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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. D.W. HEATH & ASSOCIATES, INC.; PCM FIXED INCOME FUND I, LLC; PRIVATE CAPITAL MANAGEMENT, INC.; PRIVATE COLLATERAL MANAGEMENT, INC.; DANIEL WILLIAM HEATH; AND DENIS TIMOTHY O'BRIEN, Defendants.	Case No. CV 04-02949 JFW (Ex) **COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS**

Plaintiff Securities and Exchange Commission ("Commission") alleges as follows:

JURISDICTION AND VENUE

1. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A), 21(e)

and 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendants have, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this complaint.

2. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district.

SUMMARY

3. This case involves the ongoing fraudulent and unregistered offer and sale of securities perpetrated by Daniel William Heath ("Heath") and Denis Timothy O'Brien ("O'Brien") through various affiliated entities, D.W. Heath & Associates, Inc. ("Heath & Associates"), Private Capital Management, Inc. ("PCM"), Private Collateral Management, Inc. ("Private Collateral Management"), and the PCM Fixed Income Fund I, LLC (the "PCM Fund") (collectively, "defendants"). Since at least 1996, defendants have targeted senior citizens and induced them to invest their retirement and other funds in promissory notes offered through PCM or the PCM Fund (the "PCM Notes"). Defendants have sold the PCM notes to at least 803 elderly investors nationwide. The current value of these investments is at least $69.9 million, all of which is purportedly under the management and control of defendants.

4. To lure investors, defendants have held – and are scheduled to hold in the coming months – group workshops and one-on-one meetings, in which they tout the PCM Notes as safe, secured, and liquid investments. Specifically, Heath, O'Brien, and defendants' sales agents represent to investors, among other things, that (1) investor money is pooled to make business loans that are secured by the

borrowers' assets; (2) the PCM Notes pay a "guaranteed" return of at least 5.5% to 8% per year, which can be paid in cash or allowed to accrue at the investors' discretion; (3) investors will be repaid their principal at maturity, or they may redeem all or part of their investment before maturity subject to a penalty of up to 10%; (4) independent third-party IRA administrators conducted "due diligence" on the PCM Notes for the protection of investors; and (5) PCM and the PCM Fund are California business entities.

5. These representations are all false. First, defendants have not used investor funds to make any secured loans. Defendants have not recorded any UCC-1 financing statements that show PCM, the PCM Fund, or any of the defendants as a secured creditor on any loans. The PCM Notes also are not liquid. In fact, defendants have failed to promptly honor redemption requests from investors, who have been able to take their money out only after threatening to file, or actually filing, a lawsuit against defendants. Nor is it true that defendants' IRA administrators have conducted due diligence or otherwise approved the PCM Notes as a safe investment. Furthermore, there is no record that PCM or the PCM Fund are California business entities.

6. In addition to these misrepresentations, defendants appear to be operating an undisclosed Ponzi scheme. In fact, a November 2002 Private Placement Memorandum ("PPM") provided by Heath to the IRA administrators – but never distributed to investors – states that funds from new investors will be used to pay principal and interest to existing investors.

7. Defendants also failed to disclose to investors that in March 1998, the California Department of Corporations ("DOC") issued two desist-and-refrain orders ("D & R Orders") against Heath & Associates, Heath, PCM, and the PCM Fund for engaging in the unregistered sale of securities and for acting as unregistered broker-dealers. Despite the fact Heath consented to these orders, defendants continue to use unlicensed sales agents to conduct an unregistered

offering. Heath and O'Brien also are misleading investors into believing that the D & R Orders do not apply to the PCM Notes offering, when they know otherwise. Defendants have not registered themselves or their offering with the Commission.

8. The defendants, by engaging in the conduct described in this complaint, have violated, and unless enjoined will continue to violate, the securities registration and antifraud provisions of the Securities Act and Exchange Act. By this complaint, the Commission seeks a temporary restraining order and other emergency relief, preliminary and permanent injunctions, disgorgement with prejudgment interest, and civil penalties against all of the defendants; an asset freeze against and the appointment of a receiver over Heath & Associates, PCM, Private Collateral Management, and the PCM Fund; and a personal asset freeze against Heath.

THE DEFENDANTS

9. D.W. Heath & Associates, Inc., was incorporated in California in 1998. It has offices in Hemet, Brea, and Pasadena, California, but the address provided to the California Secretary of State is a commercial receiving mail facility (i.e., a mail drop) in Placentia, California. Heath & Associates purports to be a financial services company established in 1983 that provides investment advice and estate planning services to senior citizens. Heath & Associates is the servicing and marketing agent for PCM and the placement and servicing agent for the PCM Fund. On March 30, 1998, the DOC issued D & R Orders against and stipulated to by Heath & Associates, Heath, PCM, and the PCM Fund for the unregistered sale of securities and for acting as an unregistered broker-dealer. Heath & Associates is not registered with the Commission.

10. PCM Fixed Income Fund I, LLC, purports to be a California limited liability company, but is a business entity of unknown form. It uses the same business address as Heath & Associates in Hemet, California. The PCM Fund is

not registered with the Commission.

11. Private Capital Management, Inc., purports to be a corporation, but is a business entity of unknown form. It is the general manager of the PCM Fund and receives investor funds. PCM is also referred to as "a Private Collateral Management company" in documents provided to investors. PCM is not registered with the Commission.

12. Private Collateral Management, Inc., was incorporated in California in 1995, but the California Secretary of State recently suspended its corporate status. Its address of record is the same mail drop as Heath & Associates. Private Collateral Management is not registered with the Commission.

13. Daniel William Heath, age 47, resides in Chino Hills, California. He controls Heath & Associates, the PCM Fund, PCM, and Private Collateral Management. Heath is the president and senior financial consultant of Heath & Associates, the chief executive officer and chief financial officer of the PCM Fund, the co-founder, president, chief executive officer, and chief financial officer of PCM, and the president of Private Collateral Management. Heath is the signatory on PCM's bank accounts. He does not hold any securities licenses and is not registered with the Commission.

14. Denis Timothy O'Brien, age 49, resides in Yorba Linda, California. He is a director of Heath & Associates, where he also serves as an associate and financial consultant. O'Brien does not hold any securities licenses and is not registered with the Commission.

THE FRAUDULENT SCHEME

A. Defendants' Offering And Sales Efforts

15. Since at least 1996 to the present, defendants have offered and sold PCM Notes to at least 803 investors nationwide. The PCM Notes purportedly held in investors' IRA accounts are valued at $69.9 million. This figure has been calculated by adding the total principal invested with defendants and the accrued

interest promised by defendants to investors.

16. Defendants target senior citizens in their ongoing solicitations. Heath & Associates sponsors free financial workshops for senior citizens at various Southern California restaurants. Using leads developed from senior citizens who attended previous workshops, defendants mail and telephone invitations to prospective investors, luring them with a free lunch. At least one investor saw a newspaper ad for the workshops.

17. Defendants also are using an Internet website (www.seniorz.org) to promote their upcoming workshops. According to the website, workshops are scheduled through the end of April 2004, at five different Southern California locations. Defendants have scheduled workshops at a restaurant in Glendale, California, through June 2004.

18. Heath & Associates has held two investor workshops per month at one restaurant in Hemet, California for at least the past seven years. In that restaurant, serving staff is not allowed in the room during the workshops.

19. At the workshops, senior citizens listen to presentations by Heath and O'Brien, who describe themselves as financial consultants. They assure investors that the PCM Notes are safe, secured, and liquid. They represent that IRA administrators have conducted "due diligence" on the PCM Notes and that investors can use IRA funds to buy them. Heath and O'Brien explain at the workshops that the notes are "secured" corporate notes that are "backed by assets" of the borrower. They further tell prospective investors that the PCM Notes are much safer than stocks and bonds, do not fluctuate in price, and pay a much higher rate of return than bank certificates of deposits. They also tell prospective investors that the PCM Notes pay a "guaranteed" annual return of 5.5% to 8%, which investors can elect to receive each month or reinvest in the PCM Notes.

20. To learn more about the PCM Notes, prospective investors are required to sign up for a free, one-on-one consultation with a Heath & Associates

financial consultant. Prospective investors can schedule their follow up consultation at the end of the workshop. They are given a list of financial documents – including bank, brokerage, and mutual fund statements, and their tax returns for the last two years – to bring with them to their one-on-one appointment. Prospective investors are also asked to fill out a "Seminar Questionnaire" that asks for the name and telephone number of two other people whom they know "would benefit from this seminar."

21. Investors are not provided with any other documents at the workshops, except for a one-page brochure about Heath & Associates, which includes "testimonials" from clients and professional associates.

22. Heath, O'Brien, and defendants' other sales agents conduct the one-on-one sessions with prospective investors. At these sessions, Heath and O'Brien reiterate that the PCM Notes are "safe" because they are "secured" and "backed by assets," and that the returns paid to investors are "guaranteed." O'Brien compares the notes to a home mortgage, where the lender can foreclose on the property if the borrower defaults. Heath and O'Brien also explain that PCM pools investor funds to make collateralized loans to small and medium-sized companies, and that PCM is experienced in making these loans and in managing the loan portfolio for investors. No other use of investor funds is disclosed to prospective investors.

23. During the one-on-one sessions, Heath and O'Brien also tell investors that PCM and the investors share in the profits generated by the interest paid on the loans by the borrowers. They also represent that the PCM Notes mature in two to six years. Investors, however, are assured that they may redeem all or part of their principal before maturity subject to a penalty of up to 10%. O'Brien assured at least one investor that he could get his money out at any time, and that the amount of the penalty would decrease as his PCM Note matured.

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24. Some investors purchase the PCM Notes at their first one-on-one session, while others do so during second or third appointments.

25. Defendants do not provide investors with any offering materials or financial statements about PCM or the PCM Fund. Some investors have been given a PCM brochure in connection with their first investment. Other investors received the brochure years after they invested, and only after asking Heath & Associates for some information about their investment. This brochure is targeted at senior citizens, and describes generally that the PCM Notes are secured corporate notes designed for investors seeking high current monthly income, capital preservation, and liquidity, and that investors may redeem their PCM Notes through a "quarterly repurchase program."

B. <u>The Mechanics Of Investing With Defendants</u>

26. If a prospective investor decides to invest in the PCM Notes through an IRA account, the investor must open a new IRA account with an IRA administrator previously selected by Heath & Associates. Once the new IRA is opened, the investor then transfers funds from his existing IRA account into the new one, and directs the IRA administrator to purchase the PCM Notes on his or her behalf. The IRA administrator transfers the investor's funds to PCM or the PCM Fund as payment for the PCM Notes. Investors can designate their Heath & Associates financial consultant as the "Financial Representative" on their new IRA.

27. If a prospective investor decides to invest non-IRA funds in the PCM Notes, Heath and O'Brien tell the investor to make out a check to PCM or Private Capital Management. If the investor does not have funds readily available, Heath & Associates will help the prospective investor sell other investments to free up cash to invest in the PCM Notes. In one case, a Heath & Associates financial consultant wrote a letter by hand to the investor's annuity company, instructing that the annuity be sold, and had the investor sign the letter on the spot without

informing the investor that she would have to pay taxes and fees for liquidating her annuity.

28. When investors purchase the PCM Notes through an IRA, the funds are held in the name of the PCM Fund. When investors purchase the PCM Notes using non-IRA funds, the funds are held in the name of PCM. The defendants, however, generally do not explain the difference between PCM and the PCM Fund when describing the investment at the workshops or during the one-on-one sessions. Some investors did not know whether their funds were invested in PCM or the PCM Fund until after they gave their money to Heath &Associates and they received documentation showing how their money was invested.

29. Some investors are given a receipt and asked to sign an "Investments Agreement," in which they indicate whether their interest payments are to be paid monthly or allowed to accrue on account. This Agreement also authorizes Heath & Associates to act as the "sole servicing agent" for the investment. Some investors were also asked to sign a PCM "New Account Application." Neither the Investments Agreement nor the New Account Application discloses any information about the PCM Notes.

30. In connection with a non-IRA investment, some investors have received a promissory note and a security agreement. Others merely have received a purchase confirmation and receipt reflecting an investment in a "secured corporate note."

31. After making their initial investment, investors receive quarterly account statements either from Heath & Associates or the IRA administrator. The account statements show both the purported value of the investment, the amount of interest generated, and any principal or payments that have been made or interest that has accrued. For IRA investments, the IRA administrator generates the account statement based on information provided by Heath & Associates.

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32. Some investors receive their investment returns in monthly payments. Defendants usually send interest checks to investors at the beginning of each month.

C. Defendants' Misrepresentations And Omissions

1. The Defendants Are Operating An Undisclosed Ponzi Scheme

33. While defendants represent that investor funds will be used to make collateralized loans to businesses, a PPM for the PCM Notes offering dated November 1, 2002, which Heath provided to Heath & Associates' IRA administrators in 2003, states that investor funds will be used to, among other things, make principal and interest payments to other investors. This PPM was never disseminated to investors, even though some investors specifically requested a PPM or any offering materials. Such undisclosed use of investor funds constitutes a Ponzi scheme.

2. The PCM Notes Are Not Secured

34. Neither PCM, the PCM Fund, nor any of the other defendants have provided any secured loans to borrowers. No UCC-1 financing statements that identify PCM, the PCM Fund, or any of the defendants as a secured creditor have been filed with the State of California or any other state. Nor are Heath & Associates, PCM, or Private Collateral Management licensed to operate under the California Finance Lenders Law or the California Residential Mortgage Lending Act. Even if defendants have used investor funds to make any collateralized loans, the security interests in the collateral have not been perfected under the UCC, and consequently, contrary to defendants' representations, investors' funds are not secured or protected.

3. The PCM Notes Are Not Liquid

35. Some investors have been unable to redeem their PCM Notes as Heath, O'Brien, and defendants' sales agents have represented. Rather than honoring redemption requests, Heath & Associates has told some investors that

the PCM Notes "renew automatically." At least one investor had to wait five months to redeem her investment while Heath & Associates purportedly "audited" her account. O'Brien told one investor that a $50,000 redemption would disrupt their operations and that they would have to pay him in monthly installments of $10,000. And when that investor retained an attorney, Heath unexpectedly went to the investor's home and tried to convince him that he should not have an attorney representing him and that he would be better off just leaving things in Heath's hands. Other investors could not redeem their investments until they resorted to threatening or filing a lawsuit. In another case, Heath and O'Brien flatly denied that the investor could make "premature" redemptions because it was not "typed" in the PCM Note that the investor received.

4. Defendants Did Not Disclose And Lied About the D & R Orders

36. Defendants failed to disclose to investors that in March 1998, the DOC issued the D & R Orders against Heath, Heath & Associates, PCM, and the PCM Fund for engaging in the unregistered sale of securities and for acting as unregistered broker-dealers. Heath knew about the orders, as he consented to and signed the stipulation for the entry of the D & R Orders.

37. In early 2003, the IRA administrator used by Heath & Associates at the time learned that the D & R Orders had been issued. When the IRA administrator could not obtain assurances from Heath and Heath & Associates that they were complying with the D & R Orders, the IRA administrator stopped accepting any new or additional investments in the PCM Notes. As a result, in March 2003, the IRA administrator sent a certified letter to investors notifying them of the two D & R Orders. In response, Heath & Associates sent a letter to the same investors and falsely represented that its future solicitations would comply with California state securities laws and would be made through NASD licensed broker-dealers. Defendants never have complied with the D & R Orders, and continue to be unlicensed, to use unlicensed brokers, and to engage in an

unregistered offering.

38. In addition, after March 2003, Heath and O'Brien repeatedly downplayed the significance of the D & R Orders or falsely represented to investors that they did not apply to the PCM Notes offering. They claimed that defendants were not selling securities. Heath also told the IRA administrator that the D & R Orders were unrelated to the PCM Fund, and that they should not have been on his record, but that it would cost too much to have them "wiped off." Heath told an investment adviser, who was trying to get information for an investor, that the D & R Orders were inapplicable because he was operating under an exemption as "the issuer" and he was not "brokering the deal." Similarly, O'Brien also told investors that the letter from the IRA administrator should not have been sent to all investors because the D & R Orders only affected approximately 14 new investments. In addition, O'Brien told at least one investor that the DOC had issued the D & R Orders because an investor had complained that she should get her money back because PCM had failed to file a form with the DOC.

5. <u>The IRA Administrators Did Not Approve The Offering</u>

39. Heath & Associates has used two different IRA Administrators during the course of the PCM Notes offering. Heath and O'Brien repeatedly have misrepresented the role that the IRA administrators played in the offering. They have told prospective and existing investors that the IRA administrators have performed due diligence for the protection of investors. The two IRA administrators, however, have never conducted "due diligence" or approved the PCM Notes in any way.

6. <u>PCM And The PCM Fund Are Not California Business Entities</u>

40. Heath and O'Brien represent to investors that PCM and the PCM Fund are California legal business entities. O'Brien represented to at least one investor that PCM is a California corporation. The PPM provided to the IRA

administrators represents that the PCM Fund is a California limited liability corporation. Neither representation is true. Neither PCM nor the PCM Fund are, or have ever been, registered as California legal business entities.

D. <u>Heath's And O'Brien's Scienter</u>

41. As the principal officer and control person of defendant entities, Heath knew, or was reckless in not knowing, that (1) the PCM Notes offering was an apparent Ponzi scheme because he gave the IRA administrators the PPM and controlled PCM's bank accounts; (2) the PCM Notes were not liquid because he personally participated in tactics designed to delay investors' liquidations of their accounts; (3) the PCM Notes were not secured and safe because he did not cause UCC-1 financing statements to be filed in order to perfect collateralized loans purportedly made by PCM and the PCM Fund; (4) he failed to disclose the D & R Orders and misrepresented their applicability to the PCM Notes offering; (5) the IRA administrators did not conduct "due diligence" on the PCM Notes; and (6) PCM and the PCM Fund have never been California corporate entities.

42. O'Brien, a Heath & Associates director, also knew, or was reckless in not knowing, that (1) the PCM Notes are not liquid because he has failed to disclose to investors that their Notes renew automatically and that "premature" redemptions are not permitted; (2) the D & R Orders are not disclosed to investors; and (3) Heath & Associates, Heath, PCM and the PCM Fund are misrepresenting their compliance with the D & R Orders.

43. As a sales agent offering and selling securities, O'Brien had an affirmative duty, and was required, to conduct an independent investigation related to the PCM Notes. Appropriate due diligence would have revealed to him the true nature of the PCM Notes offering, including the apparent Ponzi scheme, the lack of liquidity, and the D & R Orders. O'Brien, however, did not conduct any independent investigation regarding his and other sales agents' representations about the PCM Notes to investors. Indeed, O'Brien has admitted to one investor

that he did not know, nor did he need to know, how investor funds were used.

FIRST CLAIM FOR RELIEF

UNREGISTERED OFFER AND SALE OF SECURITIES

Violations of Sections 5(a) and 5(c) of the Securities Act

44. The Commission realleges and incorporates by reference paragraphs 1 through 43 above.

45. The defendants, and each of them, by engaging in the conduct described above, directly or indirectly, made use of means or instruments of transportation or communication in interstate commerce or of the mails, to offer to sell or to sell securities, or to carry or cause such securities to be carried through the mails or in interstate commerce for the purpose of sale or for delivery after sale.

46. No registration statement has been filed with the Commission or has been in effect with respect to the offerings alleged herein.

47. By engaging in the conduct described above, each of the defendants violated, and unless restrained and enjoined will continue to violate, Sections 5(a) and 5(c) of the Securities Act, 15 U.S.C. §§ 77e(a) and 77e(c).

SECOND CLAIM FOR RELIEF

FRAUD IN THE OFFER OR SALE OF SECURITIES

Violations of Section 17(a) of the Securities Act

48. The Commission realleges and incorporates by reference paragraphs 1 through 43 above.

49. The defendants, and each of them, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails:

a. with scienter, employed devices, schemes, or artifices to defraud;

b. obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

c. engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

50. By engaging in the conduct described above, each of the defendants violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

<u>THIRD CLAIM FOR RELIEF</u>

FRAUD IN CONNECTION WITH THE

PURCHASE OR SALE OF SECURITIES

Violations of Section 10(b) of the Exchange Act

and Rule 10b-5 thereunder

51. The Commission realleges and incorporates by reference paragraphs 1 through 43 above.

52. The defendants, and each of them, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employed devices, schemes, or artifices to defraud;

b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

53. By engaging in the conduct described above, each of the defendants violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that the defendants committed the alleged violations.

II.

Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d), temporarily, preliminarily, and permanently enjoining the defendants and their officers, agents, servants, employees, and attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the order or judgment by personal service or otherwise, and each of them, from violating Sections 5(a), 5(c), and 17(a) of the Securities Act, 15 U.S.C. §§ 77e(a), 77e(c), and 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

III.

Issue, in a form consistent with Fed. R. Civ. P. 65, a temporary restraining order and a preliminary injunction freezing the assets of each of Heath, Heath & Associates, the PCM Fund, PCM, and Private Collateral Management, appointing a receiver over Heath & Associates, the PCM Fund, PCM, and Private Collateral Management, prohibiting each of the defendants from destroying documents, and requiring accountings from each of the defendants.

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IV.

Order each defendant to disgorge all ill-gotten gains from their illegal conduct, together with prejudgment interest thereon.

V.

Order each defendant to pay civil penalties under Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

VI.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VII.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: April 27, 2004

s/ Jose F. Sanchez
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