FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RED RIVER SECURITIES, LLC (CRD No. 149860), and BRIAN KEITH HARDWICK (CRD No. 4522460), Respondents.	Disciplinary Proceeding No. 2013035344201 Hearing Officer–CC **EXTENDED HEARING PANEL DECISION** February 9, 2017

Respondents sold interests in five oil and gas joint ventures. The Hearing Panel held that joint venture interests are securities and that Respondents fraudulently misrepresented and omitted material facts in connection with their sales. The Hearing Panel also held each Respondent liable for supervisory violations and the firm responsible for suitability violations. For this misconduct, the firm is expelled, Hardwick is barred in all capacities, and Respondents are jointly and severally ordered to pay restitution and costs. The Hearing Panel dismissed allegations of unregistered distribution, one alleged misrepresentation, several alleged suitability violations as to the firm, and all alleged suitability violations as to Hardwick.

Appearances

For Complainant: John Luburic, Esq., Albert A. Starkus, Esq., Christopher Burky, Esq., Penelope Brobst Blackwell, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For Respondents: Red River Securities, LLC and Brian Keith Hardwick: Mark A. Hendrix, Esq., Valerie P. Thomas, Esq., Krage & Janvey, LLP.

I. Introduction

This case involves Respondents' fraudulent sales of interests in oil and gas joint ventures issued by Regal Energy, LLC ("Regal Energy"), a close affiliate of Respondent Red River Securities, LLC ("Red River Securities"). Each joint venture was structured as a general partnership. A key issue is whether the joint venture interests are securities. The prevailing legal presumption is that joint venture interests generally are not securities, but based on the particular facts and circumstances, they may be deemed securities. Here, we find that the general partnership interests are securities because the investors could not exercise ultimate control, as a majority, over the joint ventures' business activities. The case also addresses whether the written materials that the firm used to sell joint venture interests contained misrepresentations and omissions and, if so, whether they were fraudulent. We find that Respondents intentionally misrepresented and omitted material facts in connection with their sales of joint venture interests. We also find that the firm approved two customers as suitable who were in fact not suitable. Finally, we find that the firm and Hardwick failed to maintain and enforce an adequate supervisory system and written supervisory procedures.

As to one alleged misrepresentation, we find that the Department of Enforcement ("Enforcement") failed to meet its burden of proof. We dismiss Enforcement's allegations that Respondents sold interests in two of the joint venture offerings in violation of the general solicitation prohibition for the private placement of securities under Regulation D. We dismiss Enforcement's suitability allegations as to all but two investors and as to Hardwick.

For these violations, we expel Red River Securities, bar Brian Keith Hardwick ("Hardwick") from associating with any member firm in any capacity, and order Respondents to pay restitution to customers. In light of the bar and expulsion, we do not impose sanctions for Respondents' suitability and supervision violations.

II. Background

Hardwick and his partner, Terry Gray ("Gray"), founded Red River Securities in January 2009. As chief executive officer, Hardwick filed Red River Securities' FINRA membership application in March 2009.[1] As part of Red River Securities' membership application, Hardwick submitted the firm's business plan, which stated that it would engage in the private placement of securities, specifically joint venture interests in oil and gas partnerships.[2] Five years later, on March 5, 2014, Hardwick filed the firm's Uniform Request for Broker-Dealer Withdrawal

---

[1] Tr. 67-68; Joint Stipulations ("Stip.") ¶ 7.

[2] Tr. 78-80; Joint Exhibit ("JX')-10, at 3. *See also* JX-10, at 4 ("Red River Securities intends to primarily sell securities (joint venture interests) through direct participation programs in oil and gas joint ventures."). FINRA approved Red River Securities' membership in December 2009. Stip. ¶ 3.

("Form BDW").[3] At the time, Red River Securities was the subject of an "investment-related investigation" by FINRA.[4]

Hardwick associated with Red River Securities and maintained active securities registrations from March 2009 through February 2014.[5] On February 25, 2014, Red River Securities filed a Uniform Termination Notice for Securities Industry Registration ("Form U5") to terminate Hardwick's association in a registered capacity with the firm.[6] Hardwick is not currently registered with FINRA or associated with a FINRA member firm.[7]

III. Findings of Fact

A. Red River Securities, Regal Energy, and Their Business Affiliates

Regal Energy was closely affiliated with Red River Securities.[8] Red River Securities' sole business was to act as the exclusive placement agent for Regal Energy.[9] Regal Energy's marketing materials describe Regal Energy as "an independent oil and gas company dedicated to the exploration, development and production of crude oil and natural gas."[10] Red River Securities held an exclusive selling arrangement with Regal Energy, the issuer of the oil and gas joint ventures in this case.[11] Hardwick and Gray founded Regal Energy in 2007. Together, they operated Regal Energy down the hall from Red River Securities.[12]

In August 2009, Hardwick and Gray formed Regal Energy Operating, LLC ("Regal Operating").[13] Regal Operating is also affiliated with Regal Energy and Red River Securities. Hardwick and Gray founded and managed Regal Operating to handle all oil- and gas-related

---

[3] Hearing Transcript ("Tr.") 71; JX-1.

[4] JX-1, at 2.

[5] Tr. 69-70. Hardwick initially registered with FINRA in April 2002 when he was associated with another FINRA member firm. Tr. 70.

[6] Tr. 73-74; Complainant's Exhibit ("CX")-30; CX-31.

[7] Answer ("Ans.") ¶ 9.

[8] Tr. 81-82; JX-10, at 3; CX-34.

[9] CX-33, at 4.

[10] Tr. 84-87; CX-33, at 1.

[11] Tr. 81; JX-10, at 3. Through Regal Energy, Hardwick created the five oil and gas joint ventures at issue in this case: Regal Boonsville #2 Joint Venture ("Boonsville #2"); Regal Waggoner #1 Joint Venture ("Waggoner #1"); Regal Waggoner #2 Joint Venture ("Waggoner #2"); Regal Cosper #1 Joint Venture ("Cosper #1"); and Regal Pierce #1 Joint Venture ("Pierce #1"). *See* JX-2–JX-8.

[12] Tr. 81-83; CX-34.

[13] CX-36.

operations for Regal Energy's oil and gas projects.[14] Hardwick was and is the chief operating officer of both Regal Energy and Regal Operating (together, the "Regal Entities").[15]

Hardwick and the Regal Entities relied heavily on Joe Paul Nichols ("Nichols") and Jody Redlich ("Redlich") in their operation of oil and gas joint ventures.[16] The Regal Energy marketing brochures that Hardwick prepared and approved identify Nichols as Production Superintendent and Redlich as Chief Operations Officer of Regal Operating.[17] Hardwick named Redlich and Nichols to these positions in January 2010.[18] Hardwick testified that, five days after appointing them, Nichols and Redlich became consultants of Regal Operating instead.[19] This notwithstanding, Red River Securities and Hardwick held Nichols and Redlich out to the public as officers of Regal Operating for at least two more years.[20]

While acting as officers of Regal Operating, Redlich and Nichols also operated their own oil and gas industry businesses, some of which competed with the Regal Entities.[21] Redlich and Nichols jointly own Tree Operating LLC ("Tree Operating"), which is a drilling operator located in the same office suite as the Regal Entities.[22] Redlich testified that Tree Operating handles drilling operations for drilling leases that Nichols and Redlich own.[23] The two also own and operate Tight Rock Consulting ("Tight Rock"), a contractor also involved in oil and gas drilling.[24] Redlich and Nichols also own Triad Exploration Partners ("Triad"), another entity that drills oil and gas wells,[25] and North Texas Tubular and Equipment Company, LLC ("North Texas"), one of many vendors that billed the joint ventures for drilling, testing, and completion expenses.[26]

[14] Tr. 82-83; CX-36.

[15] Tr. 83-84.

[16] Tr. 86; CX-33, at 2.

[17] Tr. 85-87, 98; CX-33, at 2.

[18] Tr. 87, 1630-1633.

[19] Tr. 86-87. We did not find Hardwick's testimony credible on this point, given the substantial evidence that, subsequent to January 2010, Nichols and Redlich were identified by the Regal Entities in official documents as officers.

[20] Tr. 88-94, 96; CX-57; CX-98.

[21] Redlich and Nichols have been business partners in the oil and gas industry since 2005. Tr. 1601.

[22] Tr. 1602-1603; CX-39; CX-40.

[23] Tr. 1602.

[24] Tr. 1637.

[25] Tr. 1603; CX-41; CX-42.

[26] Tr. 1369-1370; CX-43; CX-196.

Overall, Redlich's and Nichols's business dealings with the Regal Entities proved very lucrative for Redlich and Nichols.[27] Redlich testified that, during the 14 years that he has known Hardwick, he and his businesses have made significant amounts of money through the Regal Entities.[28] In addition to providing prospecting, drilling, and other services to Regal Operating for joint ventures, Redlich and Nichols assigned rights to oil and gas leases to Regal Energy.[29] Over the years, they sold the Regal Entities leases for drilling rights totaling approximately $1 million.[30]

B. Red River Securities' Sales and Regal Energy's Operation of Oil and Gas Joint Ventures

To solicit investors for Regal Energy's joint ventures, Red River Securities provided potential investors with confidential information memoranda ("CIM"). Hardwick was responsible for preparing and approving final CIMs and all subsequent amendments for customer solicitations.[31] The CIMs for the five joint ventures at issue are similar. Each included a Joint Venture Agreement ("JVA"), a Preformation Subscription Agreement ("Subscription Agreement"), a Purchaser Questionnaire, a Turnkey Drilling Contract, and a Turnkey Completion Contract.[32]

All CIMs state that the joint venture interests are securities that are exempt from registration with the Securities and Exchange Commission ("Commission") and that the Commission has not specifically determined that the securities are exempt.[33] All CIMs state that Regal Energy is the managing venturer.[34] The CIMs uniformly state that only Regal Energy, as managing venturer, has authority to decide whether to offer investors units, act on behalf of the joint venture, legally bind the joint venture, conduct the day-to-day operations of the joint venture, and hire operators to drill, complete,[35] operate, and if necessary, abandon and plug a well.[36] According to the CIMs' terms, no other venturer "shall have any right or authority to take

---

[27] *See, e.g.*, CX-104 (list of Regal energy lease payments, several of which are payable to Nichols, Redlich, or Triad); CX-106 (list of Regal Energy payments of geological origination fees to Tight Rock).

[28] Tr. 1625-1630.

[29] Tr. 1466-1467; CX-101.

[30] Tr. 1466-1467, 1627-1630; CX-101; CX-104, at 2, 7, 9, 11, 13, 19, 20.

[31] Tr. 101, 103.

[32] JX-2–JX-8.

[33] JX-2, at 4; JX-3, at 4; JX-4, at 4; JX-5, at 4; JX-6, at 5; JX-7, at 42; JX-8, at 44. The CIMs also state that Red River Securities believes that the units are not securities. JX-2, at 4; JX-3, at 4; JX-4, at 4; JX-5, at 4; JX-6, at 5; JX-7, at 42; JX-8, at 44.

[34] Tr. 107-111.

[35] After drilling, wells must be "completed" in order to continuously operate and produce gas or oil.

[36] Tr. 107-114; JX-2, at 15, 121, 124-126; JX-3, at 14, 106, 108-110; JX-4, at 13, 99, 101-103; JX-5, at 14, 106, 108-110; JX-6, at 15, 107, 109-111; JX-7, at 52, 109, 111-113; JX-8, at 54, 110, 112-114.

any action on behalf of or in the name of the joint venture."[37] Those powers rest in the "sole and absolute discretion" of the managing venturer, Regal Energy.[38] The CIMs state that the managing venturer possesses all authority to interpret unclear or ambiguous provisions in the CIMs.[39]

Substantially all the terms of the joint ventures' operations and management were pre-determined by Regal Energy before the joint ventures were created.[40] Under the governing JVAs, Regal Energy installed Regal Operating as the operator of each joint venture and the joint ventures were obligated to execute Turnkey Drilling Contracts with Regal Energy.[41] Hardwick drafted, approved, and signed the Turnkey Drilling Contracts on behalf of both parties—the joint venture and Regal Energy.[42] Once a well was drilled, Redlich, through Regal Operating, made a recommendation as to whether to complete, and the joint venture would execute a Turnkey Completion Contract.[43] Hardwick drafted and signed the Turnkey Completion Contracts on behalf of both parties.[44] In each of the five joint ventures at issue, Regal Operating recommended completion.[45]

Investors were expected to pay their initial capital contribution per unit or fraction of a unit purchased[46] and an additional capital contribution if the managing venturer determined to complete the well.[47] Venturers were also assessed monthly costs for expenses associated with operations. Any venturer who failed or refused to pay a required capital contribution or assessed cost for drilling, completion, operation, or other expense associated with the well would be treated as having abdicated his or her interest in the well.[48]

---

[37] JX-2, at 127; JX-3, at 111; JX-4, at 103; JX-5, at 111; JX-6, at 112; JX-7, at 114; JX-8, at 115.

[38] JX-2, at 127; JX-3, at 111; JX-4, at 103; JX-5, at 111; JX-6, at 112; JX-7, at 114; JX-8, at 115.

[39] JX-2, at 127; JX-3, at 111; JX-4, at 103; JX-5, at 111; JX-6, at 112; JX-7, at 114; JX-8, at 115.

[40] Tr. 117.

[41] Tr. 114, 117.

[42] Tr. 117-119; JX-2, at 165; CX-45; CX-52; CX-60; CX-66; CX-72.

[43] Tr. 118-119.

[44] Tr. 118-119; JX-2, at 171; CX-46; CX-53; CX-61; CX-67; CX-73. The turnkey contracts obligated the joint ventures to pay under the terms of the contract, regardless of whether the joint venture replaced the managing venturer.

[45] Tr. 156.

[46] The majority of investors in the Regal joint ventures purchased a fraction of one unit. Tr. 161-162, 185-186, 190; CX-47.

[47] Tr. 115-116, 155-156; JX-2, at 15-17; JX-3, at 14-16; JX-4, at 13-15; JX-5, at 14-16; JX-6, at 15-17; JX-7, at 52-54; JX-8, at 54-56.

[48] Tr. 115-116, 155-156; JX-2, at 15-17; JX-3, at 14-16; JX-4, at 13-15; JX-5, at 14-16; JX-6, at 15-17; JX-7, at 52-54; JX-8, at 54-56.

The CIMs allowed for the venturers to replace Regal Energy as the managing venturer only if 60 percent of the interest holders voted to replace it.[49] The removal of Regal Energy under such circumstances would not apply retroactively, so any actions that Regal Energy had already commenced or contracts that it had already executed on behalf of the joint venture would remain in effect.[50] In the JVA, Regal Energy established rules and procedures for how such a vote would occur.[51] The JVA required a special meeting of the venturers be held to allow for a vote to remove the managing venturer and, in order for the vote to occur, a quorum of at least 50 percent of unit holders must participate.[52] The rules and procedures Regal Energy established for special meetings stated that only the managing venturer (Regal Energy), or holders of not less than ten percent of the units entitled to vote at the meeting, could call for a special meeting.[53] Only Regal Energy had the list of investors for each joint venture, and according to the terms of the JVA Hardwick drafted, Regal Energy was required to treat the list of investors as confidential and proprietary.[54] Hardwick testified that he was never asked for a list of investors, and he never shared that information for any of the Regal Energy joint ventures.[55] If a venturer wanted to obtain a list of other investors in any particular joint venture, the only resource for that information was Regal Energy.[56]

The CIMs for the five joint ventures at issue contained several generalized risk disclosures. They all stated that inherent in the venture are risks related to the failure to locate gas or oil and drilling a dry hole, speculative revenues from production, inability to sell or transfer units, abandonment of units for non-payment, and the possible loss of the entire investment.[57] CIMs for all of the joint ventures stated that participation involved a high degree of risk.[58] They also indicate that, although Red River Securities is paid a due diligence fee of three percent of the aggregate capital contributed to the venture, there is no assurance that the due diligence provided by Red River Securities is as extensive or as detailed as an independent third party broker-dealer.[59]

---

[49] Tr. 124; JX-2, at 120, 131; JX-3, at 105, 114; JX-4, at 98, 106; JX-5, at 105, 113; JX-6, at 106, 114; JX-7, at 108, 116; JX-8, at 109, 117.

[50] Tr. 124-125.

[51] Tr. 125-127.

[52] Tr. 125-126; JX-2, at 143-144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[53] Tr. 125-126; JX-2, at 143-144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[54] Tr. 128; JX-2, at 144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[55] Tr. 130-131.

[56] Tr. 131.

[57] JX-2, at 3, 27-34; JX-3, at 3, 25-32; JX-4, at 3, 22-29; JX-5, at 3, 23-30; JX-7, at 41, 62-68.

[58] JX-2, at 3, 27-34; JX-3, at 3, 25-32; JX-4, at 3, 22-29; JX-5, at 3, 23-30; JX-7, at 41, 62-68.

[59] JX-2, at 29; JX-3, at 27-28; JX-4, at 25; JX-5, at 26; JX-7, at 64.

Red River Securities targeted their sales to individuals listed on a leads list provided by Regal Energy.[60] Regal Energy believed the individuals on the list were prequalified as accredited investors. Red River Securities had no pre-existing relationship with individuals on the list.[61] The brokers at Red River Securities called the individuals on the list to introduce themselves and Red River Securities and to obtain information about the individuals' net worth, liquidity, and income.[62] Hardwick testified that Red River Securities did not send out offering materials (CIMs) without first making a suitability determination.[63]

C. The Joint Ventures at Issue

Red River Securities offered five joint ventures between January 2010 and July 2013.

1. Boonsville #2 Joint Venture

Red River Securities offered the Boonsville #2 joint venture from January 5, 2010, through November 29, 2011.[64] The Boonsville #2 was formed to drill and own two wells in Wise County, Texas, in an area known as the "Barnett Shale."[65] Red River Securities offered and sold 72 units to 156 investors and raised $9,540,000.[66] The CIM stated that the minimum investment was one unit, although the record indicates that the majority of investors purchased less than one unit.[67] The cost per unit was $79,500 plus a $53,000 per-unit completion assessment and additional assessments for completion costs and monthly costs from the operation of the wells.[68] According to the Boonsville #2 CIM, once the joint venture was fully capitalized and commenced operations, the managing venturer (Regal Energy) was entitled to receive 18.75 percent of net revenues and the joint venture was entitled to receive 52.5 percent of net revenues.[69] According to the Boonsville #2 CIM, investors "contribute 100% of the drilling and

---

[60] Tr. 132.

[61] Tr. 132.

[62] Tr. 134-135.

[63] Tr. 137. In July 2011, Hardwick emailed Red River Securities' compliance officer, Laurie Roberts ("Roberts") suggesting that registered representatives at the firm should be making 2000 "dials" per week or 400 per day. CX-205; Tr. 138-139. Hardwick testified that he attempted to push the firm's sales force to make this many calls, but determined that it was not possible. Tr. 139. He stated that, at most, they were able to make 160 to 180 calls per day. Tr. 139.

[64] CX-195.

[65] JX-2, at 3.

[66] JX-2, at 3; CX-87; CX-199.

[67] Tr. 101, 103; CX-199.

[68] JX-2, at 15.

[69] JX-2, at 16. Royalty interest holders were entitled to receive 25 percent of net revenues and the affiliated operator (Regal Operating) was entitled to receive 3.75 percent of net revenues. JX-2, at 16.

testing costs and the completion costs for which the [v]enture" will receive only 52.50 percent of any net revenues.[70]

2. Waggoner #1 Joint Venture

Red River Securities offered the Waggoner #1 joint venture from July 21, 2010, through November 29, 2010.[71] The Waggoner #1 was formed to drill and own one well in Wise County, Texas, in the Barnett Shale.[72] Red River Securities offered and sold 15 units to 40 investors and raised $2,517,804.[73] The CIM stated that the minimum investment was four units, although the record indicates that the majority of investors purchased less than one unit.[74] The cost per unit was $83,926.80 plus an $83,926 per-unit completion assessment and additional assessments for completion costs and monthly costs from the operation of the wells.[75] According to the Waggoner #1 CIM, once the joint venture was fully capitalized and commenced operations, the managing venturer (Regal Energy) was entitled to receive 7.50 percent of net revenues and the joint venture was entitled to receive 63.75 percent of net revenues.[76] According to the Waggoner #1 CIM, investors "contribute 100% of the drilling and testing costs and the completion costs for which the [v]enture" will receive only 63.75 percent of any net revenues.[77]

3. Waggoner #2 Joint Venture

Red River Securities offered the Waggoner #2 joint venture from March 4, 2011, through June 24, 2011.[78] The Waggoner #2 joint venture was formed to drill and own one well in Wise County, Texas, in the Barnett Shale.[79] This well was an offset to the Waggoner #1 well.[80] Red River Securities offered and sold 15 units to 48 investors and raised $2,517,804.[81] The CIM stated that the minimum investment was four units, although the record indicates that the majority of investors purchased less than one unit.[82] The cost per unit was $83,926.80 plus an $83,926 per-unit completion assessment and additional assessments for completion costs and

[70] JX-2, at 40.

[71] CX-195.

[72] JX-3, at 3.

[73] JX-3, at 3; CX-87; CX-200.

[74] CX-200; Tr. 101, 103.

[75] JX-3, at 14-15.

[76] JX-3, at 15. Royalty interest holders were entitled to receive 25 percent of net revenues and the affiliated operator (Regal Operating) was entitled to receive 3.75 percent of net revenues. JX-3, at 15.

[77] JX-3, at 37.

[78] CX-195.

[79] JX-4, at 3.

[80] JX-4, at 3.

[81] JX-4, at 3; CX-87; CX-201.

[82] CX-201; Tr. 101, 103.

monthly costs from the operation of the wells.[83] According to the Waggoner #2 CIM, once the joint venture was fully capitalized and commenced operations, the managing venturer (Regal Energy) was entitled to receive 7.50 percent of net revenues and the joint venture was entitled to receive 63.75 percent of net revenues.[84] According to the Waggoner #2 CIM, investors "contribute 100% of the drilling and testing costs and the completion costs for which the [v]enture" will receive only 63.75 percent of any net revenues.[85]

4. Cosper #1 Joint Venture

Red River Securities offered the Cosper #1 joint venture from September 15, 2011, through January 23, 2013.[86] The Cosper #1 was formed to drill and own one well in Johnson County, Texas, in the Barnett Shale.[87] Red River Securities offered and sold 36 units to 131 investors and raised $5,258,437.20.[88] The CIM stated that the minimum investment was 12 units, although the record indicates that the majority of investors purchased less than one unit.[89] The cost per unit was $58,427.08 plus an $87,640.62 per-unit completion assessment and additional assessments for completion costs and monthly costs from the operation of the wells.[90] According to the Cosper #1 CIM, once the joint venture was fully capitalized and commenced operations, the managing venturer (Regal Energy) was entitled to receive 7.50 percent of net revenues and the joint venture was entitled to receive 63.75 percent of net revenues.[91] According to the Cosper #1 CIM, investors "contribute 100% of the drilling and testing costs and the completion costs for which the [v]enture" will receive only 63.75 percent of any net revenues.[92]

5. Pierce #1 Joint Venture

Red River Securities offered the Pierce #1 joint venture from April 27, 2012, through July 15, 2013.[93] The Pierce #1 joint venture was formed to drill and own one well in Smith County, Texas, in an area known as the "Rodessa Sand."[94] Red River Securities offered and sold

---

[83] JX-4, at 13-14.

[84] JX-4, at 14. Royalty interest holders were entitled to receive 25 percent of net revenues and the affiliated operator (Regal Operating) was entitled to receive 3.75 percent of net revenues. JX-4, at 14.

[85] JX-4, at 33.

[86] CX-195. On June 20, 2012, Hardwick updated the CIM for Cosper #1. CX-6, at 3.

[87] JX-5, at 3.

[88] JX-5, at 3; CX-87; CX-202.

[89] CX-202; Tr. 101, 103.

[90] JX-5, at 14-15.

[91] JX-5, at 15. Royalty interest holders were entitled to receive 25 percent of net revenues and the affiliated operator (Regal Operating) was entitled to receive 3.75 percent of net revenues. JX-5, at 15.

[92] JX-5, at 34.

[93] CX-195. On June 20, 2012, Hardwick updated the CIM for Pierce #1. CX-8, at 43.

[94] JX-7, at 41.

24 units to 81 investors and raised $4,045,612.56.[95] The CIM stated that the minimum investment was nine units, although the record indicates that the majority of investors purchased less than one unit.[96] The cost per unit was $120,403.13 plus a $48,164.06 per-unit completion assessment and additional assessments for completion costs and monthly costs from the operation of the wells.[97] According to the Pierce #1 CIM, once the joint venture was fully capitalized and commenced operations, the managing venturer (Regal Energy) was entitled to receive 11.4844 percent of net revenues and the joint venture was entitled to receive 55.3125 percent of net revenues.[98] According to the Pierce #1 CIM, investors "contribute 93.75% of the drilling and testing costs and the completion costs for which the [v]enture" will receive only 55.3125 percent of any net revenues.[99]

D. Red River Securities' and the Regal Entities' Compensation

Red River Securities received a commission of 12 percent of the total capital raised from investors for each joint venture plus an additional three percent as a due diligence fee.[100] Thus, right off the top, Red River Securities and Hardwick received 15 percent of the funds that Red River Securities raised for each joint venture. Red River Securities earned commissions and due diligence fees of $1,432,000 for the Boonsville #2 offering, $377,670.60 for the Waggoner #1 offering, $377,670.60 for the Waggoner #2 offering, $788,765.58 for the Cosper #1 offering, and $581,657.43 for the Pierce #1 offering.[101]

Regal Operating, as operator of each well received a monthly operating fee of $600 per well.[102] Regal Energy also received a management fee for each joint venture. According to the CIM terms, "[i]n consideration of the supervision and management of the Joint Venture during the drilling periods" Regal Energy will receive a one-time management fee in the amount equal to the difference between the total turnkey price (i.e., total offering proceeds) and the "actual cost of operations."[103] The management fees were substantial. For Boonsville #2, Regal Energy

---

95 JX-7, at 41; CX-87; CX-203.

96 CX-203; Tr. 101, 103.

97 JX-7, at 52-53.

98 JX-7, at 53. Royalty interest holders were entitled to receive 25 percent of net revenues, an industry partner was entitled to receive 4.6975 percent of net revenues, and the affiliated operator (Regal Operating) was entitled to receive 3.5156 percent of net revenues. JX-7, at 53.

99 JX-7, at 72.

100 Tr. 356-357; JX-2, at 29; JX-3, at 113; JX-4, at 105; JX-5, at 112; JX-6, at 113; JX-7, at 115; JX-8, at 116. Hardwick prepared the CIMs as majority owner of the issuer, Regal Energy, and conducted "due diligence" on his own work as majority owner of Red River Securities. Tr. 356. For this, Red River Securities received three percent of total capital raised. Tr. 356-357; JX-2, at 29; JX-3, at 113; JX-4, at 105; JX-5, at 112; JX-6, at 113; JX-7, at 115; JX-8, at 116.

101 CX-87. Red River Securities and Hardwick received due diligence fees and commissions on the five offerings of approximately $3.6 million. Tr. 360.

102 Tr. 358; JX-2, at 129; JX-3, at 113; JX-4, at 105; JX-5, at 112; JX-7, at 115.

103 JX-2, at 128; JX-3, at 112-113; JX-4, at 104-105; JX-5, at 111-112; JX-7, at 114-115.

received a management fee of $3,293,524, which was 35 percent of total offering proceeds.[104] For Waggoner #1, Regal Energy received a management fee of $418,616.57, which was 17 percent of total offering proceeds.[105] For Waggoner #2, Regal Energy received a management fee of $773,640.24, which was 31 percent of total offering proceeds.[106] For Cosper #1, Regal Energy received a management fee of $1,575,717.95, which was 30 percent of the total offering proceeds.[107] For Pierce #1, Regal Energy received a management fee of $1,044,637.85, which was 27 percent of total offering proceeds.[108]

Redlich and Nichols, on behalf of Regal Energy, prepared authorizations for expenditures ("AFEs") for each joint venture.[109] The AFEs were estimates of all costs the joint venture would incur to complete the well(s). Hardwick approved the AFEs.[110] Redlich and Nichols typically built into the AFEs (and Hardwick approved in the AFEs) contingency amounts of 10 to 30 percent for unforeseen, miscellaneous costs.[111] Hardwick used the AFEs to calculate the total turnkey prices for the joint ventures.[112] Specifically, Hardwick doubled the AFE estimate and deducted 10 percent to determine the total price for each venture.[113] Because the AFEs were used to determine the total turnkey price, they also influenced the size of Regal Energy's management fee.[114]

IV. Discussion

A. The Joint Venture Interests Are Securities

Before we consider the allegations of misconduct, we must first determine if the joint venture interests are securities. The Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") define "security" to include investment contracts.[115] The Supreme Court has defined an investment contract as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely

---

[104] CX-87; Tr. 359-360.

[105] CX-87; Tr. 359-360.

[106] CX-87; Tr. 359-360.

[107] CX-87; Tr. 359-360.

[108] CX-87; Tr. 359-360.

[109] Tr. 1614-1615.

[110] Tr. 304-306.

[111] Tr. 305-308; JX-12.

[112] Tr. 319-320.

[113] Tr. 319-320; 612-613.

[114] Regal Energy's management fee was the difference between the total turnkey price and the actual cost of drilling and completing the wells.

[115] *See* Section 2(1) of the Securities Act; Section 3(a)(10) of the Exchange Act.

from the efforts of the promoter or a third party . . . ."[116] The venturers in this case invested money in the common enterprise of a Regal joint venture. The joint ventures were formed as general partnerships, which ordinarily are not considered investment contracts (and therefore securities) because unlike limited partnerships, they grant partners—the investors—control over the significant decisions of the enterprise.[117] "However, where investors are prevented from making these significant decisions, '[the Commission] and the courts will look through form to the substance of the investment arrangements to determine whether the interests involved are securities.'"[118]

The critical issue with respect to determining if joint venture interests such as those in this case are securities is the third prong of the *Howey* analysis—the expectation of profits derived solely from the efforts of others.[119] To this end, the Fifth Circuit has established a test to determine whether a general partnership meets the third prong of the *Howey* analysis. In *Williamson*, the Fifth Circuit stated that an investment contract exists if any one of the following factors is present: (1) an agreement among the parties leaves so little power in the hands of the investor that the arrangement distributes power as would a limited partnership; (2) the investor is so inexperienced or unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the investor is so dependent on some unique entrepreneurial or managerial ability of the manager that he cannot replace the manager or otherwise exercise meaningful partnership powers.[120] The Commission[121] and the National Adjudicatory Council ("NAC")[122] have adopted the *Williamson* test.[123]

Under the first prong of the *Williamson* test, we consider whether the individual investors or venturers delegated to the managing venturer the day-to-day management and operation of the venture, the power to act on behalf of and legally bind the venture, and full plenary power over

---

[116] *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-99 (1946). In *Howey*, the Court held that, in order to find an investment contract exists, there must be (1) an investment of money; (2) in a common enterprise; and (3) an expectation of profits derived solely from the efforts of a third party. 328 U.S. 298-99.

[117] *Williamson v. Tucker*, 645 F.2d 404, 422 (5th Cir. 1981); *Maximo Justo Guevara*, 54 S.E.C. 655, 660 (2000).

[118] *Guevara*, 54 S.E.C. 655, 660 (citing *Jay Frederick Keeton*, 50 S.E.C. 1128, 1132 n.13 (1992)).

[119] *Rivanna Trawlers Unlimited v. Thomson Trawlers, Inc.*, 840 F.2d 236, 240 (4th Cir. 1988).

[120] *Williamson*, 645 F.2d at 423.

[121] *See Guevara*, 54 S.E.C. at 660.

[122] *See Dist. Bus. Conduct Comm. for District No. 9 v. Guevara*, No. C9A970018, 1999 NASD Discip. LEXIS 1, at *8-9 (NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000); *Dep't of Enforcement v. De Vietien*, No. 2006007544401, 2010 FINRA Discip. LEXIS 45, at *22 (NAC Dec. 28, 2010).

[123] Applying the *Williamson* factors, the United States District Court for the Northern District of Texas held that interests in oil and gas joint ventures, similar to the Regal oil and gas joint ventures at issue, were securities. *See SEC v. Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358 (N.D. TX Mar. 21, 2016), *reh'g denied*, 2016 U. S. Dist., LEXIS 88410 (July 8, 2016). The Eastern District of Texas similarly concluded that interests in oil and gas joint ventures organized like the Regal joint ventures were securities. *See SEC v. Sethi Petroleum, LLC,* 2016 U.S. Dist. LEXIS 104577 (E.D. Tex. Aug. 9, 2016).

the drilling operations.[124] The investors in the Regal joint venture granted Regal Energy, as managing venturer, authority to act on behalf of the joint venture, legally bind the joint venture, conduct the day-to-day operations of the joint venture, and hire operators to drill, complete, operate, and if necessary, abandon and plug a well.[125] According to the CIMs' terms, no other venturer had "any right or authority" to take any action on behalf of or in the name of the joint venture.[126]

The Regal joint ventures are similar in another way to other joint venture interests that courts have found to be securities. The Regal CIMs allowed the venturers to replace Regal Energy as the managing venturer only if 60 percent of the interest holders in the venture voted to replace.[127] The removal of Regal Energy, however, would not apply retroactively. Actions that Regal Energy had already commenced or contracts that it had already executed on behalf of the joint venture would remain in effect.[128] Additionally, Regal Energy established rules and procedures for how such a vote would occur.[129] The JVA required a special meeting of the venturers be held to allow for a vote to remove the managing venturer and that a quorum of at least 50 percent of unit holders participate for the vote to occur.[130] The rules and procedures that Regal Energy established for special meetings stated that only the managing venturer (Regal Energy), or holders of not less than ten percent of the units entitled to vote at the meeting, could call for a special meeting.[131]

Only Regal Energy had the list of investors for each joint venture, and according to the terms of the JVA that Hardwick drafted, Regal Energy was required to treat the list of investors as confidential and proprietary.[132] The investors were geographically dispersed with no pre-existing relationships.[133] Thus, any rights that the venturers had to vote Regal Energy out of power or call a meeting was hindered by the investors' lack of contact information for each other. Indeed, if a Regal venturer wanted to obtain a list of other investors, the only resource for that information was Regal Energy, the entity that the investors may want to replace.[134] Courts

[124] *Williamson*, 645 F.2d at 424.

[125] Tr. 107-114; JX-2, at 15, 121, 124-126; JX-3, at 14, 106, 108-110; JX-4, at 13, 99, 101-103; JX-5, at 14, 106, 108-110; JX-6, at 15, 107, 109-111; JX-7, at 52, 109, 111-113; JX-8, at 54, 110, 112-114.

[126] JX-2, at 127; JX-3, at 111; JX-4, at 103; JX-5, at 111; JX-6, at 112; JX-7, at 114; JX-8, at 115.

[127] Tr. 124; JX-2, at 120, 131; JX-3, at 105, 114; JX-4, at 98, 106; JX-5, at 105, 113; JX-6, at 106, 114; JX-7, at 108, 116; JX-8, at 109, 117.

[128] Tr. 124-125.

[129] Tr. 125-127.

[130] Tr. 125-126; JX-2, at 143-144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[131] Tr. 125-126; JX-2, at 143-144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[132] Tr. 128; JX-2, at 144; JX-3, at 125; JX-4, at 116; JX-5, at 123; JX-6, at 124; JX-7, at 126; JX-8, at 127.

[133] CX-199–CX-203.

[134] Tr. 131.

have rejected such investor "powers" as evidence that joint venture interests are not securities.[135] Under the first *Williamson* factor, we find that the Regal joint venturers "were given what are essentially sham or illusory powers."[136]

The second *Williamson* factor requires consideration of the investors' experience and knowledge in the particular business of the venture at issue.[137] The evidence in this case satisfies the second *Williamson* factor. "Courts look to the investor's experience and knowledge in the particular business of the venture at issue, not the investor's general business experience."[138] Red River Securities did not limit its search to investors with a background in oil and gas drilling. Rather, the firm targeted their sales to thousands of individuals listed on a leads list provided by Regal Energy.[139] Although some of the investors may have previously invested in oil and gas ventures, their occupational experience was as varied and wide-ranging as the parts of the country in which they lived.[140] We find that the second *Williamson* factor is also present.[141]

The third *Williamson* factor requires us to assess the venturers' reliance on the unique abilities of Regal Energy that they cannot replace the manager or otherwise exercise meaningful venture powers.[142] "In assessing the third *Williamson* factor, [an adjudicator] may consider 'the representations and promises made by promoters or others to induce reliance upon their entrepreneurial abilities.'"[143] Here, as a follow-up to cold calls, Red River Securities solicited

---

[135] *See Sethi Petroleum, LLC*, 2016 U.S. Dist. LEXIS 104577, at *35 (finding that venturers' only connection to each other was inclusion on the same cold call list and that it constituted a "significant barrier" to the investors' ability to exercise power); *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *17-20 (holding that venturers' ability to call a meeting, remove the managing venture, and amend the JVA does not defeat a finding that joint venture interests are securities because they required percentage votes (like 60% to replace managing venturer), the investors had no information about each other, the managing venturer was required to treat the identities of the investors as confidential, and the venturers were located across the country and contacted by cold calls); *SEC v. Merch. Capital, LLC*, 483 F.3d 747, 758 n.8 (11th Cir. 2011) (holding that the requirement for a two-thirds vote of geographically distant, unacquainted venturers in order to dissolve the partnership made the power to dissolve the partnership illusory).

[136] *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *24.

[137] *Williamson*, 645 F.2d at 424.

[138] *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *25. *See also Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 134 n.3 (5th Cir. 1989) (holding that the knowledge inquiry in *Williamson* means knowledge tied to the underlying business of the joint venture); *Merch. Capital*, 483 F.3d 747, 762 (holding that, regardless of investors' general business experience, if they are inexperienced in the particular business of the venture, they are more likely to rely on the efforts of the managing venturer and the products fall within the definition of security).

[139] Tr. 132.

[140] CX-199–CX-203.

[141] *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *26 (finding joint venture interests were securities where respondents made hundreds of daily cold calls to thousands of people on lead lists without limiting their solicitations to investors with knowledge or experience about the oil and gas industry).

[142] *Williamson*, 645 F.2d 404, 424.

[143] *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *45 (citing *Gordon v. Terry*, 684 F.2d 736, 742 (11th Cir. 1982)). *See also Koch v. Hankins*, 928 F.2d 1471, 1478 (9th Cir. 1991) (holding that, in determining whether the

customers to invest in the joint venture interests with a form letter and promotional materials that touted the oil and gas knowledge and experience of Regal Operating.[144] It stated that "the officers of [Regal Operating] together have more than three decades experience in drilling and operating wells."[145] Red River Securities represented that "[Regal Operating] and its affiliates operate more than 100 wells throughout Texas and Kansas."[146] They touted their history of more than 100 well completions.[147]

Furthermore, Regal Energy and Hardwick ensured that all joint venture documents centralized control in the Regal Entities. The terms of the JVAs were not negotiable. Investors had to consent to the terms as written. Under the governing JVAs, which were part of the CIMs, Regal Energy installed Regal Operating as the operator of each joint venture, and the joint ventures were obligated to execute Turnkey Drilling Contracts with Regal Energy.[148] Hardwick drafted, approved, and signed the Turnkey Drilling Contracts on behalf of both parties—the joint venture and Regal Energy.[149] Once a well was drilled, Regal Operating made a recommendation as to whether to complete the well, and the joint venture would execute a Turnkey Completion Contract with Regal Operating.[150] Hardwick drafted and signed the Turnkey Completion Contracts on behalf of both parties.[151] The evidence demonstrates that when they invested, venturers expected to rely on Regal Energy's experience and expertise in oil and gas drilling and that Regal Energy's and Hardwick's oil and gas successes convinced them to invest.[152] We find that this case meets the third *Williamson* factor as well.

---

investors relied on the efforts of others, courts may consider promotional materials and representations made by the promoters).

[144] Tr. 84; CX-33.

[145] Tr. 86; CX-33, at 2.

[146] Tr. 86; CX-33, at 2.

[147] CX-33, at 5.

[148] Tr. 114, 117.

[149] Tr. 117-119; JX-2, at 165; CX-45; CX-52; CX-60; CX-66; CX-72.

[150] Tr. 118-119.

[151] Tr. 118-119; JX-2, at 171; CX-46; CX-53; CX-61; CX-67; CX-73.

[152] Several investors testified that Red River Securities touted Regal Energy's experience and expertise in oil and gas drilling and that they relied on this in determining to invest. Tr. 1228-1229, 1274, 1284, 1523-1524. Investors also testified that they never planned to manage the joint ventures and had no oil and gas drilling experience. Tr. 1091, 1166, 1179, 1205-1206, 1226, 1244, 1299, 1314, 1499, 1535. The investors who testified were not acquainted with each other and stated that they had no expectation of recovering their losses. All stated that they testified because they hoped to prevent Red River Securities from selling similar products to other unsuspecting investors. We found the investors' testimony to be credible.

We need only find one of the three *Williamson* factors to conclude that the Regal joint venture interests are securities.[153] We find that all three factors are present and conclude that the joint venture interests are securities.

B. Misrepresentations and Omissions

Cause one of the Complaint alleges that Respondents fraudulently misrepresented and omitted material facts in the Regal CIMs, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010.[154] Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 prohibit the use, in connection with the purchase or sale of any security, of any fraudulent and deceptive acts and practices.[155] In order to find that Respondents violated Exchange Act Rule 10b-5, the preponderance of the evidence must demonstrate that Red River Securities and Hardwick (1) made material misrepresentations or omissions; (2) in connection with the purchase or sale of a security; and (3) acted with scienter.[156] FINRA Rule 2020 parallels Exchange Act Rule 10b-5, and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device. As discussed in detail below, we find that Hardwick and Red River Securities misrepresented and omitted material facts, as alleged in the Complaint.

1. Red River Securities and Hardwick Made Material Misrepresentations and Omissions in Connection with the Purchase of Securities

Exchange Act Rule 10b-5(b) makes it unlawful for any person, directly or indirectly, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances in which they were made, not misleading in connection with the purchase or sale of a security. The Complaint alleges that Red

---

[153] *Arcturus Corp.*, 2016 U.S. Dist. LEXIS 37358, at *15. The NAC has noted that because "the three *Williamson* factors are presented in the disjunctive, . . . satisfaction of one factor is sufficient to conclude that the interest in question is a security." *Guevara*, 1999 NASD Discip. LEXIS 1, at *9 n.5.

[154] As an alternative to cause one, cause two alleges that Respondents' conduct violated Section 17(a) of the Securities Act and FINRA Rule 2010. Cause three alleges, as an alternative to causes one and two, that Respondents acted negligently and violated FINRA Rule 2010 by engaging in the conduct identified in cause one.

[155] Conduct that violates Commission or FINRA rules is inconsistent with high standards of commercial honor and just and equitable principles of trade and therefore violates FINRA Rule 2010. *Joseph Abbondante*, 58 S.E.C. 1082, 1103 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). FINRA Rule 0140 states that persons associated with a member, like Hardwick, have the same duties and responsibilities under FINRA's rules as members.

[156] *See Basic v. Levinson*, 485 U.S. 224, 235 n.13 (1988); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996). In addition, to find a violation of Exchange Act Rule 10b-5, we must find that Hardwick and Red River Securities used the means or instrumentality of interstate commerce, or of the mails or any facility of any national securities exchange in the sale of securities. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y 1992). Here, Respondents do not dispute that Red River Securities regularly communicated with customers both inside and outside of Texas by U.S. mail and telephone calls, thereby satisfying the interstate commerce requirement. *See SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (stating that the jurisdictional requirements of the federal anti-fraud provisions are satisfied by intrastate telephone calls or the use of the U.S. mail), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

River Securities and Hardwick misrepresented and omitted material facts in the CIMs they used to sell joint venture interests to investors. The Supreme Court has stated that, in the context of Exchange Act Rule 10b-5, the "maker" of a misrepresentation or omission "is the person or entity with the ultimate authority over the statement, including its content and whether and how to communicate it."[157] Thus, to find liability, we must conclude that Hardwick had ultimate authority over the content of the CIMs.

Hardwick testified that he was responsible for drafting and approving the CIMs, the exhibits attached to the CIMs, and all amendments to the CIMs for the five joint ventures at issue.[158] Hardwick is the majority owner and chief executive officer of Red River Securities, and he determined, on behalf of Red River Securities, to mail the CIMs to customers to solicit prospective investors for the five Regal joint ventures.[159] We find that Hardwick and Red River Securities are the "makers" of the material misrepresentations and omissions in this case.

a. Alleged Misrepresentations as to the Status of Other Wells

Cause one of the Complaint alleges that, when Respondents drafted the Cosper #1 and Pierce #1 CIMs, they included a table showing Regal Energy's current activities in the Barnett Shale. The table reported that the Waggoner #1 well and the Regal Blessing #1 Joint Venture ("Blessing #1") well were producing. Cause one alleges that they were "shut in" and not producing.[160] Cause one further alleges that, while Red River Securities used the Cosper #1 and Pierce #1 CIMs to solicit investors, other Regal wells listed in the table (Boonsville #1, Waggoner #2, and Boonsville #2) stopped producing and were shut in (although they were not shut in when the CIM originally was drafted), but Respondents continued using the CIMs without amending them. Cause one also alleges that both CIMs were amended on June 20, 2012, but the well status of other Regal wells was not amended at that time. Cause one alleges that, by listing the well status for these five wells as "producing," Respondents made a material misrepresentation because the wells were in fact shut in. We conclude that Enforcement failed to prove these allegations by a preponderance of the evidence.

First, the evidence provides contradictory information as to when and whether the Waggoner #1 and Blessing #1 wells were in fact producing. Hardwick initially advised FINRA that Waggoner #1 was shut in February 1, 2012,[161] but later stated that he was mistaken and indicated it was "plugging" in July 2012.[162] He stated in a February 29, 2012 letter to investors that it had been temporarily shut in, but Regal Energy intended to bring it back into production

---

157 *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011).

158 Tr. 101, 103.

159 Tr. 67, 137; Stip. ¶ 9. As discussed in subsection IV.A., we find that the joint venture interests are securities.

160 Generally, a well that is shut in is not producing. A well may be shut in temporarily or permanently.

161 Tr. 214; CX-79.

162 Tr. 139, 217-218, 1490; CX-82, at 2.

upon receipt of investors' payment of assessments.[163] In a July 31, 2012 partnership distribution statement, Regal Energy reported that Waggoner #1 was temporarily shut in as of July 26 until gas prices increased.[164] Other evidence related to Waggoner #1 showed a well status report indicating that the well was shut in most of February 2012,[165] evidence of income from gas sales reported in March 2012,[166] gas vented to tanks through April 2012,[167] and income from oil sales reported in May 2012.[168] Various documents showed contradictory evidence as to when and whether the well had electricity, a pumper, a compressor, repair and maintenance charges, and saltwater hauling during the first half of 2012.[169] Similarly, the evidence regarding the Blessing #1 well was unclear. Red River Securities advised FINRA that it was shut in December 1, 2012.[170] A March 21, 2012 well report stated that it had loaded with fluid and was shut in, waiting for a "swab rig."[171] The remaining three wells were shut in some time during the period when the Cosper #1 and Pierce #1 CIMs were in use, but after the June 2012 amendments.[172] The evidence suggests that wells were often shut in temporarily and, when re-opened, produced again.

Second, we are not able to discern the materiality of these classifications. As to the Waggoner #1 and Blessing #1 wells, the experts provided varied and inconsistent explanations of the meaning and significance of the terms "shut in" and "producing." Enforcement's expert, Daniel T. Reineke ("Reineke"), testified that "shut in" and "producing" are not the only choices for classification and that many other classifications exist.[173] His testimony suggested to us that well status could change daily. He stated that a well may be temporarily shut in for mechanical reasons or waiting for the price of gas or oil to increase, but capable of producing and that a well in this state is different than a well that is permanently shut in and waiting to be taken out of production.[174] He also testified that a well producing any amount of oil, regardless of how small, may be considered "producing," a well that is shut in one day may be producing the next, and a well producing gas venting to tanks is not producing but is "venting to tanks."[175]

[163] CX-21.

[164] CX-13, at 18.

[165] Respondents' Exhibit ("RX")-44, at 177.

[166] CX-13, at 14.

[167] RX-44, at 135.

[168] CX-13, at 16.

[169] Tr. 493, 635, 1003; CX-12; CX-13.

[170] CX-82.

[171] RX-44, at 177.

[172] CX-82.

[173] Tr. 846-847, 872-873, 985-986.

[174] Tr. 812-813, 846-847, 985-988.

[175] Tr. 965, 971-972, 984. Reineke's testimony as to the definition of "producing" varied in that he also testified that, in order to be classified as "producing" a well must be producing oil or gas in sellable quantities. Tr. 1030-1031.

Respondents' expert, Michael F. Krehel ("Krehel"), testified that the term "shut in" is a loose term used in the industry and a well would be considered producing if it is producing any amount of oil or gas.[176] He testified that a well may be shut in for hours, days, or weeks, and its status as shut in has nothing to do with the well's ultimate ability to produce oil or gas.[177] He stated that a well quite frequently could be producing, shut in, and then producing again.[178] Even standard industry glossaries provide different definitions of "producing well."[179] The one consistent conclusion appears to be that "shut in" status need not be permanent.

Furthermore, as to the Boonsville #1, Boonsville #2, and Waggoner #1 wells, all shut in some time during the use of the Pierce #1 and Cosper #1 CIMs, we are not convinced that Respondents' failure to revise or delete the CIM is material. The tables discuss Regal Energy's activities in the Barnett Shale.[180] The Pierce #1 well was in the "Rodessa Sand," not the Barnett Shale, so production comparison, against which the CIMs warned, was pointless. The CIMs also warned that information such as the production information at issue here should be considered accurate only as of the date of the CIM.[181]

Given the contradictory nature of the evidence, we are unable to determine whether or not these wells were in fact producing and the materiality of the well status classifications used in the CIMs. We therefore find that Enforcement failed to prove this allegation.

b. Respondents Failed to Disclose Authorizations for Expenditures in Boonsville #2 and Waggoner #1 CIMs

Cause one of the Complaint alleges that Respondents failed to include AFEs in the CIMs for Boonsville #2 and Waggoner #1. Cause one alleges that AFEs were necessary to enable investors to calculate Regal Energy's management fee and that the failure to include them with the CIMs is a material omission. We conclude that the AFEs were the only means of calculating an estimate of Regal Energy's management fee and that by not including them in the Boonsville #2 and Waggoner #1 CIMs, Respondents intentionally omitted material information.

Rule 2120 and Exchange Act Rule10b-5 are designed to ensure that securities professionals fulfill their obligation to customers to be accurate when making statements about

---

[176] Tr. 1681.

[177] Tr. 1687.

[178] Tr. 1691.

[179] *Compare* CX-210 (defining a producing well as a well that produces oil or gas in paying quantities or any quantity whatsoever) *with* CX-211 (defining a producing well as a well that produces fluids (gas, oil, or water).

[180] JX-5, at 78; JX-7, at 20.

[181] JX-6, at 6; JX-8, at 45.

securities.[182] "The antifraud provisions 'give rise to a duty to disclose any information necessary to make an individual's voluntary statements not misleading.'"[183]

Redlich and Nichols prepared the AFEs and Hardwick approved them.[184] The Boonsville #2 and Waggoner #1 CIMs stated that Regal Energy may receive a one-time management fee in the amount equal to the excess, if any, of the total turnkey price (the total amount invested) over the actual cost of operations, which is the cost that the AFEs estimate.[185] Both CIMs also stated that Regal Energy could not reasonably predict the total actual costs that may be incurred while drilling the wells and therefore could not reasonably predict the amount of its management fee.[186] The AFEs, however, were an excellent indicator of actual costs and therefore an accurate indicator of Regal Energy's sizeable management fee.[187] In fact, for Boonsville #2, the actual well cost of $4,815,475 was 91 percent of the AFE's estimated cost of $5,300,000.[188] For Waggoner #1, the actual well cost of $1,721,516 was 123 percent of the AFE's cost of $1,398,780.[189] The actual costs of the remaining three joint ventures were 91 to 100 percent of the estimates contained in the AFEs.[190]

"A fact is material if there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision."[191] In the case of an omission, materiality turns on whether the "disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[192] In other words, a misstated or omitted fact is material if a reasonable investor would have viewed the fact as having altered the "total mix" of information made available.[193] The "reasonable investor" standard is an objective one.[194]

---

[182] *Michael R. Euripides*, No. C9B950014, 1997 NASD Discip. LEXIS 45, at *16-17 (NBCC July 28, 1997).

[183] *Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 SEC LEXIS 334, at *33 (Feb. 20, 2007) (citing *SEC v. Druffner*, 353 F. Supp. 2d 141, 148 (D. Mass. 2005)); *see also SEC v. Fehn*, 97 F.3d 1276, 1290 n.12 (9th Cir. 1996) (stating that the federal securities laws impose a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading).

[184] Tr. 304, 306, 1614.

[185] JX-2, at 40; JX-3, at 17.

[186] JX-2, at 40; JX-3, at 17.

[187] Tr. 323 (Hardwick reaffirming his on-the-record testimony that AFEs have been fairly accurate predictors of actual cost).

[188] JX-11, at 3. Regal Energy received a management fee of $3,293,524 for Boonsville #2. JX-11, at 3.

[189] JX-11, at 3. Regal Energy received a management fee of $418,616 for Waggoner #1. JX-11, at 3.

[190] JX-11, at 3.

[191] *Donner Corp.*, 2007 SEC LEXIS 334, at *29. *See also Basic*, 485 U.S. 224, 231-32.

[192] *Basic*, 485 U.S. 224, 231-32.

[193] *See In re Time Warner, Inc. Sec. Litig.*, 9 F.3d 259, 267-68 (2d Cir. 1993); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[194] *TSC Indus.*, 426 U.S. 438, 445; *Robert Tretiak*, 56 S.E.C. 209, 222 (2003).

Respondents argue that the management fee is of minimal consequence because it is drawn from the proceeds of the offering, not from the revenues the joint venture generates. They argue that the management fee does not affect the investors' return on investment and is therefore not material. We do not agree. Even Hardwick believed them to be so relevant that he used them exclusively to price the offerings.[195] We find that a reasonable investor would find material information related to the amount of the venture's start-up capital that would go to Regal Energy rather than the joint venture's business.[196] A reasonable investor would find this information particularly material given that Regal Energy is so closely affiliated with Red River Securities, which benefitted indirectly from Regal Energy's sizeable management fees.[197]

We find that, by failing to include AFEs in the CIMs for Boonsville #2 and Waggoner #1, Red River Securities and Hardwick intentionally omitted material facts.

c. Respondents Misrepresented the Amount of Income Distributed to Investors in Other Regal Energy Joint Ventures

Cause one alleges that Respondents misrepresented in the Boonsville #2 CIM the amount of income distributed to investors in other Regal Energy joint ventures, including one joint venture involving an oil well described as a direct offset to the Boonsville #2 well. We find that information of this nature would be material to an investor and Respondents intentionally misrepresented it, as alleged.

In a section of the Boonsville #2 CIM that discussed Regal Energy's prior activities, the CIM boasted that the Boonsville #2 joint venture was the sixth joint venture in which Regal Energy had acted as managing venturer.[198] Although the CIM cautioned investors that prior performance may not be indicative of future results, it went on to tell potential investors the amount of the distributions that each other joint venture had paid to venturers.[199] The CIM represented, as of December 31, 2009, the following:

- Regal Nash #1 Joint Venture ("Nash #1") had been in production for 19 months with distributions to venturers of $435,851 and operating expenses of $202,130.

---

[195] Tr. 320 (Hardwick testifying that he determined the total turnkey price for the offering by doubling the AFE and deducting ten percent).

[196] *See Dist. Bus. Conduct Comm. No. 3 v. Prendergast*, No. C3A960033, 1999 NASD Discip. LEXIS 19, at *35 (NAC July 8, 1999) (holding that intended use of proceeds is material), *aff'd*, Exchange Act Release No. 44632, 2001 SEC LEXIS 2767 (Aug. 1, 2001).

[197] *Cf. Kevin D. Kunz*, 55 S.E.C. 551, 565 (2002) (finding that, when a broker-dealer has a self-interest, other than a standard commission, in serving the issuer, that interest could influence its recommendation and is therefore material); *Michael A. Niebuhr*, 52 S.E.C. 546, 552 (1995) (stating that a brokerage firm's personal interest in a recommended security is a material fact).

[198] JX-2, at 43.

[199] JX-2, at 43.

- Boonsville #1 had been in production for 14 months with distributions to venturers of $478,186 and operating expenses of $150,620.[200]
- Regal Nash #2 Joint Venture ("Nash #2") had been in production for 14 months with distributions to venturers of $212,204 and operating expenses of $133,308.
- Regal Bennett #1 Joint Venture ("Bennett #1") had been in production for eight months with distributions to venturers of $854,355 and operating expenses of $239,421.[201]

As written, these passages imply that investors in the joint venture offerings received the distribution amounts listed. Hardwick conceded that this was incorrect.[202] In fact, as of December 31, 2009, distributions to investors in Nash #1 were only $102,839, distributions to investors in Boonsville #1 were only $154,500, distributions to investors in Nash #2 were only $22,241, and distributions to investors in Bennett #1 were only $293,350.[203] Respondents contend that the term "venturer" (with a lower case "v") in the prior activities section of the CIM meant something other than "investors" or "unit holders." They urge us to consider the definition section in the Boonsville #2 CIM, which defined "Venturers" (with an upper case "V") as all unit holders.[204] Respondents argue that potential investors should have noticed the difference between upper case "V" versus lower case "v" and understood that the amount described as distributions was in reality the total revenue of the joint venture, not the amount distributed to the investors. We do not agree. We read the CIM as referring to (upper case) Venturers as the investors in the current offering (Boonsville #2), and (lower case) venturers as investors in other Regal offerings. We find Respondents' strained interpretation of their use of upper and lower case "v" to be nonsensical. We conclude that a potential investor would read the CIM as we do and reasonably assume that "distributions to venturers" were in fact distributions to investors.

The actual distributions to investors were between 10 percent and 34 percent of the amount represented in the Boonsville CIM. We find Respondents' misrepresentations to be material in that they led the reader to understand that Regal Energy's other oil and gas joint ventures, including one that was a direct offset to the Boonsville #2, were more lucrative for investors than they in fact were. This is exactly the type of information that a potential investor would factor into his consideration.[205] We find that Respondents misrepresented material facts in their presentation of Regal Energy's prior activities in the Boonsville #2 CIM.

---

[200] The CIM advised investors that Boonsville #2 would be "a direct offset to [Regal Energy's] already proven Regal Boonsville #1H, a horizontal well drilled laterally in the Barnett Shale." JX-2, at 81.

[201] JX-2, at 43.

[202] Ans. ¶ 41; Tr. 261, 270.

[203] Tr. 1399-1404; CX-50, at 32, 76, 101, 182.

[204] *See* JX-2, at 27.

[205] *See, e.g.*, *SEC v. Helms*, 2015 U.S. Dist. LEXIS 110758, at *12-13 (W.D. Tex. Aug. 21, 2015) (finding material misrepresentations by oil and gas royalty-interest sellers that they had prior experience with mineral companies); *Dep't of Enforcement v. Goritz*, No. C10000037, 2002 NASD Discip. LEXIS 7, at *14 (NAC Apr. 26, 2002)

d. Respondents Failed to Disclose Material Conflicts of Interest

Cause one alleges that Respondents failed to disclose a series of conflicts of interest related to Redlich and Nichols. Cause one alleges that Respondents failed to disclose (1) in the Waggoner #1 and Waggoner #2 CIMs that Regal Energy intended to purchase the land lease from related parties Redlich and Nichols; (2) in the Cosper #1 CIM conflicts of interest resulting from Redlich's and Nichols' ownership (through Tight Rock Consulting) of a low-producing well on the same pad as the Cosper #1 well; and (3) in the Waggoner #1, Waggoner #2, Cosper #1, Pierce #1, and Boonsville #2 CIMs, that a large percentage of each individual joint venture's costs would be paid to related parties Redlich and Nichols for drilling, testing, and completion of the wells. We find that Respondents intentionally omitted these material facts, as alleged.

In December 2009, one month before Hardwick named Redlich Chief Operating Officer of Regal Operating, Tight Rock entered into an agreement with Regal Operating to provide drilling services to Regal Operating for several joint ventures at issue in this case.[206] Throughout 2010 and 2011, Tight Rock billed Regal Operating for geological origination fees for several of the relevant joint venture wells.[207]

Although Respondents deny that Redlich was in fact an officer of Regal Energy or Regal Operating, Regal Operating issued a press release on January 25, 2010, in which it identified Redlich as an officer.[208] One year later, on February 28, 2011, Redlich signed a letter to Hardwick as the chief operations officer of Regal Operating.[209] In January 2012, Redlich signed legal documents on behalf of, and as chief operations officer of, Regal Operating.[210] Redlich prepared AFEs for various joint ventures in which he signed as chief operating officer of Regal Operating.[211] Redlich held himself out to the public, including potential Regal joint venture investors, as an officer of the Regal Entities.[212] Redlich and Nichols also received significant sums of money from the Regal Entities for prospecting, drilling, and other services related to the joint ventures.[213]

(finding material representations in a limited partnership offering memorandum that general partner had relevant experience in capital formation).

[206] JX-13.

[207] CX-105.

[208] Tr. 86-87; CX-33.

[209] Tr. 87-88; CX-57.

[210] Tr. 90-92; CX-98.

[211] Tr. 89; CX-57.

[212] Tr. 89.

[213] *See* Tr. 1625-1630 (Redlich's testimony regarding Regal Energy payments to Redlich, Nichols, or a related entity of $30,000, $116,514, $50,000, $217,000, $100,000, $110,000, $110,000, and $220,000); Tr. 1641 (Redlich's testimony that he prepared the AFEs (which built in payments to Redlich and his companies) for the Regal joint ventures); JX-13 (December 2009 agreement whereby Tight Rock agreed to provide drilling services to Regal Operating for some of the joint ventures at issue in this case); CX-101 (assignment of wellbore from Redlich and

In October 2009, Redlich conveyed his interest in the Waggoner lease (for Waggoner #1 and Waggoner #2) to Regal Energy for $393,120.[214] Hardwick admitted during his testimony that the Waggoner #1 and Waggoner #2 CIMs did not disclose that Regal Energy paid Redlich $393,120 for the Waggoner lease, notwithstanding that he and his affiliates were insiders to the Regal Entities.[215]

In September 2011, Redlich and Nichols assigned to Regal Energy a lease involving the Cosper-Whitehorn #1 well, a well related to Tree Operating (which Redlich and Nichols owned) and is not at issue in this case.[216] Regal Energy paid Redlich and Nichols $220,000 for drilling rights on this land.[217] The Cosper-Whitehorn #1 well and the Cosper #1 well were on the same pad, approximately 15 feet apart from one another, and The Cosper-Whitehorn #1 was not a good producer.[218] Hardwick admitted that he did not disclose in the Cosper #1 CIM that Redlich and Nichols had conveyed the Cosper lease to Regal Energy.[219] Redlich testified that Hardwick never even asked him how much he and Nichols originally paid for the lease.[220] Respondents nonetheless paid Redlich and Nichols for the lease and passed that cost on to the joint venture. Respondents also did not disclose in the Cosper #1 CIM that the nearby Cosper-Whitehorn #1 well that Redlich and Nichols had previously drilled was not a high-producing well.[221]

In the five joint ventures at issue, Redlich and Nichols prepared AFEs for Regal Energy (which Regal Energy used to price the offerings), advised Hardwick about drilling and completion of wells, and provided drilling and completion services to Regal Energy, all for substantial sums of money.[222] The AFEs they prepared built in a "geological origination" fee that the joint ventures paid directly to Tight Rock, Redlich's company.[223] And Regal Energy relied on Redlich to recommend the completion of each

---

Nichols to Regal Energy); CX-104, at 2, 7, 9, 11, 13, 19, 20 (list of Regal energy lease payments, several of which are payable to Nichols, Redlich, or Triad); CX-105 (Regal Energy payments of geological origination fees to Tight Rock); CX-196 (payments from Boonsville #2 to North Texas and Triad, both affiliated with Redlich and Nichols).

[214] JX-14; CX-104, at 13-17.

[215] Tr. 347.

[216] Tr. 1464-1466; CX-100; CX-101; CX-104, at 19-20.

[217] CX-104, at 19-20.

[218] Tr. 918-922, 1464-1465; CX-100.

[219] Tr. 348-349.

[220] Tr. 1662.

[221] Tr. 918-922.

[222] *See* note 213, *supra*.

[223] Tr. 1642-1643; JX-12. For example, for Boonsville #2, the joint venture paid a total geological origination fee of $480,000. JX-12, at 1-2. For Waggoner #1 and Waggoner #2, the joint ventures paid $116,565 each. JX-12, at 3-4.

joint venture's well.[224] Redlich had a strong incentive to encourage Regal Energy to form joint ventures and drill for oil and gas and to recommend completion. None of these conflicts was explained in any of the five CIMs at issue.

The CIMs all contained similar conflicts sections.[225] The disclosures are general in nature and address the conflicts caused by the affiliation between Hardwick, Red River Securities, Regal Energy, Regal Operating, and the ventures. They indicate that contracts between the venture and Regal Energy may not be the result of an arm's length negotiation and that Red River Securities' due diligence may not be as extensive and thorough as that of a third-party broker-dealer. The disclosures do not, however, address the myriad conflicts that resulted from Regal Energy's interrelationship with Redlich, Nichols, and their many companies. We find that disclosures of this nature, related to hidden conflicts of interest that drain money from the ventures, would be material to a reasonable investor.[226]

We find that Respondents failed to disclose material conflicts of interest related to Redlich and Nichols, as alleged in cause one.

e. Respondents Failed to Disclose that a Well Was a "Wildcat"

Cause one alleges that the Pierce #1 well was an exploratory well drilled in a formation that did not have concrete historic production records—a well described by the reviewing geologist and seller of the lease as a "wildcat well." Cause one alleges that the "wildcat" status of the well presented a significant risk that Respondents failed to disclose in the Pierce #1 CIM. The evidence establishes that "wildcat" is an industry term used to describe an exploratory well in an area that does not have historic production; the reviewing geologist stated the Pierce #1 well was a wildcat well; and Respondents knew and failed to disclose this material fact in the CIM.

The Pierce #1 joint venture was a single well offering outside of the Barnett Shale.[227] On February 29, 2012, Regal Energy paid geologist Scott Heape ("Heape"), through SBHL Management, Inc. ("SBHL"), $515,625 for a lease for the Pierce #1 well.[228] On that same day, SBHL had purchased the lease.[229] Also on that day, Heape met with Roberts, Red River

[224] Tr. 1639-1640.

[225] *See*, *e.g.*, JX-2, at 19-20.

[226] *See William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *16-17 (Mar. 31, 2016) ("Investors 'must be permitted to evaluate overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest.'") (citations omitted); *cf. Richard H. Morrow*, 53 S.E.C. 772, 781 (1998) (stating that a securities professional must not only avoid affirmative misstatements but also must disclose material adverse facts).

[227] Tr. 290.

[228] Tr. 349; CX-109.

[229] CX-108. The amount listed on the lease assignment states that SBHL paid consideration of $100. Hardwick testified that all such assignments list $100 as consideration to keep the actual amount confidential. Tr. 352-353.

Securities' chief compliance officer, Hardwick, and Redlich.[230] During that meeting, Heape, the seller of the lease and a licensed geologist, described the Pierce #1 well as a wildcat, a term that Hardwick admitted has come to be synonymous with risk.[231] Hardwick also had at one time characterized the Pierce #1 well as a "10,000-foot-deep wildcat in the middle of nowhere."[232] Krehel, Respondents' expert, testified that a wildcat well is an exploratory well about which the subsurface geology and pressure regime are not known.[233] A commonly used oil industry glossary defines "wildcat" as "an exploration well" and states "little if anything about the subsurface geology is known with certainty, especially the pressure regime."[234] Enforcement's expert, Reineke, testified that a wildcat well is a well drilled in an area where there is no production from the ground formation that the well intends to penetrate.[235] Reineke stated that a wildcat well is riskier than a well in an area of known production or an offset to a producing well.[236] We do not find the experts' descriptions to be contradictory. We credit both and conclude that the significance of the term "wildcat" in relation to oil and gas exploration is an increased risk associated with the well. Hardwick admits that the CIM he prepared for Pierce #1 did not use the term "wildcat" to describe the well.[237]

We find Respondents' decision to omit from the CIM that the Pierce #1 well was a wildcat well to be a material omission. The Pierce #1 joint venture depended on the success of one well. That well carried risk in addition to the usual risk that one would expect with any oil or gas venture. An investor who hopes to get returns from production would want to know about this increased risk before investing. The reviewing geologist, Hardwick, and two experts agreed the well was a wildcat well, and the evidence supports the conclusion that the term "wildcat" denotes a well that carries an increased risk of not producing. We find that information of this nature would be material to a reasonable investor considering the Pierce #1 joint venture.[238]

---

[230] Tr. 298-299.

[231] Tr. 299-300; CX-107.

[232] Tr. 303-304. Hardwick argued that the term "wildcat" is used for obtaining a drilling permit and it is therefore not significant to investors. Tr. 291; CX-214. We are not persuaded that Hardwick's disclosure on the drilling permit that the well was a wildcat well should somehow relieve Respondents of the need to disclose this fact to investors.

[233] Tr. 1695-1696; 1702-1703.

[234] CX-213. The definition continues, "this higher degree of uncertainty necessitates that the drilling crews be appropriately skilled, experienced and aware of what various well parameters are telling them about the formations they drill." CX-213.

[235] Tr. 894. Reineke testified, "so if you are drilling in a geological prospective area where you think there's some hydrocarbons but there's not any proven developed production out of that common source of supply, then it would be a wildcat." Tr. 894.

[236] Tr. 894. *See IP Petroleum Co., Inc.*, 116 S.W.3d 888, 892, 2003 Tex. App. LEXIS 8043, at *4 (Sept. 11, 2003) (defining "wildcat" well as "'a speculative well that does not offer a reasonable expectation of profit to a reasonably prudent operator under the same or similar facts and circumstances'") (citations omitted).

[237] Tr. 300.

[238] *See SEC v. Hasho*, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992) (finding that the failure to disclose risk factors is a material omission); *Alvin W. Gebhart*, 58 S.E.C. 1133, 1170 (2006) (finding that misrepresentations and omissions that bore directly on the level of risk involved with an investment were material), *aff'd in part and remanded on*

We hold that Respondents intentionally omitted the material fact that the Pierce #1 well was a "wildcat" well from the Pierce #1 CIM.

f. Respondents Failed to Disclose that Hardwick Prepared a Report They Attributed to an Independent Geologist

Cause one alleges that the "independent" geologist reports Respondents included in the CIMs for Boonsville #2, Waggoner #1, Waggoner #2, and Cosper #1 were prepared by Hardwick, not Tobin Andrews ("Andrews"), the geologist who signed the reports. Cause one alleges that, by not disclosing this fact, Respondents omitted material information. We agree that this information is material and should have been disclosed. Oil and gas joint ventures, by their very nature, depend largely on whether a trained geologist determines that oil and gas production is possible in the area. We find that Respondents intentionally chose not to disclose Hardwick's involvement in drafting the geologist's reports.

The CIMs for each of the four joint ventures included a document titled "Geological Review."[239] The Geological Reviews indicate that Andrews, a trained petroleum geologist licensed by the state of Texas, prepared them and they contain his signature and official seal.[240] In reality, Hardwick, not Andrews, prepared the first draft of the Geological Reviews.[241] Andrews reviewed the drafts and within days returned them with slight modifications and a bill for $500.[242]

Hardwick admits he is not a trained geologist.[243] That did not stop him, however, from making significant changes to the geologist reports after Andrews returned them to him.[244] Respondents argue that the changes were not relevant. Hardwick testified, "I would think that any material change after [Andrews submits the final report] – [Andrews would] need to be informed, but typos, I think, would be an exception."[245] But Hardwick's changes well exceed

---

other grounds, 255 F. App'x 254 (9th Cir. Nov. 21, 2007). Hardwick testified that the Pierce #1 CIM also failed to disclose that the joint venture bought the lease from Heape. Tr. 355. Given that Heape was the reviewing geologist who recommended the land for drilling, we find this omission to be material as well.

239 JX-2, at 81; JX-3, at 68; JX-4, at 60; JX-5, at 61.

240 JX-2, at 81-86; JX-3, at 68-72; JX-4, at 60-66; JX-5, at 61-68.

241 Tr. 328; CX-88; CX-90; CX-93; CX-95. Hardwick testified that he used a template. We do not find Hardwick's testimony that he used a template persuasive, given that Respondents did not produce any such template. Rather, based on Hardwick's testimony, it appears he used past geological reviews that Andrews previously prepared for other Regal Energy joint ventures and changed some of the descriptions of the land. In fact, one of the drafts Hardwick sent to Andrews already included Andrews' signature and official stamp. Tr. 334; CX-90.

242 Tr. 335; CX-89 (Andrews' edits returned to Hardwick within three days and accompanied by a $500 invoice); CX-92 (Andrews' edits returned to Hardwick within five days and accompanied by a $500 invoice); CX-94 (Andrews' edits returned to Hardwick within one day and accompanied by a $500 invoice); CX-96 (Andrews' edits returned to Hardwick within one day and accompanied by a $500 invoice).

243 Tr. 326.

244 Tr. 331-333, 336-338, 339-344.

245 Tr. 331.

anything that can be described as correcting typographical errors. In the CIM for Boonsville #2, he changed the numbers for the distributions paid to investors and operating expenses incurred for an offset well.[246] In the CIM for Waggoner #1, he changed the reported thickness of the Barnett Shale formation in the area to be drilled and deleted the statement that the joint venture could save money by using a water disposal well in the area in lieu of paying to remove excess fluid.[247] In the Waggoner #2 CIM, Hardwick added a chart that listed the most recent production figures, as posted by the state of Texas, for wells within a five-mile radius of the Waggoner #2 well.[248] In the Cosper #1 CIM, Hardwick added research conducted by another group to demonstrate the production potential of the region in which the Cosper #1 well would be drilled.[249]

We find that Respondents' failure to disclose to investors Hardwick's participation in drafting and editing geological reports, purportedly the work of a state-licensed petroleum geologist, was a material omission. To be material, there must be a substantial likelihood that disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available.[250] We find that, when the investment involves oil and gas drilling, a geologist's report generally is a central part of the information mix. Also, a reasonable investor would want to know that Hardwick, an individual who personally and through his businesses stood to earn significant sums of money from the joint venture, prepared the first draft of the geologist's report, even though he is not a trained geologist, and that he made additions and revisions to the trained geologist's signed report without the geologist's knowledge.[251] We conclude that Respondents intentionally made material omissions by hiding these facts.

2. Respondents Acted with Scienter

Respondents acted with scienter when they misrepresented and omitted material facts in the CIMs for Boonsville #1, Waggoner #1, Waggoner #2, Cosper #1, and Pierce #1. The Supreme Court has defined scienter as the "intent to deceive, manipulate or defraud."[252] Scienter

---

[246] Tr. 331-333; CX-89, at 4; JX-2, at 83.

[247] Tr. 336-338; CX-92, at 4; JX-3, at 69.

[248] Tr. 339-341; CX-94, at 5; JX-4, at 62. The initial draft that Hardwick sent to Andrews included the introductory paragraph for the chart, but did not include the actual chart, which covered four pages and included information about numerous wells. JX-4, at 62-65.

[249] Tr. 341-344; CX-95, at 5; JX-4, at 63-66. The initial draft that Hardwick sent to Andrews included introductory language regarding research, but did not include four pages of charts and graphs that Hardwick added after the fact. JX-4, at 62-65.

[250] *Basic*, 485 U.S. 224, 231-32.

[251] *See George v. Blue Diamond Petroleum, Inc.*, 718 F. Supp. 539, 547-48 (W.D. La. July 10, 1989) (finding material fact that promoter prepared geological information contained in offering circular).

[252] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

may be established by a showing that the respondent acted intentionally or recklessly.[253] In the case of a material omission, "scienter is satisfied where, [as here,] the [respondent] had actual knowledge of the material information."[254] Recklessness has been defined as being "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 to the defendant or is so obvious that the actor must have been aware of it."[255]

We find that Respondents intentionally or recklessly endeavored to mislead average investors. Hardwick priced every offering himself. He relied on the AFEs to determine the total turnkey price. Yet, instead of including the AFEs in the CIMs for Boonsville #2 and Waggoner #1, he stated that Regal Energy could not reasonably predict its management fee. He asks us to believe he did not include the AFEs because they were mere estimates, yet he considered them reliable enough to use to price the offering. Indeed, he knew that most of the AFEs were 90 to 100 percent reliable indicators of cost. On the Boonsville #2 offering alone, Regal Energy collected a management fee well in excess of $3 million. We find that Respondents intentionally, or at a minimum recklessly, excluded the AFEs to conceal Regal Energy's potential (and considerable) management fees from potential investors.

Hardwick also knew the amount of the actual distributions that Nash #1, Boonsville #1, Nash #2, and Bennett #1 made to their investors, yet in the Boonsville #2 CIM he twisted words and relied on the use of "venturers" instead of "Venturers" to falsely inflate the actual distribution figures. We do not find credible Hardwick's suggestion that he believed potential investors would understand the difference because of the upper case/lower case use of the letter "v" explained in the Definitions section of the 176-page CIM. In our view, Hardwick's tortured explanation of the meaning of the word "venturer" deserves little weight. Hardwick had actual knowledge of the accurate information, but chose to conceal it. This is the definition of scienter.[256]

Hardwick also intentionally hid significant conflicts of interest from investors. Redlich, Nichols, and Hardwick were so intertwined that their business interests fed off each other. Redlich and Nichols benefitted substantially from Respondents' joint venture sales. They received lease payments, remuneration for prospecting, and money for drilling, testing, and completing the wells. Hardwick's idea of adequate disclosure was to include a generic conflicts section. "[A] broker's written disclosures do not work to insulate him from disciplinary claims

---

[253] *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008).

[254] *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 239 (3d Cir. 2004).

[255] *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990); *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977); *see also SEC v. Falstaff Brewing Co.*, 629 F.2d 62 (D.C. Cir. 1980) (knowledge of what one is doing, not legal definition, is sufficient to demonstrate scienter).

[256] *See Kenneth R. Ward*, 56 S.E.C. 236, 259 (2003) (finding scienter established when respondent was aware of material information and failed to disclose it to customers).

for fraud."[257] This is so particularly where, as here, the supposed disclosure is general and buried in hundreds of pages of materials. We find that Hardwick's failure to disclose Redlich's and Nichols' numerous conflicts of interest was intentional or, at a minimum, reckless.

We also find that Hardwick intentionally hid the wildcat aspect of the Pierce #1 well. There is no dispute Hardwick was aware that Heape classified it as such, and he admittedly described it as a wildcat well on the well permit. We did not find credible any of Hardwick's explanations for his actions. Investors were entitled to know that Heape, the licensed geologist and individual who sold the drilling lease to Regal Energy, described the well as a wildcat and that, on the drilling permit, Hardwick identified the well as a wildcat. Hardwick's decision to hide this information was nothing less than intentional.[258]

Hardwick similarly concealed from potential investors that he drafted the geologist reports and made unauthorized revisions to them after the geologist signed off. Hardwick did all of this even though he is not a trained and licensed geologist. Respondents included geologist reports signed and stamped by a licensed geologist in the CIMs because they knew that the reports would provide credibility to the offerings. Hardwick's decision to conceal that he, not the geologist, actually wrote and revised the reports is evidence of fraudulent intent.

"Since it is impossible to probe into the depths of a man's mind, a finding of fraudulent intent, absent an admission, must be based on inferences drawn from the evidence."[259] The record in this case is rife with evidence of intent. For example, Red River Securities' chief compliance officer, Roberts, testified that she advised Hardwick against including in Red River Securities' marketing materials the statement, "In addition to FINRA membership, Red River Securities is a member of Securities Investor Protection Corporation (SIPC)."[260] Roberts testified that she advised Hardwick that SIPC did not apply to the products that Red River Securities offered and that he should remove the statement.[261] He ignored her and left it in anyway. Hardwick also authored a memo to Roberts suggesting that registered representatives at the firm should be making 2000 "dials" per week or 400 per day.[262] These are not the actions of an individual or a firm that is interested in looking out for investors. Hardwick exhibited a cavalier attitude towards full disclosure and honesty. He intentionally misled investors and established a culture of high-pressure sales at Red River Securities.

---

[257] *Dep't of Enforcement v. Brookstone Sec., Inc.*, No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *81 (NAC Apr. 16, 2015).

[258] *See Dep't of Mkt Regulation v. Field*, No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *33 (NAC Sept. 23, 2008) (finding scienter where respondent had extensive knowledge about the securities, but nonetheless omitted key facts while recommending and selling them).

[259] *Lawrence H. Ripp*, 46 S.E.C. 771, 773 (1977) (citing *Gates v. U.S.*, 122 F.2d 571, 575 (C.A. 10 1941)).

[260] Tr. 738-739; CX-33, at 3.

[261] Tr. 738-739; CX-33, at 3.

[262] Tr. 138-139; CX-205.

The evidence demonstrates that Respondents acted intentionally or, at a minimum recklessly, when they misrepresented and omitted material facts in the CIMs they used to sell interests in Boonsville #2, Waggoner #1, Waggoner #2, Cosper #1, and Pierce #1.

C. Unregistered Distribution of Securities

Cause four of the Complaint alleges that Respondents violated FINRA Rule 2010 by contravening Section 5 of the Securities Act, which prohibits sales of unregistered securities. Cause four alleges that the securities offered through the Boonsville #2 and Cosper #1 offerings were unregistered and, as such, Respondents could sell them only in accordance with an exemption from registration that prohibited general solicitation. Cause four alleges that Respondents nonetheless engaged in a general solicitation and sold Boonsville #2 and Cosper #1 to 15 customers with whom the firm did not have a pre-existing relationship and who the firm contacted by cold call, in violation of FINRA Rule 2010. We do not find that Enforcement carried its burden of proof as to cause four and therefore dismiss this cause.

The Boonsville #2 offering occurred between January 2010 and December 2011. The Cosper #1 offering occurred between September 2011 and January 2013. Thus, we consider the law applicable to the registration of securities as it read between January 2010 and January 2013. Section 5 of the Securities Act prohibits any person from offering or selling securities unless a registration statement is filed or in effect with the Commission or an exemption from registration is available.[263] A prima facie case of a Section 5 violation requires a showing that "(1) the defendant directly or indirectly sold or offered to sell securities; (2) through the use of interstate transportation or communication and the mails; (3) when no registration statement was in effect."[264] Once a prima facie case is established, the burden shifts to the person relying on an exemption to establish its availability.[265] A violation of Section 5 of the Securities Act constitutes a violation of FINRA Rule 2010.[266]

There is no dispute that the Boonsville #2 and Cosper #1 offerings were not registered. Securities Act Rules 501 through 508 provide exemptions from registration for small, private offerings. Respondents contend that their sales qualify for an exemption under Rule 506, which is a safe harbor exemption under Regulation D.[267] Under Rule 506, an issuer may sell its securities to an unlimited number of "accredited investors"[268] and up to 35 unaccredited

---

[263] 15 U.S.C § 77e.

[264] *ACAP Fin., Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28-29 (July 26, 2013), *aff'd*, 783 F.3d 763 (10th Cir. 2015). *See also Dep't of Enforcement v.* (NAC Sept. 25, 2015).

[265] *Ahmed*, 2015 FINRA Discip. LEXIS 45, at *93.

[266] *Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63.

[267] *Ahmed*, 2015 FINRA Discip. LEXIS 45, at *94.

[268] Rule 501 defines "accredited investors to include any person whose net worth or joint net worth with a spouse exceeds $1 million and any individual whose income exceeds $200,000 in each of the two most recent years or joint income with that person's spouse exceeds $300,000 in each of the two most recent years. 17 C.F.R. § 230.501(a).

investors who are also sophisticated.[269] To qualify for an exemption under Rule 506, an offering must also meet the general conditions set forth in Rule 502, "including refraining from general solicitation or advertising."[270]

Enforcement alleges in cause four that, with respect to 15 investors (10 in Boonsville #2 and 5 in Cosper #1), Respondents engaged in a general solicitation.[271] "[T]he [Commission] has issued a no-action letter recognizing that offers to clients obtained through general solicitation do not constitute general solicitation so long as 'sufficient time' passes 'between establishment of the relationship and [the] offer."[272] The Commission subsequently provided additional no-action guidance suggesting that, in the case of semi-continuous offerings, if the issuer waits for 30 days following its initial contact and qualification of an investor to offer an investment, the solicitation may not constitute a general solicitation.[273]

Roberts testified that Red River Securities conducted a suitability determination after each initial telephone contact and before offering materials were mailed to the customer.[274] She also testified that, as a policy, the firm waited 30 days after initial contact to offer potential investors specific securities.[275] Of the ten Boonsville #2 investors identified in the Complaint, two appear to have been pre-existing customers, so we do not find they were solicited by way of general solicitation.[276] Of the remaining eight Boonsville #2 investors, seven were initially contacted by a representative of Red River Securities 30 to 50 days prior to the firm's mailing of the CIM, one was contacted 21 days prior to the firm's mailing of the CIM, and all eight invested one or more months after initial contact.[277] All five of the Cosper #1 investors were first contacted by Red River Securities months prior to the firm's mailing of the Cosper #1 CIM.[278] We find that Red River Securities allowed sufficient time to pass between initial contact and solicitation, and that they did not engage in a general solicitation.

Enforcement argues that, because the initial contact between Red River Securities and these 15 customers occurred when the Boonsville #2 and Cosper #1 offerings were already

---

[269] 17 C.F.R. § 230.506(b).

[270] *SEC v. Schooler*, 2015 U.S. Dist. LEXIS 44338, at *7 (S.D. Cal. Apr. 3, 2015); 17 C.F.R. § 230.502.

[271] The evidence indicates that each of the 15 investors were accredited in that they each reported net worth of $1 million or more. CX-110; CX-112.

[272] *Schooler*, 2015 U.S. Dist. LEXIS 44338, at *14 (citations omitted); *see also E.F. Hutton & Co.*, No-Action Letter, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985).

[273] *LampTech., Inc.*, No-Action Letter, 1997 SEC No-Act LEXIS 638 (May 29, 1997).

[274] Tr. 657, 673-689.

[275] Tr. 695. Generally, we found Roberts' testimony to be credible and supported by documentary evidence.

[276] CX-110, at 13-14, 21.

[277] CX-110, at 1-12, 15-19, 22-24.

[278] CX-112.

active, we should consider the initial contact as the offer.[279] We decline to follow Enforcement's reasoning given the continuing and overlapping nature of Red River Securities' many offerings during the period that Red River Securities contacted the 15 customers (March 2010 through March 2012).[280] For the reasons discussed, we dismiss the allegations of cause four of the Complaint.

D. Suitability

Cause five of the Complaint alleges that principals at Red River Securities, supervised by Hardwick, determined the suitability of investors in the five offerings at issue without having complete information and, as such, approved 15 investors who were not in fact suitable, in violation of NASD Rule 2310 (for sales prior to July 9, 2012), FINRA Rule 2111 (for sales on or after July 9, 2012), and FINRA Rule 2010. As discussed in more detail below, we dismiss cause five as to Hardwick. We dismiss the allegations of cause five as to all but two customers with respect to Red River Securities. As to two customers (JM and FB), we find that Red River Securities approved the sales of unsuitable investments.

NASD Rule 2310(a)[281] provided that, in recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable based upon the facts disclosed by the customer as to his other security holdings, financial situation, and needs. NASD Rule 2310(b) provided that, before executing a transaction, a member shall make reasonable efforts to obtain information related to (1) the customer's financial situation; (2) the customer's tax status; (3) the customer's investment objectives; and (4) other information considered to be reasonable in making recommendations. IM-2310-2(b)(5) stated that recommending the purchase of a security in amounts that are inconsistent with the reasonable expectation that the customer has the financial ability to meet the commitment has been found unsuitable. FINRA Rule 2111 states that a member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for the customer, based on the information obtained through reasonable diligence and the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation. "A broker's recommendations must be consistent with his customer's best interests, and he or she must

---

[279] Enforcement cites *Bateman Eichler, Hill Richards, Inc.*, SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985); FINRA NTM 05-18, at 6 (Mar. 2005), http://www.finra.org/sites/default/files/NoticeDocument/p013455.pdf.

[280] *See* CX-195 (showing the dates during which Red River Securities offered the five joint ventures at issue).

[281] Effective July 9, 2012, FINRA Rule 2111 superseded NASD Rule 2310, IM-2310-2, and IM-2310-3.

abstain from making recommendations that are inconsistent with the customer's financial situation."[282]

We reviewed the information Red River Securities maintained for each of the 15 customers identified in the Complaint. Customers AG & MG invested $9,937 in Boonsville #2 on July 1, 2010.[283] The firm recorded their liquidity at $15,000, but showed that they had been in real estate for 37 years, had a net worth in excess of $1 million, owned multi-family residential and commercial real estate, were 63 years old, and earned an income of $80,000 per year.[284] AG & MG's objective was to generate income.[285] Enforcement argues that, given this liquidity level, the investment was not suitable. We disagree. This investment was not particularly large (they purchased .125 of one unit), and they invested in only one joint venture. We do not find that Enforcement met its burden to prove that this investment was not suitable, and we dismiss cause five as to customers AG & MG.

Enforcement argues that AR's purchases were not suitable because his liquidity was $20,000. Enforcement alleges that AR was not suitable to invest $10,490.85 in Waggoner #1 on November 19, 2010; $20,981.70 in Waggoner #2 on March 14, 2011; and $9,937.50 in Boonsville #2 on August 11, 2011.[286] AR had owned a computer software company for 30 years, was 63 years old, earned $200,000 per year, and had a net worth of $1.2 million.[287] His investment objective was income.[288] Although he invested more than $40,000 in three joint ventures, given the other information available, we do not find that Enforcement met its burden of proof, and we dismiss cause five as to AR.

Enforcement alleges that customer DA was not suitable to invest $19,875 in Boonsville #2 on January 28, 2010, and $10,490.85 in Waggoner #1 on November 22, 2010. He was 80 years old and had been a doctor.[289] His net worth was $1 million, his annual income was $100,000, and his liquidity was $20,000.[290] His investment objective was income.[291] Enforcement argues that DA was not suitable in light of his age and liquidity. We disagree. Given his substantial net worth and income level, his age and liquidity are not sufficient to persuade us that he was not suitable. We find that Enforcement failed to meet its burden of proof and dismiss cause five as to DA.

---

[282] *Dane S. Faber*, 57 S.E.C. 297, 310 (2004) (citations omitted).

[283] CX-116, at 1-2.

[284] CX-116, at 1-2.

[285] CX-116, at 1-2.

[286] CX-116, at 3-5.

[287] CX-116, at 3-5.

[288] CX-116, at 3-5.

[289] CX-116, at 6-8.

[290] CX-116, at 6-8.

[291] CX-116, at 6-8.

Customer ED was 84 years old.[292] For 60 years, he owned an HVAC company, had a net worth of $1.2 million, an income of $200,000 per year, and liquidity of $20,000.[293] ED invested $39,750 in Boonsville #2 on March 19, 2010; $10,490.85 in Waggoner #1 on November 23, 2010; and $10,490.85 in Waggoner #2 on March 31, 2011.[294] His investment objective was income.[295] Enforcement argues that ED was not suitable in light of his age and liquidity. We disagree. Given his substantial net worth and income level, his age and liquidity are not sufficient to persuade us that he was not suitable. We find that Enforcement failed to meet its burden of proof and dismiss cause five as to ED.

Enforcement argues that EV's purchases were not suitable because his liquidity was $30,000. EV invested $19,875 in Boonsville #2 on March 8, 2011, and $14,606.77 in Cosper #1 on December 21, 2011.[296] He was 54 years old, spent 30 years in trailer sales and repairs, had a net worth of $4 million, and a yearly income of $300,000.[297] His investment objectives were growth and income.[298] Given his income and net worth, as compared to the size of his investments, we do not find that Enforcement met its burden of proof, and we dismiss cause five as to EV.

Customer JH was 83 years old.[299] For 50 years, he worked in wholesale jewelry and real estate.[300] He had a net worth of $1 million, liquidity of $1 million, and a yearly income of $1 million.[301] JH invested $39,750 in Boonsville #2 on January 25, 2010, and $10,490.85 in Waggoner #2 on April 18, 2011.[302] His investment objective was income.[303] Enforcement argues that JH was not suitable in light of his age. We do not agree. Given his substantial net worth, income level, and liquidity, his age is not sufficient to persuade us that he was not suitable. We find that Enforcement failed to meet its burden of proof and dismiss cause five as to JH.

Customer JI was 78 years old.[304] For 25 years, he owned and operated a door and window manufacturing business, had a net worth of $1.1 million, an income of $50,000 per year, and

---

[292] CX-116, at 9-11.

[293] CX-116, at 9-11.

[294] CX-116, at 9-11.

[295] CX-116, at 9-11.

[296] CX-116, at 12-13.

[297] CX-116, at 12-13.

[298] CX-116, at 12-13.

[299] CX-116, at 17-18.

[300] CX-116, at 17-18.

[301] CX-116, at 17-18.

[302] CX-116, at 17-18.

[303] CX-116, at 17-18.

[304] CX-116, at 19-21.

liquidity of $20,000.[305] Red River Securities' notes indicated that he chose not to take additional income from his business.[306] Enforcement alleges that JI was not suitable to invest $39,750 in Boonsville #2 on August 25, 2010; $10,490.85 in Waggoner #1 on November 24, 2010; and $31,472.55 in Waggoner #2 on March 10, 2011.[307] His investment objective was income.[308] In June 2011, Roberts marked JI's file as unsuitable for additional investments.[309] Enforcement argues that JI was not suitable in light of his income and liquidity and because his tax bracket was not disclosed. We have considered Enforcement's arguments. Although JI invested heavily in Regal joint ventures, he did so over the course of two years. His prior investment experience included oil and gas ventures, and Roberts intervened to preclude additional sales. Given his substantial net worth and ongoing business activities, we are not persuaded that he was not suitable. We find that Enforcement failed to meet its burden of proof and dismiss cause five as to JI.

Enforcement alleges that customer JP was not suitable to invest $9,937.50 in Boonsville #2 on July 29, 2011, and $15,050.39 in Pierce #1 on July 29, 2013.[310] He was 82 years old and owned 14 radio stations.[311] His net worth was $10 million, his yearly income was $500,000, and his liquidity was $1 million.[312] Enforcement argues that JP was not suitable in light of his age. We do not agree. Given his substantial net worth, liquidity, and income level, his age is not sufficient to persuade us that he was not suitable. We find that Enforcement failed to meet its burden of proof and dismiss cause five as to JP.

Enforcement argues that WP's purchases were not suitable because he was 83 years old. Enforcement contends that WP was not suitable to invest $7,303.39 in Cosper #1 on May 9, 2012, and $15,050.39 in Pierce #1 on May 17, 2013.[313] WP was a retired banker.[314] He had a net worth of $2 million, a yearly income of $50,000, and liquidity of $100,000.[315] His investment objective was income.[316] Given his income, net worth, and liquidity, and considering the size of his investments, we do not find that Enforcement met its burden of proof, and we dismiss cause five as to WP.

---

[305] CX-116, at 19-21.

[306] CX-116, at 19-21.

[307] CX-116, at 19-21.

[308] CX-116, at 19-21.

[309] CX-116, at 19-21.

[310] CX-116, at 22.

[311] CX-116, at 22.

[312] CX-116, at 22.

[313] CX-116, at 23-24.

[314] CX-116, at 23-24.

[315] CX-116, at 23-24.

[316] CX-116, at 23-24.

Customer RS invested $168,937 in Boonsville #2 on June 9, 2010.[317] The firm's records were missing RS's income figure, but indicated that he had confirmed with a principal that he was in a 35 percent tax bracket.[318] RS had a net worth of $2 million, liquidity of $300,000, and owned a construction company.[319] He was 74 years old and his investment objective was to generate income.[320] Enforcement argues that, given that the firm did not have RS's income, it could not find him suitable. We considered the other information available and find that his net worth and liquidity, coupled with his confirmed tax bracket, is sufficient for us to find RS suitable. We do not find that Enforcement met its burden of proof, and we dismiss cause five as to customer RS.

Enforcement argues that SB's purchase of .125 units of Boonsville #2 for $9,937.50 was not suitable because his liquidity was $20,000. SB invested in Boonsville #2 on August 3, 2011.[321] SB was a retired general contractor.[322] He was 71 years old and had a net worth of $3.5 million, liquidity of $20,000, and income of $70,000.[323] His investment objective was income.[324] Given SB's income and net worth, we do not find an investment of this size to be unsuitable. We do not find that Enforcement met its burden of proof, and we dismiss cause five as to SB.

Enforcement argues that JE's four joint venture investments were not suitable given his age (83 years) and lack of liquidity. JE purchased 2.375 units of Boonsville #2 for $188,812.50 on May 19, 2010; one unit of Waggoner #1 for $83,926.80 on July 22, 2010; .625 units of Waggoner #2 for $41,963.40 on March 15, 2011; and .50 unit of Cosper #1 for $29,213.55 on December 15, 2011.[325] JE was a semi-retired oil and gas attorney who was 83 years old.[326] His net worth was $7 million, and his yearly income was $600,000.[327] He owned gas wells in three states, from which he reported earning $300,000 per year. We acknowledge that JE's investments totaled approximately $344,000 over the course of 18 months. But we are persuaded by his oil and gas experience, significant net worth, and sizeable yearly income that these investments were suitable, even at his advanced age. We do not find that Enforcement met its burden of proving that JE was unsuitable for these investments, and we dismiss cause five as to JE.

---

[317] CX-116, at 25-26.

[318] CX-116, at 25-26.

[319] CX-116, at 25-26.

[320] CX-116, at 25-26.

[321] CX-116, at 27-28.

[322] CX-116, at 27-28.

[323] CX-116, at 27-28.

[324] CX-116, at 27-28.

[325] CX-116, at 31-33.

[326] CX-116, at 31-33.

[327] CX-116, at 31-33.

Enforcement argues that OS's three joint venture purchases were not suitable given his age (82 years) and lack of liquidity. OS purchased 1.5 units of Boonsville #2 for $119,250 on February 8, 2010; one unit of Waggoner #1 for $83,926.80 on August 2, 2010; and 1.5 units of Waggoner #2 for $125,890.20 on March 28, 2011.[328] OS was a retired real estate attorney with significant experience in the oil business.[329] He reported earning $11,900 per month from his oil and gas investments alone.[330] His net worth was $5 million, and his yearly income was $290,000.[331] He reported owning real estate and interests in various businesses, and he indicated that his limited liquidity in 2010 resulted from his investment in a ski lodge and purchase of a residence in an assisted living facility.[332] In light of OS's net worth, yearly income, and experience with oil and gas ventures, his age is not sufficient to establish that these investments were not suitable. We do not find that Enforcement met its burden of proving that OS was unsuitable for these investments, and we dismiss cause five as to OS.

Enforcement alleges that JM's purchases of .375 units of Boonsville #2 for $29,812.50 on February 5, 2010; .75 units of Waggoner #1 for $41,963.40 on August 24, 2010; and .125 units of Waggoner #2 on March 18, 2011 for $10,490.85 were unsuitable. JM was 74 years old and was self-employed as a farmer and dog breeder.[333] She had a net worth of $2 million, liquidity of $20,000, and annual income of $150,000.[334] Given JM's level of liquidity and her employment situation, we find that her investment of $94,754 in three joint ventures was not suitable. A firm must "abstain from making recommendations that are inconsistent with the customer's financial situation."[335] It was not suitable for JM to invest well over half of her $150,000 yearly income in three risky oil and gas joint ventures during one year, particularly given that she derived her income from seasonal self-employment. We find that Red River Securities recommended investments to JM that were unsuitable, as alleged in cause five.

Enforcement alleges that FB's purchase of .3 units of Boonsville #2 for $39,750 on June 11, 2010 was unsuitable. FB was 62 years old and had a net worth of $1 million.[336] She was a retired real estate broker.[337] The firm did not have income, liquidity, or tax information for FB when it sold her this investment. We find that the firm did not have sufficient information about

---

[328] CX-116, at 34-36.

[329] CX-116, at 34-36.

[330] CX-116, at 34-36.

[331] CX-116, at 34-36.

[332] CX-116, at 34-36.

[333] CX-116, at 14-16.

[334] CX-116, at 14-16.

[335] *Faber*, 2004 SEC LEXIS 277, at *23-24.

[336] CX-116, at 29-30.

[337] CX-116, at 29-30.

FB to determine if the recommended investment was suitable.[338] Based on the limited information available, we find that Red River Securities sold FB an investment that was not suitable.

We note that Roberts, not Hardwick, approved JM's and FB's purchases as principal. Roberts reported to Hardwick,[339] however, the evidence does not suggest that he was involved in the suitability determinations for these customers. We address supervisory deficiencies in the next cause of action, and dismiss the allegations in cause five related to JM and FB as to Hardwick.

E. Supervision

Cause six alleges that Red River Securities and Hardwick violated NASD Rule 3010[340] and FINRA Rule 2010 in several aspects of the firm's business: (1) Respondents failed to maintain and enforce a supervisory system and written supervisory procedures to address conflicts of interest created by Red River Securities' and Hardwick's participation in the offerings; (2) Respondents failed to maintain and enforce a supervisory system and written supervisory procedures to adequately address their sales of securities in private placements; and (3) Respondents failed to maintain and enforce a supervisory system and written supervisory procedures to address suitability, red flags, and other sales practice issues.

NASD Conduct Rule 3010 requires member firms to establish and maintain a system to supervise the activities of each associated person that is "reasonably designed to achieve compliance with applicable securities laws and regulations" and FINRA Rules. "Under NASD Rule 3010, a supervisor is responsible for 'reasonable supervision,' a standard that 'is determined based on the particular circumstances of each case.'"[341]

1. Failure to Maintain and Enforce a Supervisory System and Written Supervisory Procedures to Address Conflicts of Interest Created by Red River Securities' and Hardwick's Participation in the Offerings

Hardwick was chief executive officer of Red River Securities.[342] As such, all employees, including the chief compliance officer, reported to him.[343] He also owned and operated the Regal Entities and controlled every aspect of each offering.[344] Hardwick even approved the AFEs off of

---

[338] *See Jack H. Stein*, 56 S.E.C. 108, 114 (2003) (finding it improper for a broker to make recommendations based on guesswork when a customer fails to provide complete information about her assets).

[339] Tr. 648.

[340] Effective December 1, 2014, FINRA Rule 3110 superseded NASD Rule 3010.

[341] *Dep't of Enforcement v. Midas Sec., LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *22 (NAC Mar. 3, 2011) (citations omitted).

[342] Tr. 67.

[343] Tr. 648.

[344] Tr. 81-84, 98-101, 103, 117-119, 356.

which he priced the offerings.[345] Hardwick controlled the marketing materials that the sales staff sent to potential investors.[346] Hardwick's various businesses stood to share in the revenue of the joint ventures' wells, if successful.[347] Yet Hardwick was responsible for conducting due diligence for each offering.[348] In essence, he conducted due diligence on an offering that he put together himself. Roberts assisted in the task, but Hardwick was her boss and supervisor. The firm's written supervisory procedures did not address this significant conflict of interest.[349]

We find that Respondents failed to maintain and enforce a supervisory system and written supervisory procedures to address conflicts of interest created by Red River Securities' and Hardwick's participation in the offerings, in violation of NASD Rule 3010 and FINRA Rule 2010.[350]

2. Failure to Maintain and Enforce a Supervisory System and Written Supervisory Procedures to Address the Sales of Securities in Private Placements

We dismissed the allegations that Respondents engaged in sales of unregistered securities without qualifying for a Regulation D exemption because they engaged in a general solicitation with respect to 15 customers. We have considered the allegations of failure to supervise with respect to the sales of unregistered securities and find that Enforcement failed to meet its burden of proof. We acknowledge that "[a] determination that a respondent has violated [FINRA's] supervisory rule is not dependent on a finding of a violation by those subject to the respondents' supervision."[351] However, based on the evidence, we have determined to dismiss this allegation.

3. Failure to Maintain and Enforce a Supervisory System and Written Supervisory Procedures to Address Suitability, Red Flags, and Other Sales Practice Issues

Cause six alleges a variety of supervision failures related to sales practices. The Complaint alleges that, in ten instances, customer checks were returned for insufficient funds or were accompanied by notes requesting that the firm call before cashing. Cause one alleges that Red River Securities should have recognized these occurrences as red flags signaling that the customers may not be suitable for investments in the joint ventures. Roberts testified that she considered customer checks returned for insufficient funds to be red flags and, as chief compliance officer, she had several conversations with Hardwick on this subject.[352] The record

[345] Tr. 304-306.

[346] Tr. 98-101.

[347] *See* JX-2, at 16; JX-3, at 15; JX-4, at 14; JX-5, at 15; JX-7, at 53.

[348] Tr. 59-60, 356.

[349] *See* Tr. 376-382; CX-118; CX-119; JX-15, at 53.

[350] *Cf. Dep't of Enforcement v. Fox Fin'l Mgmt. Corp.*, No. 2012030724101, 2015 FINRA Discip. LEXIS 8, at *23, 29-33 (OHO Mar. 9, 2015) (finding failure to supervise for failing to address conflicts of interest created by outside business activities), *aff'd*, 2017 FINRA Discip. LEXIS 3 (NAC Apr. 2, 2015).

[351] *Robert J. Prager*, 58 S.E.C. 634, 662 (2005).

[352] Tr. 702-704, 712.

included several customer checks for joint venture participation that were returned for insufficient funds and other checks that were accompanied by notes requesting that Red River Securities call before depositing the checks.[353] Roberts testified that the firm heeded these red flags, and some of the customers were able to explain the returned checks. In some instances, Red River Securities, through Roberts, followed up appropriately.[354] In other instances, however, the firm did not. For instance, customer FB submitted a check in May 2011 that was returned for insufficient funds.[355] Red River Securities nonetheless sent her the Cosper #1 CIM in September 2011.[356] Customers OS & IS submitted a check in December 2010 that was returned for insufficient funds.[357] Red River Securities nonetheless sent them the Cosper #1 CIM in September 2011.[358] Roberts could not explain why the firm would continue to solicit customers after their checks were returned.[359]

Cause five also alleges that Red River Securities failed to ensure that the registered representatives who dealt directly with customers gathered sufficient information to make informed suitability determinations. The Complaint alleges that, while the suitability information for the customer was incomplete in the firm's file, at least 15 customers were deemed suitable for investment in a joint venture and at least 17 customers were approved for solicitation. Enforcement argues that Red River Securities did not even follow its own procedures in this regard.

Red River Securities' supervisory procedures manual states that associated persons must continually determine each customer's investment objectives and desires and must document their efforts by including in customer records customers' relative financial position, income, type of employment, level of education, marital status, and ability to hold an investment long-term.[360] Roberts testified that sales personnel were also expected to complete the customer contact sheet that called for occupation, income, investment history, risk tolerance, income, net worth, and

---

[353] Tr. 668-669, 696-697, 702-708, 711 (Roberts' testimony regarding numerous customer checks returned for insufficient funds); CX-110, at 20-21, 22-23 (showing customers VS & MS's and OS & IS's checks returned for insufficient funds); CX-115, at 2 (showing customer DW's check returned for insufficient funds); CX-116, at 29-30 (showing customer FB's checks returned for insufficient funds), 35-36 (showing customer OS's checks returned for insufficient funds); CX-117 (showing customers FB's, JB's, RB's, VS's, FV's, and HW's checks returned for insufficient funds and notes that accompanied checks requesting that Red River Securities call the customer before depositing and one stating "it will take a miracle to cover this").

[354] CX-116, at 35-36; *de bene esse* deposition of OS (May 9, 2016), at 55-56.

[355] CX-117, at 1-4.

[356] CX-116, at 29. The firm's records indicate that no one from Red River Securities had talked with FB since May 2011. CX-116, at 29.

[357] CX-110, at 22-24.

[358] CX-110, at 22-24.

[359] Tr. 705-708.

[360] JX-15, at 49; CX-118, at 48.

other information.[361] Firm procedure dictated that, after the initial call and before the firm mailed out a CIM, Roberts must determine that the customer was suitable based on information on the customer contact sheet.[362] Many of the customer contact sheets were missing significant information, but the firm and its principals nonetheless approved the clients for solicitation in direct contradiction of firm procedures.[363] For instance, Roberts approved customer CW for solicitation even though his contact sheet was missing age, liquidity, income, and tax bracket.[364] Similarly, Roberts approved customer DD for solicitation even though his contact sheet was missing telephone numbers, age, liquidity, income, and tax bracket.[365]

The evidence also suggests that Red River Securities' sales staff often assisted customers in completing their investment profiles, suggested to them that they inflate their net worth so as to qualify for investing in joint ventures, and exaggerated the positive aspects of the joint ventures. Customer LR testified that the salesperson who contacted him touted Regal Energy's previous successes, and Hardwick stated to him that Waggoner #1 was "an extraordinarily good opportunity … to have low risk and a good outcome."[366] LR testified that he continued to invest in Regal joint ventures notwithstanding prior losses because the salespeople suggested he could recoup his losses with subsequent investments.[367]

Customer JH was a school bus driver who also mowed lawns.[368] JH testified that, in order to gather enough money to invest, he had to remove money from his retirement account and borrow funds from his daughter.[369] He testified that a representative of Red River Securities "helped" him complete the customer questionnaire and told him that he could inflate his financial figures because no one would review the questionnaire.[370] JH also testified that a Red River

---

[361] Tr. 722-728; *see also* Tr. 135 (Hardwick testimony that, during the initial call, sales staff was expected to gather income, net worth, and liquidity information); RX-44, at 104 (July 18, 2012 notes from staff compliance meeting indicating firm policy that, in order for a client to receive a CIM, sections on the client contact sheet could not be left blank).

[362] Tr. 136-137, 511, 650-652, 656-657.

[363] Tr. 665-677, 691.

[364] CX-115, at 1. Red River Securities mailed CW the Cosper #1 CIM in October 2011. CX-115, at 1.

[365] CX-115, at 4. Red River Securities mailed DD the Boonsville #2 CIM in September 2010. CX-115 includes additional examples of customers who received CIMs even though the firm did not have complete information for the customer. Cause five of the Complaint specifically identified 17 customers that the firm solicited without having complete financial information. The firm's records for several of the customers indicate that pertinent information was missing from the firm's records, but Roberts nonetheless approved the customer as a prospect. CX-115, however, also indicates that the firm had not actually sent some of the 17 customers CIMs, and therefore had not solicited investments in particular joint ventures. We dismiss as to those customers. *See* CX-115, at 8 (JY), 10 (KS), 11 (RH), 14-15 (RM), 19 (SD), 22 (TM).

[366] Tr. 1093, 1108.

[367] Tr. 1130-1132. LR also testified that Red River Securities' salespeople told him that licensed geologist Heape had invested his own money in Pierce #1. Tr. 1098-1099.

[368] Tr. 1179.

[369] Tr. 1203.

[370] Tr. 1180-1182, 1209, 1216.

Securities representative implied that 97 percent of Regal Energy's wells were still in production and generating income.[371] Customer TC testified that someone from Red River Securities told him, by telephone, how to answer all of the questions on the customer questionnaire.[372] He too testified that the sales person touted Regal Energy's other successful projects and painted his investments as "reduced risk."[373] Customer GE testified that he invested in Boonsville #2 because the salesperson told him "the well was already proven … it was not a dry hole."[374] Customer RA testified that the Red River Securities' representatives "were very certain" that Regal Energy had been "very successful in their previous wells. And so [the Red River Securities representative] seemed pretty certain that I could get good returns, that there would be good revenue coming from [Boonsville #2]."[375]

Respondents argue that they directed sales staff not to discuss facts outside of the contents of the CIMs and that Roberts monitored the sales staff.[376] Respondents also instructed sales staff to mention the possibility of a "dry hole" and not to make any guarantees.[377] We have considered these efforts, but find them minimal at best. A member firm's supervisory procedures must be tailored to the firm's business lines and must establish a mechanism for ensuring compliance and detecting violations.[378] Additionally, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."[379] If indications of irregularity arise, as we find they did here, it is incumbent on the firm to respond appropriately by taking action to address the problems.[380] We find that Respondents failed in every aspect of their supervisory responsibilities. Their supervisory system was weak and flawed. The firm and Hardwick exercised little oversight over the sales force. Hardwick and Roberts[381] ignored many red flags and responded to other red

---

[371] Tr. 1188-1189.

[372] Tr. 1249.

[373] Tr. 1228, 1233-1234.

[374] Tr. 1270-1271.

[375] Tr. 1510. A Red River Securities salesperson told RA, "Some people considered them risky, but this particular one, you know, it would not be particularly risky because it was an offset … and the original well there was producing." Tr. 1509.

[376] Tr. 772; RX-44, at 128, 132, 160, 165-166.

[377] RX-44, at 197, 199, 200.

[378] *Midas Sec.*, 2011 FINRA Discip. LEXIS 62, at *20 (holding that a firm's procedures must be tailored to the specific nature of the firm's business).

[379] *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008) (citing *Michael T. Studer*, 57 S.E.C. 1011, 1023-1024 (2004)).

[380] *La Jolla Capital Corp.*, 54 S.E.C. 275, 285 (1999).

[381] Hardwick delegated supervision of the sales force to Roberts. "[I]t is not sufficient for [a] person with overarching supervisory responsibilities [to delegate] supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention … Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." *Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *50

flags with anemic corrective measures. In sum, Respondents exhibited a willful disregard of the inadequacies of their supervisory controls. We find that Respondents violated NASD Rule 3010 and FINRA Rule 2010, as alleged in cause six.[382]

V. Sanctions

We turn first to the FINRA Sanction Guidelines ("Guidelines") for fraud, misrepresentations, or material omissions of fact.[383] For cases such as this involving intentional or reckless conduct, the Guidelines recommend a fine of $10,000 to $146,000, strong consideration of a bar for individual wrongdoers, and strong consideration of an expulsion of the firm in cases in which aggravating factors exist. We find numerous aggravating factors here.

The scope and magnitude of Respondents' misconduct is remarkable. The Regal CIMs were rife with hyperbole, mischaracterization, and opaque explanations that a reasonable investor could not possibly discern. Respondents engaged in a pattern of misrepresentations and omissions that spanned nearly four years and involved sales totaling approximately $25 million to 456 investors.[384] Respondents sold their risky joint venture interests to a variety of customers. Some had knowledge of, and prior experience investing in, oil and gas joint ventures. Others, however, were unsophisticated and plainly unsuitable for these investments. Respondents did not differentiate and sold to anyone who could scrape together the necessary funds.[385] We do not find that this type of conduct was aberrant or not reflective of Respondents' typical business plan. To the contrary, we find that this was part of the firm's business model.[386]

We also find aggravating the extent of Respondents' monetary gain from this misconduct.[387] Respondents earned due diligence fees and commissions on the five offerings of approximately $3.6 million. But that was just the start. Hardwick owned the Regal Entities, both of which earned money on these offerings. Regal Energy's "one-time" management fee for the five joint ventures at issue approximated a staggering $7.1 million. Respondents also benefitted from the non-monetary perks associated with the substantial business that they directed to their long-time acquaintances, Redlich and Nichols. And in return, Respondents' investors received total distributions of less than $500,000 from the more than $25 million that they invested in these five joint ventures.

(NAC May 1, 2012) (citations omitted). We do not find that Red River Securities' employment of Roberts relieved Hardwick of responsibility.

[382] Cause one also alleges that sales manager Scot Schafer ("Schafer") made exaggerated claims to customers regarding Cosper #1 and stated to other customers that the Barnett Shale would provide a long-term, steady cash flow. The customers who testified were unable to attribute specific statements to Schafer. We therefore dismiss this allegation.

[383] FINRA Sanction Guidelines at 87 (2016), http://www.finra.org/industry/sanction-guidelines.pdf.

[384] Guidelines at 6 (Principal Considerations Nos. 8, 9).

[385] Guidelines at 7 (Principal Considerations Nos. 18, 19).

[386] Guidelines at 7 (Principal Considerations No. 16).

[387] Guidelines at 7 (Principal Considerations No. 17).

We also find aggravating that Respondents acted intentionally. Respondents stood to benefit financially from selling the Regal Energy joint ventures. They prepared CIMs that provided investors false promises and half-truths. They acted intentionally, and placed their own interests before those of the investors. Also aggravating is the fact that Respondents had a disciplinary history involving the same misconduct at issue in this case.[388]

Respondents' failure to develop and enforce a robust supervisory system is another aggravating factor.[389] Respondents' failure to supervise adequately enabled the sales force to compound misrepresentations in the written materials with false claims and promises. Respondents claim that by employing a full-time dedicated compliance officer they met their supervisory responsibilities. Hardwick, however, supervised Roberts and ignored her suggestions as he pleased. Without Hardwick's backing, Roberts's efforts were insufficient to compensate for the CIMs' undisclosed conflicts of interest, misinformation, and falsely optimistic production, and the firm's heavy-handed sales force. We also find aggravating the level of customer losses that Respondents proximately caused.[390] Investors in the five joint ventures lost astounding amounts.[391] Boonsville #2 investors lost $9,072,324. Waggoner #1 investors lost $2,659,174. Investors in Waggoner #2 lost $2,832,529. Cosper #2 investors lost $6,165,774. Investors in Pierce #1 lost $3,886,076. We find that these investors were enticed to invest in joint ventures by CIMs that were riddled with Respondents' misrepresentations and omissions. And Respondents' sales staff, who had unfettered access to the customers, compounded the falsehoods. We therefore find that the customers' considerable losses were proximately caused by Respondents, and we order Respondents, jointly and severally, to pay restitution to the injured customers.

We find Respondents' misconduct to be egregious. They preyed on customers who hoped to get into the oil and gas business by touting prior successes that in reality were marginal, buried negative facts, and presented an overall picture of each venture that was far from accurate. For intentionally misrepresenting and omitting material information in joint venture CIMs, we bar Hardwick from associating with any member firm in any capacity, expel Red River Securities from membership, and order Respondents jointly and severally to pay restitution to their injured customers in the total amount of $24,615,849.21, plus 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 until the date that restitution is paid.

Respondents must calculate the payment due to each customer as follows:

- To each of the 156 investors in the Boonsville #2 offering, Respondents are ordered jointly and severally to pay restitution to each investor equal to the

---

[388] Guidelines at 6 (Principal Considerations No. 1). *See* CX-29, at 9 (showing Respondents' settlement of FINRA disciplinary matter for failing to disclose material information in offering materials for oil and gas joint ventures).

[389] Guidelines at 6 (Principal Considerations No. 5).

[390] Guidelines at 6 (Principal Considerations No. 11).

[391] *See* CX-204.

amount of each investor's total investment less distributions received, totaling $9,072,324.33, plus interest.[392]

- To each of the 40 investors in the Waggoner #1 offering, Respondents are ordered jointly and severally to pay restitution to each investor equal to the amount of each investor's total investment less distributions received, totaling $2,659,174.51, plus interest.[393]
- To each of the 48 investors in the Waggoner #2 offering, Respondents are ordered jointly and severally to pay restitution to each investor equal to the amount of each investor's total investment less distributions received, totaling $2,832,529.50, plus interest.[394]
- To each of the 131 investors in the Cosper #1 offering, Respondents are ordered jointly and severally to pay restitution to each investor equal to the amount of each investor's total investment less distributions received, totaling $6,165,744.42, plus interest.[395]
- To each of the 81 investors in the Pierce #1 offering, Respondents are ordered jointly and severally to pay restitution to each investor equal to the amount of each investor's total investment less distributions received, totaling $3,886,076.45, plus interest.[396]

Respondents are required to provide Enforcement with proof of payment of restitution with interest to each customer. If Respondents are unable to locate a customer, they must provide Enforcement with proof that they have made a bona fide attempt to locate the customer. Any restitution Respondents are not able to pay to a customer must be paid to FINRA (without interest) as a fine.

We also considered the appropriate sanctions for Respondents' suitability and supervision violations. The Guidelines for suitability violations recommend a fine of $2,500 to $110,000 and a suspension of the firm for up to 90 days.[397] In light of the many aggravating factors present in this case, and the dearth of mitigating factors, for Red River Securities' suitability violations, we would fine the firm $25,000 and suspend it for 60 days. In light of the bar, expulsion, and restitution order, we do not impose additional sanctions.

---

[392] *See* CX-204, at 7-11 (list of Boonsville #2 investors, the amount each invested, and the amount of distributions each received).

[393] *See* CX-204, at 13-14 (list of Waggoner #1 investors, the amount each invested, and the amount of distributions each received).

[394] *See* CX-201 (list of Waggoner #2 investors and the number or fraction of units purchased).

[395] *See* CX-204, at 2-6 (list of Cosper #1 investors, the amount each invested, and the amount of distributions each received).

[396] *See* CX-203 (list of Pierce #1 investors and the number or fraction of units purchased).

[397] Guidelines at 93.

Additionally, we considered the appropriate sanctions for Respondents' supervision violations, which we also find egregious. The Guidelines for supervision violations recommend a fine of $5,000 to $73,000 and a suspension. In egregious cases, the Guidelines recommend a suspension of the responsible individual for up to two years or a bar and a suspension of the firm for up to 30 days.[398] We find that Respondents' supervisory lapses enabled the fraudulent misconduct that occurred here and resulted in unsuspecting customers investing in sometimes unsuitable oil and gas joint ventures about which they had distorted information. In cases involving supervisory lapses, "[t]he nature, extent, size, and character of the underlying misconduct aggravates [the respondent's] violations."[399] We find that the underlying misconduct in this case was egregious. In light of the many aggravating factors present in this case, and the dearth of mitigating factors, for Respondents' supervision violations, we would fine Respondents $50,000 jointly and severally, and suspend both for 30 days. In light of the bar, expulsion, and restitution order, we do not impose additional sanctions.[400]

VI. Order

Under cause one, we find that Respondents Red River Securities, LLC and Brian Keith Hardwick fraudulently misrepresented and omitted material facts from the offering materials for five private placement offerings of securities, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, and FINRA Rules 2010 and 2020. In light of our findings under cause one, causes two and three are moot and we make no findings. Under cause four, we dismiss alleged Section 5 violations. Under cause five, we dismiss allegations of suitability violations as to Hardwick and dismiss in part and uphold in part allegations that the firm allowed sales personnel to recommend and sell unsuitable securities, in violation of NASD Rule 2310 and FINRA Rules 2111 and 2010. Under cause six, we find that Respondents failed to maintain and enforce an adequate supervisory system and written supervisory procedures to address several facets of the firm's business, in violation of NASD Rule 3010 and FINRA Rule 2010.

For violations under cause one, we bar Hardwick from associating with any member firm in any capacity and expel Red River Securities from membership. These sanctions are effective immediately upon issuance of this decision. We also order Respondents to pay restitution totaling $24,615,849.21 to investors in the Boonsville #2, Waggoner #1, Waggoner #2, Pierce #1, and Cosper #1, as outlined in this decision, plus 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 until the date that restitution is paid. Respondents are ordered to pay restitution within 60 days of the effective date of this Decision and to provide Enforcement with proof of payment of restitution. If Respondents are unable to locate a customer, the firm must provide Enforcement with proof that it has made a bona fide attempt to locate the customer. Any restitution

---

[398] Guidelines at 102. *See also* Guidelines at 103 (deficient written supervisory procedures).

[399] *Pellegrino*, 2008 SEC LEXIS 2843, at *64-65.

[400] The Extended Hearing Panel considered and rejected without discussion all other arguments by the parties.

Respondents are unable to pay to a customer must be paid to FINRA (without interest) as a fine. We also order Respondents, jointly and severally, to pay costs of $16,214.46, which includes a $750 administrative fee. The fine and costs shall be payable on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action.

Carla Carloni
Hearing Officer
For the Extended Hearing Panel