BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of:

THE COMMISSIONER OF BUSINESS OVERSIGHT,

Complainant,

v.

STEVE S. STENGALL, SCOTT A. HARRIS, BOB CUETO, TIMOTHY R. BRADY, JOSEPH M. TURNER, DIRK OLSEN, HEATHER AGE, BILL MOORE, ALLIED ENERGY, INC., doing business as ALLIED ENERGY, ALLIED SYNDICATIONS, INC., doing business as ALLIED ENERGY, INC., and GRIMES COUNTY #4, A Kentucky General Partnership,

Respondents.

OAH Consolidated

Case No. 2017070929
(Desist and Refrain Order for Violations of Corporations Code Section 25401)

Case No. 2017070932
(Notice of Intention to Issue Order Levying Administrative Penalties Pursuant to Corporations Code Section 25252 and Claim for Ancillary Relief Pursuant to Corporations Code Section 25254)

ORDER OF DECISION

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby adopted by the Department of Business Oversight as its Decision in the above-entitled matter.

This Decision shall become effective on July 16, 2018.

IT IS SO ORDERED this 15th day of June, 2018.

JAN LYNN OWEN
Commissioner of Business Oversight

BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
OF THE STATE OF CALIFORNIA

In the Matter of: THE COMMISSIONER OF BUSINESS OVERSIGHT, Complainant, v. STEVE S. STENGELL, SCOTT A. HARRIS, BOB CUETO, TIMOTHY R. BRADY, JOSEPH M. TURNER, DIRK OLSEN, HEATHER AGE, BILL MOORE, ALLIED ENERGY, INC., doing business as ALLIED ENERGY, ALLIED SYNDICATIONS, INC., doing business as ALLIED ENERGY, INC., and GRIMES COUNTY #4, A Kentucky General Partnership, Respondents.	OAH Consolidated **Case No. 2017070929** (Desist and Refrain Order for Violations of Corporations Code Section 25401) **Case No. 2017070932** (Notice of Intention to Issue Order Levying Administrative Penalties Pursuant to Corporations Code Section 25252 and Claim for Ancillary Relief Pursuant to Corporations Code Section 25254)

PROPOSED DECISION

Administrative Law Judge Regina Brown, State of California, Office of Administrative Hearings, heard this matter on October 4 and 5, 2017, in Oakland, California.

Lindsay B. Herrick, Counsel, represented complainant Jan Lynn Owen, Commissioner of Business Oversight and the Department of Business Oversight.

John H. Baker, Esq., appeared on behalf of respondents Steve S. Stengell, Scott A. Harris, Timothy R. Brady and Heather Age. Respondent Scott A. Harris was present throughout the entire hearing.

Respondents Bob Cueto, Joseph M. Turner, Dirk Olsen, Bill Moore, Allied Energy, Inc., doing business as Allied Energy, Allied Syndications, Inc., doing business as Allied Energy, Inc., and Grimes County #4, a Kentucky General Partnership, did not file a notice of

defense or appear at the hearing. Complainant indicated that a default had been or will be taken against these other respondents.

The record remained open for the filing of closing briefs. Complainant's closing brief (marked for identification as Exhibit 32) and respondents' closing brief (marked for identification as Exhibit H) were filed on December 5, 2017. Complainant's reply brief (marked for identification as Exhibit 33) was filed on December 18, 2017, and respondents' reply brief (marked for identification as Exhibit I) was filed on December 19, 2017. On January 12, 2018, the record was reopened and an order (marked for identification as Exhibit 34) was issued directing the parties to submit the pages of the reporter's transcript cited in their briefs. On January 24, 2018, complainant submitted a response (marked for identification as Exhibit 35) and respondent submitted a response on January 26, 2018 (marked for identification as Exhibit J). Exhibits 35 and J were admitted into evidence, and the record was deemed closed.

The matter was submitted on January 26, 2018.

FACTUAL FINDINGS

Background

1. On May 23, 2017, complainant Jan Lynn Owen, in her official capacity as the Commissioner of Business Oversight (complainant or Commissioner), Department of Business Oversight (Department), by way of her deputy commissioner, issued a Desist and Refrain Order pursuant to Corporations Code section 25532, which was designated as OAH Case No. 2017070929.

2. Also, complainant, by way of her counsel, filed a Notice of Intention to Issue Order Levying Administrative Penalties pursuant to Corporations Code section 25252 and Claim for Ancillary Relief pursuant to Corporations Code section 25254, which was designated as OAH Case No. 2017070932. On August 21, 2017, these matters were consolidated for hearing.

3. The consolidated matter is based on alleged willful violations of the Corporate Securities Law of 1968, Corporations Code section 25000 et seq. This matter involved the offer and/or sale of securities in a partnership to conduct oil and/or gas exploration in a horizontal well in Grimes County, Texas, by means of material misrepresentations or omissions in violation of Corporations Code section 25401, by respondents Steve S. Stengell, Scott A. Harris, Timothy R. Brady and Heather Age (hereinafter referred to collectively as "respondents").

4. The consolidated matter is also based on alleged willful violations of a prior desist and refrain order for securities violations issued by a previous Commissioner, on November 13, 2007, against respondents Stengell and Harris, Allied Energy Group and others in a different offering related to oil and/or gas well exploration.

5. Respondent Stengell was president and chairman of the board of directors of Allied Energy, Inc., doing business as Allied Energy (Allied Energy), a Florida corporation with a registered address of One East Broward Boulevard, Suite 1400, Fort Lauderdale, Florida 33301, and a principal place of business or mailing address of 2800 Griffin Drive, Bowling Green, Kentucky 42101, and/or 2427 Russellville Road, Bowling Green, Kentucky 42101.

6. Respondent Harris was an executive vice president of Allied Energy and a director on its board of directors. In 2011, Harris became the Chief Executive Officer and President of Allied Energy.

7. Respondent Brady was the chief financial officer of Allied Energy and a director on its board of directors.

8. Respondent Age was the secretary and investor relations contact for Allied Energy.

9. Other relevant individuals are Dirk Olsen, a director on Allied Energy's board of directors, and Bill Moore, an agent of Allied Energy.

10. The relevant entities are: (a) Allied Energy, a Florida corporation and the Managing General Partner of "Grimes County #4;" (b) Allied Syndications, Inc., doing business as Allied Energy, Inc., also a Managing General Partner of "Grimes County #4;" and (c) "Grimes County #4," a Kentucky general partnership, also known as Grimes County 4 (Grimes County #4), which is an assumed name of Allied Energy.

11. Respondents filed a timely Notice of Defense.

The Offering of Securities for Grimes County #4

12. In March 2011, respondents offered or sold securities in the form of 75 units of partnership in Grimes County #4, at $128,428 per unit, to raise $9,632,100. These securities were offered or sold in California in issuer transactions.[1]

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[1] At hearing, complainant confirmed that, despite alluding to it in the pleadings, the Department did not allege that respondents engaged in general solicitation. In their closing brief, respondents requested that the proposed decision specifically find that "since general solicitation is a non-issue that the respondents have no need to disclose the allegation in any future offering memorandum." Respondents' request is denied as being outside the scope of this proceeding.

13. Respondents issued a confidential private placement memorandum (PPM) for accredited prospective investors only regarding investment in Grimes County #4, for oil and natural gas exploration in horizontal well development and production. The PPM included partnership information, financial statements, a partnership agreement, geology report, subscription agreement, and special risks. The PPM indicated that the offering was to raise funds "to invest in a one (1) well project consisting of a working interest in one (1) horizontal well to be drilled in Grimes County, Texas, to test the Georgetown formation." Investors were told that the Grimes County #4 partnership would "acquire a 75% Working Interest" in the well, "or an amount equal to 1% Working Interest per unit."

14. The PPM indicated that investors were referred to as "Participants." The "partnership's purpose was to conduct oil and/or gas exploration on the Drilling Site(s) and, if discovered in commercial quantities, to produce such oil and/or gas and to distribute to the Participants the cash generated from the sale of oil and/or gas and to do all things necessary or desirable in connection" with such venture. Control and management of Grimes County #4 was "vested exclusively in the Managing General Partner," which again is Allied Energy. The Managing General Partner "reserve[d] the right to act as the operator and manager of this prospect" and manage[d] "the affairs of the Partnership on a day-to-day basis." The PPM indicated that the offering involved a high degree of risk. Most importantly, the PPM included a disclosure of litigation involving respondents and Allied Energy and/or its predecessors.

The Desist and Refrain Order

15. Complainant alleges, in paragraph 16a of the Desist and Refrain Order, that respondents misrepresented, in the PPM, an Agreed Cease and Desist Order issued by the Texas State Securities Board (Texas Order) in May 2004.

The Texas Order involved an offering of securities, issued by the Chaucer Fredericksburg Prospect, Allied Energy Group and Allied Syndications, Inc. (predecessors to Allied Energy), in a natural gas venture. Respondent Stengell and Dirk Olsen served on the Advisory Board to Allied Energy Group. The Texas Order contained findings of fact and conclusions of law. The Texas Order found that the security was offered and/or sold by unregistered dealers or agents through materially misleading statements likely to deceive the public. The Texas Order was initially an Emergency Cease and Desist Order issued on March 5, 2004, and the Agreed Cease and Desist Order was issued on May 27, 2004.

The PPM[2] did not fully disclose the Texas Order. The PPM failed to disclose that the Texas Order involved unregistered securities sold or offered by materially misleading

[2] The PPM litigation section stated, in relevant part, that, in 2004:

> The Texas Securities Board (TSB), a state agency, issued a Cease and Desist Order (administrative order) which was later amended to an Agreed Cease and Desist Order against the

statements. The PPM failed to disclose that there was a finding against predecessors to Allied Energy for offering securities by materially misleading statements. Furthermore, respondents should have made a full disclosure of the Texas Order in the PPM because the Commissioner had previously determined, in the November 13, 2007 Desist and Refrain Order issued in California against respondents Stengell and Harris, that they had not completely disclosed the Texas Order.

The details in the Texas Order are the type of information a reasonable investor would consider in reaching an investment decision. The fact that a principal of Grimes County #4, like respondent Stengell, was involved with a company that was found to have violated similar business laws in Texas is an important fact to an investor when deciding whether or not to invest. This is especially true when the type of business enterprise, such as speculation in oil and/or gas wells, is the same, and there are findings of securities being sold or offered by materially misleading statements. Therefore, respondents' failure to fully disclose the Texas Order in the PPM is a material fact.

16. Complainant alleges, in paragraph 16b of the Desist and Refrain Order, that respondents omitted to disclose, in the PPM, a regulatory order issued on November 17, 2003, by the Pennsylvania Securities Commission (Pennsylvania Order).

The Pennsylvania Order involved an offering of securities issued by Sunclear Energy, Inc., in oil and/or gas ventures. The Pennsylvania Order found that the securities were offered and/or sold by Sunclear Energy, Inc., and others, through materially misleading statements. Respondent Stengell was the vice president of investor relations for Sunclear Energy, Inc. Stengell consented to the issuance of Findings of Facts, Conclusions of Law and Order in the Pennsylvania Order, which prospectively rescinded an original order. Stengell was barred for a period of six months from offering or selling securities in Pennsylvania without retaining knowledgeable counsel. Stengell was also ordered to pay costs of $1,000, and to permanently cease and desist from violating the Pennsylvania Securities Act of 1972.

> Chaucer Fredericksburg Prospect (previous drilling program sponsored by the Managing General Partner) defining the offering as a "security" and challenging the program's "exemption from registration" as set forth by State and Federal Securities laws (Regulation D). Allied vigorously responded to this order, claiming the right to an exemption from registration under Federal Regulation D Rule 506. In April 2004, the Managing General Partner, having a good and valid defense, reached a settlement agreement with the TSB to resolve this matter. As a result of this order and settlement agreement, the [TSB] required the Managing General Partner to pay an $8,000 administrative fine. . . .

The PPM did not disclose the Pennsylvania Order at all. The PPM failed to disclose that the Pennsylvania Order involved securities sold or offered by materially misleading statements. The PPM failed to disclose that respondent Stengell was a vice-president of Sunclear Energy, Inc. Furthermore, respondents should have made a full disclosure of the Pennsylvania Order in the PPM because the Commissioner had previously determined, in the November 13, 2007 Desist and Refrain Order issued in California against respondents Stengell and Harris, that they had not completely disclosed the Pennsylvania Order.

The details in the Pennsylvania Order are the type of information that would assist a reasonable investor in deciding whether to invest in Grimes County #4 and whether the management (like the managing general partners of Grimes County #4) is following the law in marketing the securities. The fact that a principal, respondent Stengell, was barred from offering or selling securities in a particular state for a period of time, and ordered to pay costs, is an important fact to an investor when deciding whether or not to invest. Therefore, respondents' failure to disclose the Pennsylvania Order in the PPM is a material fact.

17. Complainant alleges, in paragraph 16c of the Desist and Refrain Order, that respondents misrepresented, in the PPM, the administrative complaint filed on May 19, 2006, by the Division of Securities of the Commonwealth of Kentucky (Kentucky Complaint).

The Kentucky Complaint alleged that Allied Syndications, Inc., doing business as Allied Energy Group (predecessor to Allied Energy), respondent Stengell, and others were offering and selling partnership interests in oil and/or gas well ventures through multiple materially misleading statements or omissions. In a settlement agreement and final order dated April 9, 2007, the responding parties were ordered to offer rescission to all non-accredited investors to rectify inadequate disclosures made to investors. Also, Stengell and others were collectively assessed a civil fine of $25,000, of which $15,000 was suspended on condition that they complied with the settlement and did not commit future violations of federal or state securities laws. The settlement agreement indicated that Stengell's culpability for any material errors or omissions in the offering was based on his position as the senior vice-president of operations of the company.[3]

The PPM did not fully disclose the Kentucky Complaint, settlement agreement, or the final order.[4] The PPM failed to disclose that the Kentucky Complaint involved securities

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[3] Respondents contend that because the regulatory order from the Commonwealth of Kentucky was admitted as administrative hearsay, the document cannot be relied upon as admissible evidence. However, the PPM was admitted as direct evidence, so the regulatory order is relevant and supplements or explains the PPM and can be relied upon to support this factual finding.

[4] The PPM litigation section stated that, in 2006:

> The Division of Securities of the Commonwealth of Kentucky brought an administrative complaint against Allied Energy,

sold or offered by materially misleading statements and that respondent Stengell was found to be culpable based on his position in the company. The PPM failed to disclose that the Kentucky Complaint was against a predecessor of Allied Energy and respondent Stengell.

The details in the Kentucky Complaint, settlement, and final order are the type of information a reasonable investor would consider in reaching an investment decision. The fact that a principal, like Stengell, was sanctioned or found to have violated similar business laws in Kentucky is an important fact to an investor when deciding whether or not to invest in Grimes County #4. Therefore, respondents' failure to fully disclose the Kentucky Complaint, settlement, or final order in the PPM is a material fact.

18. Complainant alleges, in paragraph 16d of the Desist and Refrain Order, that respondents misrepresented, in the PPM, an Amended Cease and Desist Order (Administrative Order No. CD-2006-0015A) issued by the Alabama Securities Commission on April 27, 2006 (April 2006 Alabama Order).

The April 2006 Alabama Order involved an offering of securities issued by Heartland Resources, Inc., in oil and/or gas well ventures. The April 2006 Alabama Order found that Andrew A. Flowers "made a general solicitation ("cold call") to an Alabama investor" which violated federal securities laws and voided any exemption from registration claimed by Heartland Resources, Inc., for the securities offering in Alabama. The April 2006 Alabama Order also found that the securities were not registered or exempt from registration in Alabama.

Complainant contends that the PPM did not disclose that Flowers, Allied Energy's current registered agent, had engaged in general solicitation. Neither did the PPM disclose the findings in the April 2006 Alabama Order.

County Line Prospect, and others alleging that the offering memorandum involving County Line Prospect had various items which, in the opinion of the Division, should have been disclosed, some areas of correction and areas which in the opinion of the Division, should be expanded. The offering memorandum and other third party materials (geology and independent audit reports) included in the offering memorandum not only set forth the risks of the prospect but also accurately and correctly stated risks. In March 2007, the respondents and the Division reached an agreed settlement to resolve this matter in which the Managing General Partner paid a civil fine of $50,000.

The PPM[5] adequately disclosed the April 2006 Alabama Order. The PPM specifically stated that Flowers was subject to the cease and desist order in Alabama. No predecessors of Allied Energy were involved in the matter. Although the disclosure did not use the words, "general solicitation," the PPM provided the type of information a reasonable investor would consider in reaching an investment decision. Any omissions in the PPM regarding the April 2006 Alabama Order are immaterial.[6]

19. Complainant alleges, in paragraphs 16e and 16f of the Desist and Refrain Order, that respondents omitted to disclose to investors, in the PPM, any details of an administrative complaint issued in 2007, by the Alabama Securities Commission and a Cease and Desist Order, Administrative Order No. CD-2007-0015, issued on May 29, 2007 (May 2007 Alabama Order).

The May 2007 Alabama Order involved a securities offering in oil and/or gas ventures issued by Allied Energy Group, Allied Syndications, Inc. (predecessors to Allied Energy), and respondent Stengell, who was the Executive Vice President of Allied Energy Group and Allied Syndications, Inc. The May 2007 Alabama Order found that the securities offered or and sold by Stengell and others were neither registered nor exempt from registration. The May 2007 Alabama Order also found that their acts of general solicitation voided any exemption from registration, violated federal securities law, and involved

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[5] The PPM litigation section indicated that, in 2006:

> The Alabama Securities Commission issued an Amended Cease and Desist order (Administrative Order No. CD-2006-0015A) against one of Allied Energy's currently registered agents Andrew A. Flowers ("Flowers"), in which Flowers, certain other individuals and Heartland Resources, Inc. were ordered to immediately cease and desist from further offers or sales of any securities into, within or from the State of Alabama. The above-referenced Amended Cease and Desist Order was issued before Flowers became employed by or had any association with Allied Energy. Flowers contends that at no time did he ever sell any securities to an Alabama resident while employed by Heartland Resources, Inc. Allied Energy and Flowers have disclosed the above-referenced Amended Cease and Desist Order issued by the Alabama Securities Commission to the Commonwealth of Kentucky, Department of Financial Institutions ("DFI"), and DFI has approved Flowers as a registered agent in the Commonwealth of Kentucky for 2011.

[6] Because this disclosure was not misleading, there was no violation of Corporations Code section 25401. Therefore, the assessed administrative penalties are not warranted. (See Legal Conclusion 14.)

securities offered or sold by materially misleading statements. Stengell and others were also found to have acted illegally as a dealer, agent, investment advisor or investment advisor representative. The May 2007 Alabama Order also found that the responding parties omitted to inform investors of the March 5, 2004 Texas Order. (See paragraph 15 above.) Respondent Stengell and others were ordered to cease and desist from further offers or sales of securities in the state of Alabama.

The PPM did not fully disclose the May 2007 Alabama Order.[7] The PPM did not include the names of the issuers of the offering, the investment, the names of other individuals involved in that action, or the allegations, findings, or outcome of the May 2007 Alabama Order. More specifically, the PPM failed to disclose that the May 2007 Alabama Order involved securities sold or offered by materially misleading statements and that there was a finding against respondent Stengell and predecessors to Allied Energy.

The details in the May 2007 Alabama Order are the type of information a reasonable investor would consider in reaching an investment decision. The fact that a principal, like respondent Stengell, has been sanctioned or found to have violated similar business laws in Alabama is an important fact to an investor when deciding whether or not to invest in Grimes County #4. Also, the PPM was misleading in alluding that respondents would prevail in defending the action when in fact there is no evidence that they did prevail. Therefore, respondents' failure to fully disclose the May 2007 Alabama Order in the PPM is material.[8]

20. Complainant alleges, in paragraph 16g of the Desist and Refrain Order, that respondents omitted to disclose information, in the PPM, regarding a Cease and Desist Order issued by the Alabama Securities Commission on February 23, 2007 (February 2007 Alabama Order).

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[7] The PPM litigation section indicated that, in 2007:

> The Alabama Securities Commission issued an administrative complaint against Allied Energy challenging their offering exemption. Having a good and valid defense, the company will defend this action vigorously and anticipates a favorable conclusion. The company maintains that the state of Alabama has no rightful claim. Any conclusion against Allied Energy would not affect the financial condition of the company or operations of the partnership. The Managing General Partner has rejected the settlement offer proposed by the Commission.

[8] Because paragraph 16e of the Desist and Refrain Order apparently involves the underlying administrative complaint for the May 2007 Alabama Order alleged in paragraph 16f of the Desist and Refrain Order, the assessed administrative penalties for violations of both paragraphs are duplicative. (See Legal Conclusions 14 and 15.)

The February 2007 Alabama Order involved Ascension Financial Solutions, Inc. (Ascension) and Heartland Resources, Inc. The February 2007 Alabama Order found that John R. Bernier was an agent of Ascension and engaged in the offer and/or sale of certificates of interest or participation in oil and/or gas titles or leases issued by Heartland Resources, Inc. The February 2007 Alabama Order found that Bernier sold unregistered certificates of interest to an Alabama resident. The February 2007 Alabama Order found that the responding parties failed to disclose to investors the April 2006 Alabama Order (see Factual Finding 18) which constituted a material and misleading fact in violation of Alabama's securities law.

The details in the February 2007 Alabama Order[9] are the type of information a reasonable investor would consider in reaching an investment decision. The PPM specifically stated that Bernier was subject to the cease and desist order in Alabama. The fact that a currently registered agent of Allied Energy, like Bernier, was found to have violated similar business laws in Alabama is an important fact to an investor when deciding whether or not to invest in Grimes County #4. Moreover, the PPM was misleading because Bernier contended that he was never employed by Ascension, when the February 2007 Alabama found that he was employed by Ascension. Therefore, respondents' failure to fully disclose the February 2007 Alabama Order in the PPM is a material fact.

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[9] The PPM litigation section states that, in 2007:

> The Alabama Securities Commission issued a Cease and Desist Order (Administrative Order No. CD-2007-0006) against one of Allied Energy's currently registered agents, John R. Bernier ("Bernier"), in which Bernier, certain other individuals and Ascension Financial Solutions were ordered to immediately cease and desist from further offers or sales of any securities into, within or from the State of Alabama. The above-referenced Cease and Desist Order was issued before Bernier became employed by or had any association with Allied Energy. Bernier contends that he was never employed by Ascension Financial Solutions, that he never made any offers or sales of securities on behalf of Ascension Financial Solutions, and that the foregoing Cease and Desist Order arose from a single sale of an oil and gas interest that he made to a Florida resident while he was employed by Heartland Resources, Inc. and that such individual later moved to Alabama some time after the sale was made. Allied Energy and Bernier have disclosed the above-referenced Cease and Desist Order issued by the Alabama Securities Commission to the Commonwealth of Kentucky, Department of Financial Institutions ("DFI"), and DFI has approved Bernier as a registered agent in the Commonwealth of Kentucky for 2011.

21. Complainant alleges, in paragraph 16h of the Desist and Refrain Order, that respondents misrepresented, in the PPM, the prior November 13, 2007 Desist and Refrain Order issued in California (November 13, 2007 CA Order).

The November 13, 2007 CA Order involved an offering of securities issued by Allied Syndications, Inc., doing business as Allied Energy Group (predecessors to Allied Energy), T3 CBM Development, respondents Stengell and Harris, and others, to drill and test gas wells. The November 13, 2007 CA Order found that the securities were offered and/or sold by making materially misleading misrepresentations or omissions. The responding parties were found to have engaged in the illegal general solicitation of unregistered, non-exempt securities. The responding parties were found to have made material omissions by failing to disclose numerous regulatory or civil actions against them, including the Texas Order and Pennsylvania Order. (See paragraphs 15 and 16 above.)

The November 13, 2007 CA Order was affirmed by an administrative law judge, adopted by the Commissioner and became final as of July 30, 2008. Respondents' appeal of that decision to the Los Angeles Superior Court by petition for writ of mandate was denied on September 11, 2009, and affirmed by the California Court of Appeal, Second Appellant District, on September 20, 2010.[10]

The PPM did not fully disclose the November 13, 2007 CA Order.[11] In particular, respondents Stengell and Harris were not specifically identified in the PPM. The PPM failed to disclose that the November 13, 2007 CA Order had a finding against respondents Stengell

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[10] On December 15, 2015, the California Supreme Court denied respondents' petition for review.

[11] The PPM litigation section stated that, in 2007:

> The California Department of Corporations issued a Desist and Refrain Order against Allied Energy Group and T3 CBM Development, along with various officers and other named individuals. The complaint alleges that the offering of T3 CBM Development did not have available exemptions from registration or if such exemptions were available, they were not properly employed and alleged that the offering materials did not adequately disclose the information in the litigation section. Allied is of the opinion that such disclosure was accurately disclosed. Allied and the individuals are certain that these statements are not true and are vigorously defending the action. Allied is of the opinion that it will be successful in these proceedings, and even if this is not accomplished, these proceedings would have no material effect on the financial status of Allied or business operations for the company.

and Harris and predecessors to Allied Energy for offering securities by materially misleading statements.

The fact that principals in Grimes County #4, such as respondents Stengell and Harris, were subject to the November 13, 2007 CA Order is an important fact to an investor when deciding whether or not to invest. Also, the PPM was misleading in alluding that the appeal would be successful when in fact it was not. This is the type of information a reasonable investor would consider in reaching an investment decision. Therefore, respondents' failure to fully disclose the November 13, 2007 CA in the PPM is material.

The Sole California Investor

22. Allen J. Ebens, Jr., a cancer research scientist, was the sole investor in California. On March 26, 2011, he invested in Grimes County #4 and purchased one unit in the amount of $128,428. Ebens Jr. testified that an agent of Allied Energy, Bill Moore, called him in early March 2011, at his office at Genentech in San Francisco. However, Ebens Jr. was unconvincing when he testified that he did not know how Moore obtained his contact information. The evidence established that Ebens Jr.'s father, Allen Ebens, Sr., was an investor in Grimes County #4 and had referred Ebens Jr. to Moore.

23. Ebens Jr. acknowledged that he reviewed the litigation disclosures in the PPM. He stated that he was "concerned" about the prior litigation and conducted an internet search, but he could not find any of the prior regulatory actions.[12] He did not contact anyone at Allied Energy to inquire about the litigation disclosures, as the bold letters at the end of the litigation disclosure in the PPM instructed. (See Factual Finding 25.) He did not ask Moore, who assisted Ebens Jr. in completing the application over the telephone, about the litigation disclosures. Ebens Jr. testified that he considered the statements in the PPM to be material, he relied on the descriptions in the litigation section, and it influenced his decision to invest. He stated that the missing Pennsylvania regulatory action and the failure to include the word "emergency" for the Texas order in the PPM was material to his decision to invest. Ebens Jr. was "uncertain [that] he would not have purchased" the investment had there been full disclosures in the PPM. Both Ebens Jr. and Ebens Sr. have sued Allied Energy which renders Ebens Jr.'s testimony suspect and not entirely credible.

Respondents' Evidence

24. Respondent Harris, who testified at hearing, was the Executive Vice President of Allied Energy, at the time Ebens Jr. invested in Grimes County #4. Harris became employed with Allied Energy (or its subsidiaries) in 2003. He served as the Chief Executive

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[12] In their closing brief, respondents requested that the administrative law judge take judicial (official) notice that a "simple Google search, even today, will reveal regulatory actions in the top five responses." Official notice, pursuant to Government Code section 11515, will not be taken because respondents failed to comply with the requirements of this provision.

Officer and President, when Stengell left the company, from March 2011 until Allied Energy went out of business in January 2017, pursuant to an assignment for the benefit of creditors. Grimes County #4 was dissolved as a partnership.

25. Respondent Harris considered Grimes County #4 to be a highly risky investment in oil and/or natural gas well drilling exploration. Allied Energy sought accredited investors, like Ebens Jr., with a net worth of over $1 million, not including their home, or having income of over $200,000 a year. Accredited investors are looking for a higher return which means higher risk. Harris did not know Ebens, Jr., but he did know his father Ebens, Sr., who referred Ebens Jr.

Harris stated that he had reviewed the PPM and believed that there were no material misrepresentations or omissions. Harris contended that there was no need to specifically include the name "Allied" in the PPM litigation section because referencing it as the Managing General Partner was sufficient. If an investor had a question about the litigation disclosures, Harris would have the investor conduct an internet search on the relevant state's website. Harris was never informed by an investor that he or she could not find a state regulatory action on the internet. Harris reiterated that respondents went to great lengths to disclose all litigation and they hired a top ranked securities attorney in Kentucky, Hunter Durham, to prepare the PPM. Respondents relied on their attorney to determine what was material and needed to be disclosed in the PPM. Harris also referred to the last paragraph of the litigation section, which reads as follows:

> COPIES OF ANY OF THE ABOVE ADMINISTRATIVE PROCEEDINGS, PROCEEDINGS OCCURRING PRIOR TO 5 YEARS AGO, THE SETTLEMENT AGREEMENT OR THE RESPONSES FILED BY ALLIED AND OTHERS CAN BE MADE AVAILABLE TO THE PROSPECTIVE UNIT HOLDER AND ARE ALSO AVAILABLE FOR INSPECTION AT THE COMPANY'S OFFICES. PROSPECTIVE UNIT HOLDERS ARE ENCOURAGED AND INVITED TO ASK QUESTIONS AND REQUEST INFORMATION FROM THE MANAGING GENERAL PARTNER AS IT RELATES TO THESE PROCEEDINGS.

26. Respondent Harris acknowledged that respondents were subject to the November 13, 2007 CA Order, but they were still allowed to conduct business in California. Harris also stated that he was under the impression that the California matter was still under appeal and believed that they would win the case. Harris further stated that respondents improved their compliance processes and policies and upgraded their systems subsequent to the November 13, 2007 CA Order. They hired additional employees to listen in on calls to make sure they were in compliance. They recorded all calls and senior management randomly listened in on calls to verify compliance. They reviewed all materials sent out to investors to ensure compliance with the securities law.

Dismissal of Action Against Respondent Age

27. Under Corporations Code section 25013, a person is defined to include an individual, corporation, and partnership. Under Corporations Code section 25403, any person with knowledge directly or indirectly who controls or induces another person to violate a provision of the Corporate Securities Law of 1968, or any person who provides substantial assistance to another person in the violation of the Corporate Securities Law of 1968, is liable for the violation. Therefore, the officers and directors of Grimes County #4 are liable for the material misrepresentations and omissions made in the offer or sale of securities.

28. Complainant contends that respondent Age is subject to liability because she was the secretary of Allied Energy, filed the corporate filings and annual reports, and she served as the company contact for the public and investors in press releases on behalf of Allied Energy.

29. Respondent Harris confirmed that respondent Age was the Board's executive secretary from 2008 to 2014. According to Harris, as corroborated by Age's declaration, she was not a director or officer of the corporation or a member of the Board. Although she sat in on board meetings and took notes, Age had no input on policies and made no major decisions. She filed corporate documents prepared by respondents' attorney. She helped train new staff. She never spoke to prospective investors because she was not a licensed agent. She was paid $2,625 per month, which was not at the same level as the executives.

30. The evidence did not establish that respondent Age was a director, officer, or a person who provided "substantial assistance" to Allied Energy or Grimes County #4 or its subsidiaries, to render her liable for violations of the Corporate Securities Law of 1968, including Corporations Code sections 25401 and 25403. Therefore, the alleged violations against respondent Age are dismissed.[13]

Respondent Brady is Subject to the California Corporate Securities Law

31. According to respondent Harris, respondent Brady was the Chief Financial Officer and worked on "high level matters," but he had no involvement with Grimes County #4, and therefore, this matter should be dismissed against respondent Brady.

32. The evidence established that respondent Brady was a director on the board of directors of Allied Energy, which is the Managing General Partner of Grimes County #4. As a member of the board of directors of Allied Energy, respondent Brady is liable for the material misrepresentations and omissions made in the offer or sale of securities in Grimes County #4. (See Factual Finding 27.) In addition, respondent Brady, as the chief financial officer, substantially assisted Allied Energy as the Managing General Partner and directly

[13] The administrative penalties assessed against respondent Age are not warranted. (See Legal Conclusion 14.)

controlled Grimes County #4. (Corp. Code, § 25403.) Therefore, respondent Brady is liable for the violations of the Corporate Securities Law of 1968. (See Factual Findings 15, 16, 17, 19, 20 and 21.)

LEGAL CONCLUSIONS

1. The standard of proof in these proceedings is preponderance of the evidence given that these proceedings do not involve a suspension or revocation of a professional license or a fundamental vested right. (Evid. Code, § 115; *Ettinger v. Bd. of Medical Quality Assurance* (1982) 135 Cal.App.3d 853, 856.) The burden of proof is on complainant concerning the appropriateness of the order seeking administrative penalties and claim for ancillary relief. Respondents bear the burden on their affirmative defenses. (Corp. Code, § 25163; *People v. Salas* (2006) 37 Cal.4th 967.)

Violation of Corporations Code Section 25401

2. Corporations Code section 25401 reads:

> It is unlawful for any person to offer or sell a security in this state, or to buy or offer to buy a security in this state, by means of any written or oral communication that includes an untrue statement of a material fact or omits to state a material fact necessary to make the statements made, in the light of the circumstances under which the statements were made, not misleading.

3. The "question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." (*Lynch v. Cook* (1983) 148 Cal.App.3d 1072, 1081-1082, citing *TSC Industries, Inc. v. Northway, Inc.* (1976) 426 U.S. 438, 445.) "A fact is material if there is a substantial likelihood that, under all the circumstances, a reasonable investor would consider it important in reaching an investment decision." (*Insurance Underwriters Clearing House, Inc. v. Natomas Co.* (1986) 184 Cal.App.3d 1520, 1526.) The test of materiality, as a matter of law, is when "the established omissions are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality." (*TSC Industries v. Northway, supra*, 426 U.S. at 450.) Although expert testimony is ordinarily required to prove the material issues in an action, expert testimony is not needed with an obvious fact, such as the type described in the materiality test. (See *Lawless v. Calaway* (1944) 24 Cal.2d 81, 90-91.)[14] The issue of materiality is also a "mixed question of law and fact, involving the application of a legal standard to a particular set of facts. However if reasonable minds

[14] Respondents contend that there was no evidence regarding the materiality of the alleged misrepresentations because the sole investor only testified about the Texas and Pennsylvania cease and desist orders and he cannot represent the "reasonable investor."

cannot differ on the issue of materiality, the issue may be resolved as a matter of law." (*Insurance Underwriters Clearing House, Inc. v. Natomas Co., supra,* 184 Cal.App.3d at 1526-1527.)

4. The complete failure to disclose a prior regulatory action, including a cease and desist order, against similar predecessor interests constitutes a material omission or misrepresentation that is clearly relevant to a reasonable investor who is interested in whether management is following the law in marketing securities. (*Zell v. Intercapital Income Securities, Inc.* (9th Cir. 1982) 675 F.2d 1041, 1046.) Also, the fact that a principal, or anyone involved in the financial transactions of a business enterprise, has been sanctioned or found to have violated similar business laws in other states is a fact obviously important to an investor when deciding whether or not to invest. This is especially true when the type of business enterprise, such as speculation in oil and/or gas wells, is the same.

5. Respondents' failure to disclose the Pennsylvania Order in the PPM is clearly material. Also, respondents' failure to fully disclose the Texas Order, the Kentucky Complaint and final order, the February 2007 Alabama Order, the May 2007 Alabama Order, and the November 13, 2007 CA Order, constituted material omissions and/or misrepresentations, in violation of Corporations Code section 25401, as established in Factual Findings 15, 16, 17, 19, 20 and 21.

A Desist and Refrain Order is Appropriate

6. Corporations Code section 25532, reads, in relevant part, that:

> (a) If, in the opinion of the commissioner, (1) the sale of a security is subject to qualification under this law and it is being or has been offered or sold without first being qualified, the commissioner may order the issuer or offeror of the security to desist and refrain from the further offer or sale of the security until qualification has been made under this law or (2) the sale of a security is subject to the requirements of Section 25100.1, 25101.1, or 25102.1 and the security is being or has been offered or sold without first meeting the requirements of those sections, the commissioner may order the issuer or offeror of that security to desist and refrain from the further offer or sale of the security until those requirements have been met.
>
> [¶] ... [¶]

These arguments are not persuasive. Testimony is not required for an obvious fact or omission, as a matter of law. (*See TSC Industries, Inc., supra*, 426 U.S. at 450.)

> (c) If, in the opinion of the commissioner, a person has violated or is violating Section 25401, the commissioner may order that person to desist and refrain from the violation.
>
> [¶] ... [¶]

7. Respondents violated Corporations Code section 25401, in that they offered and sold securities to an investor in California by means of written and oral communications that included untrue statements of material fact or omitted to state material facts. Issuance of a desist and refrain order is necessary to protect the public interest. Cause exists to issue a Desist and Refrain Order against respondents in accordance with Corporations Code section 25532, subdivision (c), ordering respondents to desist and refrain from offering or selling or buying or offering to buy any security in the State of California, including but not limited to investment contracts in the form of units, by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

8. The evidence did not establish that disclosure in the PPM of the April 2006 Alabama Order (Factual Finding 18), resulted in misrepresentation or the omission of material facts, and therefore, there is no violation of Corporations Code section 25401. Respondents are not subject to a Desist and Refrain Order on this ground.

Violations of the November 13, 2007 California Desist and Refrain Order

9. Respondents Stengell and Harris were subject to the November 13, 2007 CA Order. Their violations of Corporations Code section 25401, are in direct violation of the November 13, 2007 CA Order. Cause exists to issue a Desist and Refrain Order against Stengell and Harris for violating the November 13, 2007 CA Order, in accordance with Corporations Code section 25532, subdivision (c), as set forth in Factual Findings 4, 15, 16, 17, 19, 20 and 21.

10. Again, the evidence did not establish that disclosure in the PPM of the April 2006 Alabama Order (Factual Finding 18) resulted in misrepresentation or the omission of material facts, and therefore, there is no violation of Corporations Code section 25401. Respondents Stengell and Harris are not subject to a Desist and Refrain Order, for violating the November 13, 2007 CA Order on this ground.

Administrative Penalties are Appropriate

11. Corporations Code section 25252, subdivision (a), reads:

> The commissioner may, after appropriate notice and opportunity for hearing, by orders, levy administrative penalties as follows:

> (a) Any person subject to this division, other than a broker-dealer or investment adviser, who willfully violates any provision of this division, or who willfully violates any rule or order adopted or issued pursuant to this division, is liable for administrative penalties of not more than one thousand dollars ($1,000) for the first violation, and not more than two thousand five hundred dollars ($2,500) for each subsequent violation.

12. Respondents contend that there were no willful violations of the Corporations Securities Law because they relied on their attorney who specialized in securities and prepared the PPM and they were unaware of any omissions of material facts. The courts have defined "willful" to mean "intentional, [or knowing, or voluntary, as distinguished from accidental] irrespective of evil motive or reliance on erroneous advice, or acting with careless disregard of statutory requirements." (*Rick's Electric Inc. v. Occupational Safety & Health Appeals Bd.* (2000) 80 Cal.App.4th 1023, 1035.) Corporations Code section 25401 does not require knowledge of the false or misleading nature of the statement or omission.

13. Respondents willfully violated Corporations Code section 25401, by misrepresenting or omitting material information in regulatory orders issued from other states in the PPM. Respondents Stengell and Harris willfully violated the November 13, 2007 CA Order. Cause for issuance of an order levying administrative penalties pursuant to Corporations Code section 25252, was established as set forth in Findings 15, 16, 17, 19, 20 and 21 and Legal Conclusions 2 through 5, and 11.

14. Respondents Stengell, Harris and Brady are subject to the Commissioner's imposition of administrative penalties assessed at a $1,000 penalty for material misrepresentations and omissions in the PPM for the first violation and $2,500 for each additional violation.[15] However, the amount of the penalty is reduced by $5,000, for each respondent, because of the finding of no violation involving the disclosure of the April 2006 Alabama Order (see Factual Finding 18), and paragraphs 16e and 16f of the Desist and Refrain Order are essentially duplicative. (See Factual Finding 19, footnote 8.) Therefore, the administrative penalties are reduced to

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[15] Initially, complainant sought a total of $203,500, in administrative penalties for violations of Corporations Code section 25401, and $55,000, in administrative penalties for violations of the November 13, 2007 CA Order. However, in complainant's closing brief, penalties were calculated against respondents Stengell, Harris, and Brady for a total of $18,500 each. (Note: The initial calculation of $18,000 for each respondent was incorrect in the closing brief.) Also, the calculated penalties against respondents Stengell and Harris for their violations of the November 30, 2007 CA Order totaled $18,500 each for Stengell and Harris.

$13,500 each, for respondents Stengell, Harris and Brady for a total amount of $40,500.[16]

15. Administrative penalties against respondents Stengell and Harris are appropriate for violating the November 13, 2007 CA Order. The Commissioner's order imposing administrative penalties in this matter assessed a $1,000 penalty for material misrepresentation and omissions in the PPM for the first violation and $2,500 for each additional violation. However, the amount of the penalty is reduced by $5,000, for each respondent, because of the finding of no violation involving the disclosure of the April 2006 Alabama Order, and paragraphs 16e and 16f of the Desist and Refrain Order are essentially duplicative. Therefore, the administrative penalties are reduced to $13,500 each, for respondents Stengell and Harris, for a total amount of $27,000, for violations of the November 13, 2007 CA Order.

Ancillary Relief

16. Corporations Code section 25254, subdivision (a), reads:

> If the commissioner determines it is in the public interest, the commissioner may include in any administrative action brought under [Part 3. Regulation and Notice Filing Requirements of Agents, Broker-Dealers, Investment Adviser Representatives, and Investment Advisers] a claim for ancillary relief, including, but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the administrative law judge shall have jurisdiction to award additional relief.

17. Complainant seeks ancillary relief, pursuant to Corporations Code section 25254, in the form of restitution to the one investor in California for violation of Corporations Code section 25401. The amount of restitution sought is $128,428, plus interest at the legal rate accumulated from the first day that investor tendered the investment principal to respondents.[17]

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[16] Respondents contend that Corporations Code section 25252 does not apply because respondents are not brokers-dealers, relying on Part 3 of Title 4 of the Corporations Code, which is entitled, "Regulation and Notice Filing Requirements of Agents, Broker-Dealers, Investment Adviser Representatives, and Investment Advisers." This contention fails because section 25252 expressly applies to "any person."

[17] In the closing brief, complainant calculated the interest as of the October 4, 2017 hearing date, at $4,751.84, for a combined total of $133,179.84, in restitution to be paid by respondents, severally and jointly.

18. Respondents contend that complainant seeks ancillary relief under the incorrect provision because Corporations Code section 25254 only applies to agents, broker-dealers, investment adviser representatives and investment advisers under Part 3 of the Corporations Code. Respondents, Allied Energy, and Grimes County #4 are not agents, broker-dealers, investment adviser representatives or investment advisors. Furthermore, respondents contend that complainant's Statement in Support alleges violations of Corporations Code section 25401, which is under Part 5 of the Corporations Code for fraudulent and prohibited practices. Therefore, Corporations Code section 25254 does not apply to provide ancillary relief in this matter.

19. In this instance, ancillary relief would be available under Corporations Code section 25532, subdivision (e), which states that:

> If the commissioner determines it is in the public interest, the commissioner may include in any administrative action brought under [Division 1. Corporate Securities Law of 1968 [24000-25707] a claim for ancillary relief, including but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the administrative law judge shall have jurisdiction to award additional relief.

Complainant failed to cite to Corporations Code section 25532, subdivision (e), for ancillary relief in the pleadings. Ancillary relief pursuant to Corporations Code section 25254, subdivision (a), is not appropriate.[18]

Affirmative Defenses

20. Respondent asserts that the affirmative defense of laches and the imposition of the statute of limitations bar this action. The defense of laches requires unreasonable delay plus either acquiescence in the act about which the plaintiff complains or prejudice to the defendant resulting from the delay. (*Brown v. State Personnel Bd.* (1985) 166 Cal.App.3d 1151, 1159.) There is no fixed rule as to the period of time that must elapse before the doctrine of laches may be applied because what generally makes delay unreasonable is that it results in prejudice. (*Id.*) Laches will not lie against the government where public policy

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[18] Even if complainant had cited the correct section, Corporations Code section 25532, subdivision (e), in seeking ancillary relief, the sole investor, Ebens Jr., would not be entitled to ancillary relief in the form of restitution or disgorgement. The evidence is not convincing that he would not have invested had there been full disclosure of the prior regulatory actions. Furthermore, Ebens, Jr., was not entirely credible. At most, because respondents violated Corporations Code section 25401, Ebens, Jr., might have been awarded damages of approximately ten percent of his original investment in the amount of $12,800, with no accruing interest, in the interest of the public and for fairness.

would be defeated, and the "mere failure to enforce the law, without more, will not estop the government from subsequently enforcing it. (*West Washington Properties, LLC v. California Dept. of Transportation* (2012) 210 Cal.App.4th 1136.) There is no statute of limitations in the Government Code or Corporations Code which applies to these proceedings.

21. Respondents contend that there was unreasonable delay because the pleadings were filed in May 2017, over six years after the sole investor purchased a partnership unit of Grimes County #4. Also, respondents contend that they were prejudiced because if the Department had filed its pleadings before Allied Energy made an assignment for the benefit of creditors in January 2017, respondent would have had access to all the corporate records; other witnesses would have been available, and attorney's fees and costs of the individual respondents would have been paid by Allied Energy.[19]

22. Under these circumstances, the action against respondents is not barred by the doctrine of laches. The evidence presented did not establish when the Department was notified of respondents' misconduct. There was no evidence presented that the Commissioner could have acted in 2011, as respondents contend.[20] Additionally, there is no evidence in the record to support the timeframes (as respondents argue), that the analogous statutory period of Corporations Code section 25535, which requires four years after the transaction constituting the violation to establish elements of laches, would apply. There is insufficient evidence that bringing this enforcement action has prejudiced respondents.

23. All contentions made by complainant and respondents not specifically addressed herein were considered and need not be addressed and/or are found to be without merit.

ORDER

1. The Commissioner's Desist and Refrain Order against respondents Steve S. Stengell, Scott A. Harris, and Timothy R. Brady is AFFIRMED, in part. The allegations in paragraph 16d of the Desist and Refrain Order are dismissed and stricken; however all other provisions of the Desist and Refrain Order are imposed.

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[19] At hearing, complainant's claim for attorney's fees, investigative expenses and costs was dismissed, at complainant's request.

[20] Respondents cite to the testimony of complainant's counsel Lindsay Herrick, in the reporter's transcript, dated October 4, 2017, that was stricken from the record at hearing, commencing on page 129, line 6, and the declaration of Herrick in support of costs and attorney's fees which was withdrawn at hearing. This is not admissible evidence and cannot be relied upon to establish the date that the Department initially became aware of respondents' misconduct.

2. Respondent Heather Age is DISMISSED from the Desist and Refrain Order and is not subject to administrative penalties.

3. The Commissioner's Order Levying Administrative Penalties against respondents Steve S. Stengell, Scott A. Harris, and Timothy R. Brady is AFFIRMED; however, the total amount of administrative penalties is reduced to $40,500. The administrative penalty shall be made payable to the Department of Business Oversight within 30 days of the date that the decision in this matter becomes final.

4. The Commissioner's Order Levying Administrative Penalties against Steve S. Stengell and Scott A. Harris for violations of the November 13, 2007 California Desist and Refrain Order is AFFIRMED; however, the total amount of administrative penalties is reduced to $27,000. The administrative penalty shall be made payable to the Department of Business Oversight within 30 days of the date that the decision in this matter becomes final.

5. The claim for ancillary relief pursuant to Corporations Code section 25254 is DENIED.

Dated: March 14, 2018

DocuSigned by:
Regina Brown
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REGINA BROWN
Administrative Law Judge
Office of Administrative Hearing