

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW MEXICO

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

Case No. \_\_-\_\_\_\_ (\_\_\_\_)

v.

DOUGLAS F. VAUGHAN,

THE VAUGHAN COMPANY, REALTORS, INC.,  
and

VAUGHAN CAPITAL, LLC.

Defendants

**COMPLAINT**

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

**SUMMARY**

1. Defendant Douglas F. Vaughan (“Vaughan”) is the founder, controlling shareholder, Chairman, and sole director of Defendant The Vaughan Company, Realtors, Inc. (“Vaughan Company”). He also controls Defendant Vaughan Capital, LLC (“Vaughan Capital”).

2. Beginning in approximately 1993 and continuing until at least January 31, 2010, Vaughan caused Vaughan Company to issue promissory notes to hundreds of investors in New Mexico and other states. These notes promised high, fixed interest

payments, typically ranging from 10% to 25%, over one to three years. In written offering materials and other communications, Vaughan represented that the aggregate principal on the notes would not exceed a certain limit (\$2.5 million in the most recent notes), that the notes were “secured” by certain real estate and Vaughan’s personal wealth, and that Vaughan Company used investor funds to generate profits well in excess of its obligations on the notes.

3. In June 2008, Vaughan formed Vaughan Capital and began selling “membership units” in the entity to investors. In written offering materials and other communications, Vaughan represented that Vaughan Capital would generate returns for its investors by making different types of real estate-related investments, including, for example, buying residential properties at distressed prices.

4. In truth, the Vaughan Company promissory note program and the Vaughan Capital offering are both part of a single Ponzi scheme. The aggregate principal on the promissory notes has grown to approximately \$80 million, generating an annual interest obligation to investors of approximately \$14 million. To fund Vaughan Company’s ever-increasing obligations to note holders, Defendants have relied entirely on new money raised from investors, both in the note program and in the Vaughan Capital offering.

5. Having reached the point where Vaughan Company’s cash obligations to investors have exceeded Defendants’ ability to raise new investor funds, the scheme has recently collapsed, and Vaughan and Vaughan Company have each filed for bankruptcy protection. As evidenced by their filings in those proceedings, the supposed “security” for the promissory notes pales in comparison to amounts owed on the notes.

6. As a result of the conduct described herein, Defendants have violated and, unless restrained and enjoined, will continue to violate Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 (“Securities Act”) [15 U.S.C. §§ 77e(a), 77e(c), 77q(a)] and Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. §§ 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; and Defendants Vaughan and Vaughan Company have violated Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

### **JURISDICTION AND VENUE**

7. The Court has jurisdiction pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d)-(e) and 78aa]. The Defendants, directly or indirectly, made use of the means or instruments of transportation or communication in interstate commerce, the means and instrumentalities of interstate commerce, or of the mails, in connection with the acts, practices, and courses of business set forth in this Complaint.

8. Venue lies in this judicial district pursuant to 15 U.S.C. §§ 77u (a) and 78aa and 28 U.S.C. § 1391(b) (2). Defendants reside in this district, the violations occurred in this district, and most of the defrauded investors reside in this district.

### **DEFENDANTS**

9. **Douglas F. Vaughan**, is a resident of Albuquerque, New Mexico, and the founder, controlling shareholder, Chairman, and sole director of Vaughan Company. At all times relevant to this Complaint, Vaughan’s actions have been attributable to Vaughan Company and Vaughan Capital.

10. **The Vaughan Company, Realtors, Inc.** is a New Mexico corporation with its principal place of business in Albuquerque, New Mexico. It has marketed itself as the largest independent real estate company in New Mexico. For at least the last two years, Vaughan Company's principal source of cash has been investments in its promissory notes.

11. **Vaughan Capital, LLC** is a New Mexico limited liability company with its principal place of business in Albuquerque, New Mexico. The managing member of Vaughan Capital is another New Mexico limited liability company, Phoenician Financial Services, LLC, which, in turn, is controlled by Vaughan.

### **THE DEFENDANTS' FRAUDULENT SCHEME**

#### **A. Overview of the Vaughan Company Note Program**

12. In or around 1993, Vaughan, through Vaughan Company, began offering investors promissory notes promising to pay high, fixed rates of interest. Vaughan continued offering such notes until at least January 31, 2010. Defendants' promissory note offering has never been registered with the SEC.

13. Vaughan has personally solicited investments in the promissory note program, exploiting his reputation as a successful businessman and a pillar of the Albuquerque business community. He has encouraged existing investors to help him bring in new investors, and he has paid some referrers commissions on investments they have directed to Vaughan Company. At least one of those referrers has used a website and investor seminars to attract new investors for Vaughan.

14. In recent years, Vaughan has offered promissory notes that purport to commit Vaughan Company to make fixed, monthly interest payments over one-, two-,

and three-year terms at rates typically ranging from 10 to 25 percent per year. Vaughan has told investors that he raises capital through promissory notes, instead of borrowing from banks, because he was mistreated by a bank in 1992 and vowed never to “go back to the banks” again if at all possible. He has assured investors that Vaughan Company is able to pay above-market interest rates on the notes because the profits he generates with note program funds far exceed the amounts Vaughan Company is required to pay investors.

15. In addition to making representations about the use of investor funds, Vaughan has used various means to give investors false comfort that their investments are secure.

16. First, Vaughan has represented in every promissory note that the note is “part of an issue of Promissory Notes” not to exceed a certain aggregate limit. According to the most recently issued notes, the aggregate limit is \$2.5 million; earlier notes reference aggregate limits as low as \$500,000.

17. Second, the notes represent that they are “secured by a Deed of Trust to Douglas E. Casteel.” Vaughan has told investors who have inquired about this “deed of trust” that it authorizes Mr. Casteel, as trustee, to liquidate a number of real estate holdings, including Vaughan’s multi-million dollar house, in the event of a default on the notes.

18. Third, the standard packet of materials provided to note investors includes a list of properties that purportedly “secure” the notes. According to that list, which is preceded in the packet by a cover sheet that reads in large, bold letters, “**Investment**

**Secured By Real Estate,**” the equity in those properties is approximately \$3.8 million – *i.e.*, \$1.3 million more than the total amount supposedly outstanding on the notes.

19. Finally, Vaughan himself has executed a “Personal Guarantee” in connection with each note and, in written materials provided to note investors, has cited his “guarantee” as evidence that the notes are “well collateralized.”

20. Over the years that Vaughan has offered promissory notes, many note investors have invested in multiple notes, in some cases putting their entire retirement savings into the program. As notes have matured, many investors, with Vaughan’s encouragement, have “rolled over” their investments into new notes, rather than demanding the return of their principal. Some investors even have re-invested all of their interest payments from Vaughan Company into new promissory notes.

21. There are now approximately 600 investors in the Vaughan Company promissory note program, and the aggregate principal due on the outstanding notes has grown to approximately \$80 million. The weighted average interest rate on the outstanding notes now stands at approximately 17.5%, meaning that Vaughan Company owes investors approximately \$14 million per year in interest alone.

### **B. Overview of the Vaughan Capital Offering**

22. Beginning in or around July 2008 and continuing through at least January 7, 2010, Vaughan offered and sold “membership units” in Vaughan Capital, requiring a minimum of \$125,000 to invest. This offering of Vaughan Capital membership units has never been registered with the SEC.

23. Through a private placement memorandum (“PPM”), an accompanying “Dear Investor” letter bearing Vaughan’s signature, and other written and oral

communications with investors, Vaughan has represented that Vaughan Capital would generate returns for investors by: (1) purchasing real estate in distressed markets like Las Vegas, Nevada and Phoenix, Arizona; (2) buying discounted loan portfolios; and (3) making collateralized, high interest “hard money” loans to builders and developers.

24. Vaughan sent periodic reports to actual and prospective investors purporting to show that Vaughan Capital was generating returns through its investment activity. On or about December 14, 2009, for example, he sent investors a letter claiming that Vaughan Capital had “done quite well” and enclosed an income statement purporting to show that Vaughan Capital had investment-related earnings of approximately \$698,000, and profits of approximately \$415,000, in the first nine months of 2009.

25. Between July 2008 and January 2010, Vaughan sold approximately \$6.2 million worth of Vaughan Capital membership units to approximately 22 investors. He has caused Vaughan Capital to make purported “distributions” back to investors totaling approximately \$310,000.

### **C. The Truth About The Vaughan Company Note Program and Vaughan Capital**

26. Contrary to the image cultivated by Vaughan, who paid himself at least approximately \$877,000 out of Vaughan Company between 2008 and 2009, Vaughan Company is not a profitable business. Its financial records show that, between the company’s inception and December 31, 2009, it accumulated losses totaling approximately \$61.3 million. In 2008 and 2009, the company’s cash expenditures on interest payments and routine business costs exceeded the cash generated by its real estate business by more than \$25 million.

27. In classic Ponzi fashion, Defendants have compensated for their cash shortfalls by continuing to raise new cash through the issuance of new promissory notes. They have then used investor funds to make payments to old investors, cover Vaughan Company's ordinary business costs, and make payments to Vaughan himself. Because Vaughan Company has been operating at a loss, Defendants have only been able to make payments on each new round of notes by issuing still more notes to still more investors.

28. As a result, the aggregate principal on outstanding notes now stands at approximately \$80 million, which is approximately 32 times the purported limit recited in the most recently-issued notes and more than 20 times the claimed equity in the properties that supposedly "secure" the notes. Meanwhile, Vaughan's net worth, which was supposed to provide protection to investors in the event of a default by Vaughan Company, is negative.

29. In direct violation of the promises made to Vaughan Capital investors, Vaughan also has used their money to support the Ponzi scheme. Between December 2008 and January 2010, Vaughan transferred almost all of the \$6.2 million he raised from Vaughan Capital investors to Vaughan Company's operating account. He then used those funds to cover Vaughan Company's obligations to promissory note holders and its ordinary business costs. Vaughan also has paid approximately \$83,000 from Vaughan Capital to himself.

30. Upon transferring Vaughan Capital funds to Vaughan Company, Vaughan has caused Vaughan Company to issue dozens of unsecured promissory notes to Vaughan Capital. These notes purport to require Vaughan Company to make monthly interest payments to Vaughan Capital at an annual rate of approximately 17.3%.



31. Although Vaughan Company has failed to make timely payments to Vaughan Capital under these notes, Vaughan has taken no steps to enforce Vaughan Capital's rights under the notes, nor has he advised Vaughan Capital investors as to the notes' existence. Instead, Vaughan has led Vaughan Capital investors to believe that Vaughan Capital was earning profits, paying out approximately \$310,000 in supposedly investment-related "distributions" to them. As with the payments to note investors, however, Vaughan simply used funds from other investors to make those "distributions."

#### **D. Defendants' Material Misrepresentations and Omissions**

32. As evidenced by the foregoing, Defendants have misrepresented and omitted material facts in communications with both Vaughan Company note investors and Vaughan Capital investors with the intention of defrauding those investors.

33. With respect to the Vaughan Company promissory note program, Defendants have, either intentionally or recklessly, misrepresented and concealed material information about, among other things, the total amount owed to investors under the program, the adequacy of the purported "security" for the promissory notes, the sufficiency of Vaughan's personal wealth to cover the obligations on the notes, the use of investor funds, and the source of the funds used to make payments to investors.

34. Similarly, with respect to Vaughan Capital, Defendants have, either intentionally or recklessly, misrepresented and concealed material information about what investor money would be used for and the source of the "distributions" that investors received.

35. Defendants continued to deceive investors even as the scheme began to unravel in 2009, telling note investors that monthly interest checks were late due to

various administrative problems and post office delays and persuading investors whose notes had matured to “roll over” their original investments into new notes rather than take out their principal. Even after stealing virtually all of their money, Vaughan continued to tell Vaughan Capital investors they were “doing well” and encouraged them to find other investors to help Vaughan Capital reach Vaughan’s goal of raising \$10 million through the offering.

36. Defendants even sought to hide the truth from the SEC, providing incomplete, misleading, and false information to SEC staff over the course of several months.

#### **E. The Collapse of the Scheme**

37. Starting in or around the second half of 2009, Vaughan Company’s obligations on its promissory notes began to outstrip Defendants’ ability to raise new cash from investors, and they were no longer able to make interest payments in a timely fashion. In response to inquiries from investors, however, Vaughan continued to assure them that all was well.

38. In early 2010, Defendants ceased making interest payments on promissory notes entirely. Vaughan himself stopped responding to most investor inquiries.

39. On or about February 15, 2010, Vaughan held a meeting with a group of his largest promissory note investors. At that meeting, Vaughan told the investors that he was simply having a temporary cash flow problem due to a difficult real estate market and asked for their patience. Six days later, Vaughan and Vaughan Company each filed for bankruptcy protection under Chapter 11 of the bankruptcy code.

40. On March 11, 2010, Vaughan appeared, pursuant to subpoena, for sworn testimony in an investigation by the Securities Exchange Commission. He asserted his Fifth Amendment privilege against self-incrimination and refused to answer any questions concerning Vaughan Company or Vaughan Capital.

41. Vaughan remains the controlling shareholder and sole director of Vaughan Company. Upon information and belief, notwithstanding reports of his resignation from management, he continues to be a regular presence in Vaughan Company's offices and continues to try to influence Vaughan Company's personnel and its affairs. Vaughan also continues to exercise exclusive control over the affairs of Vaughan Capital.

### **CLAIMS FOR RELIEF**

#### **FIRST CLAIM FOR RELIEF**

##### **Fraud in the Offer of Sale of Securities in Violation of Section 17(a) of the Securities Act (All Defendants)**

42. The SEC incorporates the allegations of paragraphs 1 through 41 as if fully set forth herein.

43. By engaging in the conduct described above, Defendants have, directly or indirectly, in the offer and sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, employed a device, scheme or artifice to defraud with scienter; negligently obtained money or property by means of untrue statements of material fact or by omitting to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading; or negligently engaged in transactions, practices, or

courses of business that operated or would operate as a fraud or deceit upon the purchasers of such securities.

44. By reason of the foregoing, Defendants violated, and, unless restrained and enjoined, will continue to violate Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

### **SECOND CLAIM FOR RELIEF**

#### **Fraud in Connection with the Purchase or Sale of Securities in Violation of Section 10(b) of the Exchange Act and Rule 10b-5 (All Defendants)**

45. The SEC incorporates the allegations of paragraphs 1 through 41 as if fully set forth herein.

46. By engaging in the conduct described above, Defendants have, directly or indirectly, with scienter, by use of the means or instruments of interstate commerce or by use of the mails, employed devices, schemes or artifices to defraud; made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices or courses of business which operated or would have operated as a fraud or deceit upon any person, in connection with the purchase or sale of a security.

47. By reason of the foregoing, Defendants violated, and, unless restrained and enjoined, will continue to violate Section 10(b) of the Exchange Act and Rule 10b-5 thereunder[15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5]

### **THIRD CLAIM FOR RELIEF**

#### **Unregistered Sale of Securities in Violation of Sections 5(a) and 5(c) of the Securities Act (All Defendants)**

48. The SEC incorporates the allegations of paragraphs 1 through 41 as if fully set forth herein.

49. By engaging in the conduct described above, Defendants have directly or indirectly, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, offered and sold securities or carried or caused such securities to be carried through the mails or in interstate commerce, for the purpose of sale or delivery after sale.

50. No valid registration statement was filed or in effect with the SEC, and no exemption from registration existed with respect to the securities and transactions described in this Complaint.

51. By reason of the foregoing, Defendants violated, and, unless restrained and enjoined, will continue to violate Sections 5(a) and (c) of the Securities Act [15 U.S.C. §§ 77e(a), 77e(c)].

### **FOURTH CLAIM FOR RELIEF**

#### **Acting As Unregistered Broker-Dealer in Violation of Section 15(a)(1) of the Exchange Act (Vaughan and Vaughan Company)**

52. The SEC incorporates the allegations of paragraphs 1 through 41 as if fully set forth herein.

53. Defendants Vaughan and Vaughan Company have made use of the mails or means or instrumentalities of interstate commerce to effect transactions in or to induce or attempt to induce the purchase or sale of a security without being registered in accordance with Section 15(b) of the Exchange Act.

54. By engaging in the conduct described above, Vaughan and Vaughan Company have violated Section 15(a)(1) of the Exchange Act by acting as unregistered broker-dealers in connection with their offer and sale of securities as described in this Complaint.

55. By reason of the foregoing, Vaughan violated, and unless enjoined will continue to violate, Section 15(a)(1) of the Exchange Act [15 U.S.C. § 78o(a)(1)]

**PRAYER FOR RELIEF**

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

**I.**

Find that each of the Defendants committed the violations alleged in this Complaint;

**II.**

Enter an Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently restraining and enjoining each of the Defendants from violating the laws and rules alleged against them in this Complaint;

**III.**

Order that each of the Defendants disgorge any and all ill-gotten gains, together with pre-judgment interest, derived from the activities set forth in this Complaint;

**IV.**

Order that each of the Defendants pay civil money penalties pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)]; and

**V.**

Grant such other relief as this Court may deem just or appropriate.

Respectfully submitted this 23<sup>rd</sup> day of March, 2010.

GREGORY J. FOURATT  
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