

THE UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION

BILLITTERI v. SECURITIES AMERICA, INC., <i>et al.</i> ( <i>Provident Royalties Litigation</i> )	:	3:09-cv-01568-F AND RELATED CASES
THIS DOCUMENT RELATES TO: ALL ACTIONS	: : : : :	

**CONSOLIDATED AMENDED CLASS ACTION COMPLAINT**

Plaintiffs, on behalf of themselves and all others similarly situated, by their undersigned counsel, make the following allegations on information and belief based upon the investigation of counsel, except as to the allegations pertaining specifically to Plaintiffs and Plaintiffs’ counsel, which are based on personal knowledge. The investigation conducted by Plaintiffs’ counsel included, *inter alia*, a review and analysis of: (i) publicly available news articles and reports; (ii) actions taken by the United States Securities and Exchange Commission (“SEC”) against Provident Royalties LLC (“Provident Royalties”) and related entities and individuals; (iii) the Chapter 11 proceedings related to the Provident Entities (defined in ¶¶ 51-56 herein); and (iv) offering documents, sales materials and communications (collectively the “Offering Documents”) issued and disseminated to class members by the Broker Defendants (defined in ¶¶ 27-34 herein) and the Provident Group (defined in ¶¶ 43-57 herein). Plaintiffs believe that additional substantial evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

### **NATURE OF THE ACTION**

1. Provident Royalties is a Texas-based company that holds oil and gas interests, working interests and royalty interests in oil and gas properties in the United States. Beginning in September 2006, Provident Asset Management, LLC (“PAM”), a registered broker-dealer, together with a network of affiliated broker-dealers throughout the United States, offered and sold to investors approximately \$485 million of oil and gas investments, through a series of offerings (the “Offerings”). Each Offering was structured in a similar manner involving the sale of interests in a separate “Provident” or “Shale” entity (listed in ¶ 53, herein) created to invest in the oil and gas business. Provident Royalties was a beneficial owner in each of the entities. The securities purchased by Plaintiffs and Class members in these Offerings consisted of preferred stock or partnership interests that had a highly attractive rate of return payable in the form of regular (monthly) dividends or distributions. The securities were not publicly traded and purportedly were exempt from the registration requirements of the Securities Act of 1933 under SEC Rule 506 of Regulation D.

2. Each of the Offerings was ostensibly offered and sold to “accredited” investors pursuant to a Private Placement Memorandum (“PPM”). Plaintiffs and Class members paid various fees and commissions to PAM and the Broker Defendants, which were part of a syndicate of broker-dealers, including a due diligence fee for each unit or share purchased. As described herein, the Broker Defendants participated in the offer and sale of Provident Securities (defined in ¶ 12) by disseminating materially false and misleading PPMs to Plaintiffs and the Class. In addition, the Broker Defendants breached their fiduciary duties to Plaintiffs and the Class by failing to perform adequate due diligence.

3. Among other things, Plaintiffs and Class members were promised a high rate of return and told that the Offering proceeds would be invested in the oil and gas business, including the acquisition of real estate, oil and gas leases and mineral interests, and exploration and development activities.

4. However, the PPMs disseminated to Plaintiffs and Class members failed to disclose, among other things, that Offering proceeds were commingled improperly with funds received from other investors of other Offerings, that the Provident-related entities had engaged in dozens of undocumented or improper inter-company transfers, that the proceeds of the Offerings were not invested as represented, and that later investors' funds were being used to pay "dividends" and "returns of capital" to earlier investors in Provident Securities. Moreover, the Broker Defendants did not perform adequate due diligence on the Offerings and did not have adequate due diligence procedures in place to review these investments on behalf of Plaintiffs and Class members.

5. In early 2009, the scheme began to unravel. On or about January 22, 2009, Provident Royalties announced that it would no longer accept any new investors. On or about January 29, 2009, Provident Royalties suspended dividends and payments for all investors in the Offerings.

6. On or about June 22, 2009, Provident Royalties and approximately 26 affiliated and related companies filed petitions in the United States Bankruptcy Court for the Northern District of Texas (Dallas Division) seeking relief under Chapter 11 of the United States Bankruptcy Code. Because of the filing of the Chapter 11 petition, Plaintiffs have not named the Provident-related entities or individuals as Defendants in this matter but reserve the right to bring an action against them at a later time.

7. On July 1, 2009, the SEC filed civil fraud charges against Provident Royalties and its principals, alleging that Provident Royalties made a series of fraudulent securities offerings involving oil and gas investments, and alleging that certain members of the Provident Group engaged in a Ponzi scheme.

8. The court-appointed receiver has concluded that the Offerings were based on false and misleading representations to investors. The Receiver's First Quarterly Report, filed on October 30, 2009, stated that:

At this stage, PAM has equitable disgorgement and fraudulent conveyance claims with regard to the approximately \$69 million in broker commissions that were paid in the course of the fundraising herein. **It is inescapable that there were significant, material misrepresentations made in the course of the offerings in this case**, and accordingly such commissions are avoidable.

(Emphasis added.)

9. During the Class Period, the Broker Defendants offered, solicited the sale of and/or sold Provident Securities to Plaintiffs and the Class, for their own financial interest or the financial interest of others, by means of untrue statements of material facts or omitting to state material facts in the PPMs. The Broker Defendants solicited investors to purchase Provident Securities, and caused the funds to be invested in the Provident Group. For purposes of this complaint, Plaintiffs specifically disclaim any allegations of fraudulent intent or scienter by the Broker Defendants with respect to the claims asserted against them under the Texas Securities Act and for breach of fiduciary duty.

10. The Broker Defendants received fees and/or commissions for soliciting investors in these Offerings, including a syndication fee and a specific fee related to due diligence that was purportedly performed in connection with the Offerings. The PPM for Shale Royalties 12, Inc. ("Shale 12") stated:

Syndication Fee. The proceeds of the offering will be used to pay a non-accountable due diligence fee of 1.5% of the proceeds received in this offering to Provident Asset Management, LLC, a securities broker/dealer which is an Affiliate of the Corporation. The Corporation will also pay a non-accountable syndication management fee of 3% of the proceeds of the offering to Provident Asset Management, LLC as Managing Dealer.

Sales Commissions and Due Diligence Fees. The Corporation will pay an 8% sales commission plus a 1% due diligence fee on the amount of subscription proceeds for Preferred Stock Series A to the Managing Dealer. The Corporation will pay a 6% sales commission plus a 1% due diligence fee on the amount of subscription proceeds for the Preferred Stock Series B to the Managing Dealer. The amount reflected above assumes that only Preferred Stock Series A is sold in this offering. The Managing Dealer will pay the sales commission and due diligence fee to other securities broker/dealers for subscriptions received through such broker/dealers.

An identical or nearly-identical statement was included in the PPMs for the other Offerings.

11. In breach of their fiduciary duties to Plaintiffs and the Class, the Broker Defendants failed to adequately conduct due diligence of the Provident Group and the representations in the PPMs, despite the existence of numerous red flags, as described herein. The Broker Defendants' due diligence failures included, among others, the failure to adequately investigate:

- a. the finances of the Provident Entities in light of the absence of audited financial statements;
- b. the lack of transparency of internally generated financial statements as demonstrated by unexplained or poorly documented inter-company transactions among the Provident Entities;
- c. the use of investors' Offering proceeds;
- d. the sources of payments of investor dividends and redemptions; and

- e. the apparent lack of internal controls with respect to inter-company transactions and transactions with interested parties.

12. This class action is filed on behalf of all persons and entities who, from September 1, 2006 until January 22, 2009 (the “Class Period”), purchased or acquired partnership interests, preferred stock, or other securities in the Rule 506 Entities (defined in ¶ 53 herein) (“Provident Securities”) through a series of Offerings that were offered and sold by the Broker Defendants to investors and who were damaged thereby (the “Class”).

### **JURISDICTION AND VENUE**

13. The claims asserted herein arise under the Texas Securities Act and the common law of the State of Texas.

14. This Court has subject matter jurisdiction over this dispute pursuant to the Class Action Fairness Act of 2005, codified at 28 U.S.C. § 1332(d)(2). The amount in controversy in this action exceeds \$5,000,000. The Class consists of more than 100 individuals and Plaintiffs and Defendants are citizens of different states.

15. Venue is proper in this District pursuant to 28 U.S.C. § 1391(a). Substantial acts in furtherance of the alleged misconduct and/or its effects have occurred in this District, including the issuance of the materially false and misleading PPMs.

### **PARTIES AND RELEVANT ENTITIES**

#### **PLAINTIFFS**

16. Plaintiff Robert Adams (“Adams”), a resident of Texas, purchased an interest in Provident Energy 2, LP, pursuant to the PPM for that Offering, and was damaged thereby. Adams purchased Provident Securities from Defendant NEXT Financial Group, Inc. (“NEXT”).

17. Plaintiff Joseph Billitteri (“Billitteri”), a resident of Illinois, purchased preferred

stock in Shale 12, pursuant to the PPM for that Offering, and was damaged thereby. Billitteri purchased Provident Securities from Defendant Securities America, Inc. (“Securities America”).

18. Plaintiff Karen L. Bopp, IRA (“Bopp”) purchased preferred stock in Shale Royalties 10, Inc. (“Shale 10”), pursuant to the PPM for that Offering, and was damaged thereby. Karen L. Bopp is a resident of Massachusetts. Bopp purchased Provident Securities from Defendant NEXT.

19. Plaintiff Bussell Living Trust DTD 12/05/96 (“Bussell”) purchased preferred stock in Shale Royalties 14, Inc. (“Shale 14”), pursuant to the PPM for that Offering, and was damaged thereby. The Bussell Living Trust was created pursuant to the law of the state of Washington. Bussell purchased Provident Securities from Defendant QA3 Financial Corp. (“QA3”).

20. Plaintiff John Gilgallon (“Gilgallon”), a resident of Michigan, purchased preferred stock in Shale Royalties 5, Inc. (“Shale 5”) pursuant to the PPM for that Offering, and was damaged thereby. Gilgallon purchased Provident Securities from Defendant GunnAllen Financial, Inc. (“GunnAllen”).

21. Plaintiff Scott Jessen (“Jessen”), a resident of Colorado, purchased preferred stock in Shale Royalties 3, Inc. (“Shale 3”) and Shale Royalties 9, Inc. (“Shale 9”), and purchased an interest in Provident Energy 1, LP, pursuant to the PPMs for those Offerings, and was damaged thereby. Jessen purchased Provident Securities from Defendant CapWest Securities, Inc. (“CapWest”).

22. Plaintiff Sharon Kreindel Revocable Trust DTD 02/09/2005 (“Kreindel”) purchased preferred stock in Shale 12 and Shale Royalties 20, Inc. (“Shale 20”), pursuant to the PPMs for those Offerings, and was damaged thereby. The Kreindel Revocable Trust was created

pursuant to the law of the state of Ohio. Kreindel purchased Provident Securities from Defendant Securities America.

23. Plaintiff Mary Merline (“Merline”), a resident of Michigan, purchased preferred stock in Shale Royalties 17, Inc. (“Shale 17”) pursuant to the PPM for that Offering, and was damaged thereby. Merline purchased Provident Securities from Defendant GunnAllen.

24. Plaintiff James Merrill (“Merrill”), a resident of California, purchased preferred stock in Shale 10 and Shale Royalties 16, Inc. (“Shale 16”) and purchased an interest in Provident Energy 2, LP pursuant to the PPMs for those Offerings, and was damaged thereby. Merrill purchased Provident Securities from Defendant National Securities Corporation (“National Securities”).

25. Plaintiff Don Ribacchi (“Ribacchi”), a resident of Idaho, purchased preferred stock in Shale 3, Shale Royalties 4, Inc. (“Shale 4”), Shale Royalties 6, Inc. (“Shale 6”), Shale 9, Shale 14, Shale 17, and Shale Royalties 18, Inc. (“Shale 18”) pursuant to the PPMs for those Offerings, and was damaged thereby. Ribacchi purchased Provident Securities from Defendant Capital Financial Services, Inc. (“Capital Financial”).

26. Plaintiff Lewis Wilson (“Wilson”), a resident of Texas, purchased preferred stock in Shale 16 pursuant to the PPM for that Offering, and was damaged thereby. Wilson purchased Provident Securities from Defendant NEXT.

## **DEFENDANTS**

### **The Broker Defendants**

27. Defendant Capital Financial is a registered broker-dealer with its principal place of business in Minot, North Dakota. Capital Financial was part of a national network of broker-dealers assembled by PAM, which was based in Texas. Capital Financial served as a broker-

dealer for one or more of the Offerings, including at least the Shale 3, Shale 4, Shale 6, Shale 9, Shale 14, Shale 17 and Shale 18 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. Capital Financial offered, sold or otherwise acted as a seller of Provident Securities to Plaintiff Ribacchi and Class members and acted in a fiduciary capacity to Plaintiff Ribacchi and Class members that purchased securities in the Offerings.

28. Defendant CapWest is a registered broker-dealer with its headquarters in Lakewood, Colorado. CapWest was part of a national network of broker-dealers assembled by PAM, which was based in Texas. CapWest served as a broker-dealer for one or more of the Offerings, including at least the Shale 3, Shale 5, Shale 9 and Provident Energy 1, LP Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. CapWest offered, sold or otherwise acted as a seller of Provident Securities to Plaintiff Jessen and Class members and acted in a fiduciary capacity to Plaintiff Jessen and Class members that purchased securities in the Offerings.

29. Defendant GunnAllen is a registered broker-dealer with its corporate headquarters in Tampa, Florida. GunnAllen was part of a national network of broker-dealers assembled by

PAM, which was based in Texas. GunnAllen served as a broker-dealer for one or more of the Offerings, including at least the Shale 5 and Shale 17 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. GunnAllen offered, sold or otherwise acted as a seller of Provident Securities to Plaintiffs Gilgallon and Merline and Class members and acted in a fiduciary capacity to Plaintiffs Gilgallon and Merline and Class members that purchased securities in the Offerings.

30. Defendant National Securities is a registered broker-dealer with its corporate headquarters in Seattle, Washington. National Securities was part of a national network of broker-dealers assembled by PAM, which was based in Texas. National Securities served as a broker-dealer for one or more of the Offerings, including at least the Provident Energy 2, Shale 10 and Shale 16 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. National Securities offered, sold or otherwise acted as a seller of Provident Securities to Plaintiff Merrill and Class members and acted in a fiduciary capacity to Plaintiff Merrill and Class members that purchased securities in the Offerings.

31. Defendant NEXT is a registered broker-dealer with its principal offices in

Houston, Texas. NEXT was part of a national network of broker-dealers assembled by PAM, which was based in Texas. NEXT served as a broker-dealer for one or more of the Offerings, including at least the Provident Energy 2, Shale 10, Shale 16 and Shale 19 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. NEXT offered, sold or otherwise acted as a seller of Provident Securities to Plaintiffs Adams, Bopp, Wilson and Class members and acted in a fiduciary capacity to Plaintiffs Adams, Bopp, Wilson and Class members that purchased securities in the Offerings.

32. Defendant QA3 is a registered broker-dealer with its principal offices in Omaha, Nebraska. QA3 was part of a national network of broker-dealers assembled by PAM, which was based in Texas. QA3 served as a broker-dealer for one or more of the Offerings, including at least the Shale 9 and Shale 14 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. QA3 offered, sold or otherwise acted as a seller of Provident Securities to Plaintiff Bussell and Class members and acted in a fiduciary capacity to Plaintiff Bussell and Class members that purchased securities in the Offerings.

33. Defendant Securities America is a registered broker-dealer with its principal

offices in La Vista, Nebraska. Securities America was part of a national network of broker-dealers assembled by PAM, which was based in Texas. Securities America served as a broker-dealer for one or more of the Offerings, including at least the Shale 12 and Shale 20 Offerings, and received commissions and due diligence fees for its sales of Provident Securities to investors. The Offerings were sold by means of PPMs that were prepared in Texas, and executed subscription agreements (which are governed by Texas law) were sent to Texas for processing. Plaintiffs' and Class members' subscription agreements were accepted by the relevant Rule 506 Entity in Texas and their securities were issued from Texas. Securities America offered, sold or otherwise acted as a seller of Provident Securities to Plaintiffs Kreindel and Billitteri and Class members and acted in a fiduciary capacity to Plaintiffs Kreindel and Billitteri and Class members that purchased securities in the Offerings.

34. Capital Financial, CapWest, GunnAllen, National Securities, NEXT, QA3, and Securities America are collectively referred to as the "Broker Defendants." Each of the Broker Defendants agreed to sell Provident Securities pursuant to a participation agreement they entered into with the managing dealer, PAM.

#### **The Control Person Defendants**

35. Defendant Ameriprise Financial, Inc. is a provider of financial advice with its headquarters in Minneapolis, Minnesota. The company offers financial planning, products and services to individual and institutional investors. Ameriprise distributes its products primarily through a network of financial advisors that includes direct employees, franchisees, affiliates, and its wholly-owned Securities America broker-dealer subsidiary. By reason of its ownership of 100% of Securities America, Ameriprise controls Securities America and has the ability to direct its management and policies. Ameriprise and Securities America share certain common

management, including that Ameriprise's Chief Financial Officer, Walter S. Berman, is a Director of Securities America.

36. Defendant Capital Financial Holdings, Inc. ("Capital Holdings"), formerly Integrity Mutual Funds, Inc., is a holding company that, through its subsidiary Capital Financial, provides financial services and is headquartered in North Dakota. The company offers, through Capital Financial, investment products and services to independent investment representatives, financial planners and investment advisers. By reason of its ownership of 100% of Capital Financial, Capital Holdings controls Capital Financial and has the ability to direct its management and policies. Capital Holdings and Capital Financial share the same address and phone number, and certain common management, including that Capital Holdings President, Chief Executive Officer and Chief Financial Officer, Bradley P. Wells, is a Director and Treasurer of Capital Financial; Capital Holdings Vice President and Corporate Strategy, Jacqueline L. Case, is a Vice President and Secretary of Capital Financial; and Capital Holdings Director, Vance C. Castleman, is a Director of Capital Financial.

37. Defendant Capstone Financial Group, Inc. ("Capstone") is a provider of financial services with its headquarters in South Carolina. Capstone owns 75% or more of CapWest and directs the management or policies of CapWest.

38. Defendant GunnAllen Holdings, Inc. ("GunnAllen Holdings") is a holding company that, through its subsidiary GunnAllen, provides financial services and is headquartered in Florida. The company, through GunnAllen, engages in securities brokerage, securities trading, investment banking, and money management activities. By reason of its ownership of 75% of GunnAllen, GunnAllen Holdings controls GunnAllen and has the ability to direct its management and policies. GunnAllen Holdings and GunnAllen share the same address and

phone number in Tampa, Florida. Until April of 2009, GunnAllen Holdings and GunnAllen shared the same Chief Executive Officer, Gordon Loetz.

39. Defendant National Holdings Corp. (“National Holdings”) is a holding company that, through its subsidiary National Securities, provides financial services and is headquartered in New York. The company offers, through National Securities, independent brokerage, advisory services and asset management. By reason of its ownership of 75% of National Securities, National Holdings controls National Securities and has the ability to direct its management and policies. National Holdings and National Securities share the same address and phone number, and certain common management, including that Mark Goldwasser serves as the Chief Executive Officer of both National Holdings and National Securities.

40. Defendant NEXT Financial Holdings, Inc. (“NEXT Holdings”) is a holding company that, through its subsidiary NEXT, provides financial services and is headquartered in Texas. By reason of its ownership of 75% of NEXT, NEXT Holdings controls NEXT and has the ability to direct its management and policies. NEXT Holdings and NEXT share the same address and phone number, and certain common management, including that NEXT Holdings Chairman and Chief Executive Officer, Gordon D’Angelo, is the Chairman and Chief Executive Officer of NEXT; NEXT Holdings Director, Norm Grant, is a Director of NEXT; NEXT Holdings Director, David Holtz, is a Director of NEXT; and NEXT Holdings Director, Arthur Farr, is a Director of NEXT.

41. Defendant QA3, LLC is a holding company that, through its subsidiary QA3, provides financial services and is headquartered in Nebraska. By reason of its ownership of 75% of QA3, QA3, LLC controls QA3 and has the ability to direct its management and policies. QA3, LLC and QA3 share the same address and phone number, and certain common

management, including that QA3, LLC Executive Officer, Stephen K. Wild, is the Chairman of QA3; and QA3, LLC Executive Officer, Nancy Drennen, is the Vice President and Chief Marketing Officer of QA3.

42. Ameriprise, Capital Holdings, Capstone, GunnAllen Holdings, National Holdings, NEXT Holdings, and QA3, LLC are collectively referred to as the “Control Person Defendants.”

## **NON-PARTY THE PROVIDENT GROUP**

### **The Provident Management Group**

43. HHBC Enterprise LP (“HHBC”) is a Delaware limited partnership with its principal place of business in Dallas, Texas. HHBC is an affiliate of Brendan W. Coughlin (“Coughlin”) and Henry D. Harrison (“Harrison”). HHBC owns 6,975 LLC units, or 69.75%, of Provident Royalties.

44. WPCO, LLC (“WPCO”) is a limited liability company with its principal place of business in Dallas, Texas. Paul R. Melbye (“Melbye”) and Jeanine Melbye are managing members of WPCO. WPCO owns 2,500 LLC units, or 25%, of Provident Royalties.

45. Melbye, a Dallas, Texas resident, is a founder and manager of Provident Royalties. Melbye is a principal of each Rule 506 Entity, and is the principal in charge of operations for Provident Royalties.

46. Coughlin, a Dallas, Texas resident, is a founder and manager of Provident Royalties. Coughlin is also a managing partner of PAM, and a principal of each Rule 506 Entity.

47. Harrison, a Dallas, Texas resident, is a founder and manager of Provident Royalties. Harrison is also a managing partner of PAM and a principal of each Rule 506 Entity.

48. The PPMs identified Melbye, Coughlin and Harrison as “management” of each Rule 506 Entity.

49. Joseph Blimline (“Blimline”), a Dallas, Texas resident, is a founder and manager of Provident Royalties. Blimline was a manager, employee and consultant to Provident Royalties. On March 7, 2006, Blimline entered into a Consent Order and Stipulation with the State of Michigan, Department of Labor & Economic Growth, Office of Financial and Insurance Services (the “Michigan Dept of Labor”) in connection with an offering of unregistered securities by a Nevada corporation of which he was an officer and director, Longhorn Energy Corporation. Blimline agreed to pay a civil penalty in the amount of \$1,000. Several months later, Blimline was ordered by the Michigan Dept of Labor to cease and desist in connection with another offering of unregistered securities by another Nevada corporation of which he was an officer and director, Jordan River Resources. Blimline was ordered to pay a civil penalty in the amount of \$1,000.

50. HHBC, WPCO, Melbye, Coughlin, Harrison and Blimline are collectively referred to herein as the “Provident Management Group.” The Provident Management Group is not named as a defendant in this action due to the Order Granting Temporary Restraining Order, Appointing Receiver, Freezing Assets, Staying Litigation, Prohibiting the Destruction of Documents and Accelerating Discovery, dated July 2, 2009 (the “Order Appointing Receiver”).

#### **The Provident Entities**

51. Provident Royalties is not named as a defendant in this action due to its bankruptcy filing and the Order Appointing Receiver. It is a Delaware limited liability company with its principal office in Dallas, Texas. Two companies, WPCO and HHBC, hold the majority of the interests in Provident Royalties. Provident Royalties is a beneficial owner in each of the numerous affiliated entities (the Rule 506 Entities as defined below) that issued the Provident Securities sold to investors.

52. PAM is not named as a defendant in this action due to the Order Appointing Receiver. It is a Delaware limited liability company with its principal office in Dallas, Texas. PAM was formed in Texas in September 2002 and is a member of the Financial Industry Regulatory Association (“FINRA”) and Securities Investor Protection Corporation. It has been registered with the SEC as a broker-dealer since 2004, and focuses on investments in the energy sector and specializes in direct participation programs and private placements. Coughlin and Harrison are the principals of PAM, which served as Managing Dealer for the Offerings and organized a syndicate of broker-dealers (including the Broker Defendants) to enter into placement agreements to offer and sell securities in the Offerings. PAM was previously known as AmTex Associates, LLC (“AmTex”) and certain of the Offerings were sold through AmTex. References to PAM herein include AmTex.

53. Provident Royalties and PAM raised funds from investors by creating a series of business entities that issued securities under SEC Rule 506 of Regulation D (the “Rule 506 Entities”). The Provident Securities purportedly were exempt from the registration requirement of the Securities Act of 1933. All of the Rule 506 Entities maintained their headquarters in Provident Royalties’ offices in Dallas, Texas. The Rule 506 Entities are not named as defendants due to their Chapter 11 filings in the bankruptcy proceeding and the Order Appointing Receiver. The Rule 506 Entities include:

- a. Provident Resources 1, LP, a Texas limited partnership that raised approximately \$9.1 million from 214 investors, beginning in March 2007. The Directors and Executive Officers of Provident Resources 1 are Melbye, Coughlin and Harrison. The principal office of Provident Resources 1 is located in Dallas, Texas;

- b. Provident Energy 1, LP, a Texas limited partnership that raised approximately \$7.2 million from 131 investors, beginning in March 2007. The Directors and Executive Officers of Provident Energy 1 are Melbye, Coughlin and Harrison. The principal office of Provident Energy, 1 LP is located in Dallas, Texas;
- c. Provident Energy 2, LP, a Texas limited partnership that raised approximately \$25.9 million from 498 investors, beginning in November 2007. The Directors of Provident Energy 2 are Melbye, Coughlin and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Robert Y. Jordan (“Jordan”) and W. Mark Miller (“Miller”). The principal office of Provident Energy 2 is located in Dallas, Texas;
- d. Provident Energy 3, LP, a Texas limited partnership that raised approximately \$120,000 from four investors. The Directors and Executive Officers of Provident Energy 3 are Melbye, Coughlin and Harrison. The principal office of Provident Energy 3 is located in Dallas, Texas;
- e. Shale Royalties II, Inc. (“Shale II”), a Delaware corporation that raised approximately \$9.7 million from 177 investors, beginning in September 2006. The Executive Officers and Directors of Shale II are Melbye, Coughlin, Harrison and Darin Davis (“Davis”). Melbye is also a beneficial owner of Shale II. The principal office of Shale II is located in Dallas, Texas;
- f. Shale 3, a Delaware limited liability company that raised approximately \$20 million from 339 investors, beginning in January 2007. The

Executive Officers and Directors of Shale 3 are Melbye, Coughlin, Harrison and Davis. Melbye is also a beneficial owner of Shale 3. The principal office of Shale 3 is located in Dallas, Texas;

- g. Shale 4, a Delaware corporation that raised approximately \$27.4 million from 487 investors, beginning in March 2007. The Executive Officers and Directors of Shale 4 are Melbye, Coughlin and Harrison. Coughlin and Harrison are also beneficial owners of Shale 4. The principal office of Shale 4 is located in Dallas, Texas;
- h. Shale 5, a Delaware corporation that raised approximately \$29.94 million from 499 investors, beginning in May 2007. The Directors of Shale 5 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison and Jordan. Melbye, Coughlin and Harrison are also beneficial owners of Shale 5. The principal office of Shale 5 is located in Dallas, Texas;
- i. Shale 6, a Delaware corporation that raised approximately \$27.4 million from 493 investors, beginning in November 2007. The Directors of Shale 6 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 6. The principal office of Shale 6 is located in Dallas, Texas;
- j. Shale Royalties 7, Inc. ("Shale 7"), a Delaware corporation that raised approximately \$31.3 million from 494 investors, beginning in December 2007. The Directors of Shale 7 are Melbye, Coughlin, and Harrison, and

the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 7. The principal office of Shale 7 is located in Dallas, Texas;

- k. Shale Royalties 8, Inc. (“Shale 8”), a Delaware corporation that raised approximately \$31.8 million from 497 investors, beginning in December 2007. The Directors of Shale 8 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 8. The principal office of Shale 8 is located in Dallas, Texas;
- l. Shale 9, a Delaware corporation that raised approximately \$33.2 million from 499 investors, beginning in February 2008. The Directors of Shale 9 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 9. The principal office of Shale 9 is located in Dallas, Texas;
- m. Shale 10, a Delaware corporation that raised approximately \$29.1 million from 496 investors, beginning in February 2008. The Directors of Shale 10 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 10. The principal office of Shale 10 is located in Dallas, Texas;
- n. Shale 12, a Delaware corporation that raised approximately \$34.9 million from 488 investors, beginning in April 2008. The Directors of Shale 12

are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 12. The principal office of Shale 12 is located in Dallas, Texas;

- o. Shale 14, a Delaware corporation that raised approximately \$31.1 million from 446 investors, beginning in July 2008. The Directors of Shale 14 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 14. The principal office of Shale 14 is located in Dallas, Texas;
- p. Shale Royalties 15, Inc. (“Shale 15”), a Delaware corporation that raised approximately \$27.5 million from 458 investors, beginning in July 2008. The Directors of Shale 15 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 15. The principal office of Shale 15 is located in Dallas, Texas;
- q. Shale 16, a Delaware corporation that raised approximately \$31.2 million from 466 investors, beginning in July 2008. The Directors of Shale 16 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale Royalties 16. The principal office of Shale 16 is located in Dallas, Texas;

- r. Shale 17, a Delaware corporation that raised approximately \$30.5 million from 492 investors, beginning in August 2008. The Directors of Shale 17 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. Melbye, Coughlin and Harrison are also beneficial owners of Shale 17. The principal office of Shale 17 is located in Dallas, Texas;
- s. Shale 18, a Delaware corporation that raised approximately \$24.4 million from 306 investors, beginning in October 2008. The Directors of Shale 18 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, and Miller. The principal office of Shale 18 is located in Dallas, Texas;
- t. Shale 19, a Delaware corporation that raised approximately \$12.2 million from 194 investors, beginning in October 2008. The Directors of Shale 19 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan and Miller. The principal office of Shale 19 is located in Dallas, Texas; and
- u. Shale 20, a Delaware corporation that raised approximately \$6.8 million from 91 investors, beginning in October 2008. The Directors of Shale 20 are Melbye, Coughlin, and Harrison, and the Executive Officers are Melbye, Coughlin, Harrison, Jordan, Miller and Dennis Palmer. The principal office of Shale 20 is located in Dallas, Texas.

54. Provident Royalties created two additional entities, Shale Royalties 21, Inc. and Shale Royalties 22, Inc., both Delaware corporations, which did not complete any offerings.

55. The PPM for Shale 20 included the following chart listing the commencement dates for certain of the Offerings, the number of investors, the amounts distributed to investors and the total capital contributed by investors:

**Exhibit C**  
**Provident Royalties, LLC**  
**Prior Activities – Table 1**  
**Experience in Raising Funds**  
**(Status as of August 31, 2008)**

<b>Name of Program</b>	<b>Date Offering Commenced</b>	<b>Number of Investors in Program</b>	<b>Aggregate Capital Contributions from Investors<sup>1</sup></b>	<b>Date of First Distribution of Dividends<sup>2</sup></b>	<b>Dividends and Distributions Paid to Date<sup>3</sup></b>
Shale Royalties II, Inc.	September 2006	177	\$9,755,000	1/31/2007	\$2,661,301
Shale Royalties 3, LLC	January 2007	339	\$19,995,000	5/31/2007	\$3,840,827
Shale Royalties 4, Inc.	March 2007	491	\$27,435,000	7/31/2007	\$3,715,923
Shale Royalties 5, Inc.	August 2007	499	\$29,905,000	1/31/2008	\$2,718,929
Shale Royalties 6, Inc.	November 2007	493	\$27,460,000	3/31/2008	\$1,666,586
Shale Royalties 7, Inc.	December 2007	494	\$31,370,000	5/31/2008	\$895,075
Shale Royalties 8, Inc.	December 2007	497	\$31,810,000	5/31/2008	\$617,976
Shale Royalties 9, Inc.	February 2008	499	\$33,210,000	7/31/2008	\$94,576
Shale Royalties 10, Inc.	February 2008	496	\$29,100,000	9/30/2008	\$0
Shale Royalties 12, Inc.	April 2008	488	\$34,690,000	9/30/2008	\$0
Shale Royalties 14, Inc.	July 2008	324	\$25,685,000	11/30/2008	\$0
Shale Royalties 15, Inc.	July 2008	258	\$22,900,000	11/30/2008	\$0

<sup>1</sup> This number represents the aggregate sum of funds paid by persons who acquired securities of the issuer.

<sup>2</sup> This is the first month in which investors received or will receive dividends.

<sup>3</sup> This number represents the aggregate sum of all cash distributions made to investors (as of August 31, 2008).

Shale Royalties 16, Inc.	July 2008	264	\$25,385,000	11/30/2008	\$0
Shale Royalties 17, Inc.	August 2008	36	\$2,255,000	12/31/2008	\$0
Shale Royalties, LP – Royalty Interest	July 2006	9	\$590,000	10/31/2006	\$802,400
Provident Energy 1, LP – Lease Development	March 2007	131	\$6,820,000	N/A	\$0
Provident Energy 2, LP – Lease Development	November 2007	424	\$25,110,000	N/A	\$0
Provident Resources 1, LP – Lease Development	March 2007	214	\$9,175,000	N/A	\$0

56. Provident Royalties, PAM and the Rule 506 Entities are collectively referred to as the “Provident Entities.”

57. The Provident Management Group and the Provident Entities are collectively referred to as the “Provident Group.”

#### **INTERRELATIONSHIPS OF DEFENDANTS AND THE PROVIDENT GROUP**

58. Through an interconnected network of partnerships, companies, stockholdings and other relationships, the Provident Group conducts business together and engages in overlapping financial activities, resulting in the offer and sale of securities, the co-ownership of and investment in oil and gas assets and the operation of oil and gas properties.

59. Provident Royalties has three subsidiaries that were involved in the operations of the Rule 506 Entities: Somerset Lease Holdings, Inc. (“Somerset”); Somerset Development, Inc.; and Provident Operating Company, LLC. Somerset is a Texas corporation and wholly-

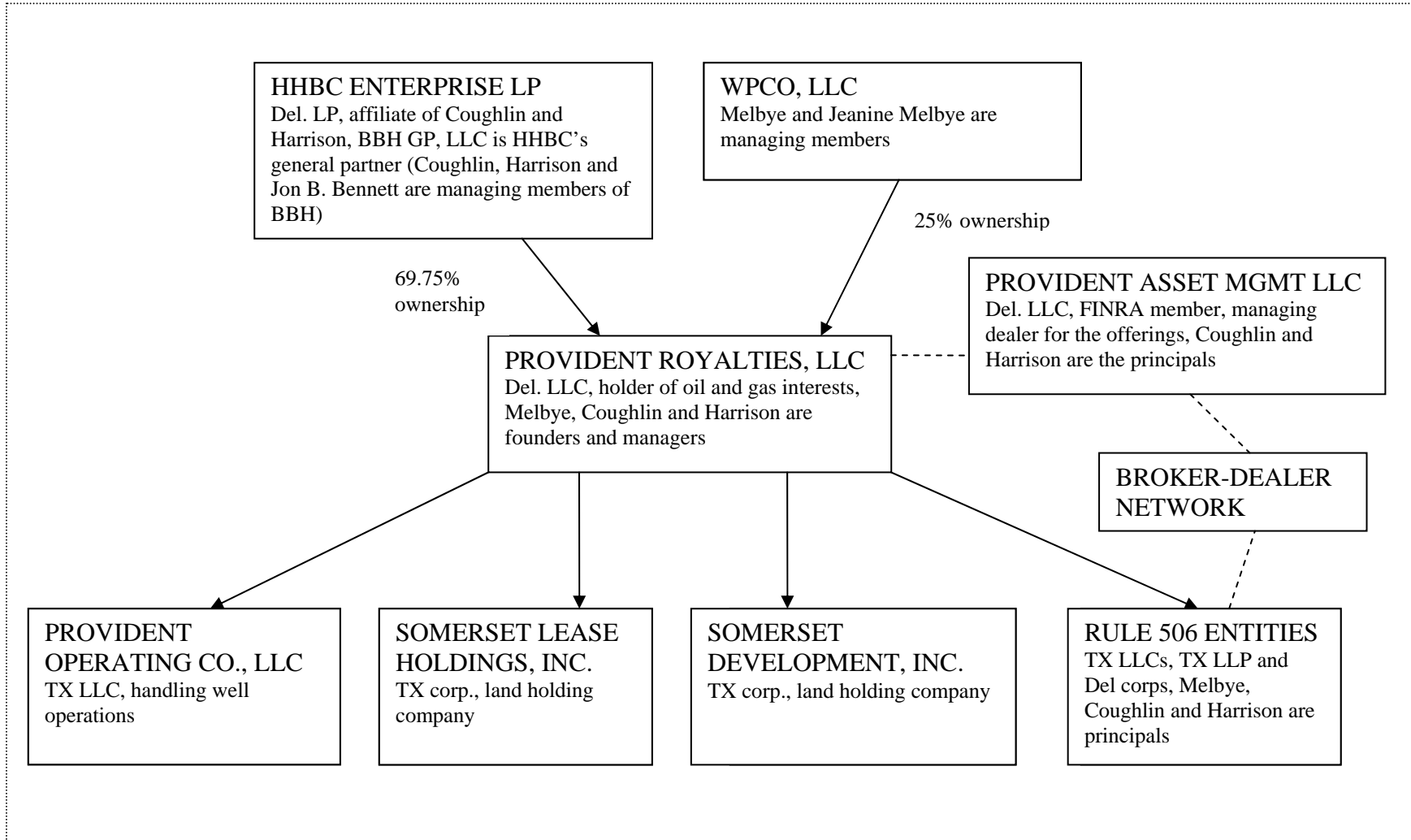
owned subsidiary of Provident Royalties. It was established primarily to hold properties owned by certain of the Rule 506 Entities including Shale Royalties II, Inc., Shale Royalties 3, LLC, Shale Royalties 4, Inc., Provident Energy 1, LP and Provident Resources 1, LP. Somerset Development, Inc. is a Texas corporation and a wholly-owned subsidiary of Provident Royalties that was also established to hold properties owned by certain of the Rule 506 Entities. Provident Operating Company, LLC is a Texas limited liability company, wholly owned by Provident Royalties, and used for well operations.

60. Thus, Provident Royalties, which has a beneficial ownership interest in each of the Rule 506 Entities, as well as other Provident related entities (such as Somerset) is owned by WPCO and HHBC. WPCO's managing members are Melbye and Jeanine Melbye. The general partner of HHBC is BBH GP, L.L.C. ("BBH"). The managing members of BBH are Coughlin, Harrison and Jon B. Bennett.

61. Coughlin and Harrison are also the principals of PAM. In sum, ownership and control of all the Provident Entities flows from the inter-locking ownership positions of the members of the Provident Management Group and their affiliated companies.

62. This organizational chart reflects the Provident Group members' relationships:

**PROVIDENT GROUP ORGANIZATIONAL CHART**



63. In addition, members of the Provident Group commingled investor funds. Funds from investors in the Rule 506 Entities were commingled and placed into one of Provident Royalties' operating accounts. Funds moved freely between the accounts of Rule 506 Entities to pay dividends or to fund operations. In addition, certain Provident Entities shared ownership interests in various oil and gas assets, shared expenses and were liable to Sinclair Oil and Gas Company ("Sinclair") under a secured credit facility.

64. The Broker Defendants participated in the drafting, preparation, approval, due diligence and/or dissemination of various materially false and misleading statements contained in the PPMs issued by the Provident Group. The Broker Defendants were paid commissions and due diligence fees by Plaintiffs and the Class. Plaintiffs and the Class also paid a syndication fee in connection with the Offerings. The Broker Defendants, as statutory sellers (under the Texas Securities Act), together with the Provident Group were responsible for the truth and accuracy of the statements contained in the PPMs issued to Plaintiffs and Class members.

65. The Broker Defendants owed both a duty under FINRA Rule 2310 and a fiduciary duty to purchasers of Provident Securities, including Plaintiffs and the Class, to perform a reasonable due diligence on behalf of investors and to determine that the Offerings were suitable investments for Plaintiffs and the Class. This duty included performing a reasonable and diligent investigation to ensure that the statements contained in the PPM were true, and that there were no omissions of material fact required to be stated in order to make the statements contained in the PPMs not misleading. In breach of their duties, the Broker Defendants failed to adequately conduct such a reasonable investigation.

## **FACTUAL ALLEGATIONS**

### **THE OFFERINGS**

66. PAM, as Managing Dealer, conducted each Offering through a syndicate of participating broker-dealers across the country that executed participation agreements with PAM, including the Broker Defendants. PAM employed wholesalers that assisted the Broker Defendants with product training through workshops and conference appearances. PAM also worked with the Broker Defendants in providing to Plaintiffs and Class members sales and marketing materials designed to encourage investors to purchase Provident Securities.

67. PAM invited the Broker Defendants to its offices for sales presentations for the Offerings. PAM paid the expenses of the Broker-Defendants and others who attended these sales presentations.

68. Each of the Broker Defendants offered, sold, or acted as a seller of Provident Securities purchased by Plaintiffs and Class members. During the Class Period, the Broker Defendants and other broker-dealers raised approximately \$485 million from over 7,700 investors, which was paid into accounts held in Texas banks. Approximately \$69 million in fees were paid to broker-dealers who sold Provident Securities.

69. For each of the Offerings, the Broker Defendants disseminated a substantially identical PPM describing the nature of the investment and solicited funds from investors. These Offerings, which took place over an approximate 30 month period, were limited to 500 investors each.

70. Most of the Offerings consisted of two series of non-convertible redeemable cumulative preferred stock, Series A and Series B (the "Preferred Stock"), which was underwritten by PAM on a best efforts basis. Several of the early Offerings (Provident Energy 1,

LP, Provident Energy 2, LP, and Provident Resources 1, LP) were for limited or general partnership interests that also purported to pay distributions to investors on terms comparable to the Preferred Stock dividends.

71. The remaining Offerings paid investors a Preferred Stock dividend monthly, beginning four months after the initial investment. Returns promised ranged from 14-18% per year.

72. Shale II through Shale 5 offered Class A Preferred Stock that paid 1.5% per month for 24 months. Shale 6 through Shale 17 issued Class A Preferred Stock that paid 1.5% per month for 36 months and Class B Preferred Stock that paid 1.25% per month for 24 months. Shale 18 through Shale 20 issued Class A Preferred Stock that paid 1.375% per month for 48 months, and Class B Preferred Stock that paid 1.167% per month for 36 months. Dividends would be paid monthly, beginning four months after the initial investment.

73. At the end of the redemption period, the Rule 506 Entity would buy back investors' interests for the redemption price, which was the value of the initial principal invested plus any accrued dividends. For example, if an investor made purchased \$100,000 in Class A Preferred Stock of Shale 5, the investor would be entitled to monthly dividends for 24 months, and at the end of that period, Shale 5 would repurchase the Preferred Stock for \$100,000 plus any unpaid dividends. Thus, redemptions for Shale II, a \$9.755 million offering, were scheduled to begin as early as September 2008, two years after the original offering commenced. Numerous additional redemptions were scheduled to commence early in 2009.

#### **MATERIALLY UNTRUE STATEMENTS AND OMISSIONS IN THE PPMs**

74. The Offerings were nearly identical in their terms and stated investment goals. The PPM for Shale 12 presented the following business plan:

The Corporation was organized to engage in all aspects of the oil and gas business, including acquiring real estate, oil and gas leases and mineral interests, and conducting exploration and development activities. The Corporation intends to acquire a combination of various producing and non-producing mineral interests [including royalty interests and working interests] in real property located within the United States. The Corporation may acquire oil and gas leases and subsequently farm-out or sublease such leases. The Corporation may acquire real estate, including surface rights, and subsequently hold or sever and sell the surface rights. The Corporation may acquire real estate, mineral interests and leases from affiliates of the Corporation or may sell real estate, mineral interests or leases to affiliates. The Corporation anticipates that its properties will be developed by oil and gas exploration and development companies, which may include affiliates of the Corporation. The Corporation may participate in oil and gas drilling programs, directly as a working interest owner or indirectly through investment in others. The Corporation may issue and sell additional securities, sell assets, or incur debt, to finance its activities or to participate on or redeem the Preferred Stock.

An identical or nearly identical statement was included in the PPMs for the other Rule 506 Entities.

75. The PPM for Shale 12 also represented that the proceeds from the Offerings would be used in the following manner:

Proceeds of the offering are intended to be used primarily to acquire Properties, and may be used to pay intangible Property Acquisition Costs, which may include an allocated portion of costs incurred by affiliates. The Corporation will use the proceeds of the offering to pay organization and offering costs, to pay non-accountable due diligence and syndication fees and sales commissions to securities broker/dealers, including an affiliate of the Corporation, and to implement its plan of business.

An identical or nearly identical statement was included in the PPMs for the other Rule 506 Entities.

76. Each of the PPMs represented that investor funds would be placed in a separate account belonging to the Rule 506 Entity at issue.

77. Each PPM included a chart setting forth the use of proceeds from that Offering, indicating the percentage of Plaintiffs and Class members' funds that would be dedicated to oil

and gas investments. For example, in Shale 12, the following description appeared in the Use of Proceeds section, indicating that eighty-six percent of investor proceeds were designated for oil and gas investments:

Assuming that the Corporation raises a total of \$35,000,000 from the sale of Preferred Stock:

	<u>MAXIMUM</u>	
Subscription Proceeds	\$35,000,000	100.00%
Organizational Expenses	\$175,000	0.50%
Syndication Fee	\$1,575,000	4.50%
Sales Commission/Due	\$3,150,000	9.00%
Diligence Fee		
Oil and Gas Investments	<u>\$30,100,000</u>	<u>86.00%</u>
Total Gross Proceeds	<u>\$35,000,000.00</u>	<u>100.00%</u>

[Footnotes omitted]

78. Under "Oil and Gas Investments," the PPM stated:

The proceeds of the offering, after payment of expenses, fees and commissions, will be used to implement the Corporation's plan of business. Proceeds will be used primarily to acquire Properties and may be used to pay overhead and administrative expenses and Property Acquisition Costs.

79. The PPMs contained untrue statements of material facts and omitted to state material facts necessary to make the statements made in ¶¶ 74-78, in light of the circumstances under which they were made, not misleading because:

- a. Provident was not using the proceeds from the Offerings to invest in the oil and gas business at the amounts reported to investors (*i.e.* purportedly over \$560 million was spent by the Provident Entities in receivership to purchase oil and gas assets but the value of these assets are estimated by the Receiver to be less than \$30 million);
- b. Less than half of investors' funds were used for the purposes stated in the PPMs;

- c. Investors' funds received in connection with one Offering were commingled with the funds received from investors in other Offerings;
- d. Funds received from later investors were used to pay dividends and returns of capital to earlier investors;
- e. The lack of audited financial statements facilitated the Provident Entities' ability to engage in financial misconduct;
- f. The Provident Entities' internal financial statements lacked transparency as to the financial performance and soundness of prior Offerings;
- g. The Provident Entities lacked adequate internal controls over its financial and accounting functions;
- h. The Provident Entities engaged in numerous undocumented and undisclosed inter-company transactions where funds from one Rule 506 Entity were loaned to another Rule 506 Entity for purchase of leases or payment of dividends;
- i. The Provident Entities were paying millions of dollars of investors' funds to a firm owned by Blimline for properties, without receiving adequate documentation of title to and values of the properties; and
- j. The Offerings were conducted to effectuate a Ponzi scheme operated by the Provident Group.

80. The anticipated sources of the Rule 506 Entities' revenue set forth in the PPMs changed over time. The Shale 5 PPM stated: "The Corporation anticipates that it will receive revenue from the payments under oil and gas leases for the Properties it acquires...[with] five primary areas that will be potential sources of revenue for the Corporation [bonuses, royalty

interest, delay rentals, carried working interest and shut-in royalties].” In contrast, the PPM for Shale 12 stated: “The Corporation anticipates that its *primary* source of revenue will be from the sale of assets. The Corporation anticipates that it *also* will receive revenue from the payments under oil and gas leases for the Properties it acquires.” (emphasis added). Both of these statements were materially false and misleading and omitted material facts, as set forth in ¶ 79, above.

81. Moreover, the Broker Defendants and the Provident Group failed to disclose the sources of funds used to pay distributions and dividends to investors. The PPMs did not disclose whether any revenues generated by the Rule 506 Entities were used to pay investors, or whether loan proceeds, income generated from properties, sales of assets, funds from investors in other Rule 506 Entities or commingled funds were used to make distributions.

82. The PPMs included a chart of information regarding certain prior Offerings, including details regarding the size of the offerings, the number of investors and the amounts paid in dividends. (See ¶ 55, *supra*.) As indicated on the chart included as an exhibit to the PPM for Shale 20, approximately \$17 million had been paid out to investors in the early Offerings. But the PPM did not disclose the sources of funds for those dividends. Accordingly, by omitting such material information from the PPMs, Plaintiffs and the Class were misled regarding the viability of the investment, the relative success of the prior Offerings, whether any of the prior Offerings had generated any operating profit, and the ability of the Provident Entities to generate any true income.

83. With respect to representations regarding the Provident Entities’ relationship with Sinclair, in presentations to broker-dealers, in marketing materials sent to investors, and in the PPMs (after Shale 5), Coughlin, Harrison, Melbye and Blimline touted their relationship with

Sinclair, an established oil and gas exploration and development company. The presentations included the Sinclair logo and characterized Sinclair as Provident Royalties' "industry partner."

84. Although certain Provident Entities had entered into a Participation Agreement with Sinclair pursuant to which Sinclair provided a loan and certain guarantees (on loans obtained from third party banks) to certain Provident Entities in exchange for joint interest in certain properties, Sinclair purportedly never authorized the use of its name or its logo in securities offering documents or other promotional materials. Accordingly, the use of Sinclair's relationship with Provident Royalties and the portrayal of its financial support of Provident Royalties in the PPMs was materially false and misleading as investors were given the impression that Sinclair was providing substantial financial support to Provident Royalties.

85. Blimline's involvement in the management of the Provident Group was not disclosed to investors. Moreover, none of the material facts with respect to Provident Royalties' improper financial dealings with Blimline, the undocumented loans and transfers, and the Michigan consent order and cease and desist order involving the sales of unregistered securities (as described in ¶¶ 49, 98-104), were disclosed to Plaintiffs and Class members.

#### **The Provident Entities' True Financial Condition and Financial Misconduct**

86. Rather than disclose its insufficient resources, Provident Royalties paid dividends to investors by using later investors' funds. For example, in October 2007, \$2.2 million was transferred from a Shale 5 bank account to a Shale 4 bank account, and a portion of those funds were used to pay dividends to Shale 4 investors.

87. Similarly, on January 3, 2008, \$88,000 was transferred from a Shale 4 bank account to a Shale 3 bank account. The Shale 3 account had a balance of \$36 immediately prior to the transfer. Immediately subsequent to the deposit, Shale 3 made payments to investors

totaling \$86,941. Therefore, the \$88,000 from Shale 4 was the only source of funds for the dividend payment.

88. In December 2008, Provident Royalties placed \$22,640,000 in new funds from investors into accounts for Shale 17, Shale 18, Shale 19 and Shale 20. Of that amount, Provident Royalties used \$11,250,000 to fund dividend and distribution payments to prior investors and pay general expenses of Provident, rather than to invest in oil and gas assets, as had been represented to investors. A spreadsheet prepared by Provident Royalties for December 2008 listed the \$11,250,000 received from new investors as moved from their original Rule 506 Entity accounts into two other accounts: \$9,500,000 was transferred into Provident Royalties' primary bank account and \$1,750,000 was transferred to Provident Royalties' operating account. At about the same time, \$10,396,150 was transferred from the primary bank account into ten separate Rule 506 Entities' accounts and used to make dividend payments and distributions to earlier investors in those Rule 506 Entities. The \$1,750,000 was used to pay general overhead and business expenses.

89. Provident Royalties characterized the transfers as "loans" but there was no documentation for the loans, there were no terms attached to the loans, and there were no procedures in place to insure that these loans were repaid.

90. Similarly, transfers from the Rule 506 Entities to Provident Royalties for payments of overhead or operating expenses were not properly documented, there were no terms attached to the transfers, and, there were no procedures in place to insure that these loans were repaid.

91. From January 1 through January 22, 2009, the last day new investor funds were accepted, Provident Royalties received approximately \$8.5 million from new investors in the

Offerings. During that period, Provident Royalties used at least \$4 million to pay returns and distributions to investors in the following Rule 506 Entities: Shale 2 (\$1,370,000); Shale 3 (\$252,000); Shale 4 (\$202,000); Shale 5 (\$198,000); Shale 6 (\$200,000); Shale 8 (\$314,000); Shale 9 (\$330,000); Shale 10 (\$316,000); Shale 12 (\$303,000); Shale 14 (\$239,000); Shale 15 (\$118,000); Shale 16 (\$139,000); and Shale 17 (\$12,000).

92. The Broker Defendants and the Provident Group did not disclose to Class members that the Provident Entities needed to use proceeds from later Offerings to pay dividends to investors in other earlier Offerings. The Provident Group transferred assets and funds from one Rule 506 Entity to another to make dividend payments in order to give the appearance that earlier investors were being paid returns on their investments. In fact, earlier investors, who had been told that roughly 86 percent of their funds would be invested in oil and gas assets, were paid returns with the funds from later investors, without Class members' knowledge. Plaintiffs and the Class were not informed that far less than 86 percent of prior investors' funds had actually been invested in oil and gas assets and that the Provident Entities did not have the financial ability to pay dividends and redemptions.

93. In connection with the Shale 19 Offering, PAM engaged Mick & Associates, PC to perform a program level review. Mick & Associates provided Grant Bettingen, Inc. with its report on November 14, 2008 (the "Mick Report").

94. The Mick Report, citing Provident Royalties' own pro forma financials, indicates that Provident Royalties was facing financial collapse once redemptions were due to start in early 2009. The Mick Report projects ongoing expenses of approximately \$203.7 million, including dividends payable totaling \$85.2 million and \$85.2 million in anticipated preferred stock redemptions, which were to accrue over the first six months of 2009.

95. As reflected in as of October 31, 2008, a consolidated Statement of Operations and Balance Sheet the Rule 506 Entities showed a year to date loss of -\$7,572,699. In addition, oil and gas revenue from Provident Royalties' properties was dropping precipitously. According to an April 2009 Confidential Information Memorandum prepared by Raymond James, evaluating Provident Royalties' assets, total oil and gas revenue decreased from \$937,527 in August 2008 to \$488,441 in October 2008.

96. Additionally, in a deposition before FINRA, Harrison acknowledged that Provident Royalties' accounting system was approximately three months behind in its calculations of the sources and uses of investor funds, and that he did not know how much revenue from operations the Provident Entities were receiving.

97. With a year to date loss of \$7,572,699 as of October 31, 2008, and negative retained earnings, the Provident Entities did not have sufficient resources to pay dividends. Neither the Provident Entities nor the Broker Defendants disclosed to Plaintiffs and Class members in the PPMs or in any other document, that the Provident Entities were operating at a loss and did not have adequate resources to pay the returns promised to investors. Revenue from the Provident Entities' oil and gas operations was inadequate to pay dividends and as the Class Period went on, revenues drastically decreased.

#### **The Provident Entities' Other Improper Business Practices**

98. The Provident Entities also engaged in numerous improper business practices in conjunction with Blimline's work for the Provident Group.

99. Provident Royalties, through the Rule 506 Entities and otherwise, advanced tens of millions of dollars to Blimline and a series of approximately 31 entities he operated and controlled for the purported purchase of oil and gas interests. Blimline claimed that he had

expertise in the oil and gas industry and that he could locate prospective oil and gas interests in targeted areas, provide the necessary title work and acquire those interests for Provident Royalties at a fair and reasonable price. In fact, Blimline's acquisitions were neither strategically targeted nor acquired at a fair and reasonable price. In many cases, there was no land or mineral acquisition at all.

100. Blimline obtained Provident Royalties' funds by simply providing it with a "purchase order." Blimline and his entities never, or only belatedly, provided Provident title documents evidencing the interests purchased.

101. Blimline acquired properties on behalf of Provident Royalties at prices far greater than the fair market value of the properties. In many instances, Blimline charged Provident Royalties a higher price than he actually paid for the properties. Blimline often received duplicate payments for the same property, but seldom returned these duplicate payments to Provident Royalties.

102. Beginning in December 2007, Blimline obtained more than \$20 million in loans from Provident Royalties. The loans were supposedly short term and were for no stated purpose.

103. Blimline ostensibly repaid some of the loans. Those loan repayments, however, were simply made with funds that Provident Royalties loaned to him at a later date. Blimline easily obtained funds from Provident Royalties with little or no documentation because there were virtually no internal accounting controls at Provident Royalties.

104. Provident Royalties also advanced funds to Blimline for the purchase of a number of ranches in Oklahoma, properties that included surface and mineral interests. Despite being paid by Provident Royalties for the properties in their entirety, Blimline transferred only the

mineral interests to Provident Royalties, while keeping the surface interests in the name of his own entities.

105. Blimline's involvement with the Provident Group, and the improper practices and financial misconduct Provident engaged in with Blimline, as described in ¶¶ 98-104, were material facts that were not disclosed to Plaintiffs and Class members.

### **THE BROKER DEFENDANTS' BREACHES OF THEIR FIDUCIARY DUTIES**

106. The Broker Defendants offered, solicited the sale of and/or sold Provident Securities to Plaintiffs and the Class. Each Broker Defendant acted as a fiduciary to Plaintiffs and Class members that purchased Provident Securities from them in the Offerings. The Broker Defendants owed due diligence obligations to investors in connection with their offer and sale of Provident Securities. In breach of those obligations, the Broker Defendants did not conduct proper or reasonable due diligence of the Provident Entities.

107. FINRA Rule 2310 regarding Direct Participation Programs states that a registered broker-dealer must have a reasonable basis for believing that the investment at issue is suitable for the investor:

#### **(2) Suitability**

...

(B) In recommending to a participant the purchase, sale or exchange of an interest in a direct participation program, a member or person associated with a member shall:

(i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member or associated person, that:

a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;

b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and

c. the program is otherwise suitable for the participant; and

(ii) maintain in the files of the member documents disclosing the basis upon which the determination of suitability was reached as to each participant.

108. Because the Offerings were part of a Ponzi scheme and the Broker Defendants failed to perform adequate due diligence, the Broker Defendants did not have a reasonable basis to believe this investment was suitable for Plaintiffs and Class members, as required by FINRA Rule 2310. The Broker-Defendants should not have solicited and offered to sell Provident Securities to Plaintiffs and Class Members.

109. As part of their fiduciary and due diligence obligations, the Broker Defendants should have evaluated the Provident Entities' financial statements, financial performance, and future financial prospects, which should have included a review of the Provident Entities' financial statements and well as general financial issues such as profits, revenue, budgets, projected revenues, the use of proceeds and purchase of properties, the role of Sinclair, and its overall internal financial controls. Proper due diligence would have made apparent that the PPMs were materially misleading because of untrue statements of material fact and omissions of material fact.

110. In the Mick Report, a "program level review" provided to a broker-dealer in connection with the Shale 19 Offering, the author cited numerous red flags related to the Provident Entities financial records and performance.

111. The Mick Report repeatedly criticized the Provident Entities' failure to properly account for inter-company transfers and the lack of transparency of the Provident Entities' financial statements:

- a. In connection with Provident Energy 1, “I believe that the ongoing accounting adjustments reemphasize the need for enhanced transparency and audited financial statements relating to Provident and each of its affiliated entities.”
- b. In connection with Shale II, the Mick Report observed that while the affiliate was reporting a \$2.7 million increase to its gross assets, it was also reporting \$5.1 million in inter-company payables, an increase of about \$3 million since six months earlier, in May 2008. “Acknowledging that much of the asset position increase can be traced to the inter-company transactions, the presence of these inter-company transactions should be adjusted out in the immediate future.”
- c. In connection with Shale 3, the Mick Report noted that the affiliate was reporting \$81 million in inter-company receivables, an increase of \$80 million from what was reported in May 2008, and concluded that “The financial information reported for this entity represents one instance, in particular, where it is difficult to appropriately discern the actual asset and liability positions (due to the presence of inter-company transactions that need to be adjusted)...Again, we would strongly recommend some additional adjustments to the Balance Sheet so that the asset positions are appropriately shown.”
- d. In its analysis of Shale 4, the Mick Report observed that: “Again, the financial information reported for this entity represents another instance where it is difficult to appropriately discern the actual asset and liability

positions due to the presence of inter-company transactions that need to be adjusted.”

- e. The Mick Report observed that Provident Royalties was reporting seventy-nine inter-company transactions and stated that “I would like to see appropriate adjusting entries made to the balance sheets to provide a transparent disclosure of each entities’ real estate and mineral holdings.”
- f. The Mick Report concluded: “there are some immediate matters that need to be addressed...Provident needs to develop financial statements that are more transparent and user friendly to broker-dealers and interested parties. To accomplish this, these financial statements need to reflect each affiliated parties’ asset positions after all inter-company transactions and negative entries are reversed...*Short of this, it is difficult to discern how the asset and liability positions of these entities stand at this time.*” (Emphasis added.)
- g. “I would like to see immediate priority and attention given to make these financial statements more transparent to broker-dealers and other interested parties (by closing out the intercompany entries to show each affiliate’s real estate and liability holdings after the advances are closed out). To the extent that Provident’s affiliated entities were to engage in inter-company transactions in the future, I further believe that the circumstances and terms of these transactions should be prominently documented as footnotes to the financial statements.”

112. Moreover, the Mick Report recognized Provident Royalties' immediate need for cash:

- a. "Provident has used the full amount of its credit line, which has a principal balance of about \$175 million...According to Provident's pro forma, approximately \$203.7 million in operating flow is needed to service Provident's administrative costs, loans, dividends, and redemptions...In the absence of additional credit line funds, Provident's operating funds will need to come from (i) a higher level of production revenues going forward, or (ii) future divestures of lease/mineral assets."
- b. "[T]he next 6 months will be a critical time in Provident's business cycle with additional cash flow resources needed from divestures and well production. In view of the significant level of capital raised in prior programs, I again would like to see some level of third-party validation with respect to Provident's financials for the remaining fiscal quarters of 2008."

113. Finally, the Mick Report emphasized dissatisfaction with the Provident Entities' failure to provide audited financial statements:

- a. "[W]e would like to see audited financial statements or alternatively a report from an independent accounting firm that validates the information reported by Provident."
- b. "[T]he ongoing accounting adjustments [to track the usage of funds] reemphasize the need for enhanced transparency and audited financial statements relating to Provident and each of its affiliated entities."

114. The Broker Defendants' failure to conduct adequate or reasonable due diligence, that would have uncovered these numerous financial red flags and lack of financial statement transparency, allowed the materially false and misleading PPMs to be distributed to Plaintiffs and Class members.

115. The Broker Defendants failed to adequately investigate, and disregarded issues in connection with, the principal financial representations of the Provident Group and the adequacy of its internal controls. The Broker Defendants failed to conduct a reasonable investigation of the use of proceeds from the Offerings, the amounts of investor funds actually used to buy oil and gas investments and the sources of payments of prior dividends and distributions. Because the Broker Defendants failed to conduct proper due diligence they failed to learn that the Provident Group did not have adequate internal controls to prevent the commingling of Class members' funds, had permitted poorly documented or undocumented inter-company transfers and that the Provident Group was improperly commingling funds received from investors in different Offerings.

116. The Broker Defendants did not fulfill their obligations under FINRA Rule 2310 or their fiduciary duties to investigate the use of investor funds and the source of paid dividends in prior Offerings, despite numerous red flags indicating that the Offerings were unsuitable investments because investors' funds were not being used in accordance with the terms set forth in the PPMs. Among the red flags that should have triggered the Broker Defendants to increase due diligence were:

- a. the absence of any audited financial statements for the Provident Entities;
- b. the lack of any detail regarding the sources of funds used to pay investors in other Rule 506 Entities;

- c. the inability of Provident Royalties to timely account for the use of investor proceeds;
- d. the massive borrowing undertaken by affiliates in the Provident Group;
- e. the purchase of oil and gas interests in amounts far less than that which was received from investors; and
- f. the lack of internal financial controls and the improper accounting related to inter-company transactions.

117. The media has characterized sales of the Offerings as an example of questionable due diligence. On September 27, 2009, *Investment News* published an article titled “Risks of Reg D deals worry state regulators” that reported:

Many are questioning the due diligence performed on private placements — known as “Reg D” offerings because of how they are filed with the SEC — as well as the fees earned by broker-dealers for such work.

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#### **“NATIONAL DEBACLE”**

Because they are so poorly vetted, private placements are “a national debacle,” said Brian Kovack, president of Kovack Securities Inc.

Broker-dealers often leave the actual analysis of the offerings to outside, third-party due-diligence firms.

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In addition to a possible conflict arising from [due-diligence firms] receiving fees from the companies they analyze, due-diligence firms often produce superficial reports that provide only the most cursory review of the issuers and their finances, say industry executives and lawyers.

The concept behind broker-dealers' being paid a due diligence fee, usually 1%, when they sell the deal, is for “time spent and to read the report and to ask questions,” Mr. Kovack said.

The reality is often different, he added, echoing other brokerage executives. “A lot of firms don't even bother reading” the due-diligence reports.

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On July 7, the SEC charged Provident Royalties LLC and a number of its related entities with operating a fraud and a Ponzi scheme in the sale of \$485 million of preferred stock and limited-partnership offerings in oil and gas deals.

The deals were sold from 2006 to 2009.

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According to the private-placement memorandum for one Provident offering, the sales commission was 8% and the due-diligence fee was 1% of the deal's total value. If Provident offered a 1% due-diligence fee to broker-dealers on all its deals, that means firms collected \$4.9 million in fees, and what constitutes broker-dealer due diligence on the Provident offerings and other deals is unknown.

118. A November 8, 2009 *Investment News* article titled “Broker-dealers grow gun-shy about private placements” addressed the need for broker-dealers to conduct proper due diligence:

However, since the Securities and Exchange Commission in July leveled charges of fraud at two highly popular private deals — involving Medical Capital Holdings Inc. and Provident Royalties LLC — that raised \$2.7 billion, executives with broker-dealers started to scrutinize private partnerships more than ever, at times causing friction between the firms that create the deals and those that sell them.

“The suitability of products and the sales practices are under much more scrutiny,” said David Levine, executive vice president of Gunn-Allen Financial Inc. He said his firm has implemented a more rigorous process of presenting such investments to an internal group that assesses risk.

New offerings are being more closely scrutinized, and broker-dealers are skittish, another executive said.

“We've done a lot of due diligence, and we'll do more due diligence. You can't go with new guys,” said Mark Goldwasser, chief executive of National Holdings Corp. “

“We need transparency, and we need accounting, or else the [private-placement] industry will be in a lot of trouble,” he said.

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“In the past, brokers could talk firms into selling deals,” she said. “Now firms are much more timid.”

### **GREATER DEMANDS**

One oil-and-gas executive who sells private partnerships finds that broker-dealers are requiring more information from the issuers of the partnerships.

Broker-dealers “are demanding third-party reports and more due diligence,” said Michael Windisch, chief financial officer of NGAS Resources Inc., which focuses on natural-gas exploration in the eastern half of the United States. “You pay for [the report], but you don't know what it will say until it's published.”

### **THE TERMINATION OF THE OFFERINGS AND SUBSEQUENT EVENTS**

119. On or about January 22, 2009, Provident Royalties announced that it would no longer accept new investors. On or about January 29, 2009, Provident Royalties suspended dividends and payments for all investors in the Offerings. Provident Royalties sent a letter to investors informing them that:

The Company's management believes that it is important in this challenging environment to preserve the long-term value of its assets for its shareholders by using the company's current cash flow to continue to manage its asset base as well as continue to participate in well elections on its acreage in order to continue to create value.

As a result, the Company has made the decision to temporarily suspend its dividend payments and postpone redemptions beginning on the January 31, 2009 distribution date. The Company's management continues to assess the current market conditions and to analyze current and forecasted cash flow and ongoing cash needs of the Company. The Company will also reevaluate its ability to pay any dividends and make redemptions on a monthly basis. Any dividends that are not timely paid, however, will continue to accrue at the stated rate.

The company believes that it has adequate cash to manage through this tough time and that, at some point, the oil and gas market will strengthen. The company is still confident in the base of assets that it owns and its interest is to preserve and create value for its shareholders. In the meantime, we intend to carefully manage our assets to the best of our abilities on behalf of our shareholders.

120. At that time, Provident Royalties owed millions of dollars to investors. For the period ending January 2009, Provident Royalties owed \$5,624,660 in monthly interest payments to investors, an amount that increases each month as new investors' dividends come due and prior investors' preferred stock redemptions come to term. For example, in addition to the \$5,624,660 owed in dividend payments on January 31, 2009, Shale II investors were also owed \$4,506,125 as a return of principal. Thus, by the end of January 2009, Provident Royalties owed investors at least \$10,130,785, with nearly \$200 million coming due in 2009.

121. In a letter dated March 5, 2009, investors were informed that Provident Royalties had retained outside advisors, including Raymond James, to assist the Provident Entities in preserving the long-term value of their assets.

122. On March 31, 2009 and April 30, 2009, in virtually identical letters, investors were informed that the suspension of dividend payments and redemptions continued, but that dividends continued to accrue.

123. On or about June 22, 2009, Provident Royalties and approximately 26 affiliated and related companies filed petitions in the United States Bankruptcy Court for the Northern District of Texas (Dallas Division) seeking relief under Chapter 11 of the United States Bankruptcy Code.

124. On July 1, 2009, the SEC filed civil fraud charges against Provident Royalties and its principals, alleging that Provident Royalties made a series of fraudulent securities offerings involving oil and gas investments, and alleging that certain members of the Provident Group engaged in a Ponzi scheme.

**CLASS ACTION ALLEGATIONS**

125. Plaintiffs bring this action pursuant to Rules 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure.

126. This is a class action filed on behalf of the Class, defined in ¶ 12 herein. The Class satisfies the requirements of Rule 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure including numerosity, typicality, commonality, superiority and adequacy.

127. Excluded from the Class are Defendants, the Provident Group, members of the immediate families of each of the Defendants, the Provident Group, and any person, firm, trust, corporation, officer, director or other individual or entity in which any Defendant, or any Provident Group member has a controlling interest or that is related to or affiliated with any of the Defendants or Provident Group members, or the legal representatives, agents, affiliates, heirs, successors-in interest or assigns of any such excluded person.

128. The members of the Class are so numerous that joinder of all members would be impracticable.

129. The number of Class members is estimated to be in the thousands. The names and addresses of the Class members can be ascertained from the books and records of the Provident Group or Defendants. Notice can be provided to such record owners by a combination of published notice and first-class mail, using techniques and a form of notice similar to those customarily used in class actions.

130. Plaintiffs will fairly and adequately represent and protect the interests of the Class members. Plaintiffs have retained competent counsel experienced in class action litigation to further ensure such protection and to prosecute this action vigorously.

131. Plaintiffs' claims are typical of the claims of the other Class members, because Plaintiffs and the Class' damages arise from and were caused by the same material misrepresentations and omissions of material fact in the PPMs made by or chargeable to Defendants. Plaintiffs do not have any interests antagonistic to, or in conflict with, the Class.

132. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Since the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the Class members to seek redress for the wrongful conduct alleged. Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

133. Common questions of law and fact exist as to all Class members and predominate over any questions affecting solely individual Class members. Among the questions of law and fact common to the Class are:

- a. Whether Defendants are liable under the Texas Securities Act as alleged herein;
- b. Whether Defendants breached their fiduciary duties as alleged herein; and
- c. The extent of injuries sustained by the Class and the appropriate measure of damages.

## COUNT I

### **§33(A)(2) OF THE TEXAS SECURITIES ACT AGAINST THE BROKER DEFENDANTS**

134. Plaintiffs repeat and reallege the allegations contained in the foregoing paragraphs as if fully set forth herein.

135. The Broker Defendants were offerors and/or sellers within the meaning of the

Texas Securities Act because they sold Provident Securities to Plaintiffs and the Class and/or actively solicited the sale of Provident Securities to Plaintiffs and the Class, pursuant to materially false and misleading PPMs. The Broker Defendants received fees, including commissions and due diligence fees, for their sales of Provident Securities to investors. The Broker Defendants were motivated at least in part by a desire to serve their own financial interests.

136. Plaintiffs and the Class purchased Provident Securities in the Offerings pursuant to the materially untrue statements and omissions of material facts in the PPMs disseminated by the Broker Defendants, and did not know, and in the exercise of reasonable diligence could not have known, of the untruths and omissions contained in those documents.

137. Plaintiffs and the Class have suffered damages as a result of the wrongs herein alleged in an amount to be proven at trial.

138. By reason of the foregoing, the Broker Defendants are liable to Plaintiffs and the Class under § 33(A)(2) of the Texas Securities Act for damages that Plaintiffs and the Class suffered in connection with their purchases of Provident Securities during the Class Period.

139. Plaintiffs, individually and on behalf of all Class members, hereby tender to Defendants those Provident Securities that Plaintiffs and the Class continue to own, in return for the consideration paid for those Provident Securities together with interest thereon. Class members that have sold their Provident Securities demand rescissory damages.

## COUNT II

### **§ 33(F)(1) OF THE TEXAS SECURITIES ACT AGAINST THE CONTROL PERSON DEFENDANTS AS CONTROL PERSONS**

140. Plaintiffs repeat and reallege the allegations contained in the foregoing paragraphs as if fully set forth herein.

141. The Control Person Defendants directly and/or indirectly controlled the Broker Defendants within the meaning of § 33(F)(1) of the Texas Securities Act as alleged herein. Each Control Person Defendant exercised control over the management, policies and operations of its subsidiary Broker Defendant and had the power to control the specific transactions and/or activities upon which Count I is predicated.

142. Each Control Person Defendant had the ability to prevent its subsidiary Broker Defendant from acting as a seller of Provident Securities. In particular, each Control Person Defendant had direct and supervisory involvement in and/or knowledge of the day-to-day operations of its subsidiary Broker Defendant and, therefore, had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

143. By reason of the foregoing, the Control Person Defendants are jointly and severally liable, under § 33(F)(1) of the Texas Securities Act, to Plaintiff and the other Class members for damages that they suffered in connection with their purchases of Provident Securities during the Class Period.

### **COUNT III**

#### **BREACH OF FIDUCIARY DUTY AGAINST THE BROKER DEFENDANTS**

144. Plaintiffs repeat and reallege the allegations contained in the foregoing paragraphs as if fully set forth herein.

145. By reason of, among other things, the Broker Defendants' direct representations and their role and responsibilities with respect to the Offerings, the Broker Defendants owed fiduciary duties to Plaintiffs and the Class with respect to the management and protection of the Class's funds invested in the Offerings.

146. The Broker Defendants were under a fiduciary duty to deal fairly with Plaintiffs and the Class and to communicate promptly to them all material facts that they knew or should have known with respect to the true nature of the investments in the Provident Entities.

147. As set forth in ¶¶ 74-85, the PPMs contained untrue statements of material fact and omitted other material facts necessary to make the statements in the PPMs not misleading. Among other things, the PPMs failed to disclose the commingling of the funds invested in other Rule 506 Entities, the failure to invest all of the proceeds as represented in the PPMs and that the funds received from one Offering were used to pay dividends to investors in prior Offerings.

148. In breach of their fiduciary duties, the Broker Defendants failed to conduct reasonable due diligence of the Provident Entities, and failed to disclose that the PPMs had misrepresented or omitted material facts as set forth in ¶¶ 74-85, and failed to conduct proper due diligence in conformance with their fiduciary duties.

149. As a result of the Broker Defendants' misconduct, Plaintiffs and the Class have suffered damages.

### **PRAYER FOR RELIEF**

**WHEREFORE**, Plaintiffs pray for relief and judgment, as follows:

A. Determining that this action is a proper class action, certifying Plaintiffs as representatives of the Class under Rule 23 of the Federal Rules of Civil Procedure and Plaintiffs' counsel as counsel for the Class;

B. Awarding Plaintiffs and the Class compensatory damages against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongful conduct in an amount to be proven at trial;

- C. Awarding Plaintiffs and the Class rescission or a recessionary measure of damages;
- D. Awarding Plaintiffs and the Class pre-judgment interest;
- E. Awarding Plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and
- G. Granting such other and further relief as the Court may deem just and proper.

**JURY TRIAL DEMANDED**

Plaintiffs hereby demand a trial by jury.

Dated: December 7, 2009

**McKOOL SMITH P.C.**

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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing document was served on all counsel of record on December 7, 2009, via the Court's CM/ECF system.

/s/Lewis T. LeClair  
Lewis T. LeClair