

Introduction

1. This is an adversary proceeding brought in the above-captioned bankruptcy cases pursuant to Part VII of the Bankruptcy Rules seeking to recover monies paid on behalf of Defendant and for recovery of monies under 11 U.S.C. § 548 and K.S.A. § 33-205.

Parties

2. Plaintiff Albert A. Riederer is the Chapter 7 Trustee of Brooke Corp., Brooke Capital and Brooke Investments.

3. Upon information and belief, Defendants are business entities and/or individuals whose exact legal structure is presently unknown.

Jurisdiction and Venue

4. This Court has jurisdiction over this proceeding under 28 U.S.C. § 1334 and 28 U.S.C. § 157.

5. This Court has venue over this proceeding under 11 U.S.C. §§ 1408 and 1409.

Facts Common to All Counts

6. Brooke Corp. owns approximately 81% of the stock of Brooke Capital who, in turn, owns 100% of the stock in Brooke Investments.

7. Brooke Corp. and Brooke Capital filed voluntary Chapter 11 petitions on October 28, 2008 in the Bankruptcy Court for the United States District of Kansas. Brooke Investments filed a voluntary Chapter 11 petition on November 3, 2008 in the Bankruptcy Court for the United States District of Kansas. FIRST

8. On October 29, 2008, the Court entered an Order appointing Albert Riederer as the Chapter 11 Trustee of Brooke Corp. and Brooke Capital. On November 13, 2008, the Court

entered an Order appointing Albert Riederer as the Chapter 11 Trustee of Brooke Investments effective as of its petition date, November 3, 2008.

9. On June 29, 2009, this Court entered an Order converting these proceedings to Chapter 7 and noted the U.S. Trustee's decision to appoint Albert Riederer as Chapter 7 Trustee of the Debtors upon conversion of these cases. (Docket No. 700).

LATER
10. This Court has entered orders directing the joint administration of the Debtors' three cases.

11. As the representative of the bankruptcy estates, the Trustee is authorized to pursue all causes of action that belong to the estates as well as any applicable state law avoidance actions pursuant to 11 U.S.C. §§ 323(b) and 544(b).

Brooke's Unsustainable Business Model

12. Brooke Corp. operated primarily through its operating subsidiaries: Brooke Credit Corporation ("Brooke Credit"), which later changed its name to Aleritas Capital Corporation ("Aleritas")¹ and Brooke Franchise Corporation ("Brooke Franchise"), which later merged into Brooke Capital. Unless otherwise noted, Brooke Corp. and its various subsidiaries are collectively referred to as "Brooke."

13. During the first ten years of its existence, Brooke primarily sold administrative services to bank-owned insurance agencies. In 1996, Brooke established a franchise model for expansion and developed a lending program to facilitate acquisition of existing insurance agencies by Brooke franchisees.

14. From 1996 to 2000, Brooke's revenues consisted almost entirely of a percentage of commissions earned by its franchisees, which Brooke retained in exchange for administrative services provided to the franchisees.

¹ Brooke owned 100% of Aleritas stock through mid 2007 when it sold 38%.

15. In 2001, however, Brooke began to restructure its operations and create additional sources of revenue. Specifically, it:

- a. Began charging consulting fees to prospective franchisees in conjunction with the franchisee's acquisition of a franchise (referred to as "BAP" fees); and
- b. Began realizing gains on the sale of loans it had initiated.

16. Through the end of 2003, all Brooke franchises were conversion agencies, meaning that the franchisee owned or acquired an existing agency when it signed up to become a Brooke franchisee.

17. When a franchise was acquired, Aleritas would typically loan the franchisee the entire amount it needed to purchase the franchise. Franchisees would then use the proceeds of the loan to pay Brooke Capital the associated fees.

? 18. Prior to 2003, Brooke employed a business model whereby it would fund loans by selling participation interests in individual loans. In 2003, however, Brooke started using loan securitizations as well as loan participations. Loan securitizations involve a finance process that distributes risk by aggregating assets into a pool and issuing new securities backed by those assets and their cash flows. The securities are then sold to investors who share the risks and rewards of the assets.

? 19. By the end of 2007, approximately 45% of the total loans Brooke had initiated had been securitized in seven securitizations. Brooke was required to over-collateralize the securitizations, which meant Aleritas had to absorb the first 15-25% of losses in any given securitization before investors would lose any of their interest in the remaining percentage of the loan.

20. Of the remaining loans that had been initiated by Brooke, 35% had been sold without recourse to participating banks but another 20% remained unsold and on Brooke's books.

21. Notwithstanding Brooke's apparent lessened exposures to the loans it had initiated, Brooke was under tremendous pressure for all the loans to perform because its business model depended on a continuous stream of willing buyers for its loans.

22. Between 2004 and 2007, Brooke experienced tremendous growth in the number of its franchise agencies. The success of a significant number of those franchise agencies was, however, questionable.

23. In 2004, Brooke also began a program of start-up agencies ("SUPs") where the franchisee was recruited and setup in a new agency without the benefit of existing business. Again, almost all of the costs for SUPs were financed through loans provided by Aleritas.

24. The success rate for SUPs was abysmal. As of September, 2008, less than one-third of the SUPs were able to timely meet their payment obligations.

25. In many instances, the commission revenues of Brooke franchisees in both conversion and SUP locations were not adequate to cover the agent's loan payments or other expenses. But pursuant to certain agreements Brooke would absorb those costs or advance funds to the agent to cover them.

26. Thus, while Brooke's payroll costs increased very quickly to support, manage and control the rapidly growing agency network, its other operating expenses increased even more dramatically, reflecting the cost of continued subsidization of an ever-growing portfolio of troubled agencies.

27. Brooke periodically disclosed in its forms 10-K its practice of making advances to franchisees either as part of its "cash management services" or its provision of "additional assistance to franchisees coping with financial stress . . ." or its financial cyclical fluctuations of revenues, receivables and payables with commission advances recorded on franchisees' monthly statements and granting temporary extensions of due dates for franchise statement balances" (See 2005 Form 10-K, page 49, 2006 Form 10-K, page 49 and essentially similar language in 2007 Form 10-K, page 60).

28. Brooke was hemorrhaging excessive amounts of money as it subsidized the expenses (including loan repayments and payment of insurance premiums) of underperforming agencies. By 2007, these operating expenses had grown so dramatically that, even with an increase of 144 agencies that year, the initial franchise fees were no longer sufficient to cover the year's other operating expenses.

29. Until the 4th quarter of 2007, Brooke also failed to provide for any loan loss allowances that were needed to reflect the true value of the loans on its books.

Improper Revenue Recognition

30. Starting in the fourth quarter of 2003 Brooke began, for the first time, to charge its franchisees a significant initial franchise fee. The revenue from such fees rapidly became the focus at Brooke and the driver behind Brooke's reported financial results.

31. In its 2004 Form 10-K Annual Report with the Securities and Exchange Commission ("SEC"), Brooke Corp. recognized the growing significance that initial franchise fees played:

Our dependence on initial fees creates an incentive for us to extend credit to borrowers that may not meet stringent underwriting guidelines.

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A significant part of our revenues are derived from one time initial fees we receive from assisting franchisees and others with the acquisition of businesses. Generating fees is largely dependent on our franchisees' and others' ability to obtain acquisition financing from Brooke Credit. Our dependence on these initial fees creates an incentive for us to extend credit to borrowers that may not meet stringent underwriting criteria. Our failure to follow stringent underwriting guidelines could adversely affect the quality of the loans we make and adversely affect our financial condition and results of operations.

(Emphasis in the original).

32. Payment of initial franchise fees were made in exchange for substantial services to be provided by Brooke on an ongoing basis and throughout the franchise relationship.

Critically, however, the services and rights provided by Brooke at the outset in exchange for the initial franchise fee were not discrete earnings events.

33. As Brooke put it,

For an initial franchise fee and a share of sales commissions or other revenues, the Company provides franchisor services to its franchisees in accordance with a franchise program pioneered by the Company.

34. Among the services Brooke provided to its franchisees were:

- a. Access to Brooke's business model.
- b. Use of Brooke's registered trade names.
- c. Access to products from Brooke's insurance companies and suppliers;
- d. Advertising services;
- e. Access to facility support and processing center support;
- f. Access to an internet based document management system used by Brooke to maintain all franchisee records on behalf of franchisees and to distribute such records to franchisees;
- g. Management and maintenance of franchisee licenses on behalf of franchisees;
- h. Negotiation of contracts with insurance carriers on behalf of franchisees; and

- i. Cash management services whereby Brooke would collect from the franchisee policy premiums, distribute the premiums to the respective carriers who issued the policies, collect from the carriers commissions earned by the franchisee on the premiums, and distribute the commissions earned to the franchisee after allocating the agreed upon amount to Brooke and deducting the franchisee's expenses.

35. Pursuant to Generally Accepted Accounting Principles ("GAAP") and relevant SEC guidelines, initial franchise fee revenues must be systematically recognized over the expected life of the franchise relationship. The reason for this, among other things, is Brooke's continuing obligations to provide various services to franchisees.

36. Brooke, however, fully recognized the revenues from the initial franchise fee at the inception of the franchise relationship.

37. Brooke's policy of fully recognizing initial franchise fee revenues at the inception of the franchise relationship constituted a clear violation of GAAP and relevant SEC guidelines.

38. In various SEC filings and disclosures, Brooke reported significant amounts of equity. This equity was, however, an illusion resulting from, among other things, Brooke's improper, up-front recognition of initial franchise fee revenues and Brooke's failure to record loan loss allowances associated with franchisees who were unable to service their debt.

39. Indeed, if Brooke had properly followed GAAP and relevant SEC guidelines, its equity for 2003 through 2007 would have been as follows:

| | 2003 (millions) | 2004 (millions) | 2005 (millions) | 2006 (millions) | 2007 (millions) |
|--------|--------------------|--------------------|--------------------|--------------------|----------------------|
| Equity | -\$9.5 | -\$23.1 | -\$44.5 | -\$96.8 | -\$67.9 ² |

² The decline in negative equity during 2007 is not the result of any improvement in Brooke's financial condition but rather a reflection of the fact that during the year, Brooke sold 38% of its interest in Aleritas and 19% of its interest in Brooke Capital so that at year end a substantial portion of the negative equity was allocated to the holders of those minority interests in Brooke's two largest subsidiaries.

40. Succinctly stated, the Debtors were continuously insolvent from 2003 through their respective bankruptcy filings.

Defendant's Insurance Agency

41. As a result of Brooke's extensive insurance carrier contacts, Brooke's franchisees were agents for numerous insurers. These included both common carriers as well as specialty carriers with whom Brooke did business through entities such as managing general agents and insurance brokers.

42. As more fully set forth herein, between 2004 and 2007, Brooke experienced tremendous growth in the number of its franchise agencies. In 2004, Brooke also began a program of start-up agencies ("SUPs") where the franchisee was recruited and setup in a new agency without the benefit of existing business. Again, almost all of the costs for SUPs were financed through loans provided by Aleritas.

43. Each agency location was charged an initial franchise fee for basic services. Franchisees were also advanced working capital to fund the operations in the early months.

44. Brooke controlled most of the cash flows for its franchise agencies. Its business practice was to pay most of the rent and other operating expenses for its agents, including loan payments, and to charge these payments (along with the percentage of ongoing commission revenues or recurring franchise fees) to the agents' monthly statements as offsets to the commission revenues earned.

45. However, in many cases, commission revenues were not adequate to cover the costs. Because the agents generally did not have funds to settle the monthly deficits, unsettled "statement balances" due Brooke built up over time. Brooke would absorb those costs or advance funds to the agent to cover them.

46. Periodically, Brooke would transfer these balances off the statements and re-characterize them as "non-statement balances" so as not to discourage or overwhelm the franchisees with the amount of their growing debt. From time to time, Brooke would write-off agent balances for accounting purposes.

47. By this Complaint, the Trustee seeks to recover from the respective Defendants the agent statement balances and other similar obligations owed by the agents to the bankruptcy estates. Alternatively, the Trustee seeks to recover from the Defendants all monies advanced to or for their benefit that constitute constructive fraudulent transfers. Finally, the Trustee seeks additional relief as detailed more fully below.

Count I
Action on Account

48. The Trustee repeats and incorporates each of the foregoing paragraphs.

49. The Debtors made loan payments and/or paid operating expenses on behalf of the Defendants including, but not limited to those amounts set forth on Exhibit 1.

50. Debtors furnished to the Defendants statements showing all amounts paid to Aleritas and/or amounts paid as operating expenses on Defendants' behalf.

51. The Defendants acknowledged the amounts paid and promised to pay the amounts shown on the statements.

52. Though duly demanded, the Defendants have failed and refused to pay.

53. The outstanding balance is not less than those amounts set forth on Exhibit I after granting to the Defendants all offsets and credits.

Count II
Money Had and Received

54. The Trustee repeats and incorporates each of the foregoing paragraphs.

55. The Debtor made loan payments and/or paid operating expenses on behalf of the Defendants including, but not limited to, those amounts set forth on Exhibit 1.

56. Defendants received the benefit of those payments and transfers.

57. Defendants did not and have not repaid any monies paid on its behalf to Debtor.

58. Though duly demanded, the Defendant has failed and refused to pay.

Count III
Action for Unjust Enrichment

59. The Trustee repeats and incorporates each of the foregoing paragraphs.

60. The Debtors made loan payments and/or paid operating expenses on behalf of the Defendants including, but not limited to those amounts set forth on Exhibit 1.

61. The Defendants unjustly benefited from the loan payments and/or operating expenses paid on their behalf.

62. The Defendants have not repaid the Debtor for the sums expended on their behalf.

Count IV
Constructive Fraudulent Conveyance
(11 U.S.C. § 548(a)(1)(B) and K.S.A. §§ 33-204(2) and 33-205(a))

63. The Trustee repeats and incorporates each of the foregoing paragraphs.

64. As detailed more fully above, the Debtors were continuously insolvent during the four-year period preceding their bankruptcy filing.

65. During the four-year period prior to the Debtors' bankruptcy filing, one or more of the Debtors transferred to or for the benefit of the Defendants various monies (including, but not limited to, those set forth on Exhibit 1).

66. Funds that were transferred to or for the benefit of the Defendants came from one or more accounts which were owned by Brooke and, therefore, they constituted an interest of the Debtors.

67. It is the Trustee's express intent to avoid all transfers that may be avoided and recovered from the Defendants under Chapter 5 of the Bankruptcy Code or applicable state law whether identified in this Complaint or which may be learned in the course of discovery.

68. Brooke advanced and/or transferred funds in which it had an interest in the gross amounts shown on the attached Exhibit 1. To the extent that Brooke had no obligation to make such advance and/or transfer of funds, then such transfer to or for the benefit of the Defendants was not for or on account of an antecedent debt and, accordingly, Brooke did not receive reasonably equivalent value for the transfer of such funds.

69. Moreover, the Debtors were engaged in a business for which their remaining property was unreasonably small and/or they were incurring debts that were beyond their ability to pay as they matured.

70. The transfers made to the Defendants (including, but not limited to those set forth on Exhibit 1) are avoidable in whole or in part pursuant to 11 U.S.C. § 548(a)(1)(B) and K.S.A. §§ 33-204(2) and 33-205(a) and are recoverable from the Defendants pursuant to 11 U.S.C. § 550 and/or K.S.A. § 33-207.

Count V
Recovery of Avoided Transfers
(11 U.S.C. § 550 and K.S.A. § 33-207)

71. The Trustee repeats and incorporates each of the foregoing paragraphs.

72. The transfers that Defendants received from the Debtors (including, but not limited to, the transfers identified on the attached Exhibit 1) are avoidable in whole or in part pursuant to 11 U.S.C. §§ 547 and 548 and/or K.S.A. §§ 33-204(2) and 33-205(a).

73. Pursuant to 11 U.S.C. § 550 and/or K.S.A. § 33-207, the Trustee is entitled to recover the avoidable transfers made to Defendants.

Count VI
Disallowance of Proof of Claim
(11 U.S.C. § 502(d))

74. The Trustee repeats and incorporates each of the foregoing paragraphs.

75. As more fully set forth above, Defendants are the transferees of avoidable transfers under 11 U.S.C. §§ 544 and/or 548.

76. The Trustee is entitled to recover monies from Defendants pursuant to 11 U.S.C. § 550.

77. The Defendants have not paid the amount of the avoidable transfers for which they are liable under 11 U.S.C. § 550.

78. Pursuant to 11 U.S.C. § 502(d), any and all claims of Defendants against the Debtors must be disallowed until such time as they respectively pay to the Trustee an amount equal to the aggregate amount of the avoidable transfers plus interest thereon and costs.

Count VII- Set-Off

79. The Trustee repeats and incorporates each of the foregoing paragraphs.

80. To the extent the Court determines that Defendants have valid claims against one or more of the bankruptcy estates herein, such sums should be set off against the obligations the Defendants have under this Complaint against the estates as may be determined by the Court herein.

WHEREFORE, the Trustee requests that this Court enter a judgment against the Defendants as follows:

- For judgment in the amount not less than the gross amount shown on Exhibit 1 of all transfers due on the Defendants' account, due as for money had and received and against Defendants and/or for unjust enrichment;

- For judgment that the monies transferred to or for the benefit of the Defendants are avoidable under 11 U.S.C. §§ 544, 548 and/or or K.S.A. §§ 33-204(2) and 33-205(a);
- That all such avoided transfers be recovered by the Trustee pursuant to 11 U.S.C. § 550;
- Awarding prejudgment interest at the maximum legal rate running from the date of each transfer to the date of judgment herein;
- Awarding post judgment interest at the maximum legal rate running from the date of judgment herein until the date the judgment is paid in full, plus costs;
- Requiring Defendants to pay forthwith the judgment amount awarded in favor of the Trustee;
- That this Court enter an Order pursuant to 11 U.S.C. § 502(d) disallowing any and all claims of Defendants or their assignees until such time as they have respectively paid in full to the Trustee an amount equal to the aggregate amount of the avoidable transfers plus interest thereon and costs; and
- That this Court set off any valid claims Defendants may have against one or more of the bankruptcy estates herein against the obligations the Defendants have pursuant to this Complaint against the estates as may be determined by the Court herein.
- Granting the Trustee such further relief as the Court deems just and equitable.

Respectfully submitted,

s/ John J. Cruciani

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