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CENTRAL DISTRICT OF CALIFORNIA
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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. LARRY R. POLHILL, Defendant.	EDCV13-1729 MRP (SPx) **COMPLAINT**

COMPLAINT

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

JURISDICTION AND VENUE

1. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) & 78aa. Defendant Larry R. Pohill has, directly or indirectly,

made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

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

SUMMARY

3. This case concerns a decades-long investment fraud perpetrated on over 485 investors who are now owed almost $160 million by American Pacific Financial Corporation ("APFC"), which was controlled at all relevant times by Defendant Larry R. Polhill.

4. Polhill used APFC to buy and sell real estate and distressed assets, offering investors the opportunity to invest in the company, mainly through the unregistered issuance of promissory notes that were allegedly secured by collateral, such as specific pieces of property.

5. Polhill made a number of material misrepresentations and omissions to investors during the course of APFC's note offering. Specifically, Polhill (i) misrepresented to investors that the notes were secured by specific collateral when, in fact, no such security interest existed; (ii) failed to disclose that what collateral did exist was often already pledged to other lenders or impaired in some other way; and (iii) misrepresented that he would notify investors if their collateral went into default. As a result, when APFC declared bankruptcy in 2010, investors who had been promised that their loans were secured by specific assets were named in the bankruptcy as unsecured creditors and left with nothing to show for their investment.

6. In addition to the promissory note offering, Polhill also offered investors the opportunity to invest in several APFC-sponsored limited partnerships, known as

"Funds." The Funds pooled investor money and used it to make loans to APFC. APFC paid interest on the loans to the Funds, and the interest was distributed out to Fund investors. Interests in the Funds were securities in the form of investment contracts, but were never registered with the SEC as they should have been.

7. As a result, Polhill has violated Sections 5(a), 5(c), and 17(a)(2) of the Securities Act, 15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)(2); Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b); and Exchange Act Rule 10b-5(b), 17 C.F.R. § 240.10b-5(b). Unless restrained and enjoined, Polhill is reasonably likely to continue to violate the federal securities laws.

THE DEFENDANT

8. **Larry R. Polhill**, age 61, resides in Grand Terrace, California. At all relevant times, he was the president of APFC and controlled its operations.

AFFILIATED ENTITY

9. **American Pacific Financial Corporation** is a California corporation formed on June 5, 1978, and based in San Bernardino, California. APFC purported to be a "private equity real estate and equity venture capital firm." On September 21, 2010, APFC filed for Chapter 11 protection in the United States Bankruptcy Court for the District of Nevada. In May 2011, the bankruptcy court appointed a Chapter 11 Trustee to take over APFC's operations, and in February 2012, the matter was converted to a Chapter 7 bankruptcy. APFC's investors are named as unsecured creditors in the bankruptcy proceeding.

STATEMENT OF FACTS

A. Background

10. APFC was incorporated in 1978, and was originally in the real estate brokerage business. Polhill took control of the company shortly after 1978, and used it to invest primarily in real estate. Although during most of APFC's existence, the company was co-owned by Polhill and another individual, Polhill had complete control over the company at all relevant times.

11. Over the years, the company became more involved in the business of buying distressed assets, including buying companies out of bankruptcy.

12. Polhill offered investors the opportunity to invest in APFC through promissory notes issued by APFC. Under the terms of these notes, APFC was supposed to make regular interest payments at rates ranging from 5%-17% per year. Also, by their terms and based on representations from Polhill, the notes were purportedly secured by specific assets owned by APFC.

13. Investors could also invest in APFC-sponsored limited partnerships, known as "Funds." The Funds pooled investor money to make loans to APFC, and APFC's interest payments on those loans were supposed to be distributed to investors in quarterly distributions.

14. Between the mid-1980s and 2007, APFC made regularly scheduled interest payments to its investors. As a result, its investor base continually grew, and the company began making larger and larger investments in distressed assets by buying numerous companies out of bankruptcy. The company's investments included companies involved in the food and beverage services, plastic lumber, semiconductors, entertainment, trucking, education and aerospace.

15. While a few of APFC's investments were successful, unbeknownst to investors, the vast majority failed. As a result, the assets held by APFC—which were securing the loans held by investors—decreased in value. A 2011 forensic examination performed on behalf of APFC's committee of unsecured creditors found that more than 83% of the company's 2005 assets were eventually written off as bad debts, and that the company was insolvent at least as early as 2005, and probably for years prior to that.

16. In early 2008, APFC ceased making its scheduled payments to most investors but continued to issue newsletters, make payments to preferred investors, and engage in other activities designed to lull investors into a false sense of security regarding their investments with the company. In its bankruptcy filing, APFC listed

its last promissory note as having been issued in April 2008.

17. In September 2010, APFC filed for Chapter 11 bankruptcy, disclosing a total of approximately $103 million owed to more than 485 "unsecured" promissory note holders, and $55 million owed to the Funds. In May 2011, the bankruptcy court appointed a Chapter 11 Trustee to investigate and oversee APFC's operations, based on allegations of fraud. In February 2012, a Chapter 7 Trustee was appointed, and the Chapter 7 Trustee has filed an adversary proceeding against Polhill alleging fraud.

B. Polhill's Fraudulent Promissory Note Offerings

18. The majority of Polhill's securities offerings were in the form of APFC promissory notes. Polhill told investors that their investments would be for a specified term, would generate interest payments on a monthly or quarterly basis, and that their investments were safe because they were secured by a specific piece of collateral owned by APFC.

19. The APFC notes were entitled "Contractual Loan Agreement/ Promissory Note Secured by Pledge of Collateral." They were made between the individual investors and APFC, and were all in the same general one-page form, which outlined the investment amount, the term of the note (usually one to four years), and the agreed-upon interest rate, which ranged between 5-17%. A sample APFC promissory note is attached hereto as Exhibit A.

20. The notes also included an extension/renewal provision that allowed APFC to automatically extend the terms of the notes if an investor did not specifically request payment at the end of the initial term. As a matter of course, the notes were routinely extended for multiple terms.

21. In addition, the notes stated that they were secured by collateral in the form of a specific asset, such as a piece of property.

22. The notes also stated that if the pledged collateral went into default, the investor would have the opportunity to choose among several different options, including receiving substitute collateral or a "principal reduction" of their loan (i.e., a

refund of some portion of their investment).

23. Polhill signed all of the notes on behalf of APFC, and was personally responsible for choosing the collateral that would be used as security for each note. Polhill did not specifically check on the adequacy of the collateral pledged for each note, but rather claimed he relied on "his gut" to inform his decisions.

24. APFC and Polhill had no procedure in place to prevent the same piece of collateral from being pledged to multiple note-holders, or issuing notes secured by collateral that had, for example, already been pledged to a bank. Additionally, APFC had no procedures in place to monitor the safety of a note's collateral during its initial and extended terms.

25. Polhill also never took any steps to perfect the notes' security interests. As a result, it was only when APFC filed for bankruptcy and named all of the note holders as "unsecured creditors," that the investors were informed that their notes were not truly "secured," and that the collateral underlying their notes often either no longer existed or was insufficient to cover all of the loans for which it had been pledged.

1. Misrepresentations regarding the Security of the Notes

26. Polhill misrepresented the security of APFC's notes to investors.

27. The notes expressly stated that they were secured by specific collateral. In addition to the terms of the notes themselves, Polhill told investors that investments in the notes were safe because they were secured by specific assets.

28. The APFC notes also included the following statement regarding the steps APFC would take to secure the notes:

> AMERICAN PACIFIC FINANCIAL CORPORATION is hereby authorized ***and instructed*** to service all pledged collateral ***including the filing of all required notices*** and taking any prudent action necessary to preserve the equity of said collateral.

(Emphasis added.)

29. These representations regarding the notes' security were false. The

notes were never truly "secured" by any collateral because Polhill failed to file the paperwork necessary to perfect a legal security interest in the collateral on behalf of investors. As a result, when APFC declared bankruptcy, over 485 investors who held allegedly "secured" notes, were listed as unsecured creditors, and had nothing to show for their investment.

30. Polhill, whose business involved buying assets out of bankruptcy, was fully aware of the importance of legal security interests, and how to perfect them. For example, in contrast to how he failed to ensure that the notes held by the investors were secured, Polhill made sure that APFC's own security interests in third party assets were legally secured through the filing of UCC paperwork.

2. Misrepresentations regarding the Status of the Notes' Collateral

31. Polhill also failed to disclose to investors that the collateral supposedly securing their notes was often impaired at the time he issued the notes.

32. Sometimes when the notes were issued to investors, the collateral identified as security for the notes had already been pledged to a senior lender, such as a bank. On other occasions, the identified collateral had been pledged to too many other investors.

33. As an example, one investor held an APFC note with a term of January 2008 to January 2011. The note stated that it was secured by real estate located in Glen Cove, New York, which the note claimed had been pledged as collateral for the note. However, Polhill and APFC had failed to disclose that this property was already encumbered by a senior mortgage. Moreover, neither Polhill nor APFC disclosed that APFC had defaulted on the mortgage payments it owed on that collateral back in 2007—well before it issued the note to the investor.

34. As another example, over 80 investors held notes from APFC note offerings from 2004 to 2008. These notes specifically stated that the notes were secured by accounts receivable owed by Café Valley, a privately-held bakery, and the notes claimed this account receivable had been pledged as collateral for the notes.

However, Polhill and APFC never disclosed that this collateral was already subject to a senior bank lien.

3. Misrepresentations regarding Events of Default

35. Pohill misrepresented and failed to disclose events of default regarding the collateral supposedly securing the APFC notes.

36. The terms of the notes issued by Polhill represented that investors would be notified of problems with their collateral by claiming that the investors would be given the option of receiving new collateral or a reduction in the principal balance of their loan in the event such problems occurred. The notes included language stating that the defined collateral would secure the note "at all times during the course of this Agreement."

37. The notes also included the following language:

> Whenever pledged collateral becomes in default, or whenever requested by AMERICAN PACIFIC FINANCIAL CORPORATION, Beneficiary agrees to release said pledged collateral to AMERICAN PACIFIC FINANCIAL CORPORATION and upon such release, Beneficiary shall select any one of these three options:
>
> (1) Receiving a principal reduction in this loan (in an amount equal to that pledged as security by the released collateral), or
>
> (2) Accepting substitute security, or
>
> (3) Directing that funds be held in trust, pending approval of replacement security by Beneficiary.

38. In addition, the last paragraph of the note stated that pledged collateral "is to be held in safekeeping by AMERICAN PACIFIC FINANCIAL CORPORATION and available for inspection to Beneficiary upon request."

39. These representations were false. Polhill and APFC did not maintain the collateral pledged as security for the notes throughout their terms, and often sold or lost the original pledged collateral without notifying investors.

40. APFC and Polhill also did not notify investors when collateral went into default and did not offer investors the options of (i) reducing their loans; (ii)

accepting substitute security; or (iii) placing their funds in trust pending their approval of a replacement security as required under the terms of the promissory note. Finally, APFC and Polhill did not hold the pledged collateral in safekeeping and available for inspection by the investors upon request.

41. In fact, APFC and Polhill had no procedures or safeguards in place to track the status of investor collateral and ensure that appropriate notice was being provided in the event of default.

42. Furthermore, even when Polhill was fully aware that collateral securing investor notes was impaired, he did not tell investors. For example, in one instance, Polhill's cousin held one of the APFC notes. When his cousin learned that the collateral securing that note was no longer valuable, the cousin asked Polhill for substitute collateral. Polhill agreed, and substituted new collateral to secure that note. However, Polhill did not inform any of the other investors holding that note that the collateral was impaired.

43. Moreover, Polhill and APFC represented that, throughout the course of the investors' investment, their notes were secured by a specific piece of collateral that the investors would be able to rely on if APFC ever failed to repay their loans or otherwise default on the notes. In reality, Polhill had often sold or disposed of the collateral with no notice to investors.

44. For example, one investor held an APFC note with an initial term of May 2003 to March 2005, which was later extended through 2008. His note specifically stated that the note was secured by accounts receivable owed by GB&L Trucking, a trucking business, and the note claimed this account receivable had been pledged as collateral for the note. However, GB&L went out of business in or about 2005. Polhill did not inform the investor until mid-2008 that GB&L had gone out of business.

45. As another example, an investor held an APFC note with an initial term of June 1997 to June 2001, which was later extended through 2008. His note

specifically stated that the note was secured by property located in Hesperia, California, and the note claimed this property had been pledged as collateral for the note. However, APFC sold the collateral in 2004. Neither Polhill nor APFC ever informed the investor that his collateral had been sold or that there was no longer any asset securing his note.

46. Each of the misrepresentations and omissions alleged above involved material information. Investors would have considered it important to their investment decision to know (i) that their purportedly "secured" promissory notes were not actually secured; (ii) that their pledged collateral was often inadequate; and (iii) that Polhill did not abide by the terms of the notes and notify investors when their pledged collateral was in default.

47. Moreover, Polhill knew, or was reckless or negligent in not knowing, that each of the misrepresentations and omissions alleged above was false and misleading.

C. Polhill's Unregistered Offering of Securities

48. In addition to committing fraud, Polhill violated the securities registration laws. As alleged above, Polhill offered investors the opportunity to invest in both promissory notes and APFC Funds.

49. Three separate Funds existed at the time APFC filed for bankruptcy. The table below shows the name of each Fund and the terms of the offerings. American Pacific Advisors, a wholly-owned subsidiary of APFC, acted as the general partner for each Fund.

Name of Fund	Offering Period	Funds Raised Since 2005
American Pacific Financial Group, LP	1989-2007	about $6 million
American Pacific Financial Group II, LP	1993-2007	about $5 million

Name of Fund	Offering Period	Funds Raised Since 2005
American Pacific Venture Fund, LP	1989-2007	about $3 million

50. APFC and Polhill controlled the Funds by using the same wholly-owned subsidiary of APFC as a general partner for each Fund. In addition, APFC and Polhill disregarded entity form by, for example, making payments to Fund investors out of APFC's common checking account. Further, the Funds were all engaged in the same type of business—loaning money to APFC. Investor money was also comingled in APFC's corporate account.

51. In addition, the offer and sale of Fund units were part of a single plan of financing—to make loans to APFC or its affiliates. The Funds also involved the same class of security (limited partnership units), they were made at or about the same time (from the late 1980s/early 1990s through the late 2000s), the same type of consideration (cash, generally in the form of IRA funds) was used in all Fund investments, and the sales of all Fund units were made for the same general purpose (to make loans to APFC). Finally, there were no periods of six months or more during which no offers or sales of Fund units were made.

52. The Funds, like the promissory notes, provided investor capital to APFC. Investors invested in a Fund, which loaned money to APFC. In exchange, APFC made interest payments to the Funds, which distributed them out to investors.

53. Polhill pooled investor funds in APFC's main checking account, and used the money at his discretion to, for example, pay APFC expenses, or make interest payments to investors.

54. Investors purchased the promissory notes in order to earn profits in the form of interest. The notes bore significant risk because while APFC marketed the notes as having the risk-reducing feature of being secured by a specific piece of collateral, in fact, the notes were not secured and were often under-collateralized.

55. In selling the promissory notes and the Fund investments, Polhill and

other APFC salesmen solicited nationwide, including through the use of e-mail, newsletters, and referrals from local businessmen. When purchasing the notes and the Fund units, investors sent money to APFC for investment purposes. APFC pooled all investor funds raised from the sale of the notes or the Fund units to use at its discretion, including making investments in distressed assets and making payments to investors. The investments were passive investments, and the investors expected to earn returns from APFC and Polhill's efforts.

56. Both the promissory notes and the interests in the Funds were securities as that term is defined under the federal securities laws. However, APFC never registered its offer and sale of its promissory notes or Fund partnership units. The reverse of each promissory note included a legend indicating that the security offering had not been registered with the SEC and was made pursuant to certain registration exemptions under the Securities Act. But neither offering qualified for such exemptions.

FIRST CLAIM FOR RELIEF

Fraud in the Offer or Sale of Securities

(Violations of Section 17(a) Of the Securities Act)

57. The SEC realleges and incorporates by reference paragraphs 1 through 56 above.

58. Polhill made material misrepresentations and omissions to investors regarding the security of their promissory notes, the status of the collateral allegedly securing their promissory notes, and APFC's investor notification procedures in the event an investor's collateral went into default.

59. By engaging in the conduct described above, Polhill directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by use of the mails, obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in

light of the circumstances under which they were made, not misleading.

60. By engaging in the conduct described above, Polhill 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

Fraud in Connection with the Purchase or Sale of Securities

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

61. The SEC realleges and incorporates by reference paragraphs 1 through 56 above.

62. Polhill made material misrepresentations and omissions to investors regarding the security of their promissory notes, the status of the collateral allegedly securing their promissory notes, and APFC's investor notification procedures in the event an investor's collateral went into default.

63. By engaging in the conduct described above, Polhill, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter, made untrue statements of a material fact or 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.

64. By engaging in the conduct described above, Polhill 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

Unregistered Offer and Sale of Securities

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

65. The SEC realleges and incorporates by reference paragraphs 1 through 56 above.

66. By engaging in the conduct described above, Polhill, directly or

indirectly, made use of means or instruments of transportation or communication in interstate commerce or of the mails, to offer to sell or to sell securities, or to carry or cause such securities to be carried through the mails or in interstate commerce for the purpose of sale or for delivery after sale.

67. No registration statement has been filed with the SEC or has been in effect with respect to any of the offerings alleged herein.

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

PRAYER FOR RELIEF

WHEREFORE, the SEC respectfully requests that the Court:

I.

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

II.

Issue a permanent injunction restraining and enjoining Polhill and his officers, agents, servants, employees, attorneys, and all persons in active concert of participation with them, and each of them, from violating Sections 5(a), 5(c), and 17(a) of the Securities Act, 15 U.S.C. §§ 77e(a), 77e(c), and 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

III.

Issue an Order directing Polhill to disgorge all ill-gotten gains from his illegal conduct, together with prejudgment interest thereon.

IV.

Issue an Order directing Polhill to pay a civil penalty under Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

V.

Issue an Order pursuant to Section 20(e) of the Securities Act and Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 77t(e) and 15 U.S.C. § 78u(d)(2), barring Polhill from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

VI.

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

VII.

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

Dated: September 24, 2013

Respectfully submitted,

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