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BEFORE THE ARIZONA CORPORATION COMMISSION

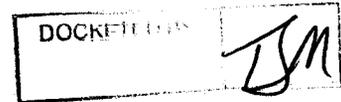
AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

2012 NOV 30

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COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

In the matter of:
CRAIG RANDAL MUNSEY, an unmarried man,
MARKETING RELIABILITY CONSULTING, LLC (d.b.a. MRC LLC), an Arizona limited liability company,
DENVER ENERGY EXPLORATION, LLC, a Texas limited liability company,
MICHAEL LEE CHRISTOPHER (CRD#2695315), an unmarried man
Respondents.

DOCKET NO. S-20804A-11-0208

SECURITIES DIVISION'S POST-HEARING BRIEF

Hearing Dates: October 1, 2, & 3, 2012

Assigned to Administrative Law Judge Marc E. Stern

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") submits its Post-Hearing Brief ("Brief") with respect to the administrative hearing held on October 1-3, 2012. This Brief is supported by the following Memorandum of Points and Authorities.

MEMORADUM OF POINTS AND AUTHORITIES

I. Procedural Background

On May 23, 2011, the Division filed a Temporary Order to Cease and Desist and Notice of Opportunity for Hearing ("TC&D") against Craig Randall Munsey ("Munsey"), Marketing Reliability Consulting, LLC ("MRC"), and Denver Energy Exploration, LLC ("DEE") alleging multiple violations of the registration and antifraud provisions of the Arizona Securities Act ("Securities Act") in connection with the offer and sale of securities. DEE filed its request for a

1 hearing on June 9, 2011, and its answer on June 22, 2011. Munsey filed a request for a hearing
2 on June 16, 2011, and his answer on June 24, 2011.

3 On December 20, 2011, the Division moved for leave to file an Amended Notice of
4 Opportunity for Hearing (“Amended Notice”), which was granted by Procedural Order dated
5 January 23, 2012. The Amended Notice was filed on January 27, 2012. The Amended Notice
6 added Michael Lee Christopher (CRD#2695315) (“Christopher”) as an additional party. On
7 February 9, 2012, Christopher filed his request for a hearing, and DEE and Christopher filed a
8 joint answer to the Amended Notice on February 27, 2012. An administrative hearing in this
9 matter was held on October 1-3, 2012.

10 **II. Jurisdiction**

11 The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona
12 Constitution and the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*

13 **III. Facts**

14 Starting in October 2010 though at least May 2011, Respondents repeatedly offered and
15 sold securities in the form of fractional undivided interests in oil or gas and/or investment
16 contracts issued by DEE within or from Arizona in violation of A.R.S. §§ 44-1841 and 44-1842.
17 (**Exs. S-12 – S-52, S-126, S-128**). Specifically, DEE, via Christopher, provided investors with
18 documents titled “Joint Venture Agreement”, which provided investors with fractional undivided
19 interests in oil and gas wells that were subdivided by the leasehold owner, DEE. DEE retained
20 25% of each well, and gave investors a percentage interest in the wells based on the investment
21 amount. (**H.T. p. 234:4 – p. 235:16, p. 241:24 – p. 242:6**). Neither Respondents nor the
22 offering was registered with the Commission during the relevant period. (**Exs. S-1(a)-(d)**).

23 Investors either located in Arizona, or sold the DEE investments by Arizona salesmen,
24 invested a total of \$420,407.25 in these well projects in return for a percentage interest in the
25 wells. (**H.T. p. 70:22 – p. 71:2, p. 136:25 – 137:21, p. 146:1-7, p. 255:6-12, p. 259:16 – p. p.**
26 **260:16, p. 261:15 – 263:24, p. 264:7-22, p. 265:5-18, p. 266:3 – p. 267:16, p. 270:12 – p.**

1 271:19, p. 272:2 – p. 274:12, p. 274: 20 – p. 275:6; Exs. S-53, S-94, S-128). There were
2 multiple well projects involving oil and gas wells leased by DEE that were offered and sold to
3 investors in or from Arizona: Julie Three Wells, Koomey/Morrison #4 (later renamed DK#4M),
4 Denver/Karber #1, and Johnson Three Wells. Denver Energy used Arizona sales representatives,
5 including Munsey and MRC, and non-party Randall Becklund, to solicit and sell the investments.
6 (H.T. p. 55:1 – p. 56:24, p. 254:10 – p. 255:12, p. 259:16 – p. 260:20, p. 121:5 – p. 122:12, p.
7 131:6-13; Exs. S-8, S-9, S-53, S-63). DEE utilized other salesmen to offer and sell the DEE
8 investment, including Don Howard who sold to one Arizona investor, Lori Cook. Becklund sold
9 the DEE investment from Arizona to two investors. (H.T. p. 254:22 – p. 255:25, p. 259:16 – p.
10 260:4, Exs. S-9, S-53). All of these salesmen were authorized by DEE to contact potential
11 investors, and DEE directed them on whom to call. (H.T. p. 123:3 – p. 124:25, p. 127:12 – p.
12 128:13, p. 260:12-20).

13 DEE provided its salesmen with lead lists, each containing hundreds of names, and
14 instructed the salesmen to call the individuals listed to offer and sell the DEE joint ventures.
15 (H.T. p. 127:12 – p. 128:13, p. 129:7-25, p. 136:25 – p. 137:16, p. 251:21 – p. 252:4, p.
16 330:16-18; Ex. S-55, Ex. S-90 at pp. 70-71, Ex. S-97). Since October 2010, salesman Munsey
17 contacted minimally one hundred leads that were offered the DEE investments, and sold the
18 investment to four investors who invested a total of \$376,100.56. (H.T. p. 127:12-25, p. 129:5 –
19 p. 131:17, p. 136:25 – p. 137:21; Exs. S-55, S-90 at p. 48:8 – p. 51:2, S-97, S-128). Munsey
20 billed MRC as the “marketing arm” of DEE, and used his MRC email,
21 crm@marketingreliabilityconsultant.com, to communicate with investors. (Ex. S-90, at p. 73:3-
22 15; Ex. S-62, Ex. S-63, Ex. S-98). DEE paid Munsey/MRC 15% of each investor’s investment,
23 for a total of \$38,176.35. (Ex. S-94; Ex. S-90, at p. 115:10-17).

24 There were multiple investors in each DEE well investment and, for each particular well
25 investment, investor funds were pooled to fund that project. (H.T. p. 235:14-20). Investors were
26 to be paid as the wells produced and the oil or gas was sold, based on the percentage interest the

1 investor had in that well. (H.T. p. 125:1-15, p. 452:8-14). The investment terms stated DEE
2 retained 25% of each well (H.T. p. 234:4 – p. 235:16), and thus also profited based on sales
3 from well production. DEE was and is the manager on the well projects and made all decisions
4 regarding use of the pooled investor funds and regarding operating the wells, including decisions
5 on the sale of the oil and gas produced. (H.T. p. 302:2 – p. 303:16, p. 304:1-19). Investors also
6 executed a Special Power of Attorney appointing DEE, via Christopher, as Managing Joint
7 Venture Partner. This document gave DEE the authority to sign and file all documents on behalf
8 of the “joint venture”. (See e.g. Ex. S-23, at bates DEE00123, Ex. S-63, at bates ACC000052).

9 DEE is and was a manager-managed LLC, solely operated by manager Christopher, and
10 during all relevant periods, Christopher held majority ownership in DEE. (H.T. p. 224:16 – p.
11 225:4; Ex. S-6). Christopher performed all managerial functions for DEE. (H.T. p. 230:5-14, p.
12 262:9-22, p. 302:5 – p. 304:19; Exs. S-8, S-9, S-92). Christopher also provided DEE salesmen
13 with information about the wells to pass along to investors. (H.T. p. 122:22 – p. 123:2).

14 Respondents failed to disclose to offerees and investors the existence of a prior cease and
15 desist order for securities violations entered against DEE in Pennsylvania in 2010. (H.T. p.
16 71:22 – p. 74:15; Exs. S-3, S-4, S-12 – S-52, S-57, S-58, S-63 – S-66; R-45). The Pennsylvania
17 proceeding and ultimate order found a violation of the Pennsylvania securities laws related to a
18 offering made by DEE in a well project named Koomey/Morrison #3. (Exs. S-3, S-4). This was
19 the same well that Munsey referenced in his telephonic offering to Mr. Jackson Roberts, aka
20 Chief investigator Robert Eckert posing as an investor during an undercover telephone call, in
21 May 2011. Munsey represented to Mr. Eckert, a potential investor, that DEE had a well project
22 called the “KM3” or “Koomey/Morrison #3” that’s “pushing out 200 barrels of oil a day”. (Ex.
23 S-126). At no time did Munsey disclose the Pennsylvania order pertaining to that exact well
24 offering during the call with Mr. Roberts, nor was it disclosed in the materials Mr. Eckert
25 received from Munsey and DEE. (H.T. p. 46:25 – p. 48:8, p. 52:7-17, p. 74:2-15; Ex. S-126).

26

1 There is no evidence that Respondents disclosed the Pennsylvania order to other offerees and
2 investors either. (H.T. p. 71:22 – p. 74:15; Exs. S-12 – S-52, S-57, S-58, S63 – S-66; R-45).

3 Further, the representations made by Munsey regarding production on the Koomey/Morrison
4 #3 were false. Christopher admitted that there was no significant production on the
5 Koomey/Morrison #3 well as of May 2011 (H.T. p. 308:8-19), which is supported by the
6 production reports available from the Texas Railroad Commission (“TRRC”), the entity that
7 regulates oil and gas wells in Texas. There was no production reported by DEE on the
8 Koomey/Morrison #3 well as of July 31, 2012. (H.T. p. 74:16 – p. 79:21; p. 292:16 – p. 293:21;
9 Exs. S-78, S-79, S-88).

10 The Koomey/Morrison #3 well was not the only well Respondents represented to be
11 producing when it was not. In May 2011, Respondents’ represented to offerees, and the offering
12 materials stated, that “all three wells [in the Johnson Three Well project] currently produce”. (H.T.
13 p. 53:14-17, p. 56:1 – p. 57:22: *see e.g.* Ex. S-63 at bates ACC000006; Ex. S-98, at bates
14 ACC000226). Per the offering materials, the Johnson Three Well project was made up of the
15 Harrison #1 well, the Harrison #2 well, and the Poco Reata #1 well. (Ex. S-63 at bates
16 ACC000040). However, there is only *one* “Harrison” well listed with the TRRC under the operator
17 number for DEE – not three – and there is no lease named “Poco Reata”. (H.T. p. 81:7 – p. 83:16;
18 Exs. S-78 – S-80).

19 Munsey also offered the Denver/Karber #1 project to Mr. Eckert in May 2011. He
20 represented that DEE owned all the rights to the “Karber field”, that DEE had drilled three wells on
21 that field, had been successful “100% of the time”, had “pulled out over 300,000 barrels of oil” on
22 those three wells, and “500,000 mcf of gas.” (Ex. S-126). However, the TRRC operator reports
23 showed that DEE had *no reported production* for any lease named “Karber” as of May 2011. (Exs.
24 S-78, S-79, Ex. S-87). In fact, the only “Karber” lease with any oil production was the Denver
25 Karber 4M, which did not have any reported production with the TRRC until September 2011. (Ex.

26

1 S-87). Additionally, there were no “Karber” leases operated by DEE with reported gas production.
2 (Exs. S-78, S-79, Ex. S-87).

3 In total, DEE raised approximately \$5 million from investors investing in various oil and
4 gas well projects. (H.T. p. 277: 23 – p. 278:12). The evidence at hearing established that non-
5 accredited investors were solicited and sold the DEE investments. (H.T. p. 148:15-21, p. 260:5-
6 11, p. 424:5 – p. 425:1, p. 461:4 - p. 466:19; Exs. M-1, M-2, S-113, S-114). DEE and
7 Christopher had no pre-existing relationship with any of the offerees or the investors that
8 invested in DEE. (H.T. p. 253:8-11, p. 263:25 – p. 264:3, p. p. 264:23 – p. 265:4, p. 265:19-
9 24, p. 274:13-19). Further, DEE had at least seven unaccredited investors as of October 2010, as
10 reported to the SEC. (Ex. S-114). Christopher admitted at hearing that he did not know the
11 names of these investors, and could not provide any information or documentary evidence on
12 their backgrounds to establish that they were sophisticated. (H.T. p.465:18 – p. 466:19).

13 IV. Legal Argument

14 A. The Well Investments Offered and Sold by Respondents are Securities.

15 The Division established at hearing that, starting in October 2010 though at least May 2011,
16 Respondents repeatedly offered and sold fractional undivided interests in oil or gas wells and/or
17 investment contracts issued by DEE. The well investments offered and sold by Respondents fall
18 squarely under the definition of securities under the Securities Act. *See* A.R.S. § 44-1801(26).

19 1. Fractional undivided interest in oil and gas rights.

20 A “fractional undivided interest in oil, gas, or other mineral rights” is a security. A.R.S. §
21 44-1801(26). Although “not every transaction involving the sale of a fractional undivided
22 interest in oil, gas, or other mineral rights is necessarily the sale of a ‘security’ under the Act”,
23 when a portion of the owner’s interest is subdivided for purposes of sale to investors, it is a
24 security. *Lynn v. Caraway*, 252 F. Supp. 858, 861-62 (W.D. La. 1966)¹.

25 _____
26 ¹ Arizona courts “may use as a guide the interpretations given by the securities and exchange commission and the federal or other courts in construing substantially similar provisions in the federal securities laws of the United States.” 1996 Ariz. Sess. Laws, ch. 197, § 11(C); *see also State v. Gunnison*, 127 Ariz. 110, 112-13, 618 P.2d 604, 606-7 (1980).

1 Here, Respondents offered and sold investments that that provided investors with
2 fractional undivided interests in oil and gas wells that were subdivided by the leasehold owner,
3 DEE. Under the investment agreements, DEE retained 25% of each well, and gave investors a
4 percentage interest in the wells based on the investment amount. (H.T. p. 234:4 – p. 235:16, p.
5 241:24 – p. 242:6). One investor obtained a 7.5% interest in a project called the Julie Three
6 Well, made up of three wells leased by DEE, for \$50,000. (H.T. p. 238:24 – p. 239:1, p. 261: 15
7 – 263:24; Exs. S-12 – S-14, S-16). Two other investors each invested \$25,000, both receiving a
8 3.75% interest in the Julie Three Well project. (H.T. p. 264:7-22, p. 265:5-18; Exs. S-19 – S-
9 28).

10 Another investor obtained a 15% interest in a well project called Koomey/Morrison #4
11 (later renamed the DK#4M) for \$154,685.41. (H.T. p. 266:3, p. 267:16; Exs. S-15, S-17, S-18).
12 Additional investors in the Koomey/Morrison #4 well project received a .25% interest and a 4%
13 interest in the well for \$9,668 and \$34,638.63, respectively. (H.T. p. 269:3-14, p. 270:12 – p.
14 271:19; Exs. S-29 – S-34, S-40). Investors were issued fractional undivided interests in another
15 DEE well known as Denver/Karber #1, including an 8% interest for \$69,276.52 and a 4% interest
16 for \$34,638.69. (H.T. p. 272:2-20, p. 273:15-1, p. 273:25 – p. 274:19; Exs. S-41 – S-52).
17 Finally, DEE offered and sold investors fractional interests in a three well project known as the
18 Johnson Three Wells. (H.T. p. 249: 18 – p. 250:1). DEE sold a 1.875% interest in these wells
19 to one investor for \$17,500. (H.T. p. 274: 20 – p. 275:6; Ex. R-45). This evidence makes it
20 clear that Respondents offered and sold a security in the form of a “fractional undivided interest
21 in oil, gas, or other mineral rights”, as defined under the Securities Act.

22 2. Investment contract.

23 Respondents’ offerings also constitute an investment contract. Investment contracts are
24 included in the definition of securities. A.R.S. § 44-1801(26) (“Security means . . . investment
25 contract . . .”). The core definition of an investment contract was set forth in *S.E.C. v. W.J.*
26 *Howey Co.*, 328 U.S. 293 (1946), and this definition is now universally recognized as the starting

1 point for assessing whether any particular offer or sale constitutes the offer or sale of an
2 investment contract. Under the *Howey* test, an investment contract exists if it involves the
3 following three elements: (1) an investment of money or other consideration; (2) in a common
4 enterprise; (3) with the expectation of profits earned solely from the efforts of the promoter or a
5 thirty party. See *Howey*, 328 U.S. at 298. Although the test was designed to interpret federal
6 law, Arizona courts have adopted the *Howey* test and ordinarily apply it to determine whether an
7 investment is a security. See *Rose v. Dobras*, 128 Ariz. 209, 211, 624 P.2d 887, 889 (App.
8 1981).

9 Arizona courts agree that the “investment contract” definition of a security embodies a
10 flexible principal, “that is capable of adaptation to meet the countless and variable schemes
11 devised by those who seek to use the money of others on the promise of profits.” *Nutek Info Sys.,*
12 *Inc. v. Arizona Corp. Comm’n*, 194 Ariz. 104, 108, 977 P.2d 826, 830 (App. 1998). This flexible
13 approach recognizes the investor’s economic reality and maximizes the protection that the
14 Arizona Securities Act provides to Arizona investors.² See *Rose*, 128 Ariz. at 212, 624 P.2d at
15 890 (“The supreme court has consistently construed the definition of ‘security’ liberally.”); *Reves*
16 *v. Ernst & Young*, 494 U.S. 56, 61 (1990). Accordingly, substance controls over form. See
17 *Nutek*, 194 Ariz. at 108-09, 977 P.2d at 830-31.

18 The investments in this case satisfy all three elements of the test set forth in *Howey*. The
19 first prong of *Howey* has been established – an investment of money. DEE, through Christopher,
20 and its sales representatives, sought and obtained an investment of money from investors.
21 Christopher admitted at hearing that DEE had obtained funds from all investors investing in
22 various oil and gas well projects totaling approximately \$5 million. (H.T. p. 277: 23 – p.
23 278:12). DEE used Arizona sales representatives, including Munsey and MRC, and non-party

24 ² The Preamble to the Securities Act states:

25 The intent and purpose of this Act is for the protection of the public, the preservation of fair and equitable
26 business practices, the suppression of fraudulent or deceptive practices in the sale or purchase of
securities, and the prosecution of persons engaged in fraudulent or deceptive practices in the sale or
purchase of securities. This Act shall not be given a narrow or restricted interpretation or construction, but
shall be liberally construed as a remedial measure in order not to defeat the purpose thereof.

1951 Ariz. Sess. Laws ch. 18, § 20.

1 Randall Becklund, to solicit and sell the investments. (H.T. p. 55:1 – p. 56:24, p. 254:10 – p.
2 255:12, p. 259:16 – p. 260:20, p. 121:5 – p. 122:12, p. 131:6-13; Exs. S-8, S-9, S-53, S-63).
3 Denver Energy does not dispute that it received a total of \$420,407.25 from the investors at issue
4 in these proceedings including one Arizona investor (H.T. p. 269:3-14) and six other investors
5 that invested as a result of solicitation by Arizona salesmen (H.T. p. 70:22 – p. 71:2, p. 136:25
6 – 137:21, p. 146:1-7, p. 255:6-12, p. 259:16 – p. p. 260:16, p. 261:15 – 263:24, p. 264:7-22, p.
7 265:5-18, p. 266:3 – p. 267:16, p. 270:12 – p. 271:19, p. 272:2 – p. 274:12, p. 274: 20 – p.
8 275:6; Exs. S-53, S-94, S-128).

9 The second prong of *Howey* is also satisfied. With respect to this element, “[t]wo tests
10 have been developed to determine the existence of a common enterprise in order to satisfy the
11 second prong of the *Howey* test: (1) the horizontal commonality test and (2) the vertical
12 commonality test.” *Daggett v. Jackie Fine Arts, Inc.*, 152 Ariz. 559, 565, 733 P.2d 1142, 1148
13 (App. 1986). Arizona courts have held that commonality will be satisfied if either horizontal or
14 vertical commonality can be shown. *Daggett*, 152 Ariz. at 566, 733 P.2d at 1149.

15 “Horizontal commonality requires a pooling of investor funds collectively managed by a
16 promoter or third party.” *Daggett*, 152 Ariz. at 565, 733 P.2d at 1148. Here, there was
17 horizontal commonality because Christopher admitted that there were multiple investors in each
18 DEE project and for each particular project, investor funds were pooled to fund the project.
19 (H.T. p. 235:14-20). DEE was the manager on the projects and made all decisions regarding use
20 of the pooled investor funds. (H.T. p. 302:2-10, p. 303:2-5).

21 There was also vertical commonality. For the vertical form of commonality to be
22 established, a positive correlation between the potential profits of the investor and the potential
23 profits of the promoter need only be demonstrated. *See Daggett*, 152 Ariz. at 566, 733 P.2d at
24 1149; *Vairo v. Clayden*, 153 Ariz. 13, 17, 734 P.2d 110, 114 (App. 1987); *Foy v. Thorp*, 186
25 Ariz. 151, 158, 920 P.2d 31, 38 (App. 1996). Here, vertical commonality existed because
26 payment to both investors and DEE under the joint venture agreements was dependent on output

1 of the wells. Investors were paid as the wells produced and the oil or gas was sold, based on the
2 percentage interest the investor had in that well. (H.T. p. 125:1-15, p. 452:8-14). DEE retained
3 25% of each well (H.T. p. 234:4 – p. 235:16), and thus also profited based on sales from well
4 production. Thus, both DEE and the investors' profits were linked to production from the wells.

5 The final prong of the *Howey* test has evolved since it was first handed down over 60
6 years ago. The original definition of this prong required investors to have had an expectation of
7 profits solely from the efforts of others. *Howey*, 328 U.S. at 301. The rigidity of this prong was
8 significantly lessened in *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir. 1973).
9 There, the Ninth Circuit concluded that the “adherence to such an interpretation could result in a
10 mechanical, unduly restrictive view of what is and what is not an investment contract.” *Id.* at
11 482. The *Turner* court, “adopt[ed] a more realistic test, whether the efforts made by those other
12 than the investor are the undeniably significant ones, those essential managerial efforts which
13 affect the failure or success of the enterprise.” *Id.*

14 Arizona courts have followed *Turner* in broadening this third prong. *See Nutek*, 194 Ariz.
15 104, 977 P.2d 826; *Foy*, 186 Ariz. 151, 920 P.2d 31; *Daggett*, 152 Ariz. 559, 733 P.2d 1142. As
16 such, in order to satisfy the third *Howey* prong in Arizona, one must only establish that the efforts
17 made by those other than the investors were the undeniably significant ones, and were those
18 essential managerial efforts which affected the failure or success of the enterprise. *Id.*

19 The trier of fact must look beyond the form of the documents to the substance of the
20 transaction in deciding whether the securities laws apply to it. *Nutek*, 194 Ariz. at 109, 977 P.2d
21 at 831 (following *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981)). Arizona has adopted a
22 three factor analysis from the Fifth Circuit in *Williamson* in analyzing the third prong of *Howey*:

23 “A general partnership or joint venture interest can be designated a security if the
24 investor can establish, for example, that (1) an agreement among the parties leaves
25 so little power in the hands of the partner or venturer that the arrangement in fact
26 distributes power as would a limited partnership; or (2) the partner or venturer is so
inexperienced and unknowledgeable in business affairs that he is incapable of
intelligently exercising his partnership or venture powers; or (3) the partner or
venturer is so dependent on some unique entrepreneurial or managerial ability of the

1 promoter or manager that he cannot replace the manager of the enterprise or
2 otherwise exercise meaningful partnership or venture powers.”

3 *Nutek*, 194 Ariz. at 109, 977 P.2d at 831 (quoting *Williamson v. Tucker*, 645 F.2d at 424). The
4 level of control retained by the investor over the investment, both legal and practical, is part of
5 the third prong of the *Howey* test. *Nutek*, 194 Ariz. at 109, 977 P.2d at 831; *see also Vairo*, 153
6 Ariz. at 18; 734 P.2d at 115; *Foy*, 186 Ariz. at 158, 920 P.2d at 38; *Rose*, 128 Ariz. at 213, 624
7 P.2d at 890. This requires looking not only at the documents structuring the investment, but oral
8 and written representations made by the promoters at the time of investment. *Nutek*, 194 Ariz. at
9 109, 977 P.2d at 831 (citing *Williamson v. Tucker*, 645 F.2d at 423).

10 While the actual documents signed by DEE and the investors were titled “Joint Venture
11 Agreement”, that title alone does not insulate the offerings from the Securities Act. In *Nutek*, in
12 which investors had received LLC interests in a telecommunications business, the Arizona Court
13 of Appeals analyzed the *Williamson* factors in determining that an investment contract existed.
14 The appellate court determined that although the investors had legal control, they (1) signed over
15 all rights to managing and operating the business, (2) were so geographically dispersed that
16 effectively exercising control was prevented, and (3) the individual investors did not possess the
17 technical expertise to run the business they had invested in, thus making them reliant on others
18 for this purpose. *Nutek*, 194 Ariz. at 110-11, 977 P.2d at 832-33.

19 With the DEE investments, while the investment agreements provided investors the “right
20 to participate in all pertinent decisions”, and allowed investors to “provide input” (*see e.g. Ex. S-*
21 **13**), there was no mechanism in place for any investor to make any ultimate managerial
22 decisions. In fact, DEE, and Christopher as manager, effectively retained all essential
23 managerial and operating control over the well projects. Christopher confirmed that DEE was
24 and is the manager with respect to all of the oil and gas well projects and made all decisions as to
25 how the projects progress and regarding operation of the wells. (**H.T. p. 302:2 – p. 303:16**).
26 This also includes making decisions concerning the sale of the oil and gas produced. (**H.T. p.**
304:1-19).

1 The investment was promoted to investors as a passive investment. Salesman Munsey
2 represented to potential investors that DEE “do[es] all the work. No contractors. We are the
3 operator and the drilling company so we keep a keen eye on operations. Our diligence and
4 research on the sites we drill are unequaled.” (*E.g. Ex. S-63*). The investors that had only one
5 requirement: to invest their money. Munsey testified that other than giving investment funds to
6 DEE, the investors were supposed to “just sit back and wait for production.” (*H.T. p. 148:6-8*).

7 It is equally clear from the evidence that the investors did not have the requisite technical
8 experience to be able to run the oil and gas wells. Although at hearing Respondents attempted to
9 highlight the purported business experience of the investors, simply because an investor has
10 generalized business experience or has previously invested in the technical field of the
11 investment does not equate to the investor having the requisite experience to be able to manage
12 and operate the business of the investment. *See Nutek*, 194 Ariz. at 111, 977 P.2d at 833.
13 Further, the analysis as to whether the investors possess the requisite expertise is on each
14 individual investor, not the group of investors as a whole. *Id.* The only testimony at trial was
15 that *some* of the investors had previous oil and gas *investing* experience. (*H.T. p. 137:5 – p.*
16 *138:1, p. 143:25 – p. 144:10*). At least one investor had no experience, investing or otherwise,
17 with oil and gas. (*H.T. p. 460:18-25*).

18 There was no evidence that any investor had experience operating or managing oil and
19 gas wells. Investor Charles Haegelin from New Mexico identified himself as a “land developer”
20 in his investment documents, while investor Jacob Ullrich, a Texas investor, stated he was in the
21 “cattle” business. (*Exs. S-14, S-22*). California investor Jack Jensen’s investment documents
22 state that he worked for a technology company, and non-accredited Arizona investor Lori Cook
23 is identified as an accountant. (*Exs. S-27, S-39*). Finally, investor documents show that Florida
24 investor Alton Dwyer worked in real estate, insurance and as a general contractor; that Tennessee
25 investor Sidney du Mont was an engineer; and North Carolina investor Marshall Rauch for
26 Gamp, LLC identified himself as a “retired investor”. (*Exs. S-46, S-51, R-45*).

1 Finally, investors also executed a Special Power of Attorney appointing DEE, via
2 Christopher, as Managing Joint Venture Partner. This document gave DEE the authority to sign
3 and file all documents on behalf of the “joint venture”. (*See e.g. Ex. S-23, at bates DEE00123,*
4 *Ex. S-63, at bates ACC000052*).

5 These facts establish that the third element of the *Howey* test is met. The investments at
6 issue constitute securities in the form an investment contract.

7 **B. Respondents Sold Unregistered Securities as Unregistered Dealers and**
8 **Salesmen.**

9 The DEE securities were offered and sold within or from Arizona in violation of A.R.S. §
10 44-1841 and § 44-1842 of the Securities Act. (*Exs. S-12-S-52, S-126, S-128*).

11 The Securities Act provides that a security may not be offered or sold in or from Arizona
12 unless it is registered with the Commission. *See* A.R.S. § 44-1841. Additionally, a person who sells
13 or offers to sell securities in or from Arizona must be registered as a dealer or salesman with the
14 Commission. *See* A.R.S. § 44-1842. The evidence produced at hearing established that
15 Respondents violated A.R.S. § 44-1841 and § 1842 with numerous offers and sales of unregistered
16 securities.

17 Pursuant to A.R.S. § 44-2034, the Division presented certificates of non-registration for all
18 Respondents for the relevant time period. (*Exs. S-1(a)-(d)*). Thus, DEE, Christopher, Munsey, and
19 MRC were not registered as dealers or salesmen in Arizona during the relevant time. The offer and
20 sale of these securities violated the Securities Act.

21 **C. Respondents Utilized Fraud in the Offer or Sale of Securities.**

22 Fraud, including untrue statements of material fact and material omissions, in the offer or sale
23 of securities violates the Securities Act. *See* A.R.S. § 44-1991(A)(2) (it is a fraud to “[m]ake any
24 untrue statement of material fact, or omit to state any material fact necessary in order to make the
25 statements made, in the light of the circumstances in which they were made, not misleading.”).

1 The Division alleged and established at hearing that Respondents violated the antifraud provision
2 of the Securities Act, A.R.S. § 44-1991.

3 As it relates to fraud, the standard of materiality is whether a reasonable investor would have
4 wanted to know the omitted facts. *See Rose*, 128 Ariz. at 214, 624 P.2d at 892. In the context of
5 these provisions, the term “material” requires a showing of substantial likelihood that, under all the
6 circumstances, the misstated or omitted fact would have assumed actual significance in the
7 deliberations of a reasonable investor. *See Trimble v. American Sav. Life Ins. Co.*, 152 Ariz. 548,
8 553, 733 P.2d 1131, 1136 (1986) (citing *Rose*, 128 Ariz. at 214, 624 P.2d at 892) (quoting *TSC*
9 *Industries v. Northway, Inc.*, 426 U.S. 438 (1976)). There is an affirmative duty not to mislead
10 potential investors in any way - a heavy burden on the offeror – and the investor is not required to
11 investigate or act with due diligence. *Id.*

12 Additionally, a misrepresentation or omission of a material fact in the offer and sale of a
13 security is actionable even though it may be unintended or the falsity or misleading character of
14 the statement may be unknown. In other words, scienter or guilty knowledge is not an element of
15 a violation of A.R.S. § 44-1991. *See, e.g., Gunnison*, 127 Ariz. at 113, 618 P.2d at 607. Stated
16 differently, a seller of securities is strictly liable for any of the misrepresentations or omissions he
17 makes. *See Rose*, 128 Ariz. at 214, 624 P.2d at 892. Unlike common law fraud, reliance upon a
18 misrepresentation is not an element in fraud involving the offer or sale of securities. *Id.* The
19 evidence elicited at hearing clearly establishes fraud committed by Respondents in connection with
20 the offer or sale of the DEE investments.

21 **1. Prior securities violation.**

22 First, the Division established that Respondents failed to disclose to offerees and
23 investors the existence of a prior cease and desist order for securities violations entered against
24 DEE in Pennsylvania. A Summary Order to Cease and Desist was entered in May 2010 by the
25 Pennsylvania Securities Commission against DEE, and Findings of Fact, Conclusions of Law,
26 and Order were entered in July 2010. (Exs. S-3, S-4). The Pennsylvania proceeding and

1 ultimate order found a violation of the Pennsylvania securities laws related to a joint venture
2 offering made by DEE in the Koomey/Morrison #3 well. (Exs. S-3, S-4). Munsey failed to
3 disclose the Pennsylvania order during a solicitation made to Mr. Jackson Roberts (Mr. Eckert),
4 and in materials sent to Mr. Eckert by Munsey and DEE (H.T. p. 46:25 – p. 48:8, p. 52:7-17, p.
5 74:2-15; Ex. S-126), and there is no evidence that Respondents disclosed the Pennsylvania order
6 to other offerees and investors. (H.T. p. 71:22 – p. 74:15; Exs. S-12 – S-52, S-57, S-58, S63 –
7 S-66; R-45). The Pennsylvania order was not disclosed on DEE’s website either. (Ex. S-72).

8 Arizona case law establishes that the failure to disclose such an order to offerees is a
9 material omission that constitutes fraud. *See State ex rel Corbin v. Goodrich*, 151 Ariz. 118, 124,
10 726 P.2d 215, 221 (App. 1986) (failure to disclose previous cease and desist order against
11 company issued by Iowa securities regulator was a material omission constituting fraud under the
12 Securities Act). Other jurisdictions interpreting the identical language in the federal securities
13 laws have come to the same conclusion – failure to disclose previous violations of securities laws
14 is a material omission. *See e.g. SEC v. Merchant Capital, LLC*, 483 F.3d 747, 771 (11th Cir.
15 2007) (“The existence of a state cease and desist order against identical instruments is clearly
16 relevant to a reasonable investor, who is naturally interested in whether management is following
17 the law in marketing the securities.”); *S.E.C. v. Levine*, 671 F. Supp. 2d 14, 27-28 (D.D.C. 2009)
18 (“It cannot be disputed that a reasonable investor would want to know whether the person they
19 are sending their money to in order to purchase a stock has been previously found to have
20 violated the securities laws.”); *SEC v. Paro*, 468 F. Supp. 635, 646 (N.D.N.Y. 1979).

21 DEE and Christopher attempted to downplay the materiality of the Pennsylvania order at
22 hearing by arguing that DEE did not admit the allegations against it, and that the fine was
23 “small”. First, nowhere in the case law cited above is there any authority to distinguish
24 materiality based on whether the order was entered after hearing, by default or consent. Further,
25 there is no authority for asserting the order is immaterial merely due to the size of the fine issued.
26 An order is an order, and the failure to disclose it is a material omission. DEE may have not

1 admitted or denied the allegations, but that does not change the fact that they consented to the
2 order and that the Pennsylvania Securities Commission entered Findings of Fact, Conclusions of
3 Law, and Order in July 2010 finding a violation of Pennsylvania securities laws. (Exs. S-3, S-4).
4 Further, even if somehow relevant, there was no evidence presented at hearing that the fine
5 ultimately issued by Pennsylvania against DEE was small or large. Chief investigator Eckert
6 testified that he did not know the range of fines authorized in Pennsylvania for securities
7 violations. (H.T. p. 94:2-20; p. 115:23 – p. 116:1).

8 The case law cited above stands for the proposition that it is the existence of the order, not
9 the size of the fine or the procedural nature of how the order was issued (consent, default, after
10 hearing), which is material. The point is to allow the offeree to decide whether to invest with
11 knowledge of the existence of the order, not for DEE to make the unilateral decision not to
12 disclose it.

13 And while Respondents disputed materiality at the hearing, they ignore the fact that the well
14 investment that was the subject of the Pennsylvania order, the Koomey/Morrison #3, was
15 specifically referenced by Munsey in his offering to Mr. Jackson Roberts (Mr. Eckert). Specifically,
16 Munsey represented in his telephone pitch to Mr. Eckert that DEE has another well project called
17 the “KM3” or “Koomey/Morrison #3” that’s “pushing out 200 barrels of oil a day”. Yet Munsey
18 never mentioned the Pennsylvania order pertaining to that exact well offering. (Ex. S-126). The
19 existence of the Pennsylvania order was a material omitted fact that a reasonable investor would
20 want to know, and constitutes fraud under A.R.S. § 44-1991.

21 2. Well production.

22 Second, DEE, either directly or through its authorized sales representative, made untrue
23 statements of material fact in the offer and sale of securities when they represented that certain wells
24 had produced or were producing substantial or certain amounts of oil and gas. In reality, when these
25 representations were made, the wells were producing insignificant amounts to nothing. For
26 example, when pitching the investment opportunity to Mr. Eckert on May 18, 2011, Munsey

1 represented that the “Kooomey/Morrison #3” was “pushing out 200 barrels of oil a day”. (H.T. p.
2 46:25 – p. 48:8, p. 52:7-17; Ex. S-126). However, at the hearing, Christopher admitted that there
3 was no significant production on the Kooomey/Morrison #3 well as of May 2011. (H.T. p. 308:8-
4 19). The lack of production on this well was supported by the production reports available from the
5 Texas Railroad Commission (“TRRC”), the entity that regulates oil and gas wells in Texas, as well
6 as the entity to which operators such as DEE must report production and sales of oil. There was no
7 production reported by DEE on the Kooomey/Morrison #3 well as of July 31, 2012. (H.T. p. 74:16 –
8 p. 79:21, p. 292:16 – p. 293:21; Exs. S-78, S-79, S-88). Thus, representing that Kooomey/Morrison
9 #3 well was pushing out 200 barrels of oil a day when it was not producing at all was a material
10 misstatement of fact.

11 The Kooomey/Morrison #3 well was not the only well that was represented to be producing
12 when it was not. In May 2011, Respondents’ represented to offerees, and the offering materials
13 stated, that “all three wells [in the Johnson Three Well project] currently produce”. (H.T. p. 53:14-
14 17; p. 56:1 – p. 57:22; Ex. S-63 at bates ACC000006; Ex. S-98, at bates ACC000226). Per the
15 offering materials, the Johnson Three Well project was made up of the Harrison #1 well, the
16 Harrison #2 well, and the Poco Reata #1 well. (Ex. S-63 at bates ACC000040). However, there is
17 only one “Harrison” well listed with the TRRC under the operator number for DEE - not three – and
18 there is no lease named “Poco Reata”³. (H.T. p. 81:7 – p. 83:16; Exs. S-78 – S-80). Not only is it
19 questionable as to whether DEE has an interest in all three wells that make up the Johnson Three
20 Well project given that there is only one “Harrison” well and no “Poco Reata”, but the evidence was
21 clear that, minimally, there were not three producing wells for that joint venture offering. This was
22 a material misstatement.

23 Finally, the Division established at hearing that when Munsey offered the Denver/Karber #1
24 offering to Mr. Roberts in May 2011, he represented that DEE owned all the rights to the “Karber
25

26 ³ Christopher testified that the Johnson Three Well project was made up of Harrison #1, Harrison #2, and Harrison #3, and that Poco Reata was the former name of Harrison #3, although he could not explain why the investor materials referenced Poco Reata instead of Harrison #3. (H.T. p. 275:9 – p. 277:22; Ex. R-45). However, this is irrelevant because only one “Harrison” well is listed with the TRRC under DEE’s operator number.

1 field”, that DEE had drilled three wells on that field, had been successful “100% of the time”, had
2 “pulled out over 300,000 barrels of oil” on those three wells, and “500,000 mcf of gas.” (Ex. S-
3 126). However, the evidence established that the TRRC operator reports showed that DEE had *no*
4 *reported production* for any lease named “Karber” as of May 2011. (Exs. S-78, S-79, Ex. S-87). In
5 fact, despite the fact that several “Karber” leases had been approved for drilling by the TRRC (H.T.
6 p. 78:9 – p. 79:4; Ex. S-88, at ACC002899), the only “Karber” lease with any oil production was
7 the Denver Karber 4M, which did not have any reported production with the TRRC until September
8 2011. (Ex. S-87). Additionally, there were no “Karber” leases operated by DEE with reported gas
9 production. (Exs. S-78, S-79, Ex. S-87). Again, this is a material misstatement.

10 The evidence established numerous violations of the antifraud provision of the Securities
11 Act.

12 **D. Christopher is a Control Person.**

13 The Division alleged and proved at hearing that Christopher was a controlling person of
14 DEE pursuant to A.R.S. § 44-1999(B). Section 44-1999(B) of the Securities Act states, “Every
15 person who, directly or indirectly, controls any person liable for a violation of § 44-1991 or 44-
16 1992 is liable jointly and severally with and to the same extent as the controlled person to any
17 person to whom the controlled person is liable unless the controlling person acted in good faith
18 and did not directly or indirectly induce the act underlying the action.” Thus, the Securities Act,
19 “attaches vicarious or secondary liability to “controlling persons” as it does to a person or entity
20 that commits a primary violation of §§ 44–1991 or 1992.” *Facciola v. Greenberg Traurig, LLP*,
21 781 F. Supp. 2d 913, 922-23 (D. Ariz. 2011); *see also Eastern Vanguard Forex Ltd. v. Ariz.*
22 *Corp. Com’n*, 206 Ariz. 399, 412, 79 P.3d 86, 89 (App. 2003).

23 In Arizona, liability under A.R.S. § 44-1999(B) does not require “actual participation” by
24 the alleged control person. *Eastern Vanguard*, 206 Ariz. at 411, 79 P.3d at 98. In other words,
25 the plain language of A.R.S. § 44-1999(B) “does not support a requirement that a ‘controlling
26 person’ must have actually participated in the specific action upon which the securities violation

1 is based.” *Eastern Vanguard*, 206 Ariz. at 412, 79 P.3d at 99 (“[I]nterpreting § 44-1999(B) to
2 require ‘actual participation’ in the underlying conduct would frustrate the intent behind the
3 creation of controlling person liability: to impose accountability on those actors who had the
4 authority to control primary violators but were not legally liable under extant legal principles.”).
5 Instead, Arizona follows the SEC definition of “control” which is “the possession, direct or
6 indirect, of the *power to direct or cause the direction of the management and policies of a*
7 *person*, whether through the ownership of voting securities, by contract, or otherwise.” *Id.*
8 (citing 17 C.F.R. § 230.405 (1995) (emphasis added). A.R.S. § 44-1999(B) imposes
9 “presumptive control liability on those persons who have the *power* to directly or indirectly
10 control the activities of those persons or entities liable as primary violators of §[] 44-1991 . . .”
11 *Id.* “[T]he evidence need only show that the person targeted as a controlling person had the
12 legal power, either individually or as part of a control group, to control the activities of the
13 primary violator.” *Id.*

14 As noted in Section IV(B) above, the Division alleged and proved at hearing the primary
15 fraud violations by DEE. The Division further proved that Christopher is a control person of
16 DEE. Christopher is the sole manager of DEE, a manager-managed LLC, and during all relevant
17 periods, has held majority ownership in DEE. (H.T. p. 224:16 – p. 225:4; Ex. S-6). Christopher
18 performed all managerial functions for DEE, including: (1) approval of the content of DEE’s
19 website; (2) signing the independent contractor agreements with DEE’s salespersons on behalf of
20 DEE; (3) signing investors’ investment documents on behalf of DEE; (4) negotiating and signing
21 leases for oil and gas wells on behalf of DEE; (5) negotiating and signing vendor contracts on
22 behalf of DEE; (6) determining whether or not to sell oil and gas from the wells; and (7) making
23 the ultimate decisions as to the progression of the oil and gas projects. (H.T. p. 230:5-14, p.
24 262:9-22, p. 302:5 – p. 304:19; Exs. S-8, S-9, S-92). Christopher was the sole signatory on
25 DEE’s bank accounts. (H.T. p. 305:11 – p. 306:2). Further, Christopher provided salespersons
26 with information about the wells to pass along to investors. (H.T. p. 122:22 – p. 123:2).

1 Christopher clearly had the power to control and manage DEE, and did in fact manage
2 and control it. The Division established control person liability for Christopher as it relates to
3 DEE, such that Christopher is jointly and severally liable with DEE for violations of A.R.S. § 44-
4 1991.

5 **E. Numerous Offers and Sales of the Securities.**

6 The final consideration is the number of violations of the Securities Act by Respondents, and
7 the penalty that should be issued. In assessing the administrative penalty, “each violation” carries a
8 penalty. *See* A.R.S. § 44-2036 (an assessment of an administrative penalty may be assessed “in an
9 amount not to exceed five thousand dollars for each violation.”). Each offer and sale by
10 Respondents was a violation of the Securities Act. *See* A.R.S. § 44-1841(A) (“It is unlawful to *sell*
11 *or offer for sale* within or from this state any securities unless the securities have been registered . .
12 .”) (emphasis added); A.R.S. § 44-1842(A) (“It is unlawful for any dealer to *sell* or purchase or *offer*
13 *to sell* or buy any securities, or for any salesman *to sell or offer for sale* any securities within or from
14 this state unless the dealer or salesman is registered . . .”) (emphasis added).

15 The evidence established that DEE provided Munsey and other salesmen with lead lists of
16 potential investors to contact to offer and sell the joint venture investments. Since October 2010,
17 Munsey contacted minimally one hundred leads that were offered the DEE investments, and sold the
18 investment to four investors, who invested a total of \$376,100.56 as a result. (H.T. p. 127:12-25, p.
19 129:5 – p. 131:17, p. 136:25 – p. 137:21; Exs. S-55, S-90 at p. 48:8 – p. 51:2, S-97, S-128). DEE
20 paid Munsey 15% of each investor’s investment, for a total of \$38,176.35. (Ex. S-94). Munsey
21 billed MRC as the “marketing arm” of DEE, and used his MRC email,
22 crm@marketingreliabilityconsultant.com, to communicate with investors. (Ex. S-90, at p. 73:3-15;
23 Ex. S-62, Ex. S-63, Ex. S-98).

24 The evidence also established that DEE utilized other salesmen to offer and sell the DEE
25 investment, including Don Howard who sold to one Arizona investor, Lori Cook, and another
26 Arizona salesman who sold to two investors. (H.T. p. 254:22 – p. 255:25; p. 259:16 – p. 260:4;

1 **Exs. S-9, S-53).** All of these salesmen were authorized by DEE to contact potential investors, with
2 DEE directing them on whom to call. **(H.T. p. 123:3 – p. 124:25, p. 127:12 – p. 128:13, p. 260:12-**
3 **20).** Further, each offer and sale involved fraud, as shown above. Minimally, each Respondent
4 should be ordered to jointly and severally pay an administrative penalty in the amount of \$200,000.
5 Given that the Commission could issue a \$500,000 fine for the one hundred offers Munsey made on
6 behalf of DEE alone, this is substantially less than the maximum penalty that the Commission is
7 authorized to issue.

8 The Securities Act and Commission Rules also provide a remedy of restitution. A.R.S. § 44-
9 2032(1); R14-4-308(C). DEE investors Charles Haegelin, Lori Cook, Jacob Ullrich, Jack Jensen,
10 Alton Dwyer, Sidney Du Mont, and Gamp, LLC (Marshall Rauch) paid DEE a total of \$420,407.25.
11 Notably, at no time prior to the hearing did DEE provide any credible evidence showing payments
12 to any of these investors. DEE did not provide one cancelled check showing investor payments
13 prior to hearing, despite having access to them. **(H.T. p. 356:5-14, p. 467:10-15).** Instead, DEE
14 produced a summary document prepared in anticipation of the hearing containing, *inter alia*,
15 purported payments made to DEE investors. The document was admitted at hearing over
16 foundational objection that certain information contained in the document was inaccurate, and no
17 cancelled checks supporting the summary had been produced. **(H.T. p. 351:14 – p. 355:1, p. 361:6-**
18 **22; Ex. R-69).** The summary document admitted as Exhibit R-69 has significant foundational
19 issues such that it should be disregarded.

20 At hearing, DEE failed to produce any cancelled checks showing payments to investors, and
21 only produced eleven non-cancelled checks to investor Lori Cook. **(Ex. R-84).** The checks issued
22 to Ms. Cook establish the lack of foundation of the summary document, Exhibit R-69. The
23 summary document gives check numbers as well as dates of payment. **(Ex. R-69).** Not one check
24 date in the checks produced as Exhibit R-84 matches up with the “date of payment” column on
25
26

1 Respondent's Exhibit R-69. In fact, every check is dated one month later than the date of purported
2 payment asserted in Exhibit R-69.⁴ (**Compare Ex. R-69 at bates DEE01129 with Ex. R-84**).

3 Additional cancelled checks issued to investors have been docketed post-hearing by DEE.
4 See docket entries on 10/12/12 & 10/31/12). These checks have not been admitted into evidence. To
5 the extent that these checks are considered notwithstanding their lack of admission, it should be
6 noted that Respondents still failed to produce four cancelled checks referenced in their summary
7 exhibit. (**Compare Ex. R-69 at bates DEE01130, check nos. 5489, 5684, 5835, and 5747 with**
8 **same checks missing from docket entries on 10/12/12 & 10/31/12**). Minimally, the amounts in
9 these four checks should not be considered as a legal offset for Respondents. See A.A.C. R14-4-
10 308(C).

11 If the post-hearing checks are considered, they provide further support for the lack of
12 foundation of the summary document, Exhibit R-69. Again, the dates on the checks docketed post-
13 hearing do not match up with the "date of payment" column on Exhibit R-69 – they were all issued
14 one month later. (**E.g., compare Ex. R-69 at bates DEE01130, check nos. 2919 with "date of**
15 **payment listed as "July 2011" with same check dated August 25, 2011 in docket entries on**
16 **10/12/12 & 10/31/12**).

17 Minimally, these discrepancies call into question the foundation for the information
18 contained in the summary document, and the total payments reflected in Exhibit R-69 should be
19 ignored in favor of only those payments with adequate foundation, i.e. the cancelled checks.⁵ The

20 ⁴ For example, check 6249 is listed with a date of payment in September 2011 on Ex. R-69, but the actual check
produced by Respondents at hearing is dated October 26, 2011 (R-84).

21 ⁵ The production of checks reflecting payments to investors raises the additional question of the legitimacy of the DEE
22 operation. Not one investor payment was made by DEE until after the Commission issued the TC&D on May 23,
2011: the first investor checks were not written until June 28, 2011 (investors in the Julie 3 Well project). (**Docket**
23 **entries on 10/12/12 & 10/31/12, check nos. 2929 & 2925**). The three investors that invested in the Julie 3 Well
24 project – Mr. Haegelin, Mr. Ullrich, and Mr. Jensen – had all invested as of November 2010 (**Exs. S-13, S-19, S-26, S-**
25 **128**). As noted above, investors were paid based upon production from the well in which they invested. (**H.T. p.**
26 **125:1-15; p. 452:8-14**). DEE reported production to the TRCC on the Julie wells in December 2010, January 2011,
February 2011, March 2011, April 2011, May 2011, August 2011 and October 2011. (**Exs. S-81 – S-83**). Why Did
DEE fail to pay these investors in the Julie 3 Well project until June 2011 when there were months of reported
production on these wells? The only logical explanation is that investors began receiving payment from DEE in June
2011 as lulling payments – to keep them satisfied with their investment after the Commission had entered the TC&D.

DEE's credibility was further questioned when, despite admitting DEE is responsible for reporting disposition (sales)
of oil and gas to the TRRC (**H.T. p. 229:2-18, p. 292:16 – p. 293:25, p. 298:1-10**), Respondents produced documents

1 total in the post-hearing cancelled checks is \$48,127.85. **(Docket entries on 10/12/12 & 10/31/12).**
 2 Respondents should be ordered to pay restitution in the principal amount of \$420,407.25, plus pre-
 3 judgment interest from the date of each investor's investment (as set forth in Exhibit S-128) to be
 4 determined at the time of judgment, minus \$48,127.85 paid to investors.⁶

5 **F. No Private Offering Exemption Applies.**

6 Unless Respondents establish that an exemption applies, the registration provisions of
 7 A.R.S. § 44-1841 apply. Respondents failed to establish that the fractional undivided interests in oil
 8 or gas and/or investment contracts offered and sold are exempt from the registration provisions of
 9 A.R.S. § 44-1841. Under the Securities Act, the burden of establishing an exemption from
 10 registration is upon the party claiming it. *See* A.R.S. § 44-2033. Our Supreme Court has held that,
 11 “[b]ecause of the vital public policy underlying the registration requirement, there must be strict
 12 compliance with all the requirements of the exemption statute.” *State v. Baumann*, 125 Ariz. 404,
 13 411, 610 P.2d 38, 45 (1980) (*en banc*). During the administrative hearing, Respondents attempted
 14 to argue that the joint ventures were federal “covered securities” under federal Rule 506 of
 15 Regulation D (“Regulation D”) - the safe harbor for nonpublic offerings. *See* 17 C.F.R. § 230.506.
 16 Respondents failed to meet their burden to establish this exemption.

17
 18
 19 at the hearing showing disposition of oil from one of the Julie wells, lease no. 24590, for May, June and August 2011
 20 (Ex. R-48), but the evidence established that DEE failed to report this disposition to the TRRC. (H.T. p. 296:3 – p.
 21 298:10; Ex. S-81). Even assuming as true Christopher's testimony that the TRRC is up to six months backlogged in
 processing such reporting (H.T. p. 468:11-20), the reports run on July 31, 2012, from the TRCC website such as
 Exhibit S-81 would be current as of January 2012. Thus, Respondents cannot blame a “backlog” at the TRCC for lack
 of reporting in 2010 and 2011.

22 There are similar concerns as to how DEE was paying certain investors in months where there was no reported
 23 production. Mr. Haegelin and Ms. Cook invested in the Koomey/Morrison #4 well, which was changed to the DK4M, in
 24 December 2010 and January 2011, respectively. (H.T. p. 228:8-12; Exs. S-35, S-18). TRRC records only show
 25 production reports for that well for September 2011 through February 2012 (Ex. S-87), yet payments were made to these
 26 investors for several months after February 2012, when there was no reported production or disposition reported to the
 TRRC. (Ex. S-87, Docket entries on 10/12/12 & 10/31/12, check nos. 5392, 5527, 5584, 56615829, 5416, 5503, 5562,
 5637, 5804). DEE also failed to produce any documents showing oil sales for these subsequent months at hearing. This
 raises the question of whether DEE failed to report this information to the TRRC as it was required to do, or if these
 investors were paid with other funds to keep them complacent during the pendency of this action.

⁶ The Commission is required to include add interest to the restitution amount at a rate calculated pursuant to A.R.S. § 44-1201 (as determined on the date the judgment is entered), minus any repayments. *See* A.A.C. R14-4-308(C)(1).

1 Regulation D of the Securities Act of 1933 outlines two exemptions and a “safe harbor”
2 with respect to Section 4(2) of the Securities Act of 1933. Rule 506 provides a “safe harbor” to
3 the private offering exemption under the Securities Act of 1933. A “safe harbor” is a rule that
4 explicitly states the requirements an issuer must meet. If an issuer complies with all of the
5 requirements of the rule, it will be deemed to have complied with the statute. In this case, if Rule
6 506 of Regulation D was complied with, the issuer, DEE would be deemed to have met the
7 requirements for the section 4(2) private placement exemption.

8 An offering pursuant to Rule 506 must comply with Rules 501 through 503 of Regulation
9 D. An issuer must establish that both: (1) the issuer does not use general solicitation to market
10 the securities (Rule 502(c)) and (2) the issuer sells its securities to no more than thirty-five (35)
11 non-accredited investors who are sophisticated purchasers and an unlimited number of accredited
12 investors (Rule 506(b)(2)). Respondents cannot claim the exemption because they used general
13 solicitation to market the securities.

14 **1. General solicitations occurred.**

15 Rule 502(c) precludes the offer and sale of securities “by any form of general solicitation
16 or general advertisement . . .” 17 C.F.R. 230.502(c). In determining whether a general
17 solicitation has occurred under Rule 506, the focus is on the relationship between the issuer and
18 the potential investor. In determining whether a general solicitation has occurred, the SEC has
19 focused on whether the issuer, or a dealer acting on behalf of the issuer, had a relationship with
20 the offeree that was both “substantive” and “preexisting.” *Woodtrails-Seattle, Ltd.*, SEC No-
21 Action Letter, 1982 WL 29366 (Aug. 9, 1982); *E.F. Hutton Co.*, SEC No-Action Letter, 1985
22 WL 55680 (Dec. 3, 1985). While an issuer may be able to establish that the “substantive”
23 requirement by targeting only accredited investors (Rule 501(a)), DEE failed to do so in this
24 case. The evidence at hearing established that non-accredited investors were solicited and sold
25 the DEE investments. (H.T. p. 148:15-21, p. 260:5-11, p. 424:5 – p. 425:1, p. 461:4 - p.
26 466:19; Exs. M-1, M-2, S-113, S-114).

1 Even assuming only accredited investors were solicited to invest, DEE would still have to
2 establish each investor and offeree had a pre-existing business relationship with DEE. *See*
3 *Interpretive Release on Regulation D*, SEC Release No. 33-6455, 1983 WL 409415, Q.60 (Mar.
4 3, 1983) ("The mere fact that a solicitation is directed only to accredited investors will not mean
5 that the solicitation is in compliance with Rule 502(c)"). The relationship must be established
6 prior to the offering that is relying on the Regulation D exemption. *See E.F. Hutton Co.*, SEC
7 No-Action Letter, 1985 WL 55680. At hearing, Christopher testified that DEE and Christopher
8 had no pre-existing relationship with any of the offerees or the investors that invested in DEE.
9 (H.T. p. 253:8-11, p. 263:25 – p. 264:3, p. p. 264:23 – p. 265:4, p. 265:19-24, p. 274:13-19).

10 There was also additional evidence that precludes application of a Rule 506 exemption
11 due to a general solicitation of the investments. DEE provided its salesmen with lead lists, each
12 containing hundreds of names, and instructed the salesmen to call the individuals listed to offer
13 and sell the DEE joint ventures. (H.T. p. 127:12 – p. 128:13, p. 129:7-25, p. 136:25 – p.
14 137:16, p. 251:21 – p. 252:4, p. 330:16-18; Ex. S-55, Ex. S-90 at pp. 70-71, Ex. S-97). Again,
15 DEE and Christopher had no pre-existing relationship with anyone on any of the lead lists. (H.T.
16 p. 253:8-11). The SEC has used the following language in concluding that a general solicitation
17 exists when there is no pre-existing relationship with the issuer and those being solicited:

18 In determining what constitutes a general solicitation, the Commission's Division of
19 Corporation Finance has underscored the existence and substance of pre-existing
20 relationships between the issuer and those being solicited. *See* No Action Letter re:
21 Woodtrails-Seattle, Ltd., dated July 8, 1982. Kenman admits that persons who
22 received the Orem Associates mailings had no pre-existing relationship with
23 Kenman. These persons were selected only because their names were on lists that
24 were purchased or created by Kenman. Although the make-up of the lists may
25 indicate that the persons themselves have some degree of investment sophistication
26 or financial well-being, utilization of lists of thousands of persons with no pre-
existing relationship to the offeror clearly does not comply with the limitation of
Rule 502(c) on the manner of solicitation. *See e.g.*, No Action Letter re: Aspen
Grove dated October 5, 1982 (proposed distribution of advertising materials relating
to limited partnership interests in horse-breeding venture to members of
organizations interested in such activity, to persons in attendance at horse sale and
through advertisement in related trade journal would not comply with manner of
solicitation limitation of Rule 502(c)). Here, Kenman mailed information

1 concerning Orem Associates not only to previous Kenman investors, but to an
2 unknown number of persons with whom Kenman had no prior contact or
relationship.

3 *In the Matter of Kenman Corporation*, 32 S.E.C. Docket 1352, 1985 WL 548507, *3 n.6 (Apr.
4 19, 1985)⁷.

5 DEE also solicited investors via the DEE website that was publicly available. The DEE
6 website provided information on the oil and gas well projects and the leases involved in the joint
7 ventures, provided contact information for anyone visiting the website to contact DEE, and
8 allowed visitors to input their name and email address into the website for information about
9 “opportunities”. (Ex. S-72). The website even cautioned about risks associated with investing in
10 oil and gas and referenced “Regulation D”. (Ex. S-72). Potential investors were provided the
11 DEE website address when salesmen, such as Munsey, solicited them. (H.T. p. 40:1 – p. 45:15;
12 Exs. S-58, S-62, S-63, S-72). At least one offeree was provided offering materials for the joint
13 ventures after representing to DEE that he had visited the DEE website. (Ex. S-98).

14 Both cold calling from lead lists and utilization of the DEE website were general
15 solicitations that make the private offering exemption inapplicable. For these reasons alone, a
16 Rule 506 exemption is unavailable to DEE.

17 **2. DEE cannot establish that the unaccredited investors were sophisticated.**

18 The second requirement to take advantage of a Rule 506 exemption is that the security is
19 sold to accredited investors and no more than thirty-five non-accredited investors who are
20 sophisticated purchasers. *See* 17 C.F.R. § 230.506 (b)(2)(ii). A sophisticated investor either
21 alone or with a qualified purchaser representative “has such knowledge and experience in
22 financial and business matters that he is capable of evaluating the merits and risks of the
23 prospective investment.” *Id.*; *see also Mark v. FSC Sec. Corp.*, 870 F.2d 331, 334 (6th Cir. 1989)
24 (Respondent “is required to offer evidence of the issuer’s reasonable belief as to the nature of

25 _____
26 ⁷ DEE would not qualify for the exemption contained in Section 4(2) for “transactions by an issuer not involving a public offering” is inapplicable because of these same facts. *See In re EMX Corporation*, 55 S.E.C. Docket 179, 1993 WL 391651, *3 (September 29, 1993) (citing *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 901 (5th Cir. 1977)).

1 *each purchaser.*)". At hearing, Respondents failed to provide any evidence to prove that all
2 unaccredited investors were sophisticated at the time of investment.

3 DEE had at least seven unaccredited investors as of October 2010, as reported to the SEC.
4 **(Ex. S-114)**. Christopher admitted at hearing that he did not know the names of these investors,
5 and could not provide any information or documentary evidence on their backgrounds to
6 establish that they were sophisticated. **(H.T. p.465:18 – p. 466:19)**. For this reason alone, DEE
7 cannot take advantage of a Rule 506 exemption.

8 **3. DEE cannot avoid violations of the antifraud statute with an**
9 **exemption from the registration provisions of the Act.**

10 Finally, exemptions are inapplicable to the antifraud rules contained in both federal and
11 Arizona securities laws. *See e.g.* 15 U.S.C. § 77q(c); *Little v. First California Co.*, 1977 WL
12 1054 (D. Ariz. 1977) ("Even though bank securities are exempt from the registration
13 requirements of the 1933 Act, transactions in bank securities are not exempt from the anti-fraud
14 provisions of either the 1933 Act or the 1934 Securities Exchange Act."); A.R.S. § 44-1991;
15 *MacCollum v. Perkinson*, 185 Ariz. 179, 186, 913 P.2d 1097, 1104 (App. 1896) (holding that the
16 statutory definition of a security for registration purposes is limited under A.R.S. § 44-1801(22)
17 and the specified exemptions, but that the "securities fraud statute . . . includes the sale of even
18 those securities that are exempted from the registration requirements."). Even if the DEE
19 securities were exempt from registration – which they are not – they are not exempted from the
20 antifraud provisions of A.R.S. § 44-1991.

21 Respondents failed to meet their burden of proving an exemption from registration.

22 **CONCLUSION**

23 The evidence produced at hearing includes the following:

24 A. Respondents offered unregistered securities in the form of fractional undivided
25 interests in oil or gas wells and/or investment contracts within or from Arizona to offerees over
26 one hundred times;

1 B. DEE sold unregistered securities in the form of fractional undivided interests in oil
2 or gas wells and/or investment contracts through unregistered dealers or salesmen in or from
3 Arizona to seven investors totaling \$420,407.25;

4 C. Of the \$420,407.25, Munsey and MRC, also unregistered with the Commission,
5 sold unregistered securities in the form of fractional undivided interests in oil or gas wells and/or
6 investment contracts in or from Arizona to five investors totaling \$376,100.56;

7 D. Every offer and sale of the unregistered securities included fraud in connection
8 with the offer and sale of securities by all Respondents;

9 E. That Christopher acted as the control person for DEE.

10 Based upon the evidence admitted during the administrative hearing, the Division
11 respectfully requests this tribunal to:

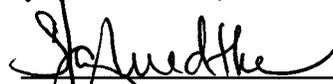
12 1. Order DEE, Christopher, Munsey, and MRC, pursuant to A.R.S. § 44-2032(1), to
13 jointly and severally pay restitution in the amount of \$372,279.40 (\$420,407.25 minus \$48,127.85
14 reflected in investor repayments), plus pre-judgment interest from the date of each investor's
15 investment as set forth in Exhibit S-128 (interest rate to be calculated at the time of judgment
16 under A.R.S. § 44-1201);

17 2. Order DEE, Christopher, Munsey, and MRC to pay an administrative penalty of not
18 more than five thousand dollars (\$5,000) for each violation of the Act, as the Court deems just and
19 proper, pursuant to A.R.S. § 44-2036(A). The Division recommends DEE, Christopher, Munsey,
20 and MRC to pay jointly and severally an administrative penalty in the amount of \$200,000.00.

21 3. Order DEE, Christopher, Munsey, and MRC to cease and desist from further
22 violations of the Act pursuant to A.R.S. § 44-2032.

23 4. Order any other relief this tribunal deems appropriate or just.

24 RESPECTFULLY SUBMITTED this 30th day of November, 2012.

25 

26 Stacy Luedtke
Attorney for the Securities Division of the
Arizona Corporation Commission

1 ORIGINAL AND THIRTEEN (13) COPIES of the foregoing
2 filed this 30th day of November, 2012, with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 W. Washington St.
6 Phoenix, AZ 85007

7 COPY of the foregoing hand-delivered
8 this 30th day of November, 2012, to:

9 Mr. Marc E. Stern
10 Administrative Law Judge
11 Arizona Corporation Commission/Hearing Division
12 1200 W. Washington St.
13 Phoenix, AZ 85007

14 COPY of the foregoing mailed
15 this 30th day of November, 2012, to:

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