

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Sandlapper Securities, LLC,  
Greenville, SC,

Trevor Lee Gordon,  
Greenville, SC,

and

Jack Charles Bixler,  
Greenville, SC,

Respondents.

DECISION

Complaint No. 2014041860801

Dated: June 23, 2020

**Member firm, its chief executive officer, and its vice-president misrepresented and omitted material facts concerning sales of fractional interests in saltwater disposal wells. In addition, the firm's chief executive officer and president breached their fiduciary duties to an investment fund and caused an affiliate entity to act as an unregistered securities dealer, and the member firm and chief executive officer failed to establish, maintain, and enforce written supervisory procedures and failed to supervise the firm's registered representatives. Held, findings and sanctions affirmed.**

**Appearances**

For the Complainant: Gregory Firehock, Esq., Leo Orenstein, Esq., William Thompson, III, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Gilbert Boyce, Esq., Joseph Ingrisano, Esq.

## Decision

This case arises out of sales of fractional interests in saltwater disposal wells operated in the Permian Basin in Texas. Saltwater disposal wells are often depleted oil or gas wells into which waste fluids can be injected for safe disposal. The process of oil and gas production creates “saltwater,” which is considered hazardous waste because of its high salt content, hydrocarbons, and industrial compounds. Hydraulic fracturing of shale gas well sites produces millions of gallons of this saltwater. Produced saltwater that is not chemically treated to remove impurities or reused by the oil and gas producer is piped or trucked from the well to these saltwater disposal wells for containment. Saltwater disposal wells can be profitable in two ways. First, when the produced saltwater is delivered to the disposal well, the disposal well operator charges a per barrel fee for water injected into the disposal well. Second, the saltwater disposal well operator skims the residual oil from the water before injecting it into the disposal well and sells the skimmed oil.

The instant appeal involves the alleged misconduct of Sandlapper Securities, LLC (“Sandlapper”), its chief executive officer Trevor Gordon, and its vice-president Jack Bixler (collectively, “Respondents”). Respondents, through an affiliate entity created and controlled by Respondents, purchased fractional interests in several saltwater disposal wells from the disposal well operator and then resold those interests to an investment fund managed by Respondents, as well as to other investors.

FINRA’s Department of Enforcement (“Enforcement”) alleges that Respondents’ conduct surrounding these transactions violated both federal securities laws and FINRA rules. Cause one alleges that Respondents willfully defrauded the investment fund by fraudulently interposing another entity between the fund and the well operator and charging undisclosed, excessive markups. Cause two alleges that in connection with these same sales to the investment fund, Gordon and Bixler breached fiduciary duties of loyalty and care to the investment fund. The third cause of action alleges that with respect to the sales of saltwater disposal well interests to individual investors, Gordon and Sandlapper committed securities fraud by charging excessive markups when selling those interests as securities through the firm between late 2014 and November 2015. The fourth cause alleges that Gordon committed securities fraud by charging excessive markups when selling the saltwater disposal well interests as “real estate” to investors between January 2013 and November 2015. Cause five alleges that Gordon and Bixler willfully caused the entity interposed into the sales transaction to operate as an unregistered securities dealer. The final two causes of action involved allege supervisory failures—cause six alleges that Gordon and Sandlapper failed to establish and implement supervisory procedures adequate to address the conflicts of interests inherent to the sales transactions, and cause seven alleges that Gordon and Sandlapper failed to adequately supervise the private securities transactions.

On November 29, 2018, after an 11-day hearing, an Extended Hearing Panel (“Hearing Panel”) concluded that Respondents engaged in the misconduct charged in the complaint. The Hearing Panel barred Gordon and Bixler, expelled Sandlapper, and ordered Respondents to pay restitution. Respondents have appealed the Hearing Panel Decision pursuant to FINRA Rule 9311 to the National Adjudicatory Council (“NAC”). As discussed in the decision below, the NAC affirms the Hearing Panel’s findings and the sanctions.

I. Factual Background

A. Respondents

1. Sandlapper Securities, LLC

Sandlapper has been a FINRA member firm since 2006. The firm is a full-service broker-dealer and dealer-manager of investment products. Sandlapper, whose main office is in Greenville, South Carolina, has approximately 60 registered representatives in 13 branch offices. Sandlapper represented that it has “significant experience in the acquisition and operation of commercial real estate, business entities, finance and management as well with alternative financial instruments.” The firm’s registered representatives were also heavily focused on “replacement property solutions” such as IRS § 1031 real estate exchanges.<sup>1</sup>

2. Trevor Lee Gordon

Gordon is the founder and majority owner of Sandlapper, and serves as the firm’s chief executive officer, managing member, and, for some of the relevant period, chief compliance officer. He first became registered with a FINRA firm in 1997 and registered with Sandlapper in 2006. He is currently registered with Sandlapper as a general securities representative, general securities principal, and operations professional.

3. Jack Charles Bixler

Bixler is a principal, vice president, and minority owner of Sandlapper. During the relevant period, he was president of the Capital Markets Division of Sandlapper. Bixler first registered with FINRA in 1970 and registered with Sandlapper in 2006. He is currently registered with Sandlapper as a general securities representative, general securities principal, and operations professional.

B. RJ and RBJ

RJ is a developer of saltwater disposal wells in the Permian Basin of Texas. Through his business, RBJ, RJ constructs and operates numerous saltwater disposal wells. As the well operator, RBJ develops the wells and oversees their daily operations. To fund these activities, RBJ issued fractional interests in the wells to investors. RBJ used “third for a quarter” pricing, a common form of financing in the oil and gas industry. RBJ priced interests so that sales of 75 percent of the well would cover the total anticipated cost of development, allowing RBJ to keep the remaining 25 percent of each well as compensation for developing and operating it. In addition, RBJ typically sold his saltwater disposal well interests on a “turnkey basis,” meaning investors paid a fixed price, typically between \$45,000 and \$55,000 per one percent interest, based upon RBJ’s anticipated development costs, in exchange for fractional, undivided interests

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<sup>1</sup> An IRS § 1031 exchange is a strategy that allows an investor to defer paying capital gains taxes on an investment property when it is sold, as long another like-kind property is purchased with the profit gained by the sale of the first property.

in a well developed and operated by RBJ. If the costs of development exceeded estimates, RBJ absorbed the excess, meaning that RBJ, not the investors, bore the risk of any cost overruns. The budget for developing a well was set forth in an Authority for Expenditure (“AFE”), which RBJ prepared. During the relevant period, RJ almost always had saltwater disposal well interests to sell, although his focus was on the operation of the wells rather than finding investors.

Through their connections in the oil and gas industry, Gordon and Bixler, along with former Sandlapper representatives JS and PB met RJ. RJ wanted to remain focused on the substance of his business—the development and maintenance of the saltwater disposal wells—rather than bringing in investment funds. He looked to Sandlapper to provide the investors.

### C. Gordon and Bixler’s Investment Fund Creation and Management

In March 2011, Gordon and Bixler, along with JS and PB (collectively, the “Tiburon Team”), formed Tiburon Saltwater Reclamation Fund I (the “Fund”) as a Delaware limited-liability company to invest in interests in saltwater disposal wells. Through these investments, Fund investors received a share of profits in proportion to their ownership interest in the Fund.

The Tiburon Team also owned and controlled the Fund’s manager, TSWR Fund Management, LLC (“Fund Management”), which was responsible for communicating with investors and marketing the Fund to broker-dealers and investors. Gordon was the chief executive officer of Fund Management, and Bixler was vice-president of marketing. In addition, the Tiburon Team served as the sole members of the Fund’s Investment Committee, making all of the investment decisions for the Fund.<sup>2</sup> As the Investment Committee, the Tiburon Team was required to use its “good faith business judgment as to the best interests of the Funds.” Moreover, the Fund’s private placement memorandum (“PPM”) represented that the Fund Management would “attempt to mitigate [adverse conflicts of interest] by the exercise of business judgment in an attempt to fulfill its fiduciary obligations.” Through their ownership of Fund Management and Sandlapper, the Tiburon Team, including Gordon and Bixler, collected fees, commissions, and other payments which exceeded 16 percent of investor funds. As managers of the Fund, Gordon and Bixler jointly decided which disposal well interests the Fund purchased.

Sandlapper served as the managing broker-dealer and placement agent for the Fund. Its registered representatives solicited Sandlapper customers to invest in the Fund through Sandlapper, with Gordon overseeing all sales of Fund interests by the firm’s representatives. In addition, registered representatives at other firms sold interests in the Fund as part of a selling group established by Sandlapper. Between August 2011 and December 2014, approximately 170 investors purchased units in the Fund for close to \$12.5 million.

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<sup>2</sup> Gordon and Bixler were also members of Sandlapper’s investment committee, which was responsible for “reviewing and accepting” the firm’s participation in private placements, direct participation programs and underwritings.

D. Tiburon Team Establishes TSWR Development

In June 2011, Gordon, Bixler, and the other Tiburon Team created TSWR Development, LLC (“TSWR Development”) as a vehicle to acquire interests in RBJ’s saltwater disposal wells and resell them to investors, including the Fund and retail customers. TSWR Development had no staff or facilities, and its business address was the same as Sandlapper’s. Gordon served as the managing member of TSWR Development. The Fund’s PPM represented that TSWR Development was formed “to take advantage of entire facilities that could be taken down with various cash and financing options given the limitation of the Fund to leverage for purposes of acquisition” and to “maximize cash flow in the Fund by attempting to remain fully invested at all times.” The PPM also noted that TSWR Development was formed “to make working interests in the developed facilities available to exchange buyers seeking real property replacement options when executing an IRS § 1031 exchange.” As Gordon noted at the hearing, the PPM contemplated “side-by-side investing,” whereby TSWR Development would assist the Fund in taking advantage of opportunities when the Fund lacked sufficient funds to invest.<sup>3</sup>

The Fund’s original PPM did not disclose to investors that TSWR Development would resell interests to the Fund. Fund disclosures informed investors that the Fund’s managers (including Gordon and Bixler) would be compensated only through considerable commissions and fees. While the Fund’s PPM disclosed that there may be conflicts of interest between the Fund, its managers, and their affiliates, it addressed only the possibility that the managers may pursue other opportunities and might not devote their full attention to the Fund. It did not speak to the prospect that the Fund might purchase investments from an affiliate like TSWR Development, or how such investments would be priced.

The Fund first disclosed TSWR Development to its investors in an amendment to the PPM dated September 10, 2012. The amended PPM acknowledged that affiliated transactions between the Fund and TSWR Development presented potential conflicts of interest for Fund Management and represented that it had adopted safeguards against self-interested transactions. The Fund engaged an independent due diligence provider, who made several recommendations to militate against potential conflicts. Based on the recommendations, the PPM represented that the Fund would obtain independent appraisals for all transactions with affiliates, including TSWR Development, that the Fund would abide by “investment guidelines” for all transactions, and that the Fund had “adopted a conflicting opportunity procedures to address the circumstances when an investment may be an appropriate investment opportunity for the Fund and another investor or fund affiliated with [Fund Management] or one of its Affiliates.” Under those circumstances in which conflicting opportunities arise, “[a]ll things being equal, the Manager will present the investment opportunity to the investment entity that has the funds available for investment for the longest period of time, or allocated the Investment pro rata.” Finally the PPM represented that Fund Management would exercise “business judgment in an attempt to fulfill its fiduciary obligations.”

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<sup>3</sup> Under the terms of the PPM, the Fund was prohibited from borrowing money to fund its investments.

Contrary to the statements made in the amended PPM, the Fund never obtained an independent appraisal in its transactions with any affiliate, including TSWR Development. Gordon maintained that while he diligently searched for appraisers to conduct independent appraisals of the saltwater disposal wells, he was unable to find anyone willing to conduct such an appraisal.<sup>4</sup> Thus, the Tiburon Team caused the Fund to engage in affiliate transactions with TSWR Development without obtaining independent appraisals. They also failed to adopt written investment guidelines, only setting an unwritten goal of returning investors principal within 36 months.

In June 2013, after TSWR Development had sold four tranches of disposal well interests to the Fund, the Fund sent investors a supplement amending the conflict of interest disclosures in the PPM, deleting the requirement that all transactions between the Fund and TSWR Development be independently appraised. While eliminating the requirement for an appraisal, absent limited conditions that never materialized, this amendment did not disclose that Fund Management had failed to obtain appraisals on the prior affiliate transactions, and the supplement did not purport to apply retroactively. The supplement informed investors that where an interest in a well was being “sold straight out of development, certain assumptions will be made in pricing the holding,” though the “final price and assumptions must continue to meet [investment] guidelines. This price will not be made at arm’s length.”

E. TSWR Development Purchases and Sells Saltwater Disposal Well Interests to the Fund

Initially, the Fund itself directly purchased saltwater disposal well interests in two wells—the Tom and Clark wells—from RBJ for \$45,000 per one percent interest. However, beginning in December 2012, Gordon and Bixler directed TSWR Development to purchase saltwater disposal well interests from RBJ and then caused the Fund to purchase those interests from TSWR Development at undisclosed markups.

1. Tom Well

On October 19, 2012, Gordon and Bixler directed the Fund to purchase, directly from RBJ, five percent of the Tom well for \$225,000, or \$45,000 per once percent interest—within the average range charged by RBJ per share. Approximately six weeks later, on December 1, 2012, Gordon and Bixler directed TSWR Development to enter into an agreement with RBJ to purchase a 20 percent interest in the Tom well for \$900,000, again, at a price of \$45,000 per one percent interest. Although TSWR Development agreed to purchase the interests, it did not have the funds to pay for its investment. As of the date of its purchase agreement, TSWR

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<sup>4</sup> The record contains no evidence of Gordon’s purported attempts to locate an appraiser. In fact, according to both RJ, who has been in the saltwater disposal well business in the Permian Basin for years, and Enforcement’s expert, who has extensive consulting and investment experience in the business, appraisals historically have been available for saltwater disposal wells.

Development had approximately \$273 in its bank account, and was not able to pay RBJ the purchase price at the time. TSWR Development was able to acquire its interests by delaying payment for the interests until it resold a portion of those interests at a markup and by borrowing from individual investors in the Fund.<sup>5</sup>

On December 6, 2012, five days after its purchase from RBJ, TSWR Development sold a 5.2 percent interest in the Tom well to the Fund for \$610,158.76, or \$117,338.22 per one percent interest. The following day, TSWR Development transferred the Fund's payment to RBJ in partial satisfaction of its December 1 purchase. Over the next two weeks, TSWR Development borrowed a total of \$200,000 from three customers, each of whom was an existing investor in the Fund, and immediately wired the loan proceeds to RBJ. On January 4, 2013, TSWR Development sold an additional .75 percent of its interest in the Tom well to the Fund for \$88,003.67. After this sale, TSWR Development immediately paid RBJ the remainder of the amount it owed for its interests in the Tom well.

While TSWR Development had repaid RBJ, it still had to repay \$200,000 in loans plus interest. On March 7, 2013, Gordon and Bixler directed the Fund to buy an additional 2.5 percent of the well from TSWR Development for \$293,345.58, or approximately \$117,000 per one percent interest. That same day, TSWR Development repaid the loans plus interest. At this point TSWR Development owned approximately 11.5 percent of the Tom well, with the cost of its interests covered by the Fund. TSWR Development's undisclosed markups were, on average, approximately 160 percent.

## 2. Clark Well

As with the Tom well, Gordon and Bixler initially directed the Fund to make the purchase of interests in the Clark well. On March 20, 2013, the Fund purchased a 13 percent interest in the Clark well for \$585,000, or \$45,000 per one percent interest. Several days later, on March 25, 2013, Gordon and Bixler directed TSWR Development to purchase 12 percent interest in the Clark well for \$540,000—again \$45,000 per one percent interest. As with its acquisition of the Tom well, TSWR Development did not have the funds to invest in the Clark well. Thus, it borrowed the funds from the same three customers as before and resold a fraction of its interest to the Fund at a markup. On March 27 and 28, 2013, TSWR Development borrowed \$350,000 from these customer and used the proceeds of the loans to pay RBJ on March 29, 2013, leaving an unpaid balance of \$190,000.

On April 5, 2013, ten days after TSWR Development had acquired its interests in the Clark well, it sold four percent in the well to the Fund for \$200,000, or \$50,000 per one percent interest. That same day, TSWR paid the outstanding \$190,000 it owed to RBJ.

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<sup>5</sup> TSWR Development's actions ran counter to the conflicting opportunities requirements in the Fund's PPM. While the Fund had enough funds at the ready to purchase the interests, TSWR Development did not. TSWR Development had almost no cash on hand and instead relied on RBJ's willingness to forbear payments.

On June 5, 2013, TSWR Development sold an additional 2.5 percent of its interest in the Clark well to the Fund for \$416,297.22, or \$166,518.89 per one percent interest. TSWR Development's undisclosed markups were, on average, approximately 111 percent.

F. TSWR Development Sells Saltwater Disposal Well Interests to Other Investors

In addition to its sales to the Fund, TSWR Development sold "direct working interests" ("DWIs") to individual investors and small funds created by Sandlapper representatives and representatives at other broker-dealers who were members of Sandlapper's selling group. The DWIs were fractional, undivided ownership interests in individual saltwater disposal wells, all of which TSWR Development had obtained from RBJ. Gordon and Bixler marketed the DWIs to individuals through a network of brokers. Gordon created economic models and projections used by selling group brokers to market the interests. Under a purchase and sale agreement ("PSA"), an investor in a DWI acquired a certain percentage of TSWR Development's interests in the well's "operations, associated equipment and lease interest."

Investors in the DWIs also entered into a management agreement with Fund Management, under which the investors engaged Fund Management as the "asset manager for all interests in saltwater disposal wells." Gordon participated in most aspects of TSWR Development's offerings of DWIs. Specifically, Gordon prepared offering documents, marketed the interests to broker-dealers for sales to retail customers, and signed many of the subscription agreements and other documents on behalf of TSWR Development.

Prior to November, 2014, TSWR Development sold DWIs to investors as purported "real estate" interests rather than securities, attracting investors who were looking to engage in IRS § 1031 exchanges of real property. This allowed TSWR Development to sell the DWIs without filing a registration statement with the SEC and it ostensibly enabled registered representatives of Sandlapper and other member firms to sell DWIs away from their firms without being subject to firm supervision.

In late 2014, FINRA staff sent a request for information pursuant to FINRA Rule 8210 to Gordon and Sandlapper requesting that they provide their basis for concluding that the DWIs were not securities. Shortly thereafter, TSWR Development began offering the DWIs as private placements, through Sandlapper. In recognition that earlier DWIs "may be considered securities for purposes of the Securities Act," TSWR Development offered investors "rescission" or "repurchase" of their mischaracterized "real estate" investments. TSWR Development sold over \$11.5 million in DWIs to investors at undisclosed markups ranging from 67 percent to 376 percent.

1. Tom Well

In addition to its sales to the Fund, TSWR Development also sold some of its interests in the Tom well to individual investors as DWIs. On January 23, 2013, TSWR Development sold 2.15 percent of the Tom well to an investor for \$269,937, or \$125,552 per one percent interest. On September 5, 2013, TSWR Development sold an investor a 1.05 percent interest for \$119,231. TSWR Development sold another investor a 4.4 percent interest in the Tom well for



\$499,463, or \$113,514 per one percent interest on October 1, 2014.<sup>6</sup> The undisclosed markups TSWR Development charged investors in the Tom well averaged 160 percent.

2. Clark Well

Similarly, TSWR Development sold almost all of its remaining Clark well interests as DWIs to individual investors. On September 13, 2013, TSWR Development sold .5 percent interest in the Clark well for \$107,000, or \$214,000 per one percent share. On October 1, 2013, it sold SI a 3.5 interest in the Tom well for \$639,521, or \$182,720 per one percent interest. On January 30 and February 12, 2014, TSWR Development sold an additional two percent in Clark well interests for \$250,000 per one percent interest. The undisclosed markups TSWR Development charged investors in the Clark well averaged 160 percent.

3. Merket Well

In about March 2014, TSWR Development sought to purchase a 32 percent interest in Merket well. But after TSWR Development agreed to purchase Merket well interests, RBJ withdrew from that deal and sought other financing because TSWR Development never paid the purchase price. On June 5, 2014, however, TSWR Development negotiated a purchase of a 4 percent interest in Merket well from RBJ for \$160,000, or \$40,000 per one percent interest. TSWR Development approached RBJ about this purchase *after* it had already entered into an agreement to sell the 4 percent interest to an individual investor. The May 23, 2014 agreement

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<sup>6</sup> This investor SI, and her husband, JI, are retirees who lived off income generated by SI's inherited rental property, a restaurant. Concerned about the reliability of the income generated from the property, SI and JI discussed alternative investments with a broker who introduced the idea of investing in a saltwater disposal well. When SI sold her rental property, she immediately looked to reinvest the proceeds in an IRS § 1031 exchange to avoid adverse tax consequences. The broker forwarded income projections from two of RBJ's wells, which indicated that SI would more than double the monthly income that she and her husband needed to live on. Based on these projections, which were created by Gordon, SI decided to invest. The projections substantially overestimated the revenues that the well ultimately generated. As a result, the monthly income generated by the well proved substantially less than the income SI previously relied on, requiring her and her husband to mortgage their home and liquidate their assets, including a recreational vehicle, among other belt-tightening measures. TSWR Development and Gordon offered rescission to SI and JI on unfavorable terms.

Notwithstanding these facts, Respondents maintain that they did right by the couple and attempt to cast Gordon's conduct in a positive light. However, JI's testimony tells a different story:

I would love to get my money back. I would love to get it invested with someone else. Sorry Trevor [Gordon], but I don't feel comfortable with doing business with Sandlapper . . .

with the investor was to sell a 4 percent interest in Merket well for \$ 360,000, or \$90,000 per one percent interest. Therefore, TSWR Development charged the investor an undisclosed markup of 125 percent.

4. Moreland Well

On July 1, 2013, TSWR Development agreed to buy a 40.9 percent interest in Moreland well from RBJ for approximately \$2.25 million, just over \$55,000 per one percent interest. TSWR Development resold more than a 35 percent interest in Moreland well to 21 different individual investors between January 2014 and May 2015 for a total of \$5,476,770, or an average markup of more than 178 percent (prices per one percent interests ranged from \$122,211 to \$175,439).

The Moreland well was the only well in which RBJ sold interests on a non-turnkey basis. RBJ drilled Moreland well to a greater depth in an attempt to enable the well to dispose of a greater volume of water than the other wells at issue in this matter. For this reason, Moreland well, unlike the other wells, subjected investors to geologic risk, which remained until the well successfully took in water in the volumes required. It was the investors, and not TSWR Development, that bore development risk.

5. Additional DWI Sales

Gordon and Bixler sold investors additional interests in RBJ-managed disposal wells through TSWR Development. On July 14, 2014, TSWR Development purchased a 29 percent interest in Haney well for \$1,305,000, or \$45,000 per one percent interest. It then resold 7.5 percent interest to four investors between August 1, 2014 and July 16, 2015 for \$1,098,844, an average undisclosed markup of more than 225 percent (prices for one percent interest ranged from \$111,940 to \$150,004).

On July 14, 2014, TSWR Development purchased a 10 percent interest in Hughes well for \$550,000, or \$55,000 per one percent interest. It then sold over a 6 percent interest to three investors for \$875,004, an average markup in excess of 165 percent (prices for one percent interest ranged from \$125,000 to \$150,004). On October 7, 2014 and November 11, 2014, it purchased a total of a 5 percent interest in the Hughes #2 well for \$285,000, reselling a 2 percent interest to one investor for \$250,000 on December 23, 2014, an average undisclosed markup in excess of 92 percent.

On November 6, 2014, TSWR Development purchased a 10 percent interest in the 137 well for \$550,000, or \$55,000 per one percent interest. From February through November 2015, it resold a 7.24 percent interest to seven investors for \$984,460, an average undisclosed markup of approximately 147 percent (prices for one percent interest ranged from \$128,750 to \$141,509). Finally, on February 15, 2015, TSWR Development purchased a 15 percent interest in Rojo well for \$1,150,000, or \$70,000 per one percent interest, and resold just under 5 percent interest to four investors for \$630,425, an average undisclosed markup of 91 percent (prices for one percent interest ranged from \$128,750 to \$140,845).

From its sales to the Fund and individual investors across all of the wells at issue, TSWR Development made a profit in excess of \$8 million.

## II. Procedural History

On September 29, 2017, Enforcement filed a seven-cause complaint against Respondents and an 11-day hearing was held in May and June of 2018. On November 29, 2018, the Hearing Panel issued its decision, finding Respondents liable for all violations alleged in the complaint. For cause one, the Hearing Panel concluded that Gordon, Bixler, and Sandlapper willfully defrauded the Fund by fraudulently interposing TSWR Development into well purchase transactions and by charging undisclosed, excessive markups, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Exchange Act Rule 10b-5, and FINRA Rules 2010 and 2020.<sup>7</sup> The Hearing Panel barred Gordon and Bixler and expelled Sandlapper from FINRA membership. In addition, Respondents were ordered to pay restitution, jointly and severally to the Fund’s investors, in the amount of \$901,418, plus interest.

Under cause two, the Hearing Panel found that Gordon and Bixler breached their fiduciary duties of loyalty and care to the Fund in connection with Fund’s purchases of the saltwater disposal well interests, in violation of FINRA Rule 2010. The Hearing Panel barred Gordon and Bixler for this violation. In addition, the Hearing Panel found Gordon and Bixler jointly and severally liable for restitution totaling \$901,418, plus interest; however, in light of the restitution order in connection with the first cause, it did not impose restitution for cause two.

Under cause three, the Hearing Panel found that Gordon and Sandlapper sold retail customers saltwater disposal well interests as securities through TSWR Development while charging excessive markups, in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 thereunder, as well as FINRA Rules 2020 and 2010. The Hearing Panel again barred Gordon and expelled Sandlapper from FINRA membership for this violation, and ordered Gordon and Sandlapper, jointly and severally, to pay restitution totaling \$2,429,664, plus interest.

Under cause four, the Hearing Panel found that Gordon sold saltwater disposal well interests to retail customers through a network of representatives while marketing the investments as “real estate,” fraudulently interposing TSWR Development into the transactions,

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<sup>7</sup> The Hearing Panel also concluded that Respondents were subject to statutory disqualification for their violations of the Exchange Act. Their willful violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 results in their statutory disqualification. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (“‘[W]illfully’ in [the Exchange Act] means intentionally committing the act which constitutes the violation,” not that “the actor [must] also be aware that he is violating one of the Rules or Acts.”); *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at \*2 n.2 (Feb. 13, 2015); see also Sections 3(a)(39)(F) (15 U.S.C. § 78c(a)(39)(F)) and 15(b)(4)(D) (15 U.S.C. § 78o(b)(4)(D)) of the Exchange Act; Article III, Section 4 of FINRA’s By-Laws.

and charging undisclosed, excessive markups in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 thereunder, as well as FINRA Rules 2020 and 2010. The Hearing Panel barred Gordon and ordered him to pay restitution totaling \$4,682,201, plus interest.

Under cause five, the Hearing Panel found that Gordon and Bixler caused TSWR Development to act as an unregistered dealer, in willful violation of Section 15(a) of the Exchange Act and FINRA Rule 2010, and barred Gordon and Bixler.

Finally, under causes six and seven, the Hearing Panel found that Gordon and Sandlapper failed to maintain and enforce an adequate supervisory system and written supervisory procedures and failed to exercise proper supervision over affiliate sales of securities, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010. For these violations, the Hearing Panel barred Gordon and expelled Sandlapper. The Hearing Panel assessed, but did not impose in light of the bar and expulsion, a fine of \$73,000, jointly and severally on Gordon and Sandlapper for these supervisory violations.

This appeal followed.<sup>8</sup>

### III. Discussion

#### A. Gordon and Bixler Caused TSWR Development to Act as an Unregistered Dealer

The Hearing Panel concluded, as alleged in cause five of the complaint, that by causing TSWR Development to act as an unregistered dealer, Gordon and Bixler willfully violated Section 15(a) of the Exchange Act and FINRA Rule 2010. We agree.

##### 1. The Saltwater Disposal Well Interests Were Securities

As an initial matter, in order to establish that TSWR Development was acting as a dealer, we must address whether the salt water disposal well interests were in fact securities. At various points in the underlying litigation, Respondents claimed that DWIs were merely “real estate,”

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<sup>8</sup> While Respondents’ notice of appeal takes exception to every aspect of the Hearing Panel Decision, their appellate brief primarily focuses on the issues of prevailing market price and scienter. At oral argument, Respondents directed the NAC subcommittee empaneled to hear the appeal (“Subcommittee”) to reread Respondents’ post-hearing brief, which addressed in detail Respondents’ arguments concerning the IRS § 1031 exchange issues, among other arguments. While we have considered the entire record, including all the briefs filed by the parties below, in our de novo review, we do not treat arguments made in Respondents’ post-hearing brief as arguments made in their appellate brief. To do so would allow Respondents to circumvent the page limits and prejudice Enforcement by precluding it from making arguments in opposition.

and not securities. We disagree with Respondents and conclude that at all times they were securities.<sup>9</sup>

“‘Congress’ purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.’” *SEC v. Edwards*, 540 U.S. 389, 393 (2004) (quoting *Reeves v. Ernst & Young*, 494 U.S. 56, 61 (1990)). “To that end, it enacted a broad definition of ‘security,’ sufficient ‘to encompass virtually any instrument that might be sold as an investment,’” including an “investment contract.” *Id.* The Supreme Court has established that an investment contract is a “contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (explaining that there is an investment contract, and consequently a security, where there is: (1) an investment of money; (2) in a common enterprise; (3) with an expectation of profits produced by the efforts of a third party). When applying *Howey*, the Supreme Court cautioned that the test should be “broadly construed by [] courts so as to afford the investing public a full measure of protection [], and that form [should be] disregarded for substance and emphasis [] placed upon economic reality.” *Id.* at 298. The Supreme Court noted that the term, security, “embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.” *Id.* at 299. Applying these factors, we find that both the investments made on behalf of the Fund and in the form of the DWIs offered by TSWR Development are securities.

Investors invested money with the expectation they would receive profits from the successful operation of the wells. The wells were a common enterprise because RBJ financed the operation of each well by pooling the contributions of investors, who shared in the profits earned by the well. Finally, the investments were completely passive—the investors expected profits solely from RBJ’s efforts in operating the saltwater disposal wells as well as Fund Management’s administration of the Fund and DWIs.<sup>10</sup>

Therefore, we find, based on the satisfaction of the *Howey* investment contracts test, that the saltwater disposal well interests were securities.

## 2. TSWR Development Acted as a Dealer

Section 15(a) of the Exchange Act makes it “unlawful for any broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless

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<sup>9</sup> There is no dispute that the interests sold to the Fund were securities. The Fund’s PPM explicitly stated that they were securities.

<sup>10</sup> We do not analyze the issue of whether the Respondents were involved in an unregistered distribution of securities in violation of Section 5 of the Securities Act of 1933 when brokers sold DWIs to investors because the complaint did not allege such a violation.

such broker or dealer is registered” with the SEC. 15 U.S.C. § 78o(a). A “dealer” is defined as anyone “who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.” 15 U.S.C. § 77b(a)(12). Thus, “[a] dealer is one who buys and sells securities for his own account, through a broker or otherwise,” and thereby “ha[s] a ‘certain regularity of participation in securities transactions at key points in the chain of distribution.’” *SEC v. Nat’l Executive Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980), *aff’d*, 545 F.2d 754 (1st Cir. 1976) (quoting *Mass. Fin. Servs., Inc. v. Sec. Investor Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass. 1976)), *aff’d*, 545 F.2d 754 (1st Cir. 1976)); *see* 15 U.S.C. § 78c(a)(5)(A) (a dealer is “any person engaged in the business of buying and selling securities . . . for such person’s account, through a broker or otherwise.”).

TSWR Development regularly bought disposal well interests from RBJ and sold the interests to investors, including the Fund. Moreover, the purchase of these interests was the primary reason for TSWR Development’s existence. TSWR Development positioned itself squarely in the middle of each transaction, for no other reason than to profit from the price difference between the buy and sell sides of the transactions. Nonetheless, Gordon and Bixler failed to register TSWR Development as a dealer with the SEC or as a FINRA member. By causing TSWR Development to act as an unregistered dealer, Gordon and Bixler willfully violated Section 15(a) of the Exchange Act and FINRA Rule 2010.

#### B. Gordon and Bixler Breached their Fiduciary Duties to the Fund

FINRA Rule 2010 imposes ethical standards on all its members and associated persons. It proscribes “a wide variety of conduct that operate as an injustice to investors or other participants in the marketplace.” *Thomas W. Heath III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, \*15 (Jan. 9, 2009), *aff’d*, 586 F.3d 122 (2d Cir. 2009); *Kimberly Springsteen-Abbott*, Exchange Act Release No. 88156, 2020 SEC LEXIS 394, at \*31 (Feb. 7, 2020) (improper allocation of broker-dealer expenses to investment funds violates FINRA Rule 2010). “Whether misconduct is within Rule 2010’s scope is ultimately a question of whether the conduct raises concerns that the associated person will not ‘comply with the regulatory requirements of the securities business’ and will not ‘fulfill his or her fiduciary duties in handling other people’s money.’” *Stephen Grivas*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173, at \*17 (Mar. 29, 2016).<sup>11</sup> FINRA has held that a breach of fiduciary duties owed to an investment fund violates FINRA Rule 2010. *See Dep’t of Enforcement v. Fretz*, No. 2010024889501, 2015 FINRA Discip. LEXIS 54, at \*73-74 (FINRA NAC Dec. 17, 2015).

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<sup>11</sup> Gordon’s and Bixler’s usurping of Fund assets in breach of their fiduciary duties to the Fund is business-related conduct, even if the misconduct did not involve a FINRA member firm. “Among other reasons, the Fund and the FINRA member firm, [Sandlapper] were interrelated: [Sandlapper] served as one of the brokers for the Fund’s offering and []members of the Fund were customers of Sandlapper at the time they invested in the Fund.” *Grivas*, 2016 SEC LEXIS 1173, at \*16.

Under the terms of the PPM and as a matter of law,<sup>12</sup> Gordon and Bixler were fiduciaries of the Fund. Indeed, Gordon and Bixler admit that they owed fiduciary duties to the Fund. As principals of Fund Management and members of the Fund's Investment Committee, Gordon and Bixler owed fiduciary duties of care and loyalty to the investors in the Fund. In addition to their roles as managers of the Fund, Gordon and Bixler were part of Sandlapper's investment committee, which reviewed and accepted the firm's participation in the Fund. Sandlapper served as the managing broker-dealer and placement agent for the Fund, and, through Gordon and Bixler, convinced its customers to participate in the Fund. Sandlapper, Gordon, and Bixler all directly benefited from those investments.

Gordon and Bixler breached their fiduciary duty of loyalty to investors in the Fund by positioning TSWR Development to usurp opportunities to invest in the Tom and Clark wells and forcing the Fund to purchase those interests at excessively high markups. The Fund's mandate was to invest in saltwater disposal wells, and on several occasions the Fund exercised this mandate when it purchased well interests in the Tom and Clark wells directly from RBJ for \$45,000 per one percent interest. In addition, the Fund had sufficient money in its operating account to make additional purchases from RBJ on the days that TSWR Development instead made those purchases. Instead of using the money in its account to make the more financially prudent purchase, and in violation of the conflicting opportunities policy, Gordon and Bixler used the Fund's money to purchase smaller interests in those wells from TSWR Development at undisclosed excessive markups. Thus, Gordon and Bixler violated their duty of loyalty by causing TSWR Development to purchase the saltwater disposal well interests from RBJ, rather than the Fund, thereby usurping the Fund's investment opportunities and then reselling those interests to the Fund at undisclosed, excessive markups.

Gordon and Bixler's fraudulent misconduct is a further breach of their fiduciary duty. As discussed below, Gordon and Bixler channeled the transactions through TSWR Development before the Fund purchased the disposal well interests, which was the use of a fraudulent device against the Fund. Gordon and Bixler were entrusted with the money of investors in the Fund and each breached his fiduciary duties to those investors, in violation of FINRA Rule 2010. *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464 at \*18 (Feb. 10, 2012) (registered person's conversion was also a breach of the fiduciary duty that he owed to a foundation, as its vice president, in violation of FINRA Rule 2010.)

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<sup>12</sup> *See Feeley v. NHAOCG, LLC*, C.A. No. 7304-VCL (Del. Ch. Nov. 28, 2012) (holding that limited liability company managers are subject to "default" fiduciary duties of loyalty and care under the Delaware Limited Liability Act. LLC documents that purport to exculpate against liability for certain types of claims do not automatically eliminate fiduciary duties.) This holding was effectively codified on August 1, 2013, when the Delaware General Assembly adopted amendments to Section 18-1104 of the Delaware Limited Liability Company Act to provide that, unless the limited liability company agreement says otherwise, the managers and controlling members of a limited liability company owe fiduciary duties of care and loyalty to the limited liability company and its members.

C. Respondents Defrauded the Fund and DWI Investors

The complaint alleges, and the Hearing Panel found, that Respondents engaged in fraud in three distinct ways—each in willful violation of Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. Cause one alleges that Gordon, Bixler, and Sandlapper willfully defrauded the Fund by fraudulently interposing another entity between the Fund and the market and by charging undisclosed, excessive markups. Cause three alleges that Gordon and Sandlapper defrauded retail customers between late 2014 and November 2015 when Gordon sold well interests as securities through TSWR Development while charging undisclosed excessive markups. Finally, cause four alleges that Gordon defrauded retail customers between January 2013 and November 2015 by selling saltwater disposal well interests through registered representatives at Sandlapper and elsewhere, marketed as “real estate,” while charging undisclosed excessive markups.

As discussed below, we find that Respondents charged the Fund and retail investors excessive markups—ranging from 67 to 376 percent—when selling disposal well interests. These markups were undoubtedly material and, in failing to disclose them, the Respondents omitted material information when selling securities. In addition, Respondents sold the disposal well interests through an entity interpositioned between RBJ and investors, TSWR Development, which did not disclose the price it paid for the disposal well interests and the resulting markups. We therefore agree with the Hearing Panel that Respondents’ conduct related to the sales of RBJ’s saltwater disposal well interests to the Fund and to individual investors constituted fraud.

1. Legal Standard for Fraudulent Markups and Interpositioning

“Section 10(b) [of the Exchange Act] prohibits individuals from using or employing, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance.” *Dep’t of Enforcement v. Escarcega*, No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at \*28 (FINRA NAC July 20, 2017). Exchange Act Rule 10b-5 specifically prohibits: (1) any device, scheme or artifice to defraud; (2) any untrue statement of a material fact or omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (3) any act, practice, or course of business that would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. *Id.* at \*28-29. FINRA Rule 2020 prohibits FINRA members and their associated persons from effecting “any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.” *Id.* A violation of the Exchange Act, the rules promulgated thereunder, or FINRA’s rules constitutes a violation of FINRA Rule 2010. *Id.*

A broker-dealer that charges customers excessive and undisclosed markups engages in fraud. *See, e.g., Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1034 (4th Cir. 1997). *See also Andrew Gonchar*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797, at \*24 n.18 (Aug. 14, 2009) (“[W]e and the Second Circuit have consistently held that, [u]nder § 10(b) of the Exchange Act, a seller has a duty to disclose the details of a markup if the markup is excessive.”); *Ettinger v. Merrill Lynch, Pierce, Fenner & Smith*, 835 F.2d 1031, 1033 (3d Cir. 1987) (“The SEC has established through its enforcement actions the principle that charging



undisclosed excessive commissions constitutes fraud.”). Courts and the SEC have long held that interpositioning can result in fraud where it is done with scienter and results in the charging of excessive and undisclosed markups. *See Donald T. Sheldon*, 51 S.E.C. 59, 78 (1992) (concluding that applicant’s interpositioning resulted in fraudulent markups, “demonstrate[d] clear scienter and, in our view, was particularly egregious”), *aff’d*, 45 F.3d 1515 (11th Cir. 1995). Because broker-dealers possess an implied duty to disclose excessive markups, “[u]ndisclosed markups on sales of securities to retail customers can violate the antifraud provisions of the securities laws if they are not reasonably related to the baseline against which they are measured and if the responsible parties acted with scienter.” *Gonchar*, 2009 SEC LEXIS 2797, at \*25 (citing *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819 (Apr. 11, 2008)).

When the basis of fraud allegations under Exchange Act Rule 10b-5 and FINRA Rule 2020 is that the respondents charged excessive and undisclosed markups, we begin our analysis by evaluating the markups.<sup>13</sup> In doing so, we acknowledge that this case does not allege violations of FINRA’s markup rules. Nevertheless, FINRA and the Commission’s pronouncements concerning markups are instructive for establishing whether a markup is reasonable or excessive. Markups in excess of five percent are presumed excessive. A firm that charges more than five percent above the prevailing market price must “be fully prepared to justify its reasons.” Notice to Members 92-16, 1992 NASD LEXIS 47 (Apr. 1992); NASD IM-2440-1.<sup>14</sup> Factors taken into consideration when determining the reasonableness of a markup include the type of security involved, the availability of the security in the market, the price of the security, and the amount of money involved in the transactions. *Id.* TSWR Development charged the Fund and DWI investors markups ranging from 67 percent to 376 percent.

We must make two findings to establish excessive markups: the prevailing market price for the security and whether the markup was excessive. *See Mark David Anderson*, Exchange Act Release No. 48352, 2003 SEC LEXIS 3285, at \*23 (Aug. 15, 2003) (holding that a dealer charges excessive markups when he charges retail customers prices not reasonably related to the prevailing market price). The respondent can challenge the finding of prevailing market price

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<sup>13</sup> There is no dispute that the markups at issue were undisclosed. Several customers testified that they were unaware of the markups. JS testified in his on-the-record testimony (“OTR”) that no one disclosed the markups to investors. In addition, at least one registered representative selling DWIs to investors did not learn about the markups until after he had made the sales. Disclosure is important because “[w]hen nothing [is] said about market price, the natural implication in the untutored minds of the purchasers [is] that the price asked [is] close to the market.” *Charles Hughes & Co., v. SEC*, 139 F.2d 434, 437 (1943), *cert. denied*, 321 U.S. 786, 88 L. Ed. 1077, 64 S. Ct. 781 (1944).

<sup>14</sup> FINRA Rule 2121 superseded NASD Rule 2440, IM-2440-1, and IM-2440-2, effective May 9, 2014. *See* SR-FINRA-2014-023, <http://www.finra.org/industry/rule-filings/SR-FINRA-2014-023>, Exchange Act Release No. 72208, 79 Fed. Reg. 30,675 (May 28, 2014). NASD Rule 2440, IM-2440-1, and IM-2440-2 were applicable during the relevant period.

and—once the markup is established—can offer reasons why it was entitled to the markups. *See Gonchar*, 2009 SEC LEXIS 2797, at \*32 (noting that respondents could provide evidence to show that their contemporaneous cost did not accurately represent the prevailing market price at the time of sale to retail customers); *Sheldon*, 51 S.E.C. at 77 (finding that burden shifted to respondent to refute evidence of fraudulent markups).

## 2. Establishing Prevailing Market Price

Enforcement bears the burden of producing evidence of the prevailing market price of the securities at the time of the sales. Enforcement alleged, and the Hearing Panel concluded, that the “relevant market price for the interests during the relevant period was the price charged by RBJ, and Respondents’ markups to the interests were unexplained by any legitimate business justification, even taking into account TSWR Development’s entitlement to a reasonable profit on the resale transactions.” Therefore, the Hearing Panel concluded that Respondents’ excessive markups were material omissions and constituted a deceptive practice, in violation of Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. *See Gonchar*, 2009 SEC LEXIS 2797, at \*24 n.18 (“[W]e . . . have consistently held that, [u]nder § 10(b) of the Exchange Act, a seller has a duty to disclose the details of a markup if the markup is excessive.”) (internal quotations omitted).

### a. Enforcement Sustained Its Burden of Establishing Prevailing Market Price

“When a dealer is not a market maker, and absent countervailing evidence, the SEC has announced that: ‘a dealer’s contemporaneous cost is the best evidence of the current market. That standard, which has received judicial approval, reflects the fact that prices paid for a security by a dealer in actual transactions closely related in time to his retail sales are normally a highly reliable indication of prevailing market price.’” *Grandon v. Merrill Lynch & Co.*, 147 F.3d 184,189 (2d Cir. 1998) (quoting *Alstead, Dempsey & Co.*, 47 S.E.C. at 1035); NASD IM-2440-2 (prevailing market price is presumptively established by the broker-dealer’s contemporaneous cost).

Because TSWR Development was not a market maker in any of the disposal well interests, the prevailing market price is TSWR Development’s cost to acquire the interests from RBJ. *See SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1469 (“If a broker-dealer is not a market maker, the best evidence of a security’s prevailing market price is generally the price at which dealers in a security trade with one another, i.e. the ‘wholesale’ price.”). The price of the interests in the Permian Basin was well established during the entire relevant period. RBJ was the sole source of the interests that TSWR Development bought and resold to the Fund or investors. RBJ continuously sold interests at a fixed price ranging from \$45,000 to \$55,000 per one percent, which is the price at which TSWR Development acquired them, and there was no identified resale market. Thus, the price available throughout the relevant period was the same as TSWR Development’s acquisition cost for all of the saltwater disposal well interests at issue in this case.

More importantly, using TSWR Development's acquisition cost is strongly supported by their interpositioning. Instead of buying and selling these securities through Sandlapper, Respondents chose to do so through TSWR Development. In such cases when respondents interpose another entity and do not disclose the transaction prices, "[the respondent] has the burden of showing that the customer's total cost or proceeds of the transaction is the most favorable under the circumstances." *Thomson & McKinnon*, 43 S.E.C. 785, 789 (1968). Here, the evidence highlights that a customer's total cost increased dramatically when it purchased well interests from TSWR Development. For example, on March 20, 2013, the Fund purchased interests in the Clark well directly from RBJ at a cost per one percent of \$45,000. On June 5, 2013, the Fund purchased additional interests in the Clark well, but bought them from TSWR Development at a cost per one percent of \$166,519, a markup of 270 percent. This pattern is repeated, with variations in the amount of the excessive markups, in all the transactions involving TSWR Development. We agree with the Hearing Panel, which found that Respondents "knowingly interposed TSWR Development between investors and the well interests for no legitimate reason." Because Respondents have not shown why the apparently favorable prices paid by TSWR Development were not obtainable by retail investors or the Fund, we use TSWR Development's acquisition price as the prevailing market price for these transactions.

Moreover, the nature of the disposal well market supports that for all of the sales at issue, TSWR Development's acquisition cost should serve as the market price for the interests. For some sales, TSWR Development agreed to sell its interests within days of its purchases. For example, on December 1, 2012, TSWR Development purchased a 20 percent interest in the Tom well from RBJ for \$900,000 (or \$45,000 per one percent interest). Five days later, TSWR Development sold a 5.2 percent interest in the well to the Fund for \$610,158.76 (or \$117,338.22 per one percent interest).<sup>15</sup> Additionally, during the relevant time period TSWR Development entered into numerous agreements to purchase well interests from RBJ, but then did not pay for

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<sup>15</sup> Respondents argue that a delay of even five days is too long to establish a dealer's contemporaneous cost or serve as reliable evidence of prevailing market price. We disagree. When the SEC generally looks to a broker-dealer's interdealer purchases within five business days of the retail sale at issue to establish contemporaneous cost, the five-day analysis has been applied to bond markup cases. *See Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630, at \*19 (Sept. 3, 2015). This is not a bond markup case. The characteristics of this market are materially different from the bond market. For example, the saltwater disposal well market is private. The long-term nature of the projects allowed RBJ to sell disposal well interests—over the course of several years—at the same price. On the other hand, bond prices depend on a variety of factors, including positive or negative news about the issuer or changes in its credit rating, and can fluctuate over a short period of time. Therefore, the prices paid for a security by a dealer in bond transactions closely related in time to the dealer's sales are a highly reliable indicator of the prevailing market price. Those considerations are not at play here. Furthermore, we note that because Respondents engaged in interpositioning, they have no grounds to argue that acquisition cost can only be used for five days to serve as the prevailing market price.

the interests until after reselling the interests to investors, sometimes months later. These transactions illustrate that the price RBJ charged remained stable for months and longer.

For the remainder of the sales, Respondents argue that the Hearing Panel mischaracterized historical transactions as contemporaneous, and that prevailing market price cannot be established using historical cost.<sup>16</sup> Respondents rely heavily on the SEC's decision in *Partnership Exchange Securities Company* that overturned a NASD disciplinary action where the NASD provided inadequate supporting evidence for its markup calculation. *See P'ship Exch. Sec. Co.*, 51 S.E.C. 1198 (1994) (hereafter "*PESCO*"). While the SEC notes in that decision that it has never looked to historical cost as the basis for determining prevailing market price, it does not assert that using historical cost is per se inappropriate. Indeed, the SEC notes that historical cost might be a proper basis for calculating markups if evidence such as expert testimony or appraisals is introduced that confirms the reliability of historical cost as a measure of current market price. *Id.* at 1203-04. "In *PESCO* [the SEC] held that, while historical cost might be a proper basis for calculating markups[], evidence should be introduced that confirms the reliability of historical cost as a measure of current market price." *Raymond James & Assoc., Inc.*, 53 S.E.C. 43, 49 (1997). Furthermore, where the security being sold is illiquid with no organized market, as is the case here, it is reasonable to look at the price the dealer paid—even months before that dealer sells that security—as the best evidence of that security's prevailing market price. *See Marini v. Adamo*, 995 F. Supp. 2d 155, 188-89 (E.D.N.Y. 2014) (rare coin dealer's purchase price appropriately used to determine prevailing market price of rare coins resold to investor approximately nine months later where court concluded the coin dealer's excessive markup constituted fraud).

b. Respondents Have Failed to Show That Acquisition Cost is Not the Best Measure of Prevailing Market Price

Respondents argue that Enforcement failed to meet its burden of showing the prevailing market price of the saltwater disposal well interests. They argue that Enforcement incorrectly relied on the undervalued prices that RBJ charged TSWR Development for the interests and made no attempt to ascertain the market prices at which other sales of interests in Permian Basin saltwater disposal wells had taken place during this period of time.

We find Respondents' position unpersuasive. Respondents are incorrect that Enforcement was obligated to reconstruct what the prevailing market price was, rather it is Respondents' obligation to establish why contemporaneous cost was invalid. The prices that TSWR Development paid were actual transactions that were the equivalent of the interdealer market. Respondents cannot simply claim that RBJ charged prices below the market to defend their excessive markups; rather, they "must provide sufficient evidence" to refute the

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<sup>16</sup> We agree with Respondents that the Hearing Panel overstated the number of transactions that were "contemporaneous." In addition, we do not rely on the theory of "riskless principal" transactions to conclude that Respondents charged excessive markups, which the Hearing Panel may have done.

presumption that their cost (RBJ's price) is the best measure of prevailing market price. *See Grey*, 2015 SEC LEXIS 3630, at \*11 (finding that respondents failed to prove sufficient evidence to establish a different prevailing market price when respondent argued that the bonds were purchased at distressed prices in unusual market conditions). The evidence demonstrates that the prices charged by RBJ did not truly fluctuate over time. From 2012 through 2015, RBJ consistently charged the same prices for a one percent interest depending on the well. Across all of its sales, TSWR Development entered into agreements to purchase well interests from RBJ, but then did not pay for the interests until after reselling the interests to investors to obtain the cash from investors, sometimes months later. The price that TSWR Development paid to RBJ, sometimes months after the purchase agreements, did not fluctuate. Furthermore, RBJ was willing to (and did) sell those interests to the Fund and other investors, and RJ represented that he often had more willing investors to buy than interests available for sale.

Therefore, for all the reasons discussed above, we find that Enforcement has presented sufficient evidence to support using the acquisition cost paid by TSWR Development as the prevailing market price.

3. Respondents' Markups Were Excessive

Markups in excess of 5 percent are presumed excessive. A firm that charges more than 5 percent above the prevailing market price must "be fully prepared to justify its reasons." NASD Notice to Members 92-16; NASD IM-2440-1. Factors taken into consideration when determining the reasonableness of a markup include the type of security involved, the availability of the security in the market, the price of the security, and the amount of money involved in the transactions. *Id.* TSWR Development charged the Fund and DWI investors markups ranging from 67 percent to 376 percent. They have articulated no justification for the size of the markups. Furthermore, these markups are so far outside any acceptable range that it is self-evident that these markups are excessive. Much smaller undisclosed markups have been deemed misrepresentations or omissions of material facts in violation of Section 10(b) and Rule 10b-5. *See Grey*, 2015 SEC LEXIS 3630, at \*40, n. 49 (finding fraudulent undisclosed markups ranging from 8.62% to 19.12%).

4. Respondents Failed to Present Sufficient Countervailing Evidence to Rebut Enforcement's Prevailing Market Price or Demonstrate That the Markups Were Reasonable

Once Enforcement has established prevailing market price and that the markups charged by Respondents were excessive by a preponderance of the evidence, Respondents have the opportunity to introduce evidence to attempt to justify the markups. *See Sheldon*, 51 S.E.C. at 70. The evidence proffered by Respondents, including Gordon's pricing strategy and Respondents' expert witness, fall far short of demonstrating that the markups charged were reasonable.

a. Gordon's Pricing Strategy

Respondents argue that FINRA rules permit them, in the absence contemporaneous transactions on which to base prevailing market price, to use economic models, such as

discounted case flow models to calculate prevailing market price. As such, they maintain that Gordon's use of cash flow models were appropriate and the pricing of the fractional interests demonstrates that the markups charged were not excessive.

Gordon testified at the hearing that he determined the price of fractional interests resold by TSWR Development by conducting an analysis of the cash flows of an operating well. Based upon the permitted water capacity of a particular well, Gordon projected how much water that well would receive over the course of twelve months. Based upon how much he expected the well to earn by returning water to the ground, and how much revenue he expected the skim oil to generate, Gordon projected revenues for the well. Then he offset the projected revenue with projected operational expenses and calculated a projected income for the well. He applied a multiple of that income to suggest a value of the well operation. Gordon applied a multiple of 3.5 times earnings, which he believed to be less than the price multiples for other disposal wells.

However, Gordon's pricing was unreasonably optimistic. The projected volume of disposed saltwater used in Gordon's projections were significantly higher from the actual water intake amounts. For example, Gordon's model for interests in the Tom and Clark wells assumed that the wells would consistently take 75 percent of their permitted capacity, even though other wells operated by RBJ had previously not taken in water at levels anywhere near 75 percent. Moreover, TSWR Development continued to price interests in the Tom and Clark wells based upon the assumption that they would operate at 75 percent capacity even after months of actual operations demonstrated that both wells fell far below that level. As another example, Gordon's production and pricing assumptions used for the Haney well predicted a volume of 12,500 barrels of water per day (50 percent of the well's permitted capacity). However, for over a two year period, the well disposed of a mere seven percent of the well's maximum daily injection volume. We therefore agree with the Hearing Panel's conclusion that Gordon's "optimistic assumptions" about the water levels were untethered to the actual performance of the disposal wells. Indeed, when a well did not take in as much water (and generated less income) than Gordon expected, he never accounted for this actual performance in determining a sales price for the interests.

The Hearing Panel's conclusion is further supported by Enforcement's expert, Daniel Reinke, an engineer and operator in the oil and gas industry with over 40 years of experience. Reinke testified that the single most important driver of revenue for saltwater disposal wells is the volume of saltwater injected into the well. He opined that the projected volume of disposed saltwater Gordon used in his economic models was unreasonable for each well at issue. Reinke concluded that it was unreasonable to assume that any of the wells would sustain a disposal volume projected by Gordon for a period of time long enough for the investor to receive the projected return on investment, and that Gordon's projected estimates would not be used by a competent appraiser to estimate the value of the well.<sup>17</sup>

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<sup>17</sup> Contrary to Gordon's assertions, Reinke represented that there were numerous engineering companies that prepared appraisals of saltwater disposal wells in the Permian Basin.

The record supports that Gordon's pricing model was driven by Respondents' desire for profit rather than data born of reasonable projections. Therefore, Gordon's pricing strategy does not demonstrate that the markups charged were reasonable.

b. Expert Testimony

Respondents also rely on the expert testimony of Joshua Johnston, a forensic accountant, whose testimony supported Gordon's pricing model. As discussed above, Gordon's methodology was flawed and does not support Respondents' markups.

Johnston also opined that the interests sold by TSWR Development to investors were different from the interests that TSWR Development purchased from RBJ. He maintained that TSWR Development purchased interests in the saltwater disposal wells that were under development ("development interests") and then sold those interests to the Fund and to DWI investors in the post-development of the saltwater disposal wells ("operating interests"). Johnston contended that operational interests are more valuable than developmental interests; generally, a well that is in development carries more risk than a well that is already operational. To determine whether a well was in development or operational, Johnston relied on the language in the PSAs between RBJ and TSWR Development, drafted by PB, one of the Tiburon Team, who stood to gain financially from the excessive markups charged.

The Hearing Panel did not give weight to Johnston's expert testimony. We agree that his opinions do not support Respondents' markups. We note that the PSAs were drafted by Respondents' colleague, PB, and the representations concerning whether or not the wells were in development or operational were inconsistent, self-serving, and often did not reflect the actual status of the wells. Furthermore, the Hearing Panel found that the comparatives in the oil and gas industry that Johnston used to justify Respondents' pricing were not close enough geographically or temporally to be reliable.

On the other hand, the Hearing Panel did rely on Enforcement's expert's testimony on this issue. Reinke explained that in the oil and gas industry, the most substantial risk associated with constructing a well is drilling the hole beneath the earth. However, saltwater disposal wells frequently use holes already drilled for oil wells that are no longer producing. Thus, he opined that there is little developmental risk when the most risky portion of development—the drilling—is already complete.<sup>18</sup> Reinke noted that for all the wells at issue, except for the

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<sup>18</sup> The Moreland well was the only well in which TSWR Development had any potential risk exposure. TSWR Development sold DWIs in the Moreland well to investors before the first injection of water in the well occurred and thus before the elimination of the geologic risk associated with the depth of the well. Operational problems required RBJ to re-drill the well to the shallower depth to which it had drilled other wells, with a reduced permitted capacity. TSWR Development did not pay for any cost overruns on the Moreland well. On the other hand, investors who, starting in January 2014, had bought DWIs in the well from TSWR Development at markups of approximately 200 percent received no distributions on the well until April 2015, more than a year after many had bought their interests.

Moreland well, there was minimal geologic risk. For example, no increase in value of the Tom or Clark well justified the markups to the Fund. In both cases, TSWR Development did not purchase the interests until months after RBJ had completed drilling the wells. TSWR Development sold interests in the wells at substantial markups before the wells were operational. Reinke opined that there is no basis to support Respondents' claim that the prices TSWR Development charged the Fund and DWI investors were justified by TSWR Development's purchase of the well interests "pre-development" and selling those interests "post development." No significant development activity occurred between the time TSWR Development purchased its interests and when it sold the interests to the Fund that could justify the markups.

Because Enforcement sustained its burden of establishing the prevailing market price of the saltwater disposal well interests and Respondents did not present sufficient evidence to justify their markups, we find that the markups charged to all investors were excessive.

#### 5. Respondents Acted with Scienter

Respondents argue that there is no evidence that they acted with scienter in pricing the saltwater disposal well interests or in interpositioning TSWR Development between RBJ and the investors. We disagree.

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). It includes intentional or reckless conduct. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known . . . or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977). The Hearing Panel concluded that Respondents acted at least recklessly, and we agree.

First, with respect to the pricing of saltwater disposal well interests, Respondents maintain that they "did their utmost to determine the proper prices of the [saltwater disposal well interests] to the best of their ability given the very limited price discovery mechanisms available to them." However, Respondents undertook no efforts to justify their prices other than Gordon's inaccurate pricing model, which was based upon faulty assumptions, and which they used largely as a marketing tool to enable registered representatives to explain the prices investors were paying for interests. Respondents presented no evidence that Gordon or anybody else made meaningful efforts to determine the market value of saltwater disposal wells. They knew that the prices they charged customers included markups from the prices of the interests but had no legitimate reason to believe that those markups were related to the actual market price of the



securities. Therefore, we find that Gordon and Bixler, and thus Sandlapper, were at a minimum reckless in their dealings with investors.<sup>19</sup>

Respondents also argue that they had legitimate reasons to interpose TSWR Development in transactions with the Fund and individual investors. With respect to the Fund, they claim that “TSWR [Development] routinely used leverage to purchase the [saltwater disposal well] [i]nterests, either in the form of loans from third parties or trade credit from RBJ itself.” The record does not support this contention. Rather, the Fund itself had the money needed to invest in the Tom and Clark wells and did not need TSWR Development’s leverage to acquire the interests. In any event, TSWR Development’s purported leverage was fiction. TSWR Development could not secure commercial loans. Instead it relied upon short-term, high-interest “bridge loans” from customers who were themselves investors in the Fund. These lenders then lent TSWR Development the funds that it used to usurp their investment opportunities. With respect to DWIs, Respondents argue that TSWR Development offered a “service to investors” by “facilitat[ing] investment in [saltwater disposal well] [i]nterests by means of an [IRS §] 1031 exchange.” Respondents did not offer evidence of TSWR Development’s having provided any such services, and there is no evidence that it provided any “service” related to the tax treatment of DWI sales. On the contrary, by initially selling DWIs as “real estate” when they were in fact securities, TSWR Development harmed investors by convincing them that the interests were eligible for an IRS § 1031 exchange when they were not. There was no legitimate business reason to interpose TSWR Development between the Fund and RBJ. We agree with the Hearing Panel that “the preponderance of the evidence, including Gordon and Bixler’s demeanor and credibility at the hearing, established that Gordon and Bixler acted out of a desire to conceal the extent of their own profits.”<sup>20</sup> Thus, we find that Respondents acted with the requisite scienter.

#### 6. The Excessive Markups Were Material

We also find that the amount of the markups was material to investors. Materiality is an objective question that turns on the significance of an omitted fact to a reasonable investor. *Amgen, Inc. v. Conn. Ret. Plans & Tr. Funds*, 133 S. Ct. 1184, 1195-96 (2013) (citing *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976)); see also *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318 (2011). A reasonable investor would want to know if they were being charged a markup between 67 and 376 percent. In addition, that reasonable investor would want to know if a “broker was interposing his own accounts between them and the market

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<sup>19</sup> Gordon’s and Bixler’s scienter is imputed to Sandlapper. *Meyers Associates, L.P.*, Exchange Act Release No. 86497, 2019 SEC LEXIS 1869, at \*37 (July 16, 2019) (noting that a firm’s scienter is imputed from that of the individuals controlling it).

<sup>20</sup> We defer to the Hearing Panel’s credibility findings, which are well supported by the record. See *Allen Holeman*, Exchange Act Release No. 86523, 2019 SEC LEXIS 1903 \*21 n.15 (July 31, 2019) (“[T]he credibility determination of the initial decision maker [in a FINRA disciplinary proceeding] is entitled to considerable weight and deference, since it is based on hearing the witnesses’ testimony and observing their demeanor.”).

and causing them to pay higher prices than they would otherwise pay.” *Grey*, 2015 SEC LEXIS 3630, at \*41.

The fact that investors did not ask about the markups or appraisals does not render that information immaterial. As we noted earlier in this decision, it is reasonable to assume that investors in the Fund and DWIs would have expected that the markups charged to be fair and related to the prevailing market price. *See Charles Hughes & Co. v. SEC*, 139 F.2d at 437. Thus, we agree with the Hearing Panel that Respondents’ excessive markup were material to investors in the Fund and the DWIs.

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For the reasons stated above, we affirm the Hearing Panel’s findings that Gordon, Bixler, and Sandlapper willfully defrauded the Fund by interposing TSWR Development into well purchase transactions and by charging undisclosed, excessive markups, that Gordon and Sandlapper sold retail customers saltwater disposal well interests as securities through TSWR Development while charging excessive markups, and that Gordon sold saltwater disposal well interests to retail customers through a network of representatives while marketing the investments as “real estate,” fraudulently interposing TSWR Development into the transactions, and charging undisclosed, excessive markups. Each violation was in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5,<sup>21</sup> and FINRA Rules 2010 and 2020.

D. Respondents’ Motion for Leave to Introduce Additional Evidence Is Denied

Subsequent to their appeal, Respondents filed a Motion for Leave to Introduce Additional Evidence Pursuant to FINRA Rule 9346. They seek permission to introduce the expert testimony of Marc Menchel, nine of Respondents’ exhibits excluded from the record, and the metadata of the typed memo summarizing RJ’s interview with FINRA (“RJ Memo”). The Subcommittee recommends that the NAC deny Respondents’ motion. We agree with the Subcommittee.

Respondents’ motion does not meet the requirements of FINRA Rule 9346. Pursuant to FINRA Rule 9346(b), a party seeking to introduce additional evidence on appeal must demonstrate that: (1) the evidence is material; and (2) there was good cause for failing to introduce the evidence below. Admitting evidence pursuant to Rule 9346 is reserved for extraordinary circumstances. *See* Rule 9346(a); *Dep’t of Mkt. Regulation v. Jerry William Burch*, Complaint No. 2005000324301, 2011 FINRA Discip. LEXIS 16, at \*21-22 (FINRA NAC July 28, 2011) (rejecting respondent’s motion to adduce additional evidence and finding that he failed to demonstrate that extraordinary circumstances existed). Furthermore, FINRA Rule 9346 applies only to “new evidence” that a party “fail[ed] to introduce . . . below.” None of the evidence Respondents seek is new—it was considered at the hearing below and was either

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<sup>21</sup> Respondents are subject to statutory disqualification for these willful violations.

rejected by the Hearing Officer (as with the Menchel testimony and RJ metadata) or withdrawn by Respondents' themselves (as with Respondents' exhibits).

Instead of the motion, Respondents could have argued in their briefs that the Hearing Officer abused his discretion when he denied their motions for leave to introduce the expert testimony of Marc Menchel and to access the RJ Memo metadata, but they did not. Even assuming they did make such an argument, however, the record does not demonstrate that the Hearing Officer abused his discretion. "Because this [Hearing Officer] discretion is broad, the party arguing abuse of discretion assumes a heavy burden that can be overcome only upon showing that the Hearing Officer's reasons to admit or exclude the evidence were so insubstantial as to render. . . [the admission or exclusion] an abuse of discretion." *Dep't of Enforcement v. North*, Complaint No. 2010025087302, 2017 FINRA Discip. LEXIS 7, at \*34 (FINRA NAC Mar. 15, 2017) (internal quotation marks omitted), *aff'd*, Exchange Act Release No. 84500, 2018 SEC LEXIS 3001 (Oct 29, 2018). Thus, for the reasons stated above, we deny Respondents' motion.

#### E. Gordon and Sandlapper's Failures to Supervise

The Hearing Panel concluded that, as alleged in cause six, Gordon and Sandlapper violated NASD Rule 3010 and FINRA Rules 3110(b) and 2010 by failing to establish, maintain, and implement supervisory procedures adequate to address the conflicts of interests created by the participation of Sandlapper and its registered representatives or their affiliates, like TSWR Development, in securities offerings. In addition, the Hearing Panel found that Gordon and Sandlapper violated the same supervision rules by failing to supervise private securities transactions, or enforce the firm's prohibitions against selling away, by treating securities sales of disposal well interests as sales of "real estate."

##### 1. Legal Standard

NASD Rule 3010(a) and FINRA Rule 3110 (a) require firms to "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules."<sup>22</sup> Under NASD Rule 3010(b) and 3110(b), each member firm must establish, maintain, and enforce written procedures to supervise the types of businesses in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with securities laws and with NASD and FINRA Rules. In other words, the rule requires that a firm's supervisory systems be documented in the its WSPs.<sup>23</sup>

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<sup>22</sup> FINRA Rule 0140 (formerly NASD Rule 0115) provides that all of FINRA's rules shall apply equally to members and associated persons and that associated persons shall have the same duties and obligations as member firms.

<sup>23</sup> FINRA rule 3110 superseded NASD Rule 3010 on December 1, 2014.

2. Gordon and Sandlapper's Supervisory Deficiencies Concerning Conflicts of Interest

We agree with the Hearing Panel that Gordon and Sandlapper failed to establish, maintain, and enforce a reasonable supervisory system and written supervisory procedures to address the conflicts of interest created by the participation of Sandlapper and its registered representatives in offerings by affiliates of the Firm and its management.

Sandlapper's main line of business involved serving as the broker-dealer and dealer-manager on private placements and offerings by affiliates. Given the risks involved in private placements, FINRA expects firms to establish and maintain adequate supervisory systems to conduct reasonable investigations into private placements to ensure that the investments are suitable for customers and non-violative of antifraud provisions or FINRA rules. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43 (Apr. 2010) (Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings).

Gordon was the chief executive officer and managing member of Sandlapper during the relevant period. He was also the designated supervisor for sales, and for at least a portion of the relevant period, the firm's chief compliance officer. Through his ownership and management of the Fund, TSWR Development, and Sandlapper, Gordon was aware of, and participated in, the activities of these entities, including sales of disposal well interests to the Fund and sales of DWIs by TSWR Development to retail customers. As a result, Gordon had substantial conflicts of interest, including his significant personal pecuniary interests in TSWR Development versus his fiduciary obligations to the Fund. Notwithstanding these apparent conflicts, Sandlapper failed to adopt or implement a supervisory system to address Gordon's conflicts. In addition, Sandlapper relied on its investment committee, which included Bixler and Gordon, to review and accept the firm's participation in private placements, but lacked written procedures to resolve conflicts by members of that committee. Therefore, Gordon and Sandlapper failed to maintain and enforce a supervisory system and written supervisory procedures to address conflicts of interest created by Sandlapper's and Gordon's participation in the offerings, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.

3. Gordon and Sandlapper Failed to Supervise Sales of DWIs as "Real Estate"

We further find that Sandlapper, through Gordon, failed to supervise sales of DWIs sold away from the firm as purported "real estate." Sandlapper's WSPs "required [representatives] to conduct their selling activities through" the firm and prohibited representatives from participating in "private securities transactions" or "selling away" from the firm. Because the firm prohibited selling away, it did not have any procedures in place to address the private securities transactions. Nevertheless, Gordon and Sandlapper knowingly permitted the firm's registered representatives to sell DWIs marketed as real estate, but that were in actuality securities, to retail investors, and to receive selling compensation for those transactions, without supervision. Sandlapper only required that registered representatives submit outside business activity forms regarding their activities related to sales of DWIs; these forms only vaguely described the representative's efforts in soliciting investments in DWIs. Through their failures to

exercise reasonable supervision of the sales of the firm's registered representatives, Gordon and Sandlapper violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

V. Sanctions

The Hearing Panel barred Gordon for willfully defrauding investors in the Fund and the DWIs, breaching his fiduciary duties to the Fund, willfully causing TSWR Development to act as an unregistered dealer, and failing to supervise. The Hearing Panel barred Bixler for willfully defrauding investors in the Fund, breaching his fiduciary duties to the Fund, and willfully causing TSWR Development to act as an unregistered dealer. As for Sandlapper, the Hearing Panel expelled the firm for willfully defrauding investors in the Fund and the DWIs and for the firm's supervisory failures. In addition to the bars and expulsion, the Hearing Panel ordered Respondents to pay restitution to affected investors. We affirm the Hearing Panel's bars, expulsion, and orders of restitution as discussed more fully below.

A. Fraud

“[The SEC has] held that violations involving fraud are particularly serious and should be subject to the most severe sanctions.” *Bernard G. McGee*, Exchange Act Release No. 80314, 2017 SEC LEXIS 987, at \*44 (Mar. 27, 2017), *petition for review denied*, 733 F. App'x 571 (2d Cir. 2018). In determining the appropriate sanctions for this misconduct, we have considered FINRA's Sanction Guidelines (“Guidelines”), including the General Principles Applicable to All Sanction Determinations and the Principal Considerations in Determining Sanctions.<sup>24</sup> The Guidelines for intentional or reckless misrepresentations or omissions of material fact recommend that we strongly consider barring an individual respondent, unless mitigating factors predominate.<sup>25</sup> For the firm, the Guidelines recommend suspending the firm with respect to any or all activities for up to two years. However, where aggravating factors predominate, the Guidelines recommend that we strongly consider expelling the firm.<sup>26</sup>

Numerous aggravating factors and the absence of mitigating factors support a decision to bar Gordon and Bixler and expel Sandlapper for fraud. Respondents' markup scheme for the Fund and the DWIs was at least reckless and involved a pattern of misconduct that spanned an extended period of time-nearly four years.<sup>27</sup> Respondents deceived investors by not disclosing the magnitude of the markups (and for early Fund investors that appraisals were not obtained)

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<sup>24</sup> See *FINRA Sanction Guidelines* (Mar. 2019), [https://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf) [hereinafter, *Guidelines*].

<sup>25</sup> *Guidelines*, at 89.

<sup>26</sup> *Id.*

<sup>27</sup> *Guidelines*, at 7-8 (Principal Consideration, Nos. 8, 9, 13).

and provided income projections that were baseless.<sup>28</sup> This resulted in extensive financial harm to investors, some of whom experienced life-altering financial losses.<sup>29</sup> While investors suffered, Respondents prospered at their expense, earning profits in excess of \$8 million.<sup>30</sup> Respondents have not accepted responsibility for their actions and have shown no remorse.<sup>31</sup>

With respect to Sandlapper, we find that expelling the firm is needed to protect the investing public. Sandlapper, acting with scienter, “abused its customers’ trust and confidence” by interpositioning an affiliated entity between its customers and RBJ and charged those customers grossly excessive and undisclosed markups, all while Sandlapper profited from those markups. *See Newport Coast Securities*, Exchange Act Release No. 88548, 2020 SEC LEXIS 917, at \*\_\_ (Apr. 3, 2020) (affirming FINRA’s expulsion of a member firm that engaged in securities fraud and supervisory violations). In addition, “[t]hese were not isolated incidents; rather, they were repeated, years-long securities law violations committed against [many] customers.” *Id.* The decision makers at the highest level of the firm used their positions as CEO and vice-president to make decisions when the interests of TSWR Development and investors were in direct conflict, to the detriment of investors. Moreover, the firm has not demonstrated that it could, or would, behave differently in the future, and we therefore believe that Sandlapper’s continued membership is a threat to investors.

Finally, we agree with Hearing Panel that it is further aggravating that Respondents attempted to conceal information from FINRA and provide inaccurate or misleading testimony or documentary information to FINRA by “(1) improperly redacting investor and bank statement information in documents provided to Enforcement, (2) endeavoring to cause a witness to execute a false affidavit, and (3) entering into a settlement agreement with one investor requiring confidentiality in a manner calculated to prevent Enforcement’s access to the investor’s evidence.”<sup>32</sup>

Respondents argue that because Enforcement failed to prove the prevailing market price of the saltwater disposal well interests or that Respondents acted with scienter they are not liable for fraud and as such, no sanctions should be imposed. We disagree. Respondents’ course of conduct demonstrates that they are fundamentally unfit to continue as a member firm and as

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<sup>28</sup> *Id.* at 7 (Principal Consideration, No. 10).

<sup>29</sup> *Id.* at 7 (Principal Consideration, No. 11).

<sup>30</sup> *Id.* at 8 (Principal Consideration, No. 16).

<sup>31</sup> *Id.* at 7 (Principal Consideration, No. 2).

<sup>32</sup> *Id.* at 8 (Principal Consideration, No. 12). Gordon required an investor, who had previously spoken with FINRA investigative staff, to execute a “Confidentiality Agreement” that prohibited the investor from communicating with regulators, including FINRA. In addition, counsel for Respondents sent an affidavit to RJ that painted a favorable picture of Respondents’ conduct to have RJ sign—which he did not.

associated persons of a FINRA member. Serious sanctions are appropriate to remedy the violations, protect investors, and deter others from engaging in similar misconduct. Accordingly, we bar Gordon (causes one, three, and four) and Bixler (cause one) from associating with any FINRA member in any capacity and expel Sandlapper (causes one and three) from FINRA membership.

We also affirm the Hearing Panel's order of restitution. The Guidelines instruct adjudicators to order restitution where it is appropriate to remediate misconduct and necessary to "restore the status quo ante for victims who would otherwise unjustly suffer loss."<sup>33</sup> We may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct"<sup>34</sup> The losses suffered by investors in the Fund and the DWIs were the "foreseeable, direct, and proximate result" of Respondents' misconduct. *See Dep't of Enforcement v. Brookstone Secs., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at \*147-153 (FINRA NAC Apr. 16, 2015). Accordingly, we order Respondents to pay restitution to be paid as set forth in Appendices A-D attached to the Hearing Panel Decision.<sup>35</sup>

B. Breach of Fiduciary Duty (Gordon and Bixler)

The Guidelines do not address violations relating breaches of fiduciary duty, nor do they provide guidance for an adequately analogous violation. We therefore look to the Guidelines' Principal Considerations in Determining Sanctions that apply to all misconduct to craft an appropriate sanction. *See Dep't of Enforcement v. Elgart*, No. 2013035211801, 2017 FINRA Discip. LEXIS 9, at \*42-44 (FINRA NAC Mar. 16, 2017), *aff'd*, 2017 SEC LEXIS 3097 (Sept. 29, 2017) (considering the nature of the misconduct and the Guidelines' Principal Considerations in Determining Sanctions that apply to all misconduct).

Upon review of the Principal Considerations, we agree with the Hearing Panel that Gordon and Bixler should be barred for their breaches of fiduciary duty. Gordon and Bixler, as principals of Fund Management and members of the Fund's Investment Committee, owed fiduciary duties of loyalty and care to the Fund. Rather than protecting the interests of the Fund, Gordon and Bixler acted in their own self-interest by causing the Fund to purchase saltwater disposal well interests at excessive markups from TSWR Development, a company they controlled and from which they benefited financially. Gordon's and Bixler's breaches of

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<sup>33</sup> *Id.* at 4 (General Principal, No. 5).

<sup>34</sup> *Id.*

<sup>35</sup> The Appendices' calculations of restitution are reduced by 5 percent to take into account that Respondents were entitled to a reasonable markup.

fiduciary duty were at least reckless.<sup>36</sup> Their misconduct harmed the Fund and its investors<sup>37</sup> while directly enriching Gordon and Bixler.<sup>38</sup> These breaches continued for six months and resulted in the Fund paying over \$935,000 in markups. Accordingly, we affirm the Hearing Panel's bars of Gordon and Bixler for their breaches of fiduciary duty.

C. Causing TSWR Development to Act as an Unregistered Dealer (Gordon and Bixler)

The Hearing Panel barred both Gordon and Bixler for causing TSWR Development to act as an unregistered dealer. We affirm these sanctions.

Although the Guidelines do not specifically address this violation, we, like the Hearing Panel, look to the Guidelines' treatment of violations of Section 5 of the Securities Act of 1933, which, absent an exemption, prohibits the sale of an unregistered security. For violations of Section 5, the Guidelines recommend a monetary sanction up to \$77,000. Where aggravating factors predominate, the Guidelines direct us to consider a suspension of up to two years or a bar. Here, aggravating factors predominate and there are no mitigating factors. Gordon and Bixler were, at a minimum, reckless when they skirted regulatory requirements by using TSWR Development as an unregistered dealer, threatening the investing public.<sup>39</sup> Gordon and Bixler used TSWR Development to engage in significant activity as a dealer of securities over an extended period of time and in numerous transactions.<sup>40</sup> These transactions resulted in widespread customer harm and warrant substantial sanctions.<sup>41</sup> Therefore, we affirm the bars of Gordon and Bixler for causing TSWR Development to act as an unregistered dealer.

D. Supervisory Violations (Gordon and Sandlapper)

We, like the Hearing Panel, have determined to aggregate the two supervisory violations here for purposes of sanctions because the two violations are part of a single systemic problem.<sup>42</sup> Based on the facts, we find it appropriate to apply the Guideline for systemic supervisory

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<sup>36</sup> *Guidelines*, at 8 (Principal Consideration, No. 13).

<sup>37</sup> *Id.* at 7 (Principal Consideration, No. 11).

<sup>38</sup> *Id.* at 8 (Principal Consideration, No. 16).

<sup>39</sup> *Id.* at 8 (Principal Consideration, No. 13).

<sup>40</sup> *Id.* at 7 (Principal Consideration, Nos. 8, 9).

<sup>41</sup> *Id.* at 7 (Principal Consideration, No. 11).

<sup>42</sup> *See id.* at 4 (General Principles Applicable to All Sanction Determinations, No. 4) (explaining that the aggregation or "batching" of violations may be appropriate for purposes of determining sanctions in disciplinary proceedings).



failures, since the supervisory failures here are significant, widespread, and occurred over an extended period of time.

The Guidelines for Systemic Supervisory Failures recommend a fine of \$10,000 to \$77,000 for responsible individuals, and a fine of \$10,000 to \$310,000 for the responsible firm.<sup>43</sup> When aggravating factors predominate, the Guidelines direct the adjudicator to consider a higher fine and a suspension of up to two-years and a bar.<sup>44</sup> We are also directed to consider, where aggravating factors predominate, a suspension of the firm for up to two years, or consider expelling the firm.<sup>45</sup> The Hearing Panel concluded that aggravating factors predominate and that Gordon and Sandlapper’s violations were egregious. We agree. Neither Gordon nor the firm addressed the troubling and readily apparent conflicts of interest inherent in the transactions at issue. In addition, Gordon and Sandlapper caused firm representatives to engage in private securities transactions without appropriate supervision. Sandlappers’ failure to address the misconduct that was occurring was particularly egregious—as the firm was unable or unwilling to address Gordon’s fraud. Because of the supervisory deficiencies, Respondents were free to engage in their fraudulent scheme for an extended period. Moreover, the supervisory failures permitted Respondents’ “violative conduct to occur or to escape detection”<sup>46</sup> and resulted in extensive harm to numerous customers.<sup>47</sup> “The number and dollar value of the transactions not adequately supervised as a result of the deficiencies” is further aggravating.<sup>48</sup>

Respondents argue that the sanctions imposed by the Hearing Panel for the supervisory violations are excessive. They maintain that because the Hearing Panel erred in its conclusion that Respondents defrauded and harmed investors, and that the aggravating factors articulated by the Hearing Panel included Respondents’ liability on the fraud counts, there remain no aggravating factors sufficient to justify the expulsion and the bar imposed. However, as discussed above, we conclude that the Hearing Panel did not err in its findings of liability, which should be considered as aggravating Gordon and Sandlapper’s misconduct. The fraudulent schemes and breaches of fiduciary duty would not have occurred if the firm had had in place effective procedures to address the conspicuous conflicts of interest that arose out of Gordon and Bixler simultaneously controlling TSWR Development and Fund Management and Sandlapper. The firm lacked written procedures to resolve conflicts of interest by members of the investment committee. While the firm had a process for conducting due diligence on private offerings by affiliates, Gordon’s conflicts contaminated that process.

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<sup>43</sup> *Guidelines*, at 105.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 106.

<sup>46</sup> *Id.* at 105 (Principal Consideration, No. 1).

<sup>47</sup> *Id.* (Principal Consideration, No. 4).

<sup>48</sup> *Id.* (Principal Consideration, No. 5).

Because of the presence of numerous aggravating factors in this case and the absence of any mitigating factors, we affirm the Hearing Panel's bar Gordon and expulsion of Sandlapper for this violation. We also affirm the Hearing Panel's decision to assess, but not impose a fine for Sandlapper and Gordon jointly and severally.<sup>49</sup>

## VI. Conclusion

Gordon, Bixler, and Sandlapper willfully defrauded the Fund by fraudulently interposing TSWR Development into well purchase transactions and by charging undisclosed, excessive markups, in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2010 and 2020 as alleged in cause one. We affirm the bars of Gordon and Bixler and Sandlapper's expulsion for this violation. In addition, we affirm the Hearing Panel's finding that Respondents are jointly and severally liable for restitution totaling \$901,418, plus interest, as set forth in Appendix A of the Hearing Panel Decision.<sup>50</sup>

We also affirm the Hearing Panel's findings that Gordon and Bixler breached their fiduciary duties of loyalty and care to the Fund in connection with Fund purchases of the disposal well interests, in violation of FINRA Rule 2010 and affirm the bars imposed for these violations.<sup>51</sup>

We further find that Gordon and Sandlapper defrauded retail customers by selling well interests as securities through TSWR Development while charging undisclosed excessive markups, in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. We affirm the Hearing Panel's imposition of a bar for Gordon and expulsion of Sandlapper. In addition, we affirm the Hearing Panel's order holding Gordon and Sandlapper to jointly and severally liable for restitution, and order them to

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<sup>49</sup> The Hearing Panel assessed a \$73,000 fine for Gordon and Sandlapper (the maximum recommended fine for an individual's supervisory violation). Because we apply the most recent version of the Guidelines, we increase the assessed fine to \$77,000, the current maximum recommended fine for an individual's supervisory violations.

<sup>50</sup> Respondents shall pay prejudgment interest at the rate set forth in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the date of the customer sale. If Respondents are unable to locate a customer, unpaid restitution should be paid to the appropriate escheat, unclaimed-property, or abandoned-property fund for the state of the customer's last known address. Satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, shall be provided to Enforcement no later than 90 days after the date when this decision becomes final.

<sup>51</sup> Like the Hearing Panel, we hold, but do not impose, Gordon and Bixler jointly and severally liable for restitution totaling \$901,418, plus interest.

pay restitution totaling \$2,429,664, plus interest, as set forth in Appendix C of the Hearing Panel Decision.

Under cause four, we affirm the Hearing Panel's finding that Gordon defrauded retail customers by selling well interests through a network of representatives while marketing the investments as "real estate," and by charging undisclosed excessive markups in willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. We affirm the bar for this violation and order Gordon to pay restitution totaling \$4,682,201, plus interest, as set forth in Appendix D of the Hearing Panel Decision.

We also affirm the Hearing Panel's finding that Gordon and Bixler caused TSWR Development to act as an unregistered dealer, as alleged in cause five, in willful violation of Section 15(a) of the Exchange Act and FINRA Rule 2010. We affirm the bars for Gordon and Bixler for this violation.

Finally, under causes six and seven, we find, like the Hearing Panel, that Gordon and Sandlapper failed to maintain and enforce an adequate supervisory system and written supervisory procedures and to exercise proper supervision over affiliate sales of securities, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010. We affirm the bar for Gordon and expulsion of Sandlapper.

We also affirm the Hearing Panel's imposition of hearing costs in the amount of \$27,453.29 and impose appeal costs in the amount of \$1,481.31.<sup>52</sup> Gordon's and Bixler's bars and Sandlapper's expulsion shall become effective seven calendar days after this decision is issued.

On Behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell,  
Vice President and Deputy Corporate Secretary

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<sup>52</sup> Pursuant to FINRA Rule 8320, the membership of any firm that fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.