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## Texas State Securities Board

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### SOAH DOCKET NO. 312-05-0553

IN THE MATTER OF  
DUNWELL CORPORATION;  
ROBERT C. DUNCAN; AND  
TAYLOR SMITH

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§  
§  
§

ORDER NO. ENF-05-CDO-1591

TO: Dunwell Corporation  
6953 Brookshire Drive  
Dallas, Texas 75230

Robert C. Duncan  
8144 Walnut Hill Lane  
Suite 285  
Dallas, Texas 75231

Taylor Smith  
368 Crenshaw  
Dallas, Texas 75217

### ORDER CONFIRMING EMERGENCY CEASE AND DESIST ORDER

#### STATEMENT OF THE CASE

The Texas Securities Commissioner issued an Emergency Cease and Desist Order (Emergency Order) on August 20, 2004, instructing Dunwell Corporation, Robert C. Duncan, and Taylor Smith (Respondents) to stop acting as securities dealers and agents until they are properly registered or an exemption is established; to stop offering for sale any unregistered non-exempt securities; to stop engaging in any fraud in connection with the offer for sale of any security; and to stop offering securities by the use of any statement that is materially misleading or otherwise likely to deceive the public. The Emergency

Order concerned Respondents' offer to sell 30% of the working interest in an oil/gas well to be drilled by Mesa Energy Operating, L.L.C. (Mesa) in Choctaw County, Alabama. Respondents denied the allegations against them and appealed the Emergency Order.

The Texas State Securities Board (Board) has jurisdiction over this matter pursuant to the §§ 23-2 and 24 of the Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 *et seq.* (Vernon 1964 and Supp. 2004). The State Office of Administrative Hearings (SOAH) has jurisdiction pursuant to TEX. GOV'T CODE ANN. ch. 2003 (Vernon 2004).

The Commissioner issued the Emergency Order on August 20, 2004, and Respondents timely filed appeals. The Board's Staff issued a notice of the hearing on September 24, 2004, stating the time and place of the hearing, the legal authority and jurisdiction under which it was to be held, the particular sections of the statutes and rules involved, and the matters asserted. The hearing was originally set for October 1, 2004, but was continued to October 19, 2004, upon a motion filed by Respondents Dunwell Corporation and Robert C. Duncan.

Administrative Law Judge (ALJ) Thomas H. Walston convened a hearing on the merits on October 19, 2004, at the SOAH hearing facilities in Austin, Texas. Attorneys James Zier and Trent Walsh appeared on behalf of Board Staff. Mr. Robert C. Duncan appeared on behalf of himself and Dunwell Corporation (Dunwell) and was represented by attorneys Al Kroemer and Frank Arnold. Neither Taylor Smith nor anyone acting on his behalf appeared at the hearing. As a result, Staff filed a motion to dismiss Taylor Smith's appeal, which was granted by Order No. 4. The evidentiary hearing concluded October 19, 2004. The parties filed their initial post-hearing briefs November 5, 2004, and their reply briefs November 15, 2004, at which time the record closed. The ALJ issued a Proposal for Decision on January 14, 2005, recommending that the Board affirm in part and set aside in part the Emergency Order.

Between June and August 2004, Dunwell, Robert Duncan, and Taylor Smith offered for sale 30% of the working interest of an oil/gas well to be drilled by Mesa in the Pintail Prospect located in Choctaw County, Alabama. The price of the offering was \$37,500 per 1% working interest, which produced a total cost of \$1,125,000 for the entire 30% working interest. Participants were also given the option, but not the obligation, to participate in any subsequent wells drilled on the leased acreage in the Pintail Prospect to the same extent they participated in the first well. Mesa owned the oil and gas lease and Respondents obtained the 30% working interest they were selling from Mesa.

Taylor Smith placed calls to prospective investors in an attempt to sell units of the working interest. Unknown to Smith, one of his calls went to the Board's "undercover" telephone line. That call was referred to Board Investigator James Abney, who posed as an interested potential investor. When he first called Abney in May 2004, Smith worked for a company called Meika. Around July 1, 2004, Respondent Duncan hired Smith to work for Dunwell and made him Vice-President. Smith mailed an offering document and made

additional sales calls to Abney concerning the Pintail Prospect while employed at Dunwell. Abney tape recorded the telephone conversations. Duncan fired Smith around July 20, 2004, after which Duncan also called Abney. Mr. Abney was not in the office at the time, but he later returned Duncan's call and recorded that conversation as well.

Based on statements and representations made in the offering document and the telephone calls from Smith and Duncan, the Commissioner issued the Emergency Order. The Order found that Respondents intentionally failed to disclose the following material facts:

- the minimum amount of investors' funds necessary to initiate the program, the disposition of such funds if they are not sufficient for that purpose, and the period of the offering;
- working interest owners may be subject to unlimited liabilities to third parties for the obligations and activities of Respondent Dunwell Corporation, and these liabilities may be in excess of and in addition to the investment amount;
- whether interests in the investment are being offered to third parties at prices or under terms differing from those presented to investors; and
- information regarding the assets, liabilities, profits, losses, cash flow and other financial data of Respondent Dunwell Corporation.

The Order also found that Respondents made materially misleading statements of fact as follows:

- that investors would receive \$1.3 million for an investment of \$37,500;
- that Respondent Dunwell Corporation has drilled and operated hundreds of oil and gas wells without disclosing the drilling results thereof, including the total investment in each of such programs and the recovery for investors, if any;
- that each well would produce 300 barrels of oil per day with no decline for 6-8 years; and
- that Respondent Duncan represented that the investment involved "some risk" when the offering document represented that the venture involved a "high degree of risk."

Respondents denied these allegations and contended that the working interests are not securities, or, alternatively, that they are exempt from coverage by the Texas Securities Act.

At the beginning of the hearing, the parties stipulated to Findings of Facts 1, 2, 4, 5 and 6 contained in the Emergency Order.<sup>1</sup> These stipulations establish that the Pintail Prospect working interests were not registered with the Board and that respondents are not registered as securities dealers or agents. These stipulations left Staff with the burden of proving the Emergency Order's Findings of Fact Nos. 7-11, as well as the Conclusions of Law.<sup>2</sup> These issues primarily concern whether the working interests offered for sale were securities under the Texas Securities Act and whether Respondents made any false or misleading representations in connection with their sales efforts. Staff has the burden of proof on these issues. Respondents also raised issues concerning whether exemptions under the Texas Securities Act applied to the working interests or the sales transactions. Respondents bear the burden of proof on the exemption issues.

### FINDINGS OF FACT

1. The Commissioner of the State Securities Board (Commissioner) issued an Emergency Cease and Desist Order on August 20, 2004, to Dunwell Corporation, Robert C. Duncan, and Taylor Smith.
2. On September 23, 2004, Respondents timely filed a request for hearing.
3. On September 27, 2004, Respondents agreed to waive the requirement to have a hearing within ten days of their requests.
4. A Notice of Hearing was mailed to each Respondent on September 24, 2004, stating the time and place of the hearing, the legal authority and jurisdiction under which it was to be held, the particular sections of the statutes and rules involved, and the matters asserted.
5. At the request of Dunwell Corporation and Robert C. Duncan, a continuance was granted from the initial hearing date.
6. The evidentiary hearing convened on October 19, 2004. Attorneys James Zier and Trent Walsh appeared on behalf of Board Staff. Mr. Robert C. Duncan appeared on behalf of himself and Dunwell Corporation and was represented by attorneys Al Kroemer and Frank Arnold. Neither Taylor Smith nor anyone acting on his behalf

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<sup>1</sup> In Section III.A. of the Proposal for Decision, Finding of Fact No. "3" was referenced as stipulated, when it should have referenced No. "4" as stipulated. The correction has been incorporated above in agreement with page 14 of the transcript of the hearing.

<sup>2</sup> Finding of Fact No. 3 concerned the last known address of Taylor Smith. However, since Mr. Smith's appeal has been dismissed, this Finding of Fact is now moot. In the Proposal for Decision, this footnote referenced Finding of Fact No. "4", when it should have referenced No. "3".

appeared at the hearing. As a result, Staff filed a motion to dismiss Taylor Smith's appeal, which was granted by Order No. 4. The evidentiary hearing concluded October 19, 2004.

7. The parties filed their initial post-hearing briefs November 5, 2004, and their reply briefs November 15, 2004, at which time the record closed.
8. Board Staff has the burden of proof to establish that the working interests were securities under the Texas Securities Act and that Respondents intentionally failed to disclose material facts or that Respondents made false or materially misleading statements in connection with their offers to sell the working interests.
9. Respondents have the burden of proof to establish that the working interests or their sales transactions were exempt from the provisions of the Texas Securities Act.
10. Staff and Respondents stipulated to the following:
  - a. Respondent Dunwell Corporation (Dunwell) maintains a last known address at 6953 Brookshire Drive, Dallas, TX 75230;
  - b. Respondent Robert C. Duncan maintains a last known address at 8144 Walnut Hill Lane, Suite 285, Dallas, TX 75231;
  - c. Respondents offered to Texas residents oil and gas working interests in a well to be drilled in Choctaw County, Alabama. Respondents are offering 30 units, representing a 30% working interest (22.5% net revenue interest), for \$37,500 per unit;
  - d. The working interests have not been registered by qualification, notification, or coordination and no permit has been granted for their sale in Texas; and
  - e. Respondents have not been registered with the Securities Commissioner as dealers or agents at any time material hereto.
11. Dunwell was not the driller/operator of the proposed oil well.
12. The working interests being sold by Respondents were securities under the Texas Securities Act (Act.)
13. Respondents were not the issuer of the working interest securities. Instead, Respondents acquired the 30% working interest they were selling from Mesa Energy Operating, L.L.C. (Mesa) who was the driller/operator of the proposed well.

14. Between July 1 and July 20, 2004, Respondent Taylor Smith (Smith) was employed by Dunwell and held the office of Vice-President of Dunwell.
15. At all times material to this proceeding, Respondent Robert C. Duncan was employed by Dunwell and held the offices of President and Secretary of Dunwell.
16. Respondents offered no evidence and did not prove that they were employees, directors, or officers of Mesa at anytime material to this proceeding.
17. Between May 2004 and July 20, 2004, Smith had a series of telephone conversations with Mr. James Abney in an effort to sell Mr. Abney one or more working interest units. Unknown to Smith, Mr. Abney was an investigator with the Texas State Securities Board. Mr. Abney tape recorded some of his telephone conversations with Smith.
18. During their telephone conversations, Smith told Mr. Abney that he could realize a return of \$1.3 million for an investment of only \$37,500. Smith made these statements as an employee and vice-president of Dunwell. These statements by Smith were a material misrepresentation of the facts concerning the investment. To realize a return of \$1.3 million, an investor would have to invest approximately \$135,000.
19. On June 30, 2004, Smith mailed Mr. Abney an offering memorandum concerning the working interests in the proposed Alabama well. Mr. Abney received the offering memorandum on July 2, 2004.
20. In connection with the offer for sale of the working interests, Respondents intentionally failed to disclose the minimum amount of investors' funds necessary to initiate the program, the disposition of such funds if they are not sufficient for that purpose, and the period of the offering. These facts would have been material to a reasonable investor that should have been disclosed by Respondents.
21. In connection with the offer for sale of the working interests, Respondents intentionally failed to disclose that working interest owners may be subject to unlimited liabilities to third parties for the obligations and activities of Respondent Dunwell Corporation, and these liabilities may be in excess of and in addition to the investment amount. However, Board Staff failed to prove by a preponderance of the evidence that working interest owners would face such unlimited liability.
22. In connection with the offer for sale of the working interests, Respondents intentionally failed to disclose whether interests in the investment are being offered to third parties at prices or under terms differing from those presented to investors. However, because Respondents did not offer interests in the investment to third

parties at prices or under terms different from those presented to investors, this was not a failure to disclose a material fact.<sup>3</sup>

23. In connection with the offer for sale of the working interests, Respondents intentionally failed to disclose information regarding the assets, liabilities, profits, losses, cash flow and other financial data of Respondent Dunwell Corporation. However, because Dunwell was not the issuer of the working interest securities and would not be the driller/operator of the proposed well, this was not a failure to disclose a material fact.
24. In connection with the offer for sale of the working interests, Respondents represented that Respondent Dunwell Corporation had drilled and operated hundreds of oil and gas wells. Board Staff did not prove that this statement was false or materially misleading.
25. In connection with the offer for sale of the working interests, Respondents represented that 300 barrels of oil per day could be produced from the proposed well with no decline for 6-8 years. Board Staff did not prove that this statement was false or materially misleading.
26. In connection with the offer for sale of the working interests, Respondent Duncan represented that the investment involved "some risk." Board Staff did not prove that this statement was false or materially misleading.
27. Respondents' conduct, acts, and practices threaten immediate and irreparable harm to the public.

#### CONCLUSIONS OF LAW

1. The State Securities Board (the "Board") has jurisdiction over this matter pursuant to Sections 23-2 and 24 of the Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 *et seq.* (Vernon 1964 and Supp. 2004-2005) (the "Act").
2. The State Office of Administrative Hearings has jurisdiction over this matter pursuant to TEX. GOV'T CODE ANN. ch. 2003 (Vernon 2000 and Supp. 2004-2005).
3. Service of proper and timely notice of the hearing was effected upon Respondents pursuant to TEX. GOV'T CODE ANN. ch. 2001 (Vernon 2000 and Supp. 2004-2005) and 7 TEX. ADMIN. CODE § 105.2.

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<sup>3</sup> Finding of Fact No. 22 in the Proposal for Decision has been changed to correct a technical error in the second sentence. The term "and" was changed to "at". The term "at" was used consistently in the Emergency Order, the transcript of the hearing, and in other places in the Proposal for Decision. The legal basis for the change is found in §2001.058(e)(3) of the Administrative Procedure Act.

4. Based on the above Findings of Fact, Respondents offered for sale securities as defined by Section 4.A of the Act.
5. Based on the above Findings of Fact, Respondents acted as dealers in securities or agents of dealers as defined by Sections 4.C and 4.D of the Act.
6. Based on the above Findings of Fact and Conclusions of Law, Respondents offered for sale securities without registering the securities with the Securities Commissioner in violation of Section 7 of the Act.
7. Based on the above Findings of Fact and Conclusions of Law, Respondents offered for sale securities without being registered as dealers or agents in violation of Section 12 of the Act.
8. Because Respondents were not the issuer of the securities, neither the securities, the sales transactions, nor the Respondents were exempt from the requirements of the Texas Securities Act pursuant to the exemptions provided by Board Rules 109.3(c) and 139.16; Texas Securities Act Section 5 .I.(c) or Section 5.Q; or § 18(a) of the federal Securities Act of 1933.
9. Based on the above Findings of Fact and Conclusions of Law, the following Findings of Fact contained in the Emergency Cease and Desist Order are set aside as to Respondents Dunwell Corporation and Robert C. Duncan:
  - Respondents are intentionally failing to disclose the material facts that working interest owners may be subject to unlimited liabilities to third parties for the obligations and activities of Respondent Dunwell Corporation, and these liabilities may be in excess of and in addition to the investment amount;
  - Respondents are intentionally failing to disclose the material facts of whether interests in the investment are being offered to third parties at prices or under terms differing from those presented to investors;
  - Respondents are intentionally failing to disclose the material facts of information regarding the assets, liabilities, profits, losses, cash flow and other financial data of Respondent Dunwell Corporation;
  - Respondents represent that Respondent Dunwell Corporation has drilled and operated hundreds of oil and gas wells, which is materially misleading in light of the fact that Respondents do not disclose the drilling results thereof, including the total investment in each of such programs and the recovery for investors, if any;

- Respondents represent that 300 barrels of oil per day will be produced with no decline for 6-8 years, which is materially misleading in light of the fact that all wells may experience production declines; and
  - Respondents represent that the investment involves “some risk”, which is materially misleading in light of the fact that Respondents represent in sales literature that the venture involves a high degree of risk.
10. Based on the above Findings of Fact and Conclusions of Law, the following Findings of Fact contained in the Emergency Cease and Desist Order are affirmed and shall remain in effect:
- Respondent Dunwell Corporation maintains a last known address at 6953 Brookshire Drive, Dallas, Texas 75230;
  - Respondent Robert C. Duncan maintains a last known address at 8144 Walnut Hill Lane, Suite 285, Dallas, Texas 75231;
  - Respondent Taylor Smith maintains a last known address at 8144 Walnut Hill Lane, Suite 285, Dallas, Texas 75231;
  - Respondents are offering to Texas residents oil and gas working interests in a well to be drilled in Choctaw County, Alabama. Respondents are offering 30 units, representing a 30% working interest (22.5% net revenue interest), for \$37,500 per unit;
  - The working interests have not been registered by qualification, notification or coordination and no permit has been granted for their sale in Texas;
  - Respondents have not been registered with the Securities Commissioner as dealers or agents at any time material hereto;
  - Respondents are intentionally failing to disclose the material facts of the minimum amount of investors' funds necessary to initiate the program, the disposition of such funds if they are not sufficient for that purpose, and the period of the offering; and
  - Respondents represent that investors will receive \$1.3 million for an investment of \$37,500, which is materially misleading in light of the fact that Respondents represent in sales literature that investors will receive an 8 to 1 return on their investment.

IT IS THEREFOR ORDERED that the Emergency Cease and Desist Order issued against DUNWELL CORPORATION and ROBERT C. DUNCAN on August 20, 2004, SHALL REMAIN IN FULL FORCE AND EFFECT, except as modified above.

IT IS FURTHER ORDERED that the Emergency Cease and Desist Order issued against TAYLOR SMITH on August 20, 2004, SHALL REMAIN IN FULL FORCE AND EFFECT, because Smith's appeal was dismissed with prejudice.

Signed this 19<sup>th</sup> day of July, 2005.

  
DENISE VOIGT CRAWFORD  
Securities Commissioner

## CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been sent to the Respondents by certified mail, return receipt requested, at their last known addresses on Page 1 of this Order, and to their representatives named below in this matter by certified mail, return receipt requested, and to the State Office of Administrative Hearings, on this the 19~~th~~ day of July, 2005.

Franklin A. Arnold  
1515 South Capital of Texas Hwy., Suite 415  
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J. Albert Kroemer  
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Thomas H. Walston  
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