

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO.:

SECURITIES AND EXCHANGE COMMISSION,)
)
Plaintiff,)
)
v.)
)
PHARMA HOLDINGS, INC.,)
EDWARD KLAPP IV, and)
EDWARD KLAPP JR.,)
)
Defendants.)
)
)

COMPLAINT FOR INJUNCTIVE AND OTHER RELIEF

Plaintiff Securities and Exchange Commission alleges:

I. INTRODUCTION

1. The Commission brings this action to permanently restrain and enjoin Defendants Pharma Holdings, Inc. (“Pharma”), Edward Klapp IV, and Edward Klapp Jr. from violating the federal securities laws through the fraudulent offer and sale of securities. From at least 2005 through approximately September 2009, the Defendants raised approximately \$5 million from at least 80 European investors, primarily residing in the United Kingdom, through the fraudulent offer and sale of Pharma stock.

2. The Defendants engaged various sales offices and agents to conduct Pharma’s offerings to investors. The Defendants also directly offered shares in later offerings to existing shareholders. Klapp IV and Klapp Jr. directly received approximately \$1.6 million of the offering proceeds.

3. In connection with its offerings of stock, Pharma issued false press releases and made false postings on its website overstating Pharma's sales revenues and net profits, and touting non-existent business agreements with multinational corporations. The Defendants also stated Pharma would soon conduct an initial public offering ("IPO") of Pharma stock or be acquired by a large corporation or mutual fund.

4. The Klapps directed investors to Pharma's website, which contained materially false information. The Klapps and Pharma also failed to disclose that Klapp IV had a felony conviction for fraud.

5. Through their conduct, the Defendants each violated Sections 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a); and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. Unless permanently enjoined, the Defendants are reasonably likely to continue to violate the federal securities laws.

II. DEFENDANTS

6. **Pharma** is a Florida corporation with its principal place of business in Jupiter, Florida. Pharma is a holding company for Canadian Drug Outlet, Med-RX Health, and Med-RX Supply, which are purportedly in the pharmaceutical supply business.

7. **Klapp IV**, 52, resides in Jupiter, Florida. Klapp IV is the president, CEO, and a managing partner of Pharma. In 1997, Klapp IV pled guilty to conspiracy to use the mails in a scheme to defraud involving false promises of loans. He was fined \$3,000, ordered to pay \$40,000 in restitution and sentenced to one year and a day in federal prison.

8. **Klapp Jr.**, 74, resides in Jupiter, Florida. Klapp Jr. is Klapp IV's father. Klapp Jr. is the vice president, secretary, CFO, and a managing partner of Pharma.

III. JURISDICTION AND VENUE

9. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d) and 22(a) of the Securities Act, 15 U.S.C. §§ 77t(b), 77t(d) and 77v(a), and Sections 21(d), 21(e), and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d), 78u(e) and 78aa.

10. The Court has personal jurisdiction over the Defendants and venue is appropriate in the Southern District of Florida, because the Defendants' acts and transactions constituting violations of the Securities Act and the Exchange Act occurred within the Southern District of Florida. Additionally, at all relevant times, Pharma's principal place of business was in the Southern District of Florida, and the individual Defendants resided in the Southern District of Florida.

11. In connection with the conduct alleged in this Complaint, the Defendants, directly and indirectly, singly or in concert with others, have made use of the means or instrumentalities of interstate commerce, the means or instruments of transportation and communication in interstate commerce, and the mails.

IV. THE DEFENDANTS' FRAUDULENT SCHEME

A. The Offerings

12. From early 2005 to approximately fall 2006, the Klapps sold Pharma shares to Argus Global Equities, Ltd. ("Argus"), formerly located in Nevis, the West Indies, for resale to offshore investors, primarily in the United Kingdom. Argus used sales agents in boiler rooms located in Spain.

13. The Argus sales agents cold called prospective investors and told them to view the Pharma website, which had press releases and postings touting Pharma's business relationships and potential profits. Argus sales agents also told investors Pharma was poised to

commence an IPO and the stock price would sky rocket.

14. Argus solicited investors and instructed them to wire their funds to various Argus bank accounts located throughout Spain and Andorra. Argus processed the financial transactions and Pharma issued the share certificates and maintained shareholder records. Argus sent Pharma more than \$800,000 of investor funds in ten separate wire transfers in various amounts from February 2005 through September 2006.

15. After Argus closed, Pharma entered into agreements in which it sold Pharma shares to Bahamas-based CTA Worldwide Services, SA (“CTA”). Pharma also used Chicago-based SHB Capital, Inc. (“SHB”), a purported investment banking company, as the distribution agent to sell CTA’s Pharma shares to offshore investors. The compensation arrangement under the agreements provided that proceeds from SHB’s sale of Pharma shares to overseas investors would be divided 50% to CTA, 10% to SHB, 39% to Pharma and 1% to an escrow agent. SHB told investors Pharma was working to conduct an IPO or would be bought out by a large company or investment fund.

16. In 2007, Pharma engaged a Swiss entity and several individuals as sales agents to sell Pharma’s stock to offshore investors. The sales agreement between Pharma and the Swiss entity provide for a fifty-fifty split of the proceeds raised from the sale of Pharma shares. The offshore investors wired their funds directly to Pharma’s bank accounts in Jupiter, Florida. The investors received Pharma stock certificates signed by Klapp IV and Klapp Jr.

17. During 2007, from their offices in Jupiter, Florida, Pharma and the Klapps solicited their existing shareholders to purchase more Pharma stock. In July 2007, Klapp IV sent Pharma shareholders a letter offering existing shareholders the opportunity to purchase “new shares” at \$5 per share. The letter stated that the purchase of “new shares” would entitle the

purchaser to free bonus shares. The letter also explained that in case of a “liquidity event” (defined as an IPO or the sale of Pharma to another company), shareholders would be entitled to sell both their current and bonus shares. The letter invited investors to contact Klapp IV at his Florida telephone number.

18. In December 2008 and January 2009, Klapp IV sent mailings to existing shareholders advising them of a new bonus share offering. Again, the Defendants offered the bonus shares in exchange for the purchase of more Pharma stock. The letters invited investors to contact Klapp IV at his Florida telephone number. At the time of the offering, the website, located and maintained in the United States, still contained false information and Klapp IV was still confirming via e-mail to certain shareholders that an IPO was coming soon.

19. The new bonus share offering also gave all participants a share conversion from common stock to preferred stock. Additionally, Klapp IV promised investors that all preferred shareholders would receive a dividend payment. Pharma, however, never paid investors in this new bonus share offering a dividend.

20. In 2009, Pharma posted an update on its website detailing the bonus share offering and announcing the offerings would only be available until June 30, 2009.

B. Misrepresentations and Omission of Material Facts

1. False Statements Concerning Pharma’s Sales Revenues and Profits

21. Pharma, through Klapp IV and Klapp Jr., falsely overstated its sales revenues and net profits in its annual reports for the years ended 2006 and 2007. The annual reports were available to shareholders and prospective investors on Pharma’s website. In its 2006 year-end annual report, Pharma reported sales of \$15.8 million for the year with an operating profit of \$4.1 million. In its 2007 year-end annual report, Pharma reported sales of \$47 million for the

year with an operating profit \$13.5 million. By contrast, in its federal corporate income tax return for 2006, Pharma reported only \$660,186 in gross receipts or sales and reported an operating loss of \$77,900. In its federal tax return for 2007, Pharma reported only \$2.7 million in gross receipts or sales and reported a net operating profit of only \$467,643.

2. Non-Existent Business Relationships

a. False Claim of McKesson Alliance

22. In 2005, Pharma issued and posted on its website three separate press releases and a research report falsely touting an “exclusive alliance” with McKesson Canada and a “strategic alliance” with McKesson USA for the distribution and sale of pharmaceuticals and medical supplies. Pharma valued these deals in the range of \$25 million to \$100 million annually. These statements were false because Pharma and its subsidiaries never had any business relationship with McKesson. These press releases and the research report remained on Pharma’s website through at least 2009.

b. False Claim of Philips Exclusive Distribution Agreement

23. On July 7, 2006, Pharma issued and posted on its website a press release claiming its wholly owned subsidiary, Med-RX Supply, “has entered into a marketing alliance with Fortune Global 500 company, Philips, a \$7 billion medical products company, and a division of Royal Philips Electronics.” The press release further stated Med-RX Supply would become the exclusive distributor of Royal Philips Electronics’ famed HeartStart OnSite Defibrillator, and projected \$50 million in sales from this product over the first year. These statements were false because neither Pharma nor Med-Rx Supply ever had any business relationship with Royal Philips Electronics. This press release remained on Pharma’s website through at least 2009.

c. False Claim of Seikagaku Distribution Agreement

24. Pharma also issued and posted on its website a press release dated October 5, 2006, falsely stating that Pharma's subsidiary, Med-RX Supply, had entered into a distribution sales agreement with Seikagaku Corporation of Japan. The press release projected Med-RX Supply's sales would exceed \$50 million in the first year as a result of the agreement with Seikagaku Corporation. These statements were false because neither Pharma nor Med-Rx Supply ever had any business relationship with Seikagaku. This press release remained on Pharma's website through at least 2009.

3. Repeated False Claims of an IPO

25. Pharma and its sales agents repeatedly told investors and prospective investors, both in written materials from Klapp IV and on Pharma's website, that Pharma would soon conduct an IPO or be bought out by a large corporation or mutual fund. Investors bought stock because of promises of an imminent IPO or buyout that would result in the company's stock skyrocketing.

26. For example, Klapp IV told investors in a letter dated December 2006 that "Management believes this company will be ripe for a buyout or public offering within the next two years." On August 14, 2007, Klapp IV responded to an investor via e-mail and reiterated the promise of an IPO, stating that Pharma was planning on a public offering that year. Later, in an e-mail to an investor in July 2008, Klapp IV again stated, "We are in the process of taking Pharma Holdings public, and that will take a bit of time but be patient." In another e-mail to an investor in March 2009, Klapp IV stated, "We are entertaining several offers to go public, but I'm just not sure about the timing."

27. Klapp Jr. also falsely promised investors an imminent IPO and directed investors to go to Pharma's website for more information on the company. In a January 7, 2008 e-mail to an investor, Klapp Jr. stated he anticipated Pharma being in a position to go public by mid-year. On January 10, 2008, Klapp Jr. told another investor in a letter the board of directors was working on taking Pharma public in 2008.

28. Despite these repeated claims, Pharma failed to take steps necessary to conduct an IPO, such as drafting and filing the required registration statement for an IPO or obtaining audited financial statements. The Defendants' representations of an impending IPO were false and misleading because, without having taken these actions, Pharma was never in a position to conduct an IPO.

4. Failure to Disclose Klapp IV's Felony Conviction

29. The Klapps and Pharma failed to disclose to investors that Klapp IV had been convicted of a felony involving fraud. The Klapps and Pharma touted Klapp IV's business acumen and many years of successful business experience in written materials they made available to investors. In a document describing Pharma's management, Pharma touted Klapp IV's "25 years experience in the media industry" and his "overall success." However, Pharma failed to disclose that Klapp IV was indicted and convicted of conspiracy to defraud through the U.S. mails, a felony involving deceit.

V. CLAIMS FOR RELIEF

COUNT I

**FRAUD IN VIOLATION OF
SECTION 17(a)(1) OF THE SECURITIES ACT**

30. The Commission repeats and realleges paragraphs 1 through 29 of its Complaint.

31. From at least 2005 through September 2009, the Defendants, directly and indirectly, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, in the offer or sale of securities, as described herein, knowingly or recklessly employed devices, schemes or artifices to defraud.

32. By reason of the foregoing, the Defendants, directly and indirectly, violated, and unless enjoined, are reasonably likely to continue to violate Section 17(a)(1) of the Securities Act, 15 U.S.C. § 77q(a)(1).

COUNT II

FRAUD IN VIOLATION OF SECTIONS 17(a)(2) AND 17(a)(3) OF THE SECURITIES ACT

33. The Commission repeats and realleges paragraphs 1 through 29 of its Complaint.

34. From at least 2005 through September 2009, the Defendants, directly and indirectly, by use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails, in the offer or sale of securities, as described herein: (a) obtained money or property by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; and/or (b) engaged in transactions, practices and courses of business which are now operating and will operate as a fraud or deceit upon purchasers and prospective purchasers of such securities.

35. By reason of the foregoing, the Defendants, directly and indirectly, have violated, and unless enjoined, are reasonably likely to continue to violate Sections 17(a)(2) and 17(a)(3) of the Securities Act, 15 U.S.C. §§ 77(q)(a)(2) and 77(q)(a)(3).

COUNT III

**FRAUD IN VIOLATION OF SECTION 10(b) OF
THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER**

36. The Commission repeats and realleges paragraphs 1 through 29 of its Complaint.

37. From at least 2005 through September 2009, the Defendants, directly or indirectly, by use of the means or instrumentalities of interstate commerce or of the mails, in connection with the purchase or sale of securities knowingly, willfully, or recklessly: (a) employed devices, schemes or artifices to defraud; (b) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices and courses of business which have operated, are now operating and will operate as a fraud upon the purchasers of such securities.

38. By reason of the foregoing, the Defendants, directly or indirectly, violated, and unless enjoined, are reasonably likely to continue to violate Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5.

RELIEF REQUESTED

WHEREFORE, the Commission respectfully requests that the Court:

I.

Declaratory Relief

Declare, determine and find that the Defendants committed the violations of the federal securities laws alleged herein.

II.

Permanent Injunctive Relief

Issue a Permanent Injunction restraining and enjoining the Defendants, their officers, agents, servants, employees, attorneys, and all persons in active concert or participation with them, and each of them, from violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

III.

Disgorgement

Issue an Order requiring all the Defendants to disgorge all ill-gotten profits or proceeds they have received as a result of the acts or courses of conduct complained of herein, with prejudgment interest.

IV.

Penalties

Issue an Order directing all the Defendants to 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).

V.

Officer and Director Bars

Issue an Order pursuant to Section 20(e) of the Securities Act, 15 U.S.C. § 77t(e), and Section 21(d)(2) of the Exchange Act, 15 U.S.C. §78u(d)(2), barring Klapp IV and Klapp Jr. from serving as an officer or director of a public company.

VI.

Further Relief

Grant such other and further relief as may be necessary and appropriate.

VII.

Retention of Jurisdiction

Further, the Commission respectfully requests that the Court retain jurisdiction over this action in order to implement and carry out the terms of all orders and decrees that may hereby be entered, or to entertain any suitable application or motion by the Commission for additional relief within the jurisdiction of this Court.

Dated: December 22, 2010

Respectfully submitted,

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