

BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of the California Corporations
Commissioner v.:

C. Mackey y Salazar,
Xavier O. Barrios,
Joseph A. Mermis,
MarrCal Oil Company, Inc.

OAH No.: 2013010048

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated June 12, 2013, is hereby adopted by the Department of Business Oversight, formerly the Department of Corporations, as its Decision in the above-entitled matter with technical and minor changes on the attached Errata Sheet pursuant to Government Code Section 11517(c)(2)(C).

This Decision shall become effective on August 11, 2013.

IT IS SO ORDERED this 12th day of July, 2013.

COMMISSIONER OF BUSINESS OVERSIGHT

/s/
Jan Lynn Owen

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of

THE CALIFORNIA CORPORATIONS
COMMISSIONER,

Complainant,

v.

C. MACKKEY y SALAZAR; XAVIER O.
BARRIOS; JOSEPH A. MERMIS; and
MARRCAL OIL COMPANY, INC.,

Respondents.

OAH No. 2013010048

PROPOSED DECISION

Administrative Law Judge Jill Schlichtmann, Office of Administrative Hearings, State of California, heard this matter on April 17 and 18, 2013, in Oakland, California.

Edward Kelly Shinnick, Corporations Counsel, represented complainant Jan Lynn Owen, Commissioner of the Department of Corporations.

C. Mackey y Salazar represented himself and was present throughout the administrative hearing. Joseph A. Mermis failed to appear and the hearing proceeded as a default against him. MarrCal Oil Company, Inc. did not request a hearing and the orders referenced in Factual Findings 2 through 5 are final as to it; therefore, MarrCal Oil Company, Inc., is not a party to this hearing. Xavier O. Barrios appeared and a continuance of his hearing was granted for good cause; therefore, he is not a party to this hearing.

The record was left open to receive evidence of the department's attorney's fees and costs, and written closing argument from both parties in accordance with a briefing schedule. Complainant's evidence was timely received and admitted into evidence as Exhibit 25. Complainant's rebuttal brief was timely received and marked for identification as Exhibit 26. Respondent's closing brief was timely received and marked for identification as Exhibit A. The record closed and the matter was deemed submitted on May 30, 2013.

FACTUAL FINDINGS

Introduction

1. The Department of Corporations is the agency responsible for enforcement of the Corporate Securities Law, Corporations Code section 25000 et seq.¹

2. On June 12, 2012, the commissioner of the department, in her official capacity, issued an Order Levying Administrative Penalties, and Order for Ancillary Relief and a Desist and Refrain Order against C. Mackey y Salazar, Xavier O. Barrios, Joseph A. Mermis and MarrCal Oil Company, Inc. (MarrCal Oil).

3. The Order Levying Administrative Penalties imposes \$29,500 in administrative penalties. (§ 25252.)²

4. The Order for Ancillary Relief imposes restitution to nine investors in the total amount of \$790,000, and recovery of attorney's fees in the amount of "at least" \$15,000. (§ 25254.)³

5. The Desist and Refrain Order demands that respondents desist and refrain from further offer or sale in the State of California of securities including, but not limited to, interests in limited liability companies and investment contracts, unless and until qualification has been made or unless they are exempt. The Desist and Refrain Order also demands that respondents desist and refrain from offering or selling or buying or offering to buy any security including, but not limited to, interests in limited liability companies and investment contracts, 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 light of the circumstances under which they were made, not misleading. (§§ 25532, 25401.)⁴

¹Further statutory references are to the Corporations Code unless otherwise noted.

²Section 25252 provides in part: The commissioner may, after appropriate notice and opportunity for hearing, by orders, levy administrative penalties.

³Section 25254 provides that if the commissioner determines it is in the public interest, the commissioner may include in any administrative action a claim for ancillary relief, including a claim for restitution or disgorgement or damages on behalf of persons injured by the act constituting the subject matter of the action. Section 25254 also entitles the commissioner to recover costs, including attorney's fees and investigative expenses.

⁴ Section 25532, subdivision (a), provides: "If, in the opinion of the commissioner, the sale of any security is subject to qualification under this law and it is being offered or sold without first being qualified, the commissioner may order the issuer or offeror of such security

6. The department has not qualified any offer or sale of securities by Salazar, Mermis, Barrios or MarrCal Oil. The department has no record of an application for qualification, or notice of exemption, for Salazar, Mermis, Barrios or MarrCal Oil.

Factual Background

7. MarrCal Oil was a corporation formed in California on October 11, 2005, and suspended in May 2007. Respondent Barrios was the president of MarrCal Oil, and respondents Mermis and Salazar were agents and managers of MarrCal Oil. Salazar was involved in soliciting investors.

8. MarrCal Oil, Salazar, Barrios and Mermis formed and managed the following limited liability companies in California: MarrCal August 2005 Associates, L.L.C.; MarrCal September 2005 Associates, L.L.C.; MarrCal December 2005 Associates, L.L.C.; and, MarrCal June 2006 Associates, L.L.C. The founding members stated that they had acquired the rights in technology that could return capped oil wells to production. The business was based on the successful utilization of technology developed by Andrew Marr. MarrCal Oil described Marr's technology as using equipment to detect paraffin build up in a well, and using heat to melt the paraffin and chemicals to create pressure to force the oil to flow out of the well. MarrCal Oil leased non-producing wells in Tennessee and planned to treat them with Marr's technology.

9. In 1993, Salazar was charged with over 90 counts of fraud in the offer and sale of securities, specifically interests in limited partnerships. Salazar stipulated that the losses to the victims were \$811,805. He was convicted of two felony counts of securities fraud on February 17, 1995, and sentenced to four years in state prison, the execution of which was suspended. Salazar was placed on probation and ordered to repay the victims of his crimes.

10. Salazar was licensed as an attorney by the California State Bar. In 1995, following his felony convictions, Salazar was disbarred.

MarrCal August 2005 Associates, L.L.C.

11. The operating agreement for the MarrCal August 2005 Associates, L.L.C., is dated August 12, 2005. It states that the purpose of the L.L.C. is "to engage in business for profit, and specifically to engage in the Enhance Oil Recovery (sic) and related business." The operating agreement identifies Salazar as the "Initial Founding Member," and identifies the following members:

to desist and refrain from further offer or sale of such security unless and until qualification has been made under this law." Section 25401 provides that it is unlawful for any person to offer or sell a security in this state 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 light of the circumstances under which they are made, not misleading.

Founding Members

Salazar, trustee for D & L Trust
Salazar, trustee for X. O. Barrios, M.D., Trust
Mermis, trustee for Mermis Family Trust

Coordinating Members

Philip Kurien
Mark Ward
Joseph A. Atencio, trustee, Atencio Family Trust

Financial Members

L. W.
J.M.

12. The Founding Members are identified in the operating agreement as having invested the time to locate, evaluate and acquire rights in technology necessary or useful to the founding of the enterprise. The operating agreement identifies the Founding Members as the members who will coordinate the operation of the business enterprise. Coordinating Members are members who have assisted in the location and coordination of resources necessary or useful in the success of the venture.

13. Financial Members are identified in the operating agreement as the members who have provided cash for the working capital to initiate the company. There were two investors in the MarrCal August 2005 Associates, L.L.C. L. W.⁵ invested \$20,000. J. M. invested \$220,000.

14. The voting power of the members is identified in the operating agreement as: Founding Members – 40 percent, Coordinating Members – 10 percent, Financial Members – 50 percent.

MarrCal September 2005 Associates, L.L.C.

15. The operating agreement for the MarrCal September 2005 Associates, L.L.C., is dated September 23, 2005. It states that the purpose of the L.L.C. is “to engage in business for profit, and specifically to engage in the Enhance Oil Recovery (sic) and related business.” The operating agreement identifies the “Initial Founding Member” as Salazar. It also identifies the following members:

Founding Members

Salazar, trustee for D & L Trust
Salazar, trustee for X. O. Barrios, M.D., Trust
Mermis, trustee for Mermis Family Trust

⁵ Initials are used to identify the Financial Members, or investors, in order to protect their privacy.

Coordinating Members

Joseph A. Atencio
Takumi Noma

Financial Members

L. G.
G. O.
T. I.
C. B.

16. Mermis is identified in the operating agreement as the Chief Financial Officer.

17. The Founding Members are identified in the agreement as having invested the time to locate, evaluate and acquire rights in technology necessary or useful to the founding of the enterprise. The operating agreement identifies the Founding Members as the members who will coordinate the operation of the business enterprise. Coordinating Members are members who have assisted in the location and coordination of resources necessary or useful in the success of the venture.

18. Financial Members are identified in the operating agreement as the members who have provided cash for the working capital to initiate the company. There were four investors in the MarrCal September 2005 Associates, L.L.C. : L. G. invested \$20,000, G. O. invested \$50,000, T. I. invested \$75,000, and C. B. invested \$15,000. The voting power of the members is identified in the operating agreement as: Founding Members – 40 percent, Coordinating Members – 10 percent, Financial Members – 50 percent.

19. Financial Member/investor G. O. lives in Los Angeles, California. G. O. has worked in the auto parts export business. His only prior investment experience was in the purchase of \$30,000 in mutual funds and a loan to an acquaintance to help finance a mortgage. G. O.'s net annual income is less than \$75,000, and his net worth is less than \$150,000.

20. G. O. met Coordinating Member Takumi Noma at a local businessperson's meeting. Noma provided G. O. with written materials and discussed the prospect of investing in MarrCal Oil with him. Noma recommended an investment in MarrCal Oil.

21. In November 2005, G. O. was at an auto supply convention in Las Vegas, when Noma advised him to meet with Salazar. He had no prior relationship with Salazar or anyone else associated with MarrCal Oil. G. O. and Salazar met for two hours. G. O. understood that MarrCal Oil had obtained proprietary technology to extract oil from old wells. He was told he could expect to receive his principal investment returned in one year and 10 percent every year thereafter.

22. G. O. was given the MarrCal Oil Company Marketing Disclosure and Contract Documents and Operating Agreement of MarrCal September 2005 Associates, L.L.C., when he invested. On December 8, 2005, G. O. invested \$50,000.

23. Shortly after investing, Noma told G. O. that Salazar had had a falling out with Marr, and G. O.'s money was gone. In February 2010, Salazar sent G. O. \$5,000. G. O. has received no other payments from Salazar or MarrCal Oil.

24. Prior to making his investment, G. O. was not told that Salazar had been convicted of two felony counts of securities fraud. The MarrCal Oil marketing documents provided to G. O. contain Salazar's resume. The resume indicates that he has a juris doctor degree, but it does not state that Salazar was disbarred.

MarrCal December 2005 Associates, L.L.C.

25. The operating agreement for the MarrCal December 2005 Associates, L.L.C., is dated December 8, 2005. It states that the purpose of the L.L.C. is "to engage in business for profit, and specifically to engage in the Enhance Oil Recovery (sic) and related business." The operating agreement identifies the "Initial Founding Member" as Salazar. It also identifies the following members:

Founding Members

Salazar, trustee for D & L Trust
Salazar, trustee for X. O. Barrios, M.D., Trust
Mermis, trustee for Mermis Family Trust
Atencio, Chief Financial Officer

Coordinating Member

Ross Blevins

Financial Members

I. R.
E. E.

26. The Founding Members are identified as having invested the time to locate, evaluate and acquire rights in technology necessary or useful to the founding of the enterprise. The operating agreement identifies the Founding Members as the members who will coordinate the operation of the business enterprise. Coordinating Members are members who have assisted in the location and coordination of resources necessary or useful in the success of the venture.

27. Financial Members are identified in the operating agreement as the members who have provided cash for the working capital to initiate the company. There were two investors in the MarrCal December 2005 Associates, L.L.C.: I. R. invested \$80,000 and E. E. invested \$110,000. The voting power of the members is identified in the operating agreement as: Founding Members – 40 percent, Coordinating Members – 10 percent, Financial Members – 50 percent.

28. I. R. lives in Ft. Lauderdale, Florida and Albuquerque, New Mexico. I. R. has a Bachelor of Arts degree in art. She owns a commercial real estate brokerage and financing company. I. R. had no investment experience except for real estate investments prior to investing in MarrCal Oil. She had no previous experience in the oil and gas industry.

29. I. R. first learned of the MarrCal Oil investment opportunity over the telephone from a business acquaintance, Ross Blevins. She had never met Salazar or anyone associated with MarrCal Oil before Blevins put her in touch with Salazar. I. R. spoke directly with Salazar from his office in California in November 2005. She did not meet Salazar in person until after she invested in MarrCal Oil when Salazar was passing through Albuquerque.

30. Prior to investing in MarrCal Oil, I. R. had about six telephone conversations with Salazar. He described an investment in MarrCal Oil's rights to new technology that was going to bring capped oil wells into production again. Salazar represented that the oil wells would generate 10 to 30 barrels of oil per day after the new device was implemented. Salazar told I. R. that in exchange for a \$200,000 investment, she would receive her own oil well. Salazar told I. R. that she would invest up to \$100,000, as needed, initially. The second \$100,000 was to come from the profits of the well production. I. R.'s \$100,000 would be repaid before the other partners received any distribution. After being repaid, I. R. was told that she would receive 50 percent of the wells' profits.

31. I. R. made a series of investments totaling \$80,000 to become the financial member of MarrCal December 2005 Associates, L.L.C. I. R. received a 50 percent share in the partnership pursuant to the operating agreement and a memorandum of understanding, which were signed by Salazar. I. R. gave the investment money to MarrCal December 2005 Associates, L.L.C., to earn a profit on the investment. I. R. exercised no control over the management of the investment, and does not know if the investment money was used as planned. The well was located in Tennessee. She was located in Florida and New Mexico.

32. Blevins and Salazar both told I. R. that the investment was a "sure thing," and that there was "no risk." They advised her that it was the best investment opportunity that they had ever seen. Salazar told I. R. that if anything went wrong, he would guarantee her investment.

33. Prior to making the investment, I. R. was not advised that Salazar had been convicted of two felony counts of securities fraud. I. R. would never have invested any money with MarrCal Oil if she had known of Salazar's convictions.

34. I. R. was supposed to start receiving money three months after making the investment. She did not receive any money, and not one of the leased wells produced any oil to her knowledge. She retained an attorney in an attempt to have her investment returned. In 2010, I. R. received \$25,000 from Salazar. She has received no further payments, and lost \$55,000 on her investment with MarrCal Oil.

35. E. E. lives in Alhambra, California. E. E. has a college degree in English literature, and is an elementary school teacher. E. E. has no training or education in business or

finance, and had never invested in anything before investing in MarrCal Oil. E. E. did not know anyone associated with MarrCal Oil before being introduced by an acquaintance, Coordinating Member Noma. Noma strongly recommended that E. E. invest in MarrCal Oil. E. E. understood that MarrCal Oil was involved in bringing oil wells back into production with a new recovery system. E. E. recalls reviewing information about MarrCal Oil on the internet.

36. E. E. invested \$110,000 in MarrCal September 2006 Associates, L.L.C. The operating agreement of MarrCal September 2006 Associates, L.L.C., was signed by Salazar on June 10, 2006. E. E. received a 50 percent share in the partnership pursuant to the operating agreement. E. E. gave the investment money to MarrCal September 2006 Associates, L.L.C., to earn a profit on the investment. E. E. exercised no control over the management of the investment. The well was located in Tennessee.

37. E. E. obtained the MarrCal Oil business plan after his investment. E. E. was never advised that a principal of MarrCal Oil had been convicted of two counts of felony securities fraud. If E. E. had been aware of this information, E. E. would have considered the information to be significant, and it may have made a difference in the decision to invest.

38. E. E. has not received any profits or reimbursement on the investment.

Real Property Trade for Investment in Oil Lease Rights

39. In 2006, H. T. was introduced to Salazar through a friend in the banking business, Coordinating Member Noma. H. T. had been a licensed real estate broker; however, in 2006 she was retired. H. T. resided in California and had no previous experience in the oil and gas industry. H. T. owned her own home and a condominium that she rented for extra income. She was tired of owning a rental property and was looking for another investment.

40. Noma recommended that H. T. meet with Salazar and consider an investment in MarrCal Oil. H. T. hoped to avoid paying tax on the capital gain on her rental property through a 1031 Exchange.⁶

41. Salazar came up with an inventive scheme of having H. T. raise the money to invest in MarrCal Oil by selling her condominium to Salazar's ex-wife, Diana Verdugo. H. T. was aware that a condominium nearby had recently been listed for \$178,000, and she figured her condominium was worth approximately the same amount. Salazar offered to have his ex-wife buy the property for \$200,000, and set up a 1031 Exchange, by investing H. T.'s interest in the condominium in MarrCal Oil. MarrCal Oil agreed to provide H. T. with an oil and gas lease

⁶ A "1031 Exchange" refers to Internal Revenue Code section 1031, which permits the seller of an investment property to defer paying taxes on the gain if the proceeds are reinvested in similar property as part of a qualifying like-kind exchange. In order to defer the taxes, the owner must identify a potential replacement property to a qualified intermediary within 45 days, and the purchase of the replacement property must be completed within the earlier of 180 days or the due date for the exchanger's tax return.

of a like kind to a fee interest so as to qualify for 1031 Exchange treatment with the Internal Revenue Service. MarrCal Oil promised that if the IRS did not accept the transaction as a tax-free exchange, MarrCal Oil would pay the additional tax on H. T.'s behalf.

42. On July 6, 2006, MarrCal Oil transferred a long-term leasehold interest in an oil well in Tennessee to H. T. H. T. agreed to allow Andrew Marr and MarrCal Oil to continue as well operators and managers of her oil well. Eighty percent of the income derived from the oil income on the lease was to be paid to H. T. until she received \$200,000. Thereafter, H. T. would receive 50 percent of the income from the well, and MarrCal Oil would receive 50 percent of the income.

43. On July 6, 2006, escrow closed and Verdugo took title to H. T.'s condominium. Either Salazar or Verdugo put \$10,000 down and Salazar arranged for a mortgage loan for the balance. The loan money went to Salazar in exchange for H. T.'s oil and gas lease interest. MarrCal Oil promised the well would produce a reasonable amount of oil, which would provide at least as much profit as the rental income on her condominium investment. Salazar promised further that if MarrCal Oil did not produce such a well within six months of the date of escrow closing, at H. T.'s option, MarrCal Oil would repurchase her oil and gas leasehold interest by either paying her \$200,000 in cash, or offering to trade it for a parcel of real estate with an equity value equal to her condominium.

44. On August 20, 2006, H. T. contacted Salazar to inquire whether MarrCal Oil had started pumping oil from her well as promised. Salazar had promised that H. T. would receive her first check at the beginning of September. H. T. was depending on the income to meet her expenses in the absence of the rental income from the condominium. On August 25, 2006, Salazar telephoned H. T. and promised that she would receive her first check by September 10, 2006. H. T. received nothing from MarrCal Oil in September as promised. Thereafter, H. T. contacted Salazar repeatedly regarding the status of the investment, advising him that she was relying on the income to pay bills. On March 7, 2007, Salazar promised that since the well was not producing oil, he would return her investment in cash by March 31, 2007. Shortly thereafter, Salazar returned \$4,000 to H. T. That is the extent of the return H. T. received on her investment. In January 2008, H. T. learned that her lease interest had expired.

45. H. T. hired an attorney to contact MarrCal Oil and demand return of her funds. On July 25, 2008, her attorney wrote to MarrCal Oil demanding a return of H. T.'s investment. On July 31, 2008, Mermis, who identified himself as the vice-president of development for MarrCal Oil, responded, claiming that the accusations made in the letter were incorrect. No further payments were made by MarrCal, but H. T. was unable to sue due to a lack of resources.

46. The representations made to H. T. omitted the following facts: 1) Salazar had been disbarred by the State Bar for his securities fraud convictions; 2) Salazar had been convicted of two felony counts of securities fraud; and 3) the investment was risky.

47. H. T. has received only \$4,000 from MarrCal Oil in exchange for her condominium.

Attorney's Fees

48. On April 30, 2013, corporations counsel filed a declaration under penalty of perjury, in which he states that he reviewed the confidential log of the hours spent on this file by attorneys employed in the enforcement division. Counsel declares that since opening the file through the hearing date of April 18, 2013, counsel have billed a total of 399 hours at an hourly rate of \$50.05. The commissioner requests reimbursement in the amount of \$19,969.95. The commissioner also requests reimbursement for the costs of hearing billed by the Office of Administrative Hearings, but does not offer evidence of those costs.

Salazar's Evidence

49. Salazar spent eight years working on this venture. He obtained the rights to the technology from Andy Marr, who developed it. Salazar contracted with Marr to oversee the use of the technology. Salazar founded MarrCal Oil as a vehicle to run what he expected would be a profitable business. Salazar leased capped oil wells located in Tennessee to drill and extract oil using the Marr technology. They drilled four wells, but were unsuccessful in extracting enough oil to make the business profitable.

50. Salazar formed the L.L.C.'s and arranged for the like-kind property transfer with H. T. in order to finance the purchase of the leases and the cost of drilling the wells with Marr's technology. Salazar considers the transactions to be real estate transactions or loans, rather than securities.

51. Although Salazar concedes that Noma, Blevins and Kurien each received either a commission or an interest in the business for their participation in bringing investors into the venture, Salazar asserts that these individuals worked for the investors rather than for MarrCal Oil or one of its L. L. C.'s.

52. Salazar participated in developing the MarrCal Oil business plan. He does not recall if the investors were given a copy of the business plan. The business plan identifies Salazar as the Chief Operating Officer. It describes Salazar as having a 30-year history of building and managing organizations in the bank, healthcare, construction, real estate and energy industries. It does not mention that Salazar was disbarred or that he was convicted of securities fraud.

53. Salazar promises that he will soon repay all of the investors. Salazar reports having paid some money to some investors, but does not recall how much. Salazar does not dispute the list of investors or amounts they invested as provided by his counsel to the commissioner.

Mermis's Evidence

54. Mermis did not appear at hearing or submit any evidence.

LEGAL CONCLUSIONS

Did Mermis and Salazar violate section 25110 by offering and selling unqualified, non-exempt securities?

1. It is unlawful in California for any person to offer or sell any security in an issuer transaction unless such sale has been qualified or unless the transaction is exempt. (§ 25110.) To establish a violation of section 25110, the department must establish an offer and/or sale involving a security that occurred in California linked to an issuer transaction and that the offer was not qualified with the department. Salazar and Mermis carry the burden of proof if they claim that the security or transaction is exempt from qualification. (§ 25163.) The evidence established that the offers made by Salazar, Mermis and MarrCal Oil were not qualified by the department. (Factual Finding 6.) No evidence of an exemption was established by respondents. The issue is whether respondents offered or sold securities as that term is defined in the California Corporate Securities Law.

2. The California Corporate Securities Law defines the term “security” broadly. The purpose of such a broad definition is “to protect the public against spurious schemes, however ingeniously devised, to attract risk capital.” (*Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 814.) The term security is defined in section 25019:

‘Security’ means any note; stock; . . . evidence of indebtedness; investment contract; . . . interest in a limited liability company and any class or series of those interests (including any fractional or other interest in that interest), except a membership interest in a limited liability company in which the person claiming this exception can prove that all of the members are actively engaged in the management of the limited liability company; provided that evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company; certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under that title or lease; . . .

3. An “investment contract,” as used in section 25109, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. (*S.E.C. v. W.J.*

Howey (1946) 328 U.S. 293.)⁷ In *Howey*, the investors were offered units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor. The United States Supreme Court held that a corporation that offered the opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by the corporation, to persons who resided in distant locations and who lacked the equipment and experience to operate the citrus grove, through service and land sale contracts, which served as a method of determining the investors' shares of profits, were offering "investment contracts," within the meaning of the federal Securities Act. (See also, *People v. Schock, supra*, 152 Cal.App.3rd 379 [sale of fractional interests in promissory notes, and secured transaction involving series of promissory notes constitute securities where transactions involved group of small individual investors who relied primarily on skill and services of company to supervise enterprise and protect investors]; *McCown v. Heidler* (1975) 527 F.2d 204 [sale of undeveloped lots by developer in real estate project constituted an "investment contract" where developer touted project as having substantial investment potential, where investors did not reside on land, and without substantial improvements pledged by developers the lots would not have a value consistent with the purchase price].)

4. The case of *Consolidated Management Group v. Department of Corporations* (2008) 162 Cal.App.4th 598, involves a similar factual scenario and is instructive. The court there held that the offer and sale of interests in out-of-state oil and gas projects constituted investment contracts and therefore securities. In *Consolidated Management Group*, a Kansas limited liability company formed a number of general partnerships that purchased oil and gas exploration and drilling equipment and leased the equipment to oil and gas operators. The case involved the sale of units of joint venture interests in the general partnerships. The individuals marketing the partnership units advised investors that the investment could potentially return 21 percent per year. Consolidated personnel had been drilling for oil for 30 years and when they found natural gas instead of oil, they had capped the wells. Consolidated retained the rights to the capped wells and planned to lease equipment to firms that would extract the natural gas from the capped wells.

The investors had no relationship with the individuals marketing the investment. The individual marketing the investment stated that he advised investors that they would be required to actively participate in the management of the partnerships, however, the investors had no experience in the oil and gas industry, and the equipment was located out-of-state.

5. In this matter, H. T., E. E., G. O., and I. R. had no previous relationship with Mermis, Salazar or the members of MarrCal Oil or the limited liability partnerships. They were not experienced in oil and gas investments. (Factual Findings 18 through 19, 28, 35 and 39.) Indeed, G. O. and E. E. had little or no prior experience in any type of investments. (Factual Findings 19 and 35.) These four investors lived far away from the location of the

⁷ Since California Corporate Securities Law was patterned after the Federal Securities Act of 1933, federal decisions interpreting that Act in defining the term "security" should be consulted. (*People v. Schock* (1984) 152 Cal.App.3rd 379, 387.)

wells, and all understood that it was respondents and their agents who would be coordinating the use of the new technology to extract oil from the capped wells. (Factual Findings 17, 19, 26, 28, 35, 36, 39 and 42.) The investors were not simply making loans to respondents; rather, they were expecting to earn profits after the initial investment was repaid. (Factual Findings 21, 30, 36 and 42.) The sale of the interests in the oil well profits constituted securities. Therefore, Mermis and Salazar violated section 25110 by offering and selling these unqualified, non-exempt securities.

Did respondents violate section 25401 by making misrepresentations or by omitting to state material facts?

6. It is unlawful in California to make untrue statements of material facts or to omit material facts when offering to sell or selling a security. (§ 25401.) Information is material if there is a substantial likelihood that a reasonable investor would consider it important in making a decision as to whether to invest. (*Insurance Underwriters Clearing House, Inc. v. Natomas Co.* (1986) 184 Cal.App.3d 1520, 1526.)

7. The evidence established that when offering the securities to H.T., E.E., G.O. and I.R., Salazar, while acting on behalf of MarrCal Oil and the limited partnerships, failed to disclose that he was convicted of two counts of felony securities fraud. (Factual Findings 24, 33, 37 and 46.) H. T., G. O. and I. R. would not have made the investment if they had known about Salazar's criminal convictions, and E. E. thought the information was significant. A reasonable investor would have been unlikely to invest in the venture if he or she had known about Salazar's criminal convictions for securities fraud. (Factual Findings 33, 37.) Salazar's failure to disclose his convictions constituted a material misrepresentation.

8. Salazar, while acting on behalf of MarrCal Oil and the limited partnerships, represented to I. R. and H. T. that there was no risk in the investment. (Factual Finding 32 and 43.) This statement was also a material misrepresentation.

9. I. R. and H. T. were unaware that Salazar was disbarred by the State Bar after being convicted of securities fraud. (Factual Findings 33 and 46.) This omission also constitutes a material misrepresentation.

10. The commissioner did not establish whether the remaining investors were unaware of Salazar's convictions, his disbarment or that the investment was risky.

11. In the sale of securities on behalf of MarrCal Oil and the limited partnerships, Salazar failed to disclose material facts to at least four investors, in violation of section 25401.

Does cause exist to levy administrative penalties?

12. Section 25252 authorizes the commissioner to issue an order levying administrative penalties against any person for willful violations of any provision of the

Corporate Securities Law and any rules promulgated thereunder. The statute permits administrative penalties in the amount of \$1,000 for the first violation and \$2,500 for each subsequent violation.

ADMINISTRATIVE PENALTIES FOR VIOLATING SECTION 25110

13. The commissioner imposed administrative penalties pursuant to section 25252, for four violations of section 25110 (selling unqualified, non-exempt securities): \$1,000 for the first violation, and \$7,500 for the next three violations, totaling \$8,500. Pursuant to Legal Conclusion 5, the commissioner has established at least four violations of section 25110, and therefore cause exists to levy administrative penalties in the amount of \$8,500 pursuant to sections 25252 and 25110.

ADMINISTRATIVE PENALTIES FOR VIOLATING SECTION 25401

14. In the commissioner's rebuttal brief, for the first time, the commissioner seeks to impose administrative penalties pursuant to section 25252 for violations of section 25401 in the amount of \$110,000. In the order, the commissioner levied penalties in the amount of \$21,000, which is based on the nine investors (\$1,000 for the first violation and \$2,500 for the remaining eight investors).⁸

15. Pursuant to Legal Conclusion 11, the commissioner only established that respondents violated section 25401 with regard to four investors (H. T., I. R., E. E. and G. O.). Therefore, the total administrative penalties that may be levied for violations of section 25401, is \$8,500. Cause therefore exists to levy administrative penalties pursuant to sections 25252 and 25401 in the amount of \$8,500.

Does cause exist to order ancillary relief?

RESTITUTION OR DISGORGEMENT OF PROFITS

16. Section 25254, subdivision (a), authorizes the commissioner to claim 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.

17. The commissioner ordered full restitution in the amount of \$790,000 and interest accumulated on the investment principal or according to proof. The figure of \$790,000 is the total amount the eight investors invested in the LLP's, plus the \$200,000 invested in the project through the 1031 Exchange offered to H. T. (Factual Findings 13, 18,

⁸At hearing, a motion to amend the order to correct the total administrative penalties sought pursuant to sections 25252 and 25401 was granted. The total is \$21,000, rather than \$20,500, as originally contained in the order.

27 and 41 through 43.)

18. No evidence of interest accumulated was presented.

19. I. R. received \$25,000 in reimbursement from Salazar. (Factual Finding (Factual Finding 34.) H. T. received \$4,000 in reimbursement from Salazar. (Factual Finding 47.) G. O. received \$5,000 in reimbursement from Salazar. (Factual Finding 23.) E. E. did not receive any reimbursement from Salazar. (Factual Finding 38.) Salazar did not present credible evidence of having reimbursed the other investors. (Factual Finding 53.) The total figure to be deducted from the \$790,000 is \$34,000. Thus, reimbursement in the amount of \$756,000 is supported by the evidence, with the respective amounts owing to the investors:

L. W.	\$ 20,000
J.M.	\$ 220,000
L. G.	\$ 20,000
G.O.	\$ 45,000
T. I.	\$ 75,000
C. B.	\$ 15,000
I. R.	\$ 55,000
E. E.	\$ 110,000
<u>H. T.</u>	<u>\$ 196,000</u>
Total:	\$ 756,000

Cause exists to order ancillary relief for restitution in the amount of \$756,000.

ATTORNEY'S FEES AND INVESTIGATIVE COSTS

20. Section 25254, subdivision (b), authorizes the commissioner to recover costs, which in the discretion of the administrative law judge may include an amount representing reasonable attorney's fees and investigative expenses for services rendered.

21. Counsel declares that since opening the file through the hearing date of April 18, 2013, counsel have billed a total of 399 hours at an hourly rate of \$50.05. The commissioner requests reimbursement in the amount of \$19,969.95. The commissioner also requests reimbursement for the costs of hearing billed by the Office of Administrative Hearings, but does not offer evidence of those costs. (Factual Finding 48.)

22. In light of the complexity of this matter, the amount of the requested reimbursement for attorney's fees is reasonable.

23. No evidence of investigative costs was offered in evidence.

24. Section 25254 does not authorize reimbursement for the costs the Office of Administrative Hearings charges for conducting the hearing, nor has the commissioner established the amount of the costs. (Factual Finding 48.)

25. Cause exists to order ancillary relief for reimbursement of attorney's fees, in the amount of \$19,969.95, pursuant to section 25254, subdivision (b).

Does cause exist to issue a desist and refrain order?

26. Section 25532, subdivision (a), provides that if, in the opinion of the commissioner, the sale of a security is subject to qualification and has been offered or sold without first being qualified, the commissioner may order the issuer or offerer of the security to desist and refrain from the further offer or sale of the security until qualification has been made. As set forth in Legal Conclusion 5, respondents Salazar, and Mermis, as officers and agents of MarrCal Oil, and Founding Members of the limited partnerships with management authority, sold securities subject to qualification without the securities first being qualified. Therefore, cause exists to issue a desist and refrain order pursuant to section 25532, subdivision (a).

27. Section 25532, subdivision (c), provides that 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. As set forth in Legal Conclusions 6 through 11, respondent Salazar, on behalf of MarrCal Oil and the limited partnerships, violated section 25401. Therefore, cause exists to issue a desist and refrain order pursuant to section 25532, subdivision (c).

Conclusion

28. The evidence established that cause exists to affirm the commissioner's Desist and Refrain Order of June 2012 against respondents Mermis and Salazar. (Legal Conclusions 26 and 27.)

29. The evidence established that cause exists to levy administrative penalties in the amount of \$17,000, for which Mermis and Salazar are jointly and severally liable. (Legal Conclusions 12 through 15.)

30. The evidence established that cause exists to order ancillary relief pursuant to sections 25254, 25110 and 25401, for restitution in the amount of \$756,000, for which Mermis and Salazar are jointly and severally liable. Cause also exists to order ancillary relief pursuant to section 25254, for reimbursement of attorney's fees in the amount of \$19,969.95, for which Mermis and Salazar are jointly and severally liable. (Legal Conclusions 16 through 25.)

ORDER

1. The Order to Desist and Refrain, issued against Joseph A. Mermis and C. Mackey y Salazar, by the Commissioner of Corporations on June 12, 2012, is affirmed.

2. The Order Levying Administrative Penalties in the amount of \$29,000 is modified to reflect administrative penalties in the amount of \$17,000. Respondents Joseph A. Mermis and C. Mackey y Salazar are jointly and severally liable for the administrative penalties, subject to credits for payments made by MarrCal Oil Company, Inc., or Xavier O. Barrios. As modified, the Order Levying Administrative Penalties is affirmed.

3. The Order for Ancillary Relief is modified to reduce the amount of restitution to \$756,000, consisting of the investors' investment principal, less amounts shown to have been previously reimbursed. The Order for Ancillary Relief is further modified to include the reimbursement of attorney's fees in the amount of \$19,969.95. Respondents Joseph A. Mermis and C. Mackey y Salazar are jointly and severally liable for the payment of restitution and attorney's fees, subject to credits for payments made by MarrCal Oil Company, Inc., or Xavier O. Barrios. As modified, the Order for Ancillary Relief is affirmed.

DATED: 6/2, 13

/s/

JILL SCHLICHTMANN

Administrative Law Judge

Office of Administrative Hearings

ERRATA SHEET

(Changes to Proposed Decision – C. Mackey y Salazar; Xavier O. Barrios; Joseph A. Mermis; and MarrCal Oil Company, Inc.)

- 1) On page 2 of the proposed decision, first paragraph of the Factual Findings, line 2, after “Corporate Securities Law” insert “of 1968 (Corporate Securities Law)”.
- 2) On page 2 of the proposed decision, third paragraph of the Factual Findings, line 1, delete “\$29,500” and insert “\$29,000”.
- 3) On page 2 of the proposed decision, third footnote, line 2, after “including” insert “, but not limited to,”.
- 4) On page 2 of the proposed decision, third footnote, line 3, after “act” insert “or practice”.
- 5) On page 2 of the proposed decision, fourth footnote, line 1, after “the commissioner,” insert “(1)”.
- 6) On page 2 of the proposed decision, fourth footnote, line 2, delete “any” and insert “a”.
- 7) On page 2 of the proposed decision, fourth footnote, line 2, after “is being” insert “or has been”.
- 8) On page 2 of the proposed decision, fourth footnote, line 3, delete “such” and insert “the”.
- 9) On page 3 of the proposed decision, fourth footnote, line 1, after “refrain from” insert “the”.
- 10) On page 3 of the proposed decision, fourth footnote, line 1, delete “such” and insert “the”.
- 11) On page 3 of the proposed decision, fourth footnote, line 1, delete “unless and”.

- 1 12) On page 3 of the proposed decision, fourth footnote, line 2, delete “law.” and
2 insert “law...”.
- 3 13) On page 3 of the proposed decision, fourth footnote, line 5, delete “are
4 make” and insert “were made”.
- 5 14) On page 12 of the proposed decision, fifth paragraph of the Legal
6 Conclusions, line 2, delete “partnerships” and insert “companies”.
- 7 15) On page 12 of the proposed decision, seventh footnote, line 1, delete
8 “Federal” and insert “federal”.
- 9 16) On page 13 of the proposed decision, seventh paragraph of the Legal
10 Conclusions, line 2, delete “partnerships” and insert “liability companies”.
- 11 17) On page 13 of the proposed decision, seventh paragraph of the Legal
12 Conclusions, line 4, delete “G.O.”.
- 13 18) On page 13 of the proposed decision, eighth paragraph of the Legal
14 Conclusions, line 1, delete “partnerships” and insert “liability companies”.
- 15 19) On page 13 of the proposed decision, eleventh paragraph of the Legal
16 Conclusions, line 1, delete “partnerships” and insert “liability companies”.
- 17 20) On page 16 of the proposed decision, twenty-sixth paragraph of the Legal
18 Conclusions, line 6, delete “partnerships” and insert “liability companies”.
- 19 21) On page 16 of the proposed decision, twenty-seventh paragraph of the
20 Legal Conclusions, line 4, delete “partnerships” and insert “liability
21 companies”.
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