

GAM

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

PAUL W. SMITH,

Defendant.

17 5480

Civil Action No. _____

COMPLAINT

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

SUMMARY

1. This matter involves a fraudulent securities offering and investment advisory fraud conducted by Paul W. Smith, a registered representative who deceived and defrauded investors for nearly 25 years.

2. From 1991 through October 2016, Smith raised approximately \$2.35 million from approximately 30 investors by representing that he would invest their money in publicly traded securities through The Haverford Group ("Haverford"), a partnership that Smith formed to serve as a pooled investment vehicle.

3. Smith convinced some of his most trusting and vulnerable brokerage customers, many of them retired or elderly, to invest their money in Haverford while knowing the investment was not legitimate, that he would not use all of their money to purchase securities on their behalf as promised, and instead would use most of their money to repay other investors and for his own personal use.

A TRUE COPY CERTIFIED TO FROM THE RECORD
DATED: DEC -7 2017
TEST: Steve Tomas
DEPUTY CLERK, UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF PENNSYLVANIA

4. Smith went to great lengths to conceal his scheme. He fabricated phony account statements that reflected fictitious account balances and gains, kept his and Haverford's activities and accounts hidden from his employers, and used money from investors to repay others, so as to avoid suspicion.

5. Smith's scheme collapsed in October 2016 when an investor he failed to repay complained to the police.

6. By knowingly or recklessly engaging in the conduct described in this complaint, Smith violated Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act"), 15 U.S.C. §§ 80b-6(1), 80b-6(2), and 80b-6(4), and Rule 206(4)-8 thereunder, 17 C.F.R. § 206(4)-8.

7. The Commission seeks (i) to enjoin Smith from engaging in the transactions, acts, practices, and courses of business alleged in this Complaint, (ii) disgorgement of ill-gotten gains from the unlawful conduct set forth in this Complaint, together with prejudgment interest, and (iii) such other relief as the Court may deem appropriate.

JURISDICTION AND VENUE

8. The Commission brings this action pursuant to Section 20(b) of the Securities Act, 15 U.S.C. § 77t(b), Section 21(d) of the Exchange Act, 15 U.S.C. § 78u(d), and Section 209(d) of the Advisers Act, 15 U.S.C. § 80b-9(d), to enjoin acts, transactions, practices, and courses of business, and to obtain disgorgement, prejudgment interest, and such other and further relief as the Court may deem just and appropriate.

9. The Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), Sections 21(e) and 27 of the Exchange Act, 15 U.S.C. §§ 78u(e) and 78aa, and Section 214 of the Advisers Act, 15 U.S.C. § 80b-14.

10. Venue lies in this judicial district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and Section 214 of the Advisers Act, 15 U.S.C. § 80b-14. Among other things, a substantial part of the acts, transactions, events, or omissions giving rise to the violation of the federal securities laws alleged herein occurred within the Eastern District of Pennsylvania. Smith resides in the district, and was present in this district for acts alleged herein.

DEFENDANT

11. Smith, age 63, is a resident of Wayne, Pennsylvania. Smith worked in the securities industry as a registered representative since 1982. From May 2007 to February 2017, Smith was a registered representative with Broker-Dealer-1, a broker-dealer registered with the Commission. Since 1991, Smith has acted as Haverford's investment adviser. In contravention of Broker-Dealer-1's policies and procedures, Smith did not inform Broker-Dealer-1 about Haverford, or his role as its adviser.

FACTS

I. Background and Formation of Haverford

12. In or around 1990, Smith formed Haverford as a partnership designed to serve as a pooled investment vehicle. In 1991, he began approaching prospective investors about making securities investments through the purchase of interests in the Haverford partnership.

13. Investors in Haverford generally were unsophisticated, and were retirees, elderly individuals, friends from Smith's country club, and longtime brokerage customers who trusted

Smith and relied on his representations regarding Haverford's supposed investment strategy and the risks involved.

14. In a document Smith created, "The Haverford Group Subscription Agreement & Disclosure Document" (the "Subscription Agreement"), Smith pitched Haverford as being "formed to make investments" and "provide [investors] with a high level of current income and capital appreciation as is consistent with the preservation of capital and the maintenance of liquidity."

15. Smith told prospective investors that Haverford's profits would be derived from Smith's supposed ability to acquire securities from issuers at a discount and sell those securities on the open market for a profit.

16. The Subscription Agreement also described Haverford's purported strategy: "The Partnership intends to participate in stock purchase and dividend reinvestment plans in which securities may be purchased directly from the issuer at a discount to their market value and simultaneously sold to capture the discount in the form of capital gain."

17. Smith orally told prospective investors that investing in Haverford generated steady and dependable returns.

18. When people invested in Haverford, they gave Smith sole discretion and authority to trade for Haverford. Many signed formal "Trade Authorizations," and all understood that Smith would invest on their behalf without their participation or input.

19. Smith made all decisions for Haverford concerning the use of investors' money and operated Haverford without any participation by any of its investors.

20. The Subscription Agreement contained a provision for Smith's purported "Management Fees and Expenses." The provision called for a "management fee" of "1/2 of 1%

of the average daily net assets” if Haverford outperformed the average yield on 30-day U.S. Treasury Bills. The Subscription Agreement also set forth an “entry fee” that would be “restored to the Partner’s account” by reducing management fees.

21. Smith charged an “entry fee” to several of the initial investors in Haverford, as indicated in the account statements he created.

22. After deciding to invest in Haverford, investors generally would write checks made out to Haverford, mail or hand them to Smith, and Smith would deposit those checks in Haverford’s checking account.

23. In several instances, customers made investments in Haverford with money that they held through Broker-Dealer-1. In those instances, Smith had Broker-Dealer-1 issue and mail checks to his customers, who would then write personal checks to Haverford. This helped to mask Haverford’s existence from Broker-Dealer 1.

II. Smith Operated Haverford in the Nature of a Ponzi Scheme

24. In the beginning, Smith made a few investments on behalf of Haverford. These limited investments aside, Smith used investors’ money to pay prior investors who requested partial or full liquidation of their accounts, including false returns on their investments, and for his own personal expenses. Smith liquidated the brokerage account in June 2011 and has not made an investment on behalf of Haverford since.

25. In order to conceal the fraud, Smith created and mailed to investors fraudulent and fictitious quarterly account statements. The statements indicated deposits and withdrawals made by an investor, represented that certain monthly “credits” were made to his/her account (attributable to supposed gains from investments), and provided a purported monthly account balance.

26. Smith also mailed to investors purported yearly income statements for tax purposes that claimed to show investment gains broken down between taxable and non-taxable gains.

27. However, Smith had not invested the money entrusted to him as he represented he would. The “credits” on the account statements attributable to supposed investment gains—and therefore the purported account balances—were made up by Smith.

28. Many investors invested additional funds after receiving these fake statements.

29. Smith generally kept Haverford’s checking account at a near-zero balance. After Smith liquidated the brokerage account, all new money from investors was used to repay other investors or for Smith’s personal use.

30. For example, in spring 2011, an investor wanted to withdraw his \$409,000 investment in Haverford, which included his principal and supposed investment gains. At the time, Haverford’s assets consisted of about \$100 in its checking account and \$53,000 worth of securities in the brokerage account.

31. Over the course of approximately six weeks, Smith raised \$390,000 of new money from unwitting investors and liquidated the brokerage account.

32. Smith paid the \$409,000 to the investor and wrote himself a check for \$20,000, which he deposited into his personal bank account for his own use.

33. In another instance, Smith needed approximately \$84,000 to repay an investor her principal and supposed investment gains. To repay this person, Smith raised new money from other investors. Two days after paying her, Smith wrote himself a check from Haverford’s checking account for \$5,000 and deposited it into his personal bank account for his own use.

34. Smith wrote at least \$247,400 worth of checks to himself from Haverford's checking account, which he deposited into his personal bank accounts and used for personal expenses. Smith also deposited approximately \$195,800 from his personal accounts into Haverford's checking account—often when an investor was seeking a return of his or her investment and funds from Haverford were not available. This had the effect of allowing the fraud to continue undetected.

III. Smith's Scheme Unravels

35. In July 2016, one of Smith's investors, a 79-year-old retired nurse, requested that Smith return her principal plus investment gains to her—a purported total of about \$126,460. However, Smith had not invested any of her money. As with other investors, Smith had taken the money for his personal use and to repay other investors.

36. In October 2016, having run out of money to continue to the fraud, Smith admitted to the investor's son that there was "no money" available to pay her. The investor then filed a complaint with her local police department, which contacted the Commission.

IV. The Extent of the Fraud

37. Smith took approximately \$2.35 million from investors, though he used a large portion of that amount to pay investors their principal and supposed "gains" as they exited their investments in Haverford.

38. Eighteen investors were still invested in Haverford when Smith's scheme unraveled. Those 18 investors made approximately \$1.21 million in principal investments and received payments from Haverford totaling approximately \$327,000. Those investors lost approximately \$886,000 of principal. Out of those 18 investors, 10 made principal investments within the last five years. The total amount that those 10 invested in the last five years, less amounts returned to them during the same period, is approximately \$318,025.

V. Smith Violated the Federal Securities Laws

39. The interests in Haverford sold by Smith to investors are securities within the meaning of both the Securities Act and the Exchange Act.

40. Smith was Haverford's investment adviser.

41. Smith engaged in the conduct described herein by use of the means or instruments of transportation or communication in interstate commerce, the instrumentalities of interstate commerce, and/or by use of the mails.

42. Smith made material untrue statements 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. A reasonable investor would consider the misrepresented facts and omitted information—including, among other items, misrepresentations and omissions regarding the lack of actual investments by Haverford, the use of Haverford's money for Smith's personal expenses, and using new investments to repay prior investors—important in deciding whether or not to purchase the Haverford securities.

43. The untrue statements and omissions 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 described herein were made in connection with and in the offer, purchase, or sale of securities and were made to investors or prospective investors in Haverford, a pooled investment vehicle.

44. In connection with the conduct described herein, Smith acted knowingly, recklessly, or negligently. Among other things, Smith knew, was reckless, or should have known that he was making material misrepresentations and omitting to state material facts necessary to make certain statements not misleading under the circumstances in connection with the offer and sale of the Haverford securities.

45. Smith was the maker of the false and misleading statements. Among other things, Smith spoke to investors, created the Subscription Agreements given to investors, and fabricated and distributed the false account and tax statements.

46. Smith obtained money or property from investors through his material untrue statements and omissions 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. Smith obtained approximately \$2.35 million in principal investments from investors, which includes approximately \$886,000 in principal investments lost by the current investors in Haverford due to Smith's fraud.

47. Smith used devices, schemes, and artifices to defraud Haverford and investors in Haverford, and engaged in acts, transactions, practices, or courses of business that operated as a fraud or deceit upon Haverford and the investors in Haverford. Among other things, Smith used Haverford's assets as his own, misled investors as to nearly every aspect of Haverford's operations, and took careful steps to hide his scheme by fabricating account statements and other documents.

FIRST CLAIM FOR RELIEF
(Violations of Section 17(a) of the Securities Act)

48. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 49 inclusive, as if they were fully set forth herein.

49. As a result of the conduct alleged herein, Defendant Smith knowingly or recklessly, in the offer or sale of securities, directly or indirectly, by the use of the means or instruments of transportation or communication in interstate commerce, or the mails:

- a. knowingly or recklessly employed devices, schemes, or artifices to defraud;

- b. knowingly, recklessly, or negligently obtained money or property by means of any untrue statements of material fact, or 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; or
- c. knowingly, recklessly, or negligently engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchasers of securities.

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

SECOND CLAIM FOR RELIEF

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

51. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 49, inclusive, as if they were fully set forth herein.

52. As a result of the conduct alleged herein, Defendant Smith knowingly or recklessly, in connection with the purchase or sale of securities, directly or indirectly, by use of the means or instrumentality of interstate commerce or of the mails, or a facility of a national securities exchange:

- a. employed devices, schemes, or artifices to defraud;
- b. made untrue statements of material fact, or 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; and

- c. engaged in acts, practices or courses of business which operated or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

53. By engaging in the foregoing conduct, Defendant Smith 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.

THIRD CLAIM FOR RELIEF

(Violations of Sections 206(1) and 206(2) of the Advisers Act)

54. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 49, inclusive, as if they were fully set forth herein.

55. As a result of the conduct alleged herein, Defendant Smith, while acting as Haverford's investment adviser, knowingly or recklessly by the use of the means and instrumentalities of interstate commerce and of the mails, directly or indirectly,:

- a. employed devises, schemes, or artifices to defraud his client or prospective client; and
- b. engaged in transactions, practices, or courses of business which operated as a fraud or deceit upon his client or prospective client.

56. By engaging in the foregoing conduct, Defendant Smith violated, and unless restrained and enjoined will continue to violate, Sections 206(1) and 206(2) of the Advisers Act, 15 U.S.C. §§ 80b-6(1) and 80b-6(2).

FOURTH CLAIM FOR RELIEF

(Violation of Section 206(4) and Rule 206(4)-8 Thereunder)

57. The Commission realleges and incorporates by reference each and every allegation in paragraphs 1 through 49, inclusive, as if they were fully set forth herein.

58. As a result of the conduct alleged herein, Defendant Smith, while acting as an investment adviser to the pooled investment vehicle Haverford, knowingly or recklessly by the use of the means and instrumentalities of interstate commerce and of the mails, directly or indirectly:

- a. made untrue statements of material facts or omitted to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; and
- b. otherwise engaged in acts, practices, or courses of business that were fraudulent, deceptive, or manipulative with respect to investors or prospective investor in the pooled investment vehicle.

59. By engaging in the foregoing conduct, Defendant Smith violated, and unless restrained and enjoined will continue to violate, Section 206(4) of the Advisers Act, 15 U.S.C. §§ 80b-6(4), and Rule 206(4)-8 thereunder, 17 C.F.R. § 206(4)-8.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

- A. Permanently restrain and enjoin Defendant Smith from violating Section 17(a) of the Securities Act, 15 U.S.C § 77q(a), 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, and Sections 206(1), 206(2), and 206(4) of the Advisers Act, 15 U.S.C. §§ 80b-6(1), 80b-6(2), 80b-6(4), and Rule 206(4)-8 thereunder, 17 U.S.C. § 206(4)-8;
- B. Order Defendant Smith to disgorge any and all ill-gotten gains derived from his unlawful conduct, together with prejudgment interest thereon;

C. Retain jurisdiction of this action for purposes of enforcing any final judgment and orders; and

D. Grant such other and further relief as this Court may deem just and appropriate.

Dated: December 7, 2017
Philadelphia, Pennsylvania

Respectfully submitted,



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