

**UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF OHIO**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MICHAEL A. BODANZA and  
PREFERRED FINANCIAL HOLDINGS CO., LLC,

Defendants,

and

PREFERRED DRILLING CO., LLC,  
PREFERRED FINANCIAL INVESTMENT CO., LLC,  
PREFERRED FINANCIAL LEASING CO., LLC, AND  
PREFERRED WELL MANAGEMENT CO., LLC,

Relief  
Defendants.

Civil Action No. 1:12-CV-1954

**COMPLAINT**

Plaintiff, the United States Securities and Exchange Commission (“SEC”), alleges as follows:

**SUMMARY**

1. This matter involves fraudulent misrepresentations and omissions in connection with the unregistered offer and sale of securities by Michael A. Bodanza (“Bodanza”), the former chief financial officer and a founding member of Preferred Financial Holdings Co., LLC (“Preferred Holdings”), a company formed in 2006 to engage in oil and gas exploration, drilling, and leasing through operating subsidiaries.

2. From June 2007 to August 2010, Bodanza and Preferred Holdings raised at least \$6,769,635 from at least 61 investors through the sale of unregistered Preferred Holdings promissory notes.

3. During this period, Preferred Holdings experienced through its operating subsidiaries a series of material operational problems and suffered significant losses, including net losses of \$1.0 million in 2007, \$2.2 million in 2008, \$1.8 million in 2009, and \$1.3 million in 2010, according to consolidated financial statements prepared in 2011.

4. Bodanza nonetheless depicted Preferred Holdings' oil and gas operations in a positive light and failed to disclose to most investors that the company had suffered significant losses from 2007 through 2010.

5. Further, Bodanza failed to disclose the following material facts to several investors:

- a. Preferred Holdings removed one of its founding members and its chief operating officer in early 2008 and sued him for causing Preferred Holdings to suffer between \$3 million to \$4 million in damages.
- b. The only drilling rig held by Preferred Holdings' drilling subsidiary suffered an irreparable breakdown in August 2008.
- c. Preferred Holdings was embroiled in an insurance coverage dispute to recover \$1 million in losses and expenses incurred as a result of the rig breakdown.
- d. Preferred Holdings' drilling subsidiary incurred \$260,000 in drilling expenses above its original cost estimates in connection with a significant joint venture in 2009.

e. Preferred Holdings' subsidiary had failed to acquire certain property in Tennessee that could be used to drill and sell gas from its own producing wells.

6. Finally, Bodanza also failed to disclose to at least three individuals who purchased promissory notes in 2010 that their investment proceeds would be used to make payments to other investors.

7. Preferred Holdings has failed to repay most of the investors whose notes have come due and is unable to pay the remaining investors.

8. Preferred Holdings' subsidiaries, Preferred Drilling Co., LLC ("Preferred Drilling"), Preferred Financial Investment Co., LLC ("Preferred Investment"), Preferred Financial Leasing Co., LLC ("Preferred Leasing"), and Preferred Well Management Co., LLC ("Preferred Management") (collectively, "Relief Defendants"), received or benefited from the investor funds raised by Bodanza and Preferred Holdings.

9. Based on the above, the SEC seeks: (a) an order of permanent injunction against Bodanza and Preferred Holdings for violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)] and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; (b) disgorgement, plus prejudgment interest, against Bodanza, Preferred Holdings, and the Relief Defendants; and (c) civil penalties against Bodanza.

#### **DEFENDANTS**

10. **Michael A. Bodanza.** Bodanza, age 45, resides in Cuyahoga Heights, Ohio. Bodanza is one of the founding members, a 12% owner, and the former chief financial officer of Preferred Holdings. From May 2002 through October 2006, Bodanza was a registered representative associated with a broker-dealer registered with the Commission, and, from

May 2005 through October 2006, Bodanza was an investment adviser representative associated with an investment adviser registered with the Commission. While associated with the broker-dealer and investment adviser, Bodanza also provided financial services through Preferred Financial Services, Inc. (“Preferred Services”).

11. **Preferred Holdings.** Preferred Holdings is an Ohio limited liability company with its principal place of business in Cuyahoga Heights, Ohio. Preferred Holdings was formed by Bodanza and three other individuals in September 2006 for the purpose of operating as a holding company to own 100% of membership interests in operating subsidiaries engaged in various oil and gas businesses.

12. **Preferred Drilling.** Preferred Drilling (f/k/a Direct Drilling Co., LLC) is an Ohio limited liability company with its principal place of business in Cuyahoga Heights, Ohio. Preferred Drilling is an operating subsidiary of Preferred Holdings that was formed in September 2006 to operate as a contract drilling company.

13. **Preferred Investment.** Preferred Investment is an Ohio limited liability company with its principal place of business in Cuyahoga Heights, Ohio. Preferred Investment is an operating subsidiary of Preferred Holdings that was formed in September 2006 to manage rights acquired in oil and gas wells.

14. **Preferred Leasing.** Preferred Leasing is an Ohio limited liability company with its principal place of business in Cuyahoga Heights, Ohio. Preferred Leasing is an operating subsidiary of Preferred Holdings that was formed in September 2006 to manage oil and gas leases, pipeline, and other infrastructure.

15. **Preferred Management.** Preferred Management is an Ohio limited liability company with its principal place of business in Cuyahoga Heights, Ohio. Preferred Management

is an operating subsidiary of Preferred Holdings that was formed in April 2010 to manage production of various oil and gas wells that previously were acquired as a result of a settlement with one of Preferred Holdings' founding members.

### **JURISDICTION**

16. The Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa]. Venue is proper in this Court 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].

17. The acts, transactions, practices, and courses of business constituting the violations alleged herein occurred within the jurisdiction of the United States District Court for the Northern District of Ohio and elsewhere.

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

### **FACTS**

#### **Bodanza's Background**

19. From 1991 to the present, Bodanza provided a variety of financial services to clients through Preferred Services, including insurance, tax preparation, and financial planning services.

20. During much of this time period, Bodanza also was associated with various entities registered with the Commission. From May 2002 through October 2006, Bodanza was a registered representative associated with a registered broker-dealer, and, from May 2005 through October 2006, Bodanza was associated with a registered investment adviser. Through these

entities, Bodanza provided brokerage and investment advisory services to his Preferred Services clients. After October 2006, another registered representative took over the brokerage accounts maintained by most of Bodanza's Preferred Services clients. However, Bodanza continued to provide insurance, tax preparation, and financial planning services to his Preferred Services clients.

### **Preferred Holdings' Inception and Initial Offering**

21. In or around August 2006, Bodanza began engaging in discussions about forming an oil and gas startup company. Bodanza and three other individuals, Founding Member A, Founding Member B, and Founding Member C, formed Preferred Holdings in September 2006. Preferred Holdings was formed for the purpose of operating as a holding company that would own 100% of membership interests in three operating subsidiaries, Preferred Drilling, Preferred Investment, and Preferred Leasing, which were formed at the same time as Preferred Holdings for the purpose of engaging in various oil and gas businesses.

22. At the time that Preferred Holdings was formed, it was intended that Bodanza would serve as its chief financial officer and would be responsible for raising funds and monitoring cash flows. Founding Member A was to act as Preferred Holdings' chief executive officer and would oversee the company. Founding Member B was not assigned a particular role, but it was contemplated that he would be a significant investor in Preferred Holdings. Founding Member C, the only founding member with any experience in the oil and gas industry, was to function as Preferred Holdings' chief operating officer and would manage the day-to-day operations.

23. Shortly after Preferred Holdings and its operating subsidiaries were formed, Preferred Holdings began the process of raising capital to fund the company's operations. Preferred Holdings prepared a private placement memorandum, investor questionnaire, and

subscription agreement for an offering which was to run from November 8, 2006 to, at the latest, June 30, 2007 (the “Initial Offering”). The Initial Offering was structured such that investors could purchase either equity membership units or promissory notes that had a five-year term and paid 10% interest annually. On November 29, 2006, Preferred Holdings filed a Form D with the Commission, claiming a registration exemption under Rule 506 of Regulation D of the Securities Act.

24. Bodanza was responsible for Preferred Holdings’ capital-raising efforts during the Initial Offering. Beginning in November 2006, Bodanza began approaching potential investors, almost all of whom were current or former Preferred Financial Services clients, and offering them the opportunity to participate in the Initial Offering. Bodanza told prospective investors that Preferred Holdings was an oil and gas startup company that was going to acquire interests in producing wells, engage in contract drilling, and manage and operate oil and gas infrastructure (e.g., pipelines and wells). Bodanza further explained that funds raised during the Initial Offering would be used by Preferred Holdings as operating capital.

25. Prospective investors were provided with a copy of a 41-page private placement memorandum that summarized the company’s business plan and operating agreement, discussed an assortment of potential risk factors, and explained the terms of the offering. The private placement memorandum also contained financial projections created by Bodanza that projected initial startup costs of \$5 million and more than \$15 million in revenues within six years.

26. Between November 8, 2006 and June 30, 2007, Bodanza sold \$1,403,000 in equity membership units and \$1,799,066 in promissory notes to 25 different investors. According to questionnaires filled out by prospective investors, all of the investors who

participated in the Initial Offering qualified as either “accredited” or “sophisticated” investors under Regulation D of the Securities Act.

**Preferred Holdings Suffers a Series of Significant Operational Problems**

27. In late 2006 or early 2007, Preferred Holdings commenced operations and began using funds raised through the Initial Offering to purchase assets for contract drilling as well as oil and gas production. Beginning in late 2007, however, Preferred Holdings experienced a series of significant operational problems.

28. *Fallout and Litigation with Founding Member C.* Founding Member C managed the day-to-day operations of the company and, among other things, entered into a contract drilling arrangement with an oil and gas production company owned by Founding Member C. In the third quarter of 2007, Bodanza, Founding A, and Founding Member B began questioning Founding Member C’s management of Preferred Holdings. The company’s drilling operations had been hampered by expense overruns and a series of minor rig breakdowns. At the same time, Founding Member C had not been able to secure the drilling contracts that he had promised to deliver. In fact, the only work that any Preferred Holdings subsidiary had performed up to that point in time was contract drilling for Founding Member C’s company, but his company had not remitted payment to Preferred Holdings for any of the work.

29. Concerned about these issues, Bodanza, Founding Member A, and Founding Member B conducted an initial inquiry into Preferred Holdings’ operations in late 2007 and, based on that inquiry, removed Founding Member C from control of Preferred Holdings’ day-to-day operations in the first quarter of 2008. Bodanza, Founding Member A, and Founding Member B then performed a thorough review of the company’s books, records, and financial position and determined that Founding Member C had caused at least \$3 million to \$4 million in

damages to Preferred Holdings through, among other things, unpaid drilling invoices, unaccounted for cash transfers, lost revenue, unanticipated expenses, and reputational damage.

30. Preferred Holdings initiated litigation against Founding Member C in July 2008 that ultimately was resolved through a settlement in October 2008. However, the only compensation received by Preferred Holdings in the settlement was interests in wells owned by Founding Member C's company which Preferred Holdings valued to be worth at most \$500,000.

31. ***Irreparable Rig Breakdown and Ensuing Insurance Arbitration.*** In August 2008, the only operating drilling rig owned by Preferred Drilling suffered an irreparable breakdown. Prior to concluding that the damage was irreparable, Preferred Holdings incurred considerable costs removing and attempting to repair the rig. Moreover, Preferred Drilling's only revenue stream was severed because the company was unable to perform any contract drilling while the rig was being replaced.

32. Preferred Holdings submitted a \$1 million claim to its insurance carrier to pay for the cost of a replacement rig and to recover its losses and expenses due to the rig breakdown. However, the carrier was willing to pay only \$260,000, and Preferred Holdings was forced to arbitrate the remainder of its claim. The arbitration process lasted until 2010 and concluded with only \$300,000 in additional funds being paid on the claim, such that Preferred Holdings received no reimbursement for the remaining \$500,000 in losses and expenses.

33. ***Cost Overruns on Joint Venture.*** In April 2009, Preferred Investment entered into an agreement to invest in five wells for Corporation X in exchange for a minority ownership interest in each well, and Preferred Drilling entered into an agreement to drill the five wells. Preferred Holdings estimated that it could complete the wells in a few months at a total cost of

approximately \$200,000. Due to a series of problems associated with the drilling, however, completion of the wells was delayed to November 2009 and came at a total cost of \$460,000.

34. ***Problems with the Acquisition of Properties in Tennessee.*** Preferred Holdings' initial business plan called for the acquisition of certain property in Tennessee that Preferred Holdings would use to drill and operate its own producing wells. In or around the second quarter of 2007, Preferred Holdings entered into an agreement to acquire a property in Tennessee. However, the acquisition could not be completed because the owner was unable to provide a clear title, and Preferred Holdings lost a \$25,000 deposit because of this failed transaction.

35. More than one year later, Preferred Leasing finally acquired a leasehold in Tennessee. However, the leasehold that Preferred Holdings acquired did not actually cover the land that Preferred Holdings wanted to develop. In addition, a pipeline restriction imposed by an oil and gas utility company prevented Preferred Holdings from selling the gas that it had mined from this property.

36. ***Resulting Operating Losses.*** Each of the problems discussed above significantly impacted Preferred Holdings' profitability and its prospects going forward. The company's consolidated financial statements prepared in 2011 reflect a net loss of \$1.0 million in 2007, a net loss of \$2.2 million in 2008, a net loss of \$1.8 million in 2009, and a net loss of \$1.3 million in 2010.

#### **The Offer and Sale of Unregistered Promissory Notes**

37. Almost immediately after the completion of the Initial Offering, Preferred Holdings faced a cash shortage and required additional financing to continue its operations. Without consulting any outside advisors, Bodanza decided to sell promissory notes similar to those sold during the Initial Offering as needed to fund the company's operations.

38. Between July 2007 and August 2010, Bodanza sold at least \$6,769,635 in Preferred Holdings promissory notes to at least 61 different investors (the “Later Notes”). The other founding members did not participate in the sale of the Later Notes.

39. Almost all of the investors who purchased the Later Notes were either current or former clients of Preferred Services. The substantial majority of Later Note investors had not participated in the Initial Offering, and most did not qualify as “accredited” investors under Regulation D of the Securities Act. The Later Notes bore annual interest rates ranging from 8% to 10% and varied in term from a few months to a few years.

40. The only documentation that Bodanza and Preferred Holdings provided to most Later Note investors was a copy of the note itself. None of the Later Note investors was given an offering memorandum or any type of company financial statements.

#### **Misrepresentations and Omissions Made During the Later Offering**

41. When soliciting the Later Notes investors, Bodanza discussed Preferred Holdings’ current oil and gas operations in a positive light. He provided information regarding what the company intended to do going forward and portrayed the Later Notes as a sound investment. Bodanza did not disclose to many Later Notes investors the company’s losses and the operational problems that had caused them.

42. Bodanza did not disclose to many investors that Founding Member C, the only founding member with any prior experience in the oil and gas business, had been removed from his position with the company and had been sued for causing Preferred Holdings to suffer between \$3 million to \$4 million in damages.

43. Similarly, Bodanza failed to disclose to some Later Note investors that Preferred Holdings’ only drilling rig had suffered an irreparable breakdown and that Preferred Holdings

was embroiled in an insurance coverage dispute to recover \$1 million in losses and expenses incurred as a result of the rig breakdown.

44. Further, Bodanza touted the Corporation X joint venture as a positive relationship for Preferred Holdings, but failed to disclose to a number of investors that Preferred Drilling incurred \$260,000 in drilling expenses above its original cost estimates in connection with a significant joint venture in 2009.

45. Finally, Bodanza promoted Preferred Holdings' intention to drill in Tennessee as one of the company's core business plans, but did not disclose to a number of investors the numerous problems that Preferred Holdings had encountered during its efforts to acquire and sell gas from property in Tennessee.

46. In addition to the above, Bodanza also failed to disclose to at least three individuals who purchased Later Notes in 2010 that their investment proceeds would be used to make payments to other investors.

#### **Current Status of Preferred Holdings**

47. Preferred Holdings did not disclose to most investors until early 2011 the operational problems and losses of its subsidiaries. In February 2011, Preferred Holdings sent investors a "status report" that provided historical information about the company and mentioned some of the operational setbacks and problems discussed above. The letter also disclosed that the company raised \$3 million in connection with the Initial Offering and \$4.5 million in connection with the Later Notes and needed to pursue additional sources of funding in order to continue operations. The status report also disclosed the existence of an SEC investigation and that Bodanza had resigned as CFO pending resolution of that investigation. It further reported that the company would not pursue any additional capital raising efforts during the pendency of the investigation.

48. As discussed above, Preferred Holdings through its subsidiaries has never been profitable and suffered net losses of \$1.0 million in 2007, \$2.2 million in 2008, \$1.8 million in 2009, and \$1.3 million in 2010, as reflected in financial statements prepared in 2011. Preferred Holdings has paid only \$2.3 million in principal and interest to the Later Note investors, and at least \$4,485,647 of the funds invested is still outstanding.

49. Preferred Holdings currently has approximately \$2.5 million in assets, but \$7.4 million in liabilities, very few ongoing operations, limited income streams, and almost no cash on hand. Many of the Later Notes are already overdue, and all of the notes purchased in the Initial Offering will come due in 2012. Preferred Holdings is not in a position to meet these obligations.

## COUNT I

### **VIOLATIONS OF SECTIONS 5(a) AND (c) OF THE SECURITIES ACT [15 U.S.C. §§ 77e(a) and (c)] (Against Defendants Bodanza and Preferred Holdings)**

50. Paragraphs 1 through 49 are realleged and incorporated herein by reference.

51. By their conduct, Defendants Bodanza and Preferred Holdings directly or indirectly: (a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise, securities as to which no registration statement was in effect; (b) for the purpose of sale or delivery after sale, carried or caused to be carried through the mails or in interstate commerce, by means or instruments of transportation, securities as to which no registration statement was in effect; and (c) made use of means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy, through the use or medium of a prospectus or otherwise, securities as to which no registration statement had been filed.

52. By reason of the foregoing, Defendants Bodanza and Preferred Holdings violated Sections 5(a) and (c) of the Securities Act [15 U.S.C. § 77e(a) and (c)].

## **COUNT II**

### **VIOLATIONS OF SECTION 17(a)(2) OF THE SECURITIES ACT [15 U.S.C. § 77q(a)(2)] (Against Defendants Bodanza and Preferred Holdings)**

53. Paragraphs 1 through 49 are realleged and incorporated herein by reference.

54. By their conduct, Defendants Bodanza and Preferred Holdings, in the offer or sale of securities, by the use of means or instruments of transportation or communication in interstate commerce and by the use of the mails, directly or indirectly, obtained money or property by means of untrue statements of material fact or omitting to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

55. By reason of the foregoing, Defendants Bodanza and Preferred Holdings violated Section 17(a)(2) of the Securities Act [15 U.S.C. § 77q(a)(2)].

## **COUNT III**

### **VIOLATIONS OF SECTION 10(b) OF THE EXCHANGE ACT [15 U.S.C. § 78j(b)] AND RULE 10b-5(b) THEREUNDER [17 C.F.R. § 240.10b-5] (Against Defendants Bodanza and Preferred Holdings)**

56. Paragraphs 1 through 49 are realleged and incorporated herein by reference.

57. By their conduct, Defendants Bodanza and Preferred Holdings, in connection with the purchase or sale of securities, by the use of means or instrumentalities of interstate commerce or by the use of the mails, directly or indirectly, made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

58. Defendants Bodanza and Preferred Holdings acted with scienter.

59. By reason of the foregoing, Defendants Bodanza and Preferred Holdings violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5(b) thereunder [17 C.F.R. § 240.10b-5].

#### **COUNT IV**

##### **UNJUST ENRICHMENT (Against Relief Defendants)**

60. Paragraphs 1 through 49 are realleged and incorporated herein by reference.

61. Relief Defendants Preferred Drilling, Preferred Investment, Preferred Leasing, and Preferred Management received or benefited from the \$6,769,635 in investor funds raised by Bodanza or Preferred Holdings. These funds are the proceeds, or are traceable to the proceeds, of the unlawful activity alleged above.

62. Relief Defendants have no legitimate claim to these funds.

63. Relief Defendants have been unjustly enriched by the receipt of these funds.

64. The Commission is entitled to an order requiring Relief Defendants to disgorge, jointly and severally with each other and Preferred Holdings, the \$4,485,647 that has not been repaid to the Later Note investors, plus prejudgment interest of \$268,143.

##### **RELIEF REQUESTED**

**WHEREFORE**, the SEC respectfully requests that this Court:

##### **I.**

Find that Defendants committed the violations alleged herein.

##### **II.**

Issue Orders of Permanent Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, restraining and enjoining Defendants Bodanza and Preferred Holdings, their agents, servants, employees, attorneys, and all persons in active concert or participation

with 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.**

Order disgorgement, plus prejudgment interest, of ill-gotten gains, derived directly or indirectly from the misconduct alleged, together with prejudgment interest thereon. Defendant Bodanza should be ordered to disgorge \$359,656, which represents the amount of compensation he received from Preferred Holdings from 2007 to 2010. In addition, Defendant Preferred Holdings and the Relief Defendants should be ordered to disgorge, jointly and severally, \$4,485,647, which represents the \$6,769,635 raised in the Later Note offering less the \$2,283,988 in principal and interest that was paid to the Later Note investors, plus prejudgment interest on that amount of \$268,143.

**IV.**

Order Defendant Bodanza to pay the SEC civil penalties 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)].

**V.**

Retain jurisdiction of this action 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.

**VI.**

Grant such other and further relief as the Court deems just and appropriate.

Dated: July 27, 2012

Respectfully submitted,

s/ Paul M. G. Helms

Paul M. G. Helms (helmsp@sec.gov)

Kathryn A. Pyszka (pyszkak@sec.gov)

U.S. Securities and Exchange Commission

175 West Jackson Boulevard, Suite 900

Chicago, Illinois 60604

Telephone: (312) 353-7390

Facsimile: (312) 353-7398

*Attorneys for Plaintiff U.S. Securities and Exchange  
Commission*