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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

PAUL N. NICHOLSON and PROFESSIONAL INVESTMENT EXCHANGE, INC.

Defendants.

Case No. SACV11-00546 JVS(RNBx)

COMPLAINT

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

I. SUMMARY

1. This is an offering fraud case. Defendant Paul N. Nicholson ("Nicholson"), a licensed broker, and Defendant Professional Investment

Exchange, Inc. ("PIE"), a private entity, fraudulently raised more than $8 million dollars in two oil-and-gas offerings.

2. From May 2007 until October 2009, Nicholson and PIE (collectively, the "Defendants") raised approximately $8.2 million from investors through two limited partnerships, Energy Opportunity Fund – VI, LLLP and Energy Opportunity Fund – VII, LLLP (collectively, "EOFs VI and VII"). In soliciting investments for EOFs VI and VII, Defendants and their salesmen claimed: (a) earlier Energy Opportunity Funds ("EOFs") earned returns of 15% to 20% annually; (b) investments in EOFs VI and VII were low risk; (c) 75% of investor proceeds would be used for investment in well enhancement and drilling operations; (d) 10% of the money raised would be used to pay sales commissions and finder's fees, and that those amounts would be paid only to licensed issuer-agents or NASD/FINRA broker-dealers; (e) approximately 5% of investor funds would be used to pay administrative expenses; and (f) Radial Jet Recovery ("R-Jet") (a purported well-enhancement technology utilized by Defendants) would increase well output by 300% to 800% for at least eight years.

3. In reality: (a) none of the EOFs generated positive returns; (b) the investments involved a high degree of risk; (c) only 50% of investor funds were used for investment in oil and gas operations; (d) 28% of investor proceeds were used to pay Commissions, and 85% of those commissions were paid to unlicensed sales staff; (e) 13% of investor funds were used to pay administrative expenses and expenses associated with a separate business operated by Nicholson; and (f) R-Jet enhanced wells did not generate output increases of 300% to 800% for any extended period of time.

4. Based on, among other things, their experiences with prior EOFs, Defendants knew or were reckless in not knowing that the projections and disclosures they made to investors were materially misleading.

5. Through their misconduct, Defendants violated Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 (the "Securities Act"), Sections 10(b) and 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), and Rule 10b-5 thereunder.

II. JURISDICTION AND VENUE

6. The Court has jurisdiction over this action under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78(aa)].

7. Defendants, directly or indirectly, made use of the means or instruments of transportation and communication, and the means or instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices, and courses of business alleged herein.

8. Venue is proper under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78(aa)] because certain of the transactions, acts, practices, and courses of business alleged herein took place in the Central District of California.

III. DEFENDANTS AND OTHER RELEVANT ENTITIES

A. Defendants

9. Paul N. Nicholson, age 56, resides in Corona Del Mar, California. During the relevant time, he was the owner and president of PIE. Nicholson has series 7, 24, 39 and 63 securities licenses. Nicholson was also the president and member owner of Macarthur Strategies ("Macarthur"), a FINRA and Commission-registered broker-dealer.

10. Professional Investment Exchange, Inc. is a California corporation with a principal place of business in Irvine, California. It was formed by Nicholson on January 16, 1996 and controlled by him until March 15, 2010. PIE is the managing general partner of EOFs VI and VII. During the period it was

controlled by Nicholson, PIE also operated as an unregistered broker-dealer, using unregistered salespeople to solicit investors for EOFs VI and VII. In March 2010, Nicholson transferred control of PIE to new management.

B. Other Relevant Entities

11. Macarthur Strategies is a California corporation with a principal place of business in Irvine, California. Macarthur was formed by Nicholson in 1990 and was registered with FINRA and the Commission as a broker-dealer. Nicholson deregistered the firm in or about February 2010.

12. Energy Opportunity Fund – VI, LLLP and Energy Opportunity Fund – VII, LLLP are Nevada limited-liability limited-partnerships with principal places of business in Irvine, California.

IV. FACTS

13. From 2007 to 2009, Defendants offered and sold limited partnership interests in EOFs VI and VII to approximately 250 investors nationwide, raising proceeds of approximately $8.2 million. The securities offerings were not registered with the Commission.

14. Private Placement Memoranda ("PPMs") for the offerings claimed that proceeds not used for permissible expenses and commissions would be used to acquire a diverse portfolio of interests in existing oil and natural gas wells, and oil-producing properties. The PPMs also stated that the majority of the invested proceeds would be used to implement the R-Jet technology, which is a technology that is supposed to significantly increase the volume of oil and gas extracted from certain wells.

15. In fact, Defendants misapplied a significant percentage of investor proceeds to pay inflated and undisclosed commissions to unlicensed salespeople, to support Nicholson's broker-dealer (Macarthur), and for other improper purposes. Defendants also made unrealistic predictions about the potential profitability of the

underlying oil and gas operations, while omitting to inform new investors that historically the operations had been almost completely unsuccessful.

A. Sales Practices

16. Defendants used a variety of methods to sell interests in the EOFs, including sales through licensed salespeople associated with Macarthur, unlicensed salespeople employed by PIE, and third-party unregistered salesmen.

17. Nicholson drafted and provided potential investors a "research report" that stated, "EOF's best and biggest investors are professional people: Lawyers, CPA's, registered reps and professionals in the oil industry, most with a breadth of oil investment experience" and "[t]hese investors report that EOF's investment is *not* a typical promoter deal, but the finest transaction they have ever seen and has leveled the playing field for consumer investors by letting them break-through the glass ceiling of success and enjoy major oil company type success."

18. In fact, many of the investors in the EOFs were elderly and retired individuals, and many had no oil-and-gas investment experience. Some of those that did have oil-and-gas investment experience were generally identified as potential sales targets because they had previously invested in oil-and-gas offerings that had been the subject of proceedings by the Commission.

19. Defendants contacted potential investors through cold calls. In these cold calls, Defendants and their sales staff provided projections to investors that had no basis in fact. For example, sales staff working under Defendants' direction told potential investors that earlier EOFs had been earning returns ranging from at least 15% to 20%. These representations were not accurate.

20. In addition, a sales representative working for Defendants falsely told a potential investor that the risk of investing in EOF VII was "so minimal, you can't even see it," and that, if the investor had invested $400,000 in the EOFs two

years earlier, he would probably have had $1 million at the time of the call. These representations were also inaccurate.

B. Material Misstatements and Omissions

21. The PPMs and other communications that Defendants provided to investors for EOFs VI and VII contain material misstatements and omissions relating to: the funds' intent to own and acquire certain assets; the funds' intended use of proceeds; the potential returns from R-Jet; the past failures of R-Jet and of the predecessor EOFs; and Nicholson's regulatory history.

1. Mischaracterization of PIE's Control Over Investor Funds

22. The PPMs suggest that the EOFs and/or PIE would play an active role in acquiring and conducting oil-and-gas operations. For example, the PPMs informed investors that the EOFs had been formed to acquire a "diverse portfolio" of oil-and-gas interests and that PIE would "oversee all aspects of the Fund's business including but not limited to: . . . liaison with drillers and operators . . .; and . . . liaison with geologists, landmen, oil and gas consultants and service providers."

23. In fact, with some small exceptions, Defendants did not plan to use, and did not use investor funds to directly "acquire" oil and gas interests or properties. Rather, the monies designated for EOFs VI and VII were re-invested in entities controlled by third parties (the "RJR sub-partnerships"). As a result, Defendants had no legal control over the use of the re-invested funds, nor the ability to redeploy them to more profitable ventures.

2. Inaccurate Description of Use of Proceeds

24. In the PPMs for EOFs VI and VII, Defendants made representations regarding how investor funds would be used. In reality, however, Defendant's actual use of the $8.2 million raised diverged significantly from the estimates contained in the PPMs.

25. The PPMs estimated that approximately 75% of investor proceeds would be used for investment in R-Jet well enhancement and drilling. In fact, as of October 2009, PIE had disbursed only $4.1 million or 50% of the $8.2 million raised for such activities.

26. The PPMs estimated that 10% of the funds raised would go towards paying sales commissions. In discussing such finder's fees and commissions, the PPMs stated that "In *no case* will such fees or commissions exceed ten percent (10%) of the subscription amount" and "*Only* licensed issuer-agents or [NASD/FINRA] broker-dealers may receive commissions" (emphasis supplied). In fact, as of October 2009, PIE had applied $2.3 million or 28% of investor funds to pay sales commissions to Macarthur ($337,000), to PIE's unlicensed sales staff ($212,000), and to outside promoters ($1.7 million).

27. The PPMs stated that approximately 5% of investor funds would be used to pay various administrative expenses of the EOFs. In fact, as of October 2009, of the $8.2 million raised, PIE had disbursed $1.1 million or 13% of investor funds to pay such expenses and also to cover undisclosed expenses, such as rent payments for Macarthur.

28. As of October 2009, Macarthur, PIE and EOFs VI and VII had disbursed approximately $234,081 directly to Nicholson through a variety of payments and reimbursements, many of which were not disclosed or anticipated in the PPMs.

29. Based on, among other things, their experiences in earlier EOF offerings, at the time Defendants were soliciting investors for EOFs VI and VII, Defendants knew or were reckless in not knowing that the use of proceeds descriptions in the PPMs were, and would be, materially inaccurate.

30. Financial records also show that Defendants were using investor funds from later EOFs to pay expenses of the earlier EOFs. In the PPMs, Defendants

represented that the "operating expenses of the wells will be passed through to the [EOF] at a fixed price," and that PIE "bears the risk of any cost overruns through completion."

31. In fact, Defendants did not maintain contingency reserves for the EOFs and thus did not have sufficient funds to pay expenses. As a result, only a year after Defendants raised $3.5 million through EOF V, the fund had a cash balance of approximately $157,000. To make up for this shortfall, immediately after Defendants started raising new funds through EOF VI in May 2007, they started using those investor proceeds to cover PIE and Macarthur expenses that had previously been covered by EOF V and the earlier EOFs. Defendants did not disclose to investors in EOFs VI and VII that the earlier EOFs were close to insolvency, and that new investors were being burdened with expenses that were unrelated to the EOF in which they had invested.

3. Disclosures/Omissions Regarding Future Prospects and Returns

32. The PPMs for EOFs VI and VII both include a chart with the title "Radial Jet Recovery vs. Traditional" that suggests that returns on R-Jet enhanced wells would increase between approximately 300% and 800%, and would remain at such levels for at least eight years. In fact, historically, very few wells had seen increases in returns at even a fraction of such levels, and those that had done so have only maintained such returns for a couple of months.

33. Defendants also omitted telling investors that earlier EOFs paid only minimal returns. For example, in May 2007, when Nicholson started EOF VI, the preceding fund, EOF V, was more than a year old, but had only generated $32,000 in oil-and-gas income from investments of approximately $3.5 million

4. Misleading Disclosure About Past Regulatory History

34. The PPM for EOF VI, dated April 2, 2007, and PPM for EOF VII, dated March 5, 2008, state that during the past five years no "formal complaint has been filed with the Securities and Exchange Commission, the National Association of Securities Dealers, or any state regulatory agency" concerning Nicholson. The PPMs fail to disclose, however, that in July 2006, the NASD censured Nicholson and fined him $7,500 for failing to establish an escrow account in connection with a private placement offering.

5. Misleading Investment Update Letters

35. Defendants also made material omissions in quarterly update letters sent to investors. In several instances, in the same letters, Nicholson solicited more money from current investors and/or solicited their assistance in identifying new investors. For example:

- In a September 2008 letter to EOF VII investors, Defendants claimed that quarterly checks on certain properties could "explode to over $400,000 from today's $3800" without disclosing that such results were highly improbable, because they depended on completely unrealistic estimates of future oil production. Defendants also failed to disclose various problems, delays and cost overruns, including two well enhancement failures associated with one lease, the postponement of work and cost overruns associated with a second lease and various operational problems with other leases.
- In a March 2009 letter, Defendants stated that "your fund is positioned for greater growth and yield potential than ever before," and that the fund's "design made it quite resilient to risks that may have sunk other oil investments." The same letter describes selected returns on certain fund properties and then makes a "highly hypothetical calculation" of what investors would receive if the current level of production continued. The letter does not disclose, however, that

there was little or no prospect that such returns would continue because initial production levels are not indicative of future production.

FIRST CLAIM

Violations of Section 17(a) of the Securities Act

36. Plaintiff Commission repeats and incorporates paragraphs 1 through 35 of this Complaint by reference as if set forth *verbatim*.

37. Defendants, directly or indirectly, singly or in concert with others, in the offer or sale of securities, by use of the means and instrumentalities of interstate commerce and by use of the mails have: (a) employed devices, schemes, and artifices to defraud; (b) obtained money or property by means of untrue statements of a material fact and omitted 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; and (c) engaged in transactions, practices, and courses of business which operate or would operate as a fraud and deceit upon the purchasers.

38. As a part of and in furtherance of their scheme, Defendants, directly and indirectly, prepared, disseminated, or used contracts, written offering documents, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material facts and misrepresentations of material facts, and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

39. For these reasons, Defendants have violated and, unless enjoined, will continue to violate Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

SECOND CLAIM

Violations of Section 10(b) of the Exchange Act and Rule 10b-5

40. Plaintiff Commission repeats and incorporates paragraphs 1 through 35 of this Complaint by reference as if set forth *verbatim*.

41. Defendants, directly or indirectly, singly or in concert with others, in connection with the purchase or sale of securities, by use of the means and instrumentalities of interstate commerce and by use of the mails have: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of a material fact and omitted 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; and (c) engaged in acts, practices, and courses of business which operate or would operate as a fraud and deceit upon purchasers, prospective purchasers, and any other persons.

42. As a part of and in furtherance of their scheme, Defendants, directly and indirectly, prepared, disseminated, or used contracts, written offering documents, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material facts and misrepresentations of material facts, and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

43. Defendants made the above-referenced misrepresentations and omissions knowingly or with severe recklessness regarding the truth.

44. For these reasons, Defendants violated and, unless 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].

THIRD CLAIM

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

45. Plaintiff Commission repeats and incorporates paragraphs 1 through 35 of this Complaint by reference as if set forth *verbatim.*

46. Defendants, directly or indirectly, singly and in concert with others, have been offering to sell, selling, and delivering after sale, certain securities, and have been, directly and indirectly: (a) making use of the means and instruments of transportation and communication in interstate commerce and of the mails to sell securities, through the use of written contracts, offering documents and otherwise; (b) carrying and causing to be carried through the mails and in interstate commerce by the means and instruments of transportation, such securities for the purpose of sale and for delivery after sale; and (c) making use of the means or instruments of transportation and communication in interstate commerce and of the mails to offer to sell such securities.

47. As described above, the investments described herein have been offered and sold to the public. No registration statements were ever filed with the Commission or otherwise in effect with respect to these securities.

48. For these reasons, Defendants have violated and, unless enjoined, will continue to violate Section 5(a) and (c) of the Securities Act [15 U.S.C. §§ 77e(a) and (c)].

FOURTH CLAIM

Violations of Section 15(a) of the Exchange Act

49. Plaintiff Commission repeats and incorporates paragraphs 1 through 35 of this Complaint by reference as if set forth *verbatim.*

50. Defendants, by engaging in the conduct described above, directly or indirectly, made use of the mails or means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to induce, the purchase or

sale of securities, without being registered as a broker or dealer, or being associated with a registered broker or dealer in accordance with Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

51. Accordingly, Defendants were brokers within the definition of that term in Section 3(a)(4) of the Exchange Act which defines "broker" as any person "engaged in the business of effecting transactions in securities for the account of others." Defendant PIE was never so registered and acted as a broker. Defendant Nicholson acted as an unregistered broker when he sold interests in the funds through PIE.

52. For these reasons, Defendants violated and, unless enjoined, will continue to violate, Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

RELIEF REQUESTED

Plaintiff Commission respectfully requests that the Court:

I.

Permanently enjoin Defendants from violating: (i) Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)]; (ii) Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 of the Exchange Act [17 C.F.R. § 240.10b-5]; (iii) Section 5(a) and (c) of the Securities Act [15 U.S.C. §§ 77e(a) and (c)]; and (iv) Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

II.

Order Nicholson to disgorge an amount equal to the funds and benefits he obtained illegally, or to which he is otherwise not entitled, as a result of the violations alleged, plus prejudgment interest on that amount.

III.

Order Nicholson to pay civil monetary penalties in an amount determined appropriate by the Court pursuant to Section 20(d) of the Securities Act [15 U.S.C.

§ 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)] for the violations alleged herein.

IV.

Order such further relief as this Court may deem just and proper.

Dated: April 8, 2011

Respectfully submitted,

s/ John B Bulgozdy
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