

100

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

FILED

SEP - 5 2000

Phil Lombardi, Clerk
U.S. DISTRICT COURT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

Civil Action No.:

vs.

00CV0766B

(M) ✓

HEARTSOFT, INC., BENJAMIN P. SHELL and
JIMMY L. BUTLER

Defendants.

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission"), for its Complaint against Defendants Heartsoft, Inc. ("Heartsoft" or the "company"), Benjamin Shell ("Shell") and Jimmy Butler ("Butler") alleges as follows:

SUMMARY

1. The Commission charges Defendants Heartsoft, and its only two officers and directors, Shell and Butler, with perpetrating a fraudulent Internet scheme involving the securities of Heartsoft, Inc., a company in the business of developing and marketing educational software.

2. In early 1999, Shell and Butler caused the company to issue a series of press releases that were simultaneously posted on Heartsoft's website. These releases included misleading statements concerning the purported "adoption" of Heartsoft's software by two large school districts, foreign distribution agreements for the software, "strategic business ventures and alliances" with various Internet companies to market the software, and a licensing agreement to develop a "child safe" Internet web browser. In

rees wv
CIT

truth, only certain schools within the two school districts had purchased copies of Heartsoft's educational software and there were no agreements to distribute the *Thinkology*, Heartsoft's newest software product, to foreign countries. Moreover, the substance of Heartsoft's purported marketing alliances and business ventures consisted of Heartsoft's purchase of advertisement space in catalogs. Finally, Heartsoft never entered into a licensing agreement to develop a "child safe" Internet web browser.

3. Based on the misleading statements, Heartsoft's stock price increased over 1500% from \$.21 to \$5.94 per share. Indeed, the misleading information was the only public information available to investors because the company failed to file any of its required quarterly or annual reports with the Commission from May 1997 until November 1999. Further, Shell and Butler profited from their conduct by selling substantial amounts of their Heartsoft stock into the market.

4. As a result of the conduct alleged herein, Heartsoft, Shell and Butler violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder; Heartsoft violated 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 13a-1 and 13a-13 [17 C.F.R. §§ 240.13a-1 and 240.13a-13] promulgated thereunder; Shell and Butler violated 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 aided and abetted Heartsoft's violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 13a-1 and 13a-13 [17 C.F.R. §§ 240.13a-1 and 240.13a-13] promulgated thereunder.

JURISDICTION AND VENUE

5. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v] and Sections 21 and 27 of the Exchange Act [15 U.S.C. §§ 78u and 78aa].

6. The Defendants 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 acts, transactions, practices and courses of business alleged herein. Certain of the acts, transactions, practices and courses of business alleged herein took place in the Northern District of Oklahoma and elsewhere.

7. The Commission brings this action pursuant to the authority conferred upon it by Sections 20(b) and 20(e) of the Securities Act, [15 U.S.C. §77t(b) and (e)], and Sections 21(d) and (e) of the Exchange Act [15 U.S.C. §78u(d) and (e)].

DEFENDANTS

8. **Heartsoft, Inc.**, a Section 15(d) reporting company based in a suburb of Tulsa, Oklahoma, develops and markets educational software products for schools and parents. The company's stock is traded on the OTC Bulletin Board ("OTCBB") under the symbol "HTSF." According to its latest annual report filed with the Commission, as of March 31, 1999, Heartsoft had approximately 9.1 million shares of common stock outstanding with 462 shareholders and more than 3,000 beneficial owners.

9. **Benjamin Shell**, age 36 and a resident of Broken Arrow, Oklahoma, is a co-founder of Heartsoft. During the relevant period, Shell was Heartsoft's president, CEO and chairman of the board.

10. **Jimmy Butler**, age 36 and a resident of Broken Arrow, Oklahoma, is a co-founder and former president of Heartsoft. During the relevant period, Butler was vice president of new development, the secretary and a director for Heartsoft.

STATEMENT OF FACTS

A. Background

11. Shell and Butler formed Heartsoft as a private company in 1985 to develop and market educational software. In March 1989, the company completed a reverse merger with a public shell company. As a result of the merger, Shell and Butler received a combined total of approximately 4 million shares of Heartsoft.

12. Heartsoft is in the business of developing educational software programs, which it markets to schools and home users. In early 1999, the company announced the development of a software program called *Thinkology*, which teaches young children critical thinking and higher order reasoning skills.

13. Since its inception, Heartsoft struggled to generate enough revenues to satisfy its day-to-day operational expenses. From 1989 to the present, the company consistently operated at a loss. According to the company's most recent audited financial statement for the fiscal year end March 31, 1999, the company had a total net loss of approximately \$520,000 on revenues of approximately \$527,000.

B. False and Misleading Press Releases

14. Beginning in mid January 1999, Heartsoft and its principals, Shell and Butler, issued numerous press releases. The releases were disseminated over various business news wires and simultaneously posted on Heartsoft's Internet web site. Shell authored each release and Butler, although an officer and director of Heartsoft, failed to

review Heartsoft's press releases. Each of the press releases made specific reference to the fact that the company's stock was publicly traded on the OTCBB and also referred investors to Heartsoft's Internet website located at www.heartsoft.com.

15. As discussed below, the press releases contained material misrepresentations and omissions concerning, among other things, a) the "adoption" of *Thinkology*, Heartsoft's newest software product, by two metropolitan school districts; b) Heartsoft's agreements to distribute *Thinkology* to several foreign countries; c) Heartsoft's formation of "strategic business ventures" and "sales alliances" with marketing and Internet companies; and d) Heartsoft's agreement to license the "first truly secure Internet browser for children." All told, a total of 29 press releases were issued through March 31, 1999.

The Adoption of Thinkology by Two Metropolitan School Districts

16. In January 1999, Heartsoft sold copies of its *Thinkology* software to certain schools within the Memphis, Tennessee and Tulsa, Oklahoma school districts. In neither instance, however, did the school districts agree to purchase the software for actual use on a district-wide basis.

17. The Memphis school district had specifically denied Heartsoft's previous request for the district's endorsement of the software. Nevertheless, Shell and Butler caused Heartsoft to issue several press releases that stated that the school districts had, in fact, "adopted" the software. The use of the term "adoption" could easily be misconstrued by the investing public to mean that the school district would actually be using the software on a district wide basis, when in truth, Heartsoft only sold copies of the *Thinkology* software to only 25 of the 165 schools in the Memphis district.

18. On January 26, 1999, Heartsoft issued a press release entitled, "Tulsa Public Schools Adopts (sic) Heartsoft's *Thinkology*." According to the release, "the Tulsa public school district purchased *Thinkology* for use in the district's Library Media Programs." To the contrary, the Tulsa district never adopted *Thinkology* on a district-wide basis, nor did the district purchase or commit to purchase *Thinkology* for its library media programs. Only 28 of 80 schools within the district had purchased a copy of the software.

Foreign Distribution Agreements

19. On January 20, 1999, Shell and Butler caused Heartsoft to issue a press release announcing that an Australian company had agreed to place a substantial order for *Thinkology* to fulfill its agreement with Heartsoft to distribute the software to Australia's 2,000 schools. The release further claimed that the Australian deal was "just the first of many such distribution agreements to be announced," and that "international sales will have a substantial impact on the company's revenues during 1999."

20. At the time of the press release, the only stocking order that had been placed by the Australian company was an order for Heartsoft's "Best Sellers," rather than *Thinkology*, and there was no pending or imminent stocking order for *Thinkology*. Moreover, at the time of this press release, no other international agreements were being negotiated.

Marketing Agreements with Internet Companies

21. In February 1999, Shell and Butler caused Heartsoft to issue two press releases that caused investors to believe that Heartsoft had entered into "strategic marketing and sales alliances" with various marketing and Internet companies.

Purportedly, these “alliances” would increase Heartsoft’s exposure to school districts and allow the company to distribute its software over the Internet.

22. For example, a February 5, 1999, press release claimed that a marketing alliance with ClassroomDirect.com, a marketing and distribution company that sells educational products to schools nationwide, “would increase Heartsoft’s exposure to school markets in the U.S. by 800% during 1999.”

23. This claim was misleading in that the “strategic marketing alliance” referenced in the press release only consisted of Heartsoft’s purchase of advertisement space in a ClassroomDirect.com catalog and on ClassroomDirect.com’s web site.

24. Similar claims were made regarding a “strategic sales and marketing alliance” with Technology Integration Group (“TIG”), another marketing and distribution company that sells educational software over the Internet. On February 12, 1999, Heartsoft announced that a “partnership” between Heartsoft and TIG would allow Heartsoft to sell its products over the Internet. The release also claimed that TIG would “co-market *Thinkology* side-by-side with the Apple Macintosh software to educators in Southern California, Nevada, Arizona and Hawaii.”

25. The substance of the “partnership” reference in the TIG press release consisted of Heartsoft’s purchase of advertisement space in TIG’s catalog. One month after the press release, TIG rescinded their advertisement agreement, stating that the information released in the press release did not accurately convey the substance of TIG and Heartsoft’s agreement.

Heartsoft's Agreement to License the First Secure Internet Browser

26. Towards the latter part of January 1999, Heartsoft began negotiations with Cytware, Inc. ("Cytware"), an Internet company, to license software for a purported new secure web browser. After signing only a "Letter of Intent" to license the software, Shell and Butler caused Heartsoft to issue a press release, on February 17, 1999, claiming that it had "completed" a software licensing agreement to create the "first secure Internet browser for children."

27. However, no licensing agreement was ever reached between the two companies and, as Shell and Butler subsequently learned, Cytware did not own the web browser software. After learning this fact, Shell and Butler failed to correct the February 17th release or remove the false press release from the company's web site.

C. Heartsoft's Stock Price and Trading Volume Increase

28. The press releases caused Heartsoft's stock price and trading volume to increase. From September 1, 1998, through January 12, 1999, Heartsoft's stock traded in a range of \$.18 to \$.28 per share with a daily average volume of approximately 12,000 shares. From January 13, 1999, when Heartsoft began issuing press releases, until March 31, 1999, the company's stock traded in the range of \$.21 to a yearly high of \$5.94, on an average daily trading volume of 117,000 shares.

29. Indeed, during the first three trading days after the issuance of the initial press release on January 13th, Heartsoft's stock price increased approximately 180%, from \$.21 to \$.81. Moreover, on February 16th, the first trading day after the issuance of the February 12th release announcing the purported marketing alliance with TIG, the stock closed at a then all time high of \$4.46 on a trading volume of 1,082,500 shares.

D. Shell and Butler Sold Shares of Heartsoft

30. During the time the press releases were issued, Shell and Butler sold substantial shares of their Heartsoft stock and generated large trading profits.

31. From February 3 through March 31, 1999, Shell sold 50,000 shares of Heartsoft, through a brokerage account with Prudential Securities, in 18 transactions at prices ranging from \$1.41 to \$4.06 per share. He received trading profits of \$89,647. The shares were sold through an account controlled by Shell.

32. From February 4 through March 31, 1999, Butler sold 27,500 shares of Heartsoft, through his brokerage account with Dean Witter Reynolds, Inc., in 17 transactions for prices ranging from \$1.41 to \$5.06 per share. His transactions were executed through brokerage accounts in his own name. In total, Butler received trading profits of \$74,255.

E. Heartsoft's Failure to File, and Timely File, Reports with the Commission

33. As a Section 15(d) reporting company, Heartsoft is required to submit quarterly and annual filings to the Commission on Forms 10-QSB and 10-KSB, respectively.

34. When Heartsoft began issuing its press releases in January 1999, the company had failed to file its annual report on Form 10-KSB for its 1997 and 1998 fiscal years.

35. When Heartsoft began issuing its press releases in January 1999, the company had failed file any quarterly reports since a February 1997, 10-QSB filing.

36. Between November 1999 and February 2000, the company filed 8 delinquent reports, which include: (1) a 1995 third quarter 10-QSB; (2) three 1997 10-

QSB's; (3) a 1998 third quarter 10-QSB; (4) a 1999 10-KSB; and (5) a second and third quarter 10-QSB for 1999. The company has not filed 10-QSB's for the first and second quarters of 1998 nor has it filed 10-KSB's for 1997 and 1998.

F. False Statement By Shell Regarding Heartsoft's Filing Status

37. Shell posted at least one false statement on an Internet message board regarding the company's filing status. In a January 26, 1999, posting on the Raging Bull message board, in response to an investor who claimed to have had "no luck finding current SEC filings," Shell falsely claimed that, "the 6/30/98 10-QSB was filed manually and not electronically. Since it was filed manually it does not show up via the Internet or other electronic sources." To date, Heartsoft has not filed its 1998 first quarter 10-QSB either manually or electronically.

CAUSES OF ACTION

FIRST CLAIM

Violations by Heartsoft, Shell and Bulter of Section 10(b) of the Exchange Act and Rule 10-5 Thereunder

38. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

39. Heartsoft, Shell and Butler, directly or indirectly, in connection with the purchase and 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 material facts and 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 and courses of

business which operate as a fraud and deceit upon purchasers, prospective purchasers and other persons.

40. As a part of and in furtherance of their scheme, Heartsoft, Shell and Butler, directly and indirectly, prepared, disseminated or used contracts, written offering documents, promotional materials, a web site, investor and other correspondence, and made oral representations 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, including, but not limited to, those set forth above.

41. Heartsoft, Shell and Butler each knew, had reason to know or recklessly disregarded the fact that their acts, practices and courses of business described above, were materially false and misleading; created or would create demand for Heartsoft stock; created or would create the appearance of active trading in Heartsoft stock; effected or would effect a rise in the price of Heartsoft stock; and supported or would support the price of Heartsoft stock.

42. By reason of the foregoing, Heartsoft, Shell and Butler violated the provisions of 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].

SECOND CLAIM

Violations By Heartsoft of Section 13(a) of the Exchange Act and Rule 13a-1 and 13a-13 Thereunder

43. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

44. Section 13(a) of the Exchange Act require issuers to file periodic reports with the Commission containing information prescribed by specific Commission rules. Rules 13a-1 and 13a-13 thereunder require issuers to file annual and quarterly reports, respectively.

45. During the period from February 1997 through October 1999, Heartsoft was required to file three annual reports on Form 10-KSB and at least seven quarterly reports on Form 10-QSB. None of these reports was filed timely, and several of the reports have never been filed.

46. By reason of these acts, Heartsoft violated Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 13a-1 and 13a-13 [17 C.F.R. § § 240.13a-1 and 240.13a-13] promulgated thereunder.

THIRD CLAIM

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

47. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

48. Defendants Shell and Butler, 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 inter-state commerce and of the mails to sell securities, through the use of written con-tracts, offering documents and otherwise; and (b) making use of the means or instruments of transportation and communication in interstate commerce and of the mails to offer to sell such securities.

49. As described in paragraphs 1 through 37, from February through March 1999, Shell and Butler publicly sold shares of Heartsoft in over-the-counter transactions. No registration statements were ever filed with the Commission or otherwise in effect with respect to these securities.

50. Accordingly, Shell and Butler violated Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. § § 77e(a), 77e(c)].

FOURTH CLAIM

Violations by Shell and Butler of Section 17(a)(1) of the Securities Act

51. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

52. Shell and Butler, directly or indirectly, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, have: (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions 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 transactions, practices or courses of business which operate or would operate as a fraud or deceit.

53. As part of and in furtherance of this scheme, Shell and Butler, directly and indirectly, prepared, disseminated or used contracts, written offering documents, promotional materials, a web site, investor and other correspondence, and made oral representations, which contained untrue statements of material fact 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, including, but not limited to, those statements and omissions set forth above.

54. Shell and Butler made the above-referenced misrepresentations and omissions knowingly or recklessly disregarding the truth.

55. By reason of the foregoing, Shell and Butler violated Section 17(a)(1) of the Securities Act [15 U.S.C. 77q(a)].

FIFTH CLAIM

Violations by Shell and Butler of Section 17(a)(2) and (3) of the Securities Act

56. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

57. Shell and Butler, directly or indirectly, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, have obtained money and property by means of untrue statements of material fact and by omissions 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. Shell and Butler, directly or indirectly, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, have engaged in transactions, practices and courses of business, which operated and will operate as a fraud and deceit upon purchasers.

59. As part of and in furtherance of this scheme, Shell and Butler, directly and indirectly, prepared, disseminated or used contracts, promotional materials, a web site, investor and other correspondence and made oral presentations which contained untrue

statements of material fact 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, including, but not limited to, those statements and omissions set above.

60. By reason of the foregoing, Shell and Butler violated Sections 17(a)(2) and (3) of the Securities Act [15 U.S.C. §77q(a)(2) and (3)].

SIXTH CLAIM

Shell and Butler Aided and Abetted Heartsoft's violation of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 Thereunder

61. The Commission repeats and realleges paragraphs 1 through 37 of this Complaint and incorporates them herein by reference as if set forth *verbatim*.

62. Shell and Butler, aided and abetted Heartsoft's violations of the reporting provisions described above.

63. Shell and Butler, as the controlling officers of Heartsoft, were responsible for filing all of Heartsoft's periodic reports required by the Commission, and each knew of the requirement that Heartsoft must file periodic reports.

64. Shell and Butler knowingly caused and provided substantial assistance to Heartsoft for its violations of its reporting responsibilities for over a three-year period.

65. As a result of the foregoing, Shell and Butler aided and abetted Heartsoft's violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 13a-1 and 13a-13 [17 C.F.R. § § 240.13a-1 and 240.13a-13] promulgated thereunder.

REQUESTED RELIEF

WHEREFORE, Plaintiff Securities and Exchange Commission respectfully requests that this Court:

I.

Enter an injunction permanently restraining and enjoining Heartsoft, Shell and Butler, their subsidiaries, officers, directors, agents, servants, employees, attorneys and all persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, and each of them, from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act [15 U.S.C. §77e(a), 77e(c) and 77q(a)], of Sections 10(b) and 13(a) of the Exchange Act [15 U.S.C. § § 78j(b) and 78m(a)], and of Rules 10b-5, 13a-1 and 13a-13 [17 C.F.R. § § 240.10b-5, 240.13a-1 and 240.13a-13] thereunder.

II.

Enter an Order requiring Heartsoft, Shell and Butler, and each of them, to disgorge those monies determined to have been received as a result of their conduct alleged herein, plus prejudgment interest.

III.

Enter an Order imposing civil penalties against Shell and Butler, 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.

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

Dated this _____ th day of September, 2000.



J. KEVIN EDMUNSON
District of Columbia No. 430746
Attorney-in-Charge for Plaintiff

SPENCER C. BARASCH
District of Columbia No. 388886
KAREN E. WHITAKER
Texas Bar No. 00785227
WILLIE C. BRISCOE
Texas Bar No. 24001788
Attorneys for Plaintiff

SECURITIES AND EXCHANGE COMMISSION
801 Cherry Street, Suite 1900
Fort Worth, Texas 76102
(817) 978-3821/-6490
FAX: (817) 978-2700