why Defendants Brian N. Hollnagel ("Hollnagel") and BCI Aircraft Leasing, Inc. ("BCI") (collectively "Defendants") should not be held in contempt of the Court's August 22, 2007 Order ("Order"). In addition to the conduct described in detail in the SEC's October 5, 2007 Motion, the SEC has learned, after its Motion was filed, of transactions entered into by Defendants in violation of the Court's Order, specifically payments made without any notice to the SEC, as well as the unreported sale at auction of six BCI aircraft due to foreclosure action by GMAC. Finally, the SEC feels it necessary to inform the Court that in Defendants' October 9th Progress Report, they falsely claim to have repaid all investors, and to have fully satisfied the Court's Order. In addition, they have contemptuously declared that they are no longer required to file the reports required by the Court's Order, despite having never asked this Court's permission to be released from this obligation and despite the fact that all investors have not been repaid.

I. DEFENDANTS FAILED TO PROVIDE THE SEC WITH NOTICE OF NUMEROUS RECENT WITHDRAWALS OF FUNDS, IN VIOLATION OF THE COURT'S ORDER.

As noted in the SEC's Motion, one of Defendants' creditors, Ungaretti & Harris LLP ("U&H"), filed a motion to intervene in this matter because Defendants had failed to repay $500,000 in legal fees. *See* Docket Entry No. 56 at 42. The SEC recently learned from counsel for U&H that on October 8th, Defendants reached an agreement with U&H, resulting in U&H withdrawing their motion. According to counsel for U&H, Defendants paid to U&H $100,000 on October 8th and agreed to make payments for the next three to four months, until all $500,000 owed is repaid. Under this Court's Order, Defendants are required to provide 48 hour notice to the SEC for all withdrawals over $20,000. The SEC received no notice of this $100,000 payment on October 8th, and as of this filing, Defendants have still not notified the SEC about this payment. Counsel for Defendants specifically represented to counsel for U&H on October 9th that Defendants had notified the SEC about the $100,000 payment. This was false.

In addition, Defendants have admitted to making numerous other recent payments for which they have provided no notice to the SEC as required under the Order. In their October 9th Progress Report, Defendants reported recently making nearly $11 million in payments to four investors. *See* Exhibit 1 at 2. Defendants failed to provide any notice of these recent payments to the SEC or even the identity of the payees. Instead, the SEC learned of three of these payments, wire transfers totaling approximately $10.7 million, from an investor, and reported these transfers in its Motion. *See* Docket Entry No. 56 at 19.

II. DEFENDANTS FAILED TO DISCLOSE GMAC'S FORECLOSURE TO THE SEC OR TO THE COURT.

Defendants have never disclosed to this Court or the SEC that BCI defaulted under loan agreements with GMAC Commercial Finance LLC ("GMAC") totaling $33 million and that GMAC foreclosed on six commercial aircraft securing these loans. By May of 2007, BCI was in default under two loan agreements with GMAC, which were secured by six commercial aircraft in the possession of BCI or BCI related entities. *See* Exhibit 2 at 6 (citing Exhibit 3). On August 23, 2007, GMAC issued a notice of Default, Notice of Acceleration, and Notice of Foreclosure of Pledges under loan agreements for six aircraft owned by BCI. This default was based on BCI's repeated failure to provide audited financial statements (as required under the loan agreements), GMAC's concerns regarding BCI's financial condition, and GMAC's concerns regarding the improper commingling of security deposits and maintenance reserves with BCI's other funds. *See id.* at 3-4. The aircraft securing the loans from GMAC had "deposits and maintenance reserves that amount to millions of dollars." *Id.* GMAC further questioned BCI's financial stability by citing to BCI's failure to produce audited financial statements in December 2006 and February 2007, and BCI's failure to pay maintenance expenses on GMAC collateral, resulting in a mechanic's lien in excess of $2 million.[1] *See id.* at 5, 8. On August 29, 2007, GMAC issued a Notification of Disposition of Collateral regarding the six aircraft, scheduling a foreclosure sale of those six aircraft on September 26, 2007.

Defendants unsuccessfully attempted to prevent the foreclosure sale by GMAC. On September 20, 2007, Defendants filed a complaint and motion for a temporary restraining order against GMAC in state court in New York attempting to halt the foreclosure sale, which was

[1] During the hearing before this Court, Defendant Hollnagel testified that BCI was permitted to use the maintenance reserves and security deposits as its own funds for the operation of its business. That is simply incorrect.

then rescheduled to October 9, 2007 pending the resolution of Defendants' motion. In its response to BCI's motion, GMAC expressed having "serious concerns regarding BCI's and the BCI [LLCs'] representations concerning its financial condition." *Id.* at 3. On October 5, 2007, the Supreme Court of New York denied Defendants' motion, and the foreclosure sale of the six aircraft occurred on October 9th. Again, Defendants never disclosed any of these events to the Court or to the SEC.

BCI's motion for a temporary restraining order, and GMAC's response, raise serious questions regarding Defendants' honesty and integrity. First, one of the BCI entities in the New York Complaint seeking to halt the foreclosure by GMAC is BCI Bermuda 2006-1, an entity under the control of BCI. This LLC was not reported by the Defendants as an asset of BCI on their Exhibit 10 to the Defendants' Response to the Motion for a Temporary Restraining Order. However, BCI 2006-1 was reported as an asset of BCI. The SEC does not know whether BCI Bermuda 2006-1 and BCI 2006-1 are the same entity. BCI 2006-1, however, is one of the entities pledged as satisfaction of BCI's obligations to its investors in this case. Due to the lack of information from the Defendants regarding this transaction, it is not clear whether this entity is related to BCI Bermuda 2006-1 which had its planes foreclosed on by GMAC this week. Second, GMAC represented that BCI directed a sublessee to make rent and maintenance reserve payments to a new account, which was not the account to which payments under such subleases were required to be paid. *See* Exhibit 2 at 8. This misdirection of funds and Defendants' failure to disclose this to GMAC constituted additional events of default under the GMAC loan agreements, and further call into question the good faith nature of Defendants' business practices.

Despite being required to report on their progress in repaying investors and, presumably, matters which would impair that progress, at no time did Defendants disclose to the SEC or to the Court GMAC's notices of Default or Disposition of Collateral or the scheduled foreclosure sale of the aircraft. The SEC learned of the foreclosure sale (and Defendants' attempts to stop it) from GMAC's counsel on October 9th. This is yet another example of Defendants' failure to report events directly bearing on their ability to repay all investors in cash as ordered by the Court.

III. DEFENDANTS' PROGRESS REPORT MISLEADINGLY CLAIMS REPAYMENT OF ALL INVESTORS.

In Defendants' October 9th Progress Report, they claim that "as of October 5, 2007, BCI succeeded in satisfying all remaining obligations to [investors]." *See* Exhibit 1 at 1. This statement is simply untrue. All investors have not been repaid in cash. The October 9th Progress Report admits that Defendants only repaid approximately $17.8 million owed to investors in cash, a fraction of the approximately $49 million owed to investors. The remaining $31.2 million was repaid with aircraft or promises of proceeds from contingent sales of aircraft under Defendants' control. As explained in detail in the SEC's Motion, this promise of proceeds from future contingent sales of aircraft by Defendants constitutes the sale of a new security. *See* Docket Entry No. 56 at 11-14. In either event, as the SEC stated in its Motion, Defendants repeatedly represented to the Court, and the Court's Order contemplates, repayment of all investors in cash. *See id.* at 5-6.

To date Defendants have failed to provide any information about these repayments. Defendants have not provided any information about which aircraft were pledged to investors as part of their settlement. The SEC is unable to determine whether aircraft belonging to defrauded

investors are being sold or given to other investors. Defendants claim that "the cash involved in the cash transactions came from three sources: (i) sale of aircraft; (ii) cash on hand; and (iii) the proceeds of a loan to BCI by commercial bank." Nevertheless, Defendants have failed to provide the SEC any information regarding which aircraft were sold, the source of the "cash on hand," or the commercial bank loan.

Finally, Defendants claim that they have completely satisfied and complied with the Court's Order that they repay all investors within 60 days, stating: "As we believe the above describes the completion of BCI's efforts regarding its remaining investors, we do not intend to provide any further progress reports."[2] Exhibit 1 at 2. This statement is simply false. Investors have not been paid cash. At the very least, certain investors are still relying on contingent sales that still have not occurred. In addition, and more importantly, Defendants simply are not permitted to decide what they will or will not do under the Court's Order. To usurp the Court's role in deciding what Defendants will or will not do under the Order without even a "by your leave" is simply the most recent of a long line of examples of Defendants' contempt for this Court, the investors, and their obligations in connection with this lawsuit.

Defendants' claim that they "are pleased to report" that they have "succeeded in satisfying all remaining obligations to [investors]" is pure fiction. Defendants have misled the Court, the SEC, and investors. Ironically, at the emergency hearing, the very things Defendants claimed they feared most if a Receiver and asset freeze were imposed have all come to pass. The "wrecking ball," a phrase Defendants used early and often at the hearing (without disclosing to the Court that the wrecking had already begun), has done substantial damage with Defendants

[2] Nothing in the Court's Order releases Defendants from their reporting obligations even if they believe that they have "satisfied all remaining obligations to [investors]." Only additional action by the Court would release them from these obligations. Defendants have not sought any such action from the Court.

remaining in control of the company. Secured creditors have seized assets; investors are being treated inequitably, victimized yet again; certain creditors are not being paid; new fraudulent securities sales have occurred; Defendants have committed systemic contempt; and Defendants have withheld critical information from this Court and from the SEC in its monitoring role under the Order. Despite Defendants' protestations to the contrary at the emergency hearing, all of these events simply would not have occurred had there been an asset freeze and receiver in place. In sum, Defendants simply must be stopped; Defendants cannot be trusted; Defendants have utterly no respect for this Court, its orders or for the public; and thus Defendants should not be permitted to continue their fraud.

IV. DEFENDANTS' BEHAVIOR CONSTITUTES CONTEMPT OF THE ORDER AND OBSTRUCTION OF THE SEC'S MONITORING ROLE UNDER THE ORDER.

As another example of Defendants' disrespect of this Court, one must look no further than Defendants' responses, or lack thereof, to the SEC's efforts to obtain information relevant to its role as Plaintiff and critical to its monitoring role under the Order. On August 31st, and on subsequent dates, the SEC issued discovery requests to Defendants for documents and other information regarding their progress in repaying investors. As of the date of the SEC's Motion, virtually the only documents produced by Defendants were related to events occurring before the Order.[3] In a rare instance of post-Order documents being produced, pursuant to the SEC's August 31st discovery request, Defendants recently produced a copy of the QuickBooks records for the various BCI-managed LLCs. However, Defendants conveniently failed to produce any post-Order QuickBooks records for BCI itself, doubtless because these accounting records would have confirmed Defendants' recent violations of this Court's order, and who knows what else.

[3] The SEC intends to move to compel production of documents called for by its various discovery requests to Defendants.

Defendants have produced virtually no information regarding their recent settlements with investors, despite the fact they have recently given that information to third parties and could have easily made copies of these documents to produce to the SEC. Clearly, details regarding settlements and new transactions would be essential to any complete and accurate progress report regarding efforts to repay investors and relevant to the SEC's monitoring role. Moreover, no information has been given to the SEC, either in its monitoring role under the Order or in response to its numerous discovery requests, regarding the source of funds used by Defendants to make the August 23rd cash payments to investors. Defendants appear to not want the SEC or this Court to know the source of those funds, even though at the hearing, Defendants admitted knowing the source of the $12.2 million that was "ready to be paid" to investors. Defendants have never disclosed the source of those funds to the Court or, despite repeated requests, the SEC, causing concern that these funds may have in fact belonged to other investors. Defendants have likewise not provided the SEC with any e-mails or other electronic communications of Defendant Hollnagel to any third parties, including Jay Hyatt and Jay Johnson. These communications, certain of which the SEC knows exist, clearly would be relevant to the issues in connection with the SEC's role as monitor, as well as issues central to this lawsuit.

Finally, the SEC has asked Defendants, in a discovery request, for information regarding legal fees paid by BCI and Hollnagel. First, this information is relevant to whether Defendants BCI or Hollnagel are paying any of the legal fees of any third party, including Hyatt and Johnson. In addition, such information is relevant to the source of funds used to pay those legal

fees, as well as whether a Receiver should be appointed.[4] It would be a cruel irony to later discover that money or assets belonging to investors were being spent defending the very people who defrauded the investors once, and are now victimizing many of them again. This is a particularly important issue given that there are at least four law firms who have worked on the case during and since the hearing. The SEC is aware that one of those law firms was paid a $1 million retainer in April 2007. The SEC is certain that significant additional funds, possibly in the millions of dollars, have been spent by Defendants for their defense. However, due to Defendants' refusal to provide easily produced documents relating to legal fees, the SEC has no idea how much Defendants have subsequently paid this law firm, or any of the other three law firms, or the source of those funds.

Taken as a whole, these actions, and Defendants' continued contempt, show that their behavior "...corruptly...influences, obstructs or impedes or endeavors to influence, obstruct or impede, the due administration of justice..." in connection with the SEC's responsibilities as monitor and in this case in general. 18 U.S.C. § 1503.

V. CONCLUSION

As a general matter, in order for the SEC to fulfill its statutory mission of protecting investors, it is absolutely vital that court orders such as the August 22nd Order the SEC obtained from this Court are enforced. This Court thus needs to address the Defendants' multiple violations of this Court's Order and not allow Defendants to essentially "cherry-pick" whichever part of the Order they wish to follow. Otherwise, failure to enforce the Order will create a dangerous precedent in which wrongdoers, without any serious ramifications, will be able to

[4] Of course, it is 7th Circuit law that a fraudster cannot use victims' funds to pay for his defense. *See* SEC v. Quinn, 997 F.2d 287, 289 (7th Cir. 1993) ("a swindler in securities markets cannot use the victims' assets to hire counsel who will help him retain the gleanings of crime"); SEC v. Cherif 933 F.2d 403, 416 (7th Cir. 1991); SEC v. Van Waeyenberghe et al., 284 F.3d 812 (7th Cir. 2002).

ignore on their own whims court orders intended to protect the interests of the investing public. Bluntly put, Defendants must not be allowed to mislead this Court, hide information critical to this Court's role in doing justice and engage in serial contempt. Not only do such actions erode the dignity and authority of this Court, but such actions may embolden other like-minded violators of the federal securities laws.

Respectfully submitted,

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