**FINANCIAL INDUSTRY REGULATORY AUTHORITY**
**OFFICE OF HEARING OFFICERS**

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| DEPARTMENT OF ENFORCEMENT,<br><br>Complainant,<br><br>v.<br><br>TEXAS E&P PARTNERS, INC., F/K/A CHESTNUT EXPLORATION PARTNERS, INC., F/K/A CHESTNUT ENERGY PARTNERS, INC. (CRD No. 127228),<br><br>and<br><br>MARK A. PLUMMER (CRD No. 4608699),<br><br>Respondents. | Disciplinary Proceeding<br>No. 2014040501801<br><br>Hearing Officer – DRS<br><br>**EXTENDED HEARING PANEL DECISION**<br><br>December 13, 2016 |

**Texas E&P Partners, Inc. is expelled for providing a falsified document to FINRA during an investigation. In light of the expulsion, no additional sanctions are imposed for having inadequate written supervisory procedures. Plummer is barred and ordered to pay restitution plus interest to affected customers for misusing their funds. He is also barred for falsifying a document produced to FINRA during an investigation and providing false and misleading testimony about the document. Respondents are also ordered to pay the costs of this proceeding.**

**Enforcement failed to prove that Respondents made misrepresentations and omissions in connection with the sale of joint venture interests or that the firm unethically misused customer funds or otherwise acted unethically. Accordingly, those charges are dismissed.**

*Appearances*

For the Complainant: Payne L. Templeton, Esq., Los Angeles, CA, Karen E. Whitaker, Esq., and Penelope Brobst Blackwell, Esq., Dallas, TX, Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Mark A. Hendrix, Esq., Valerie P. Thomas, Esq., and Ralph S. Janvey, Esq., Krage & Janvey, LLP, Dallas, TX.

## DECISION

### I. Introduction

This case arose from the sale of oil and gas joint venture interests and investors' payment of drilling completion assessments for three prospective oil and gas wells. The Department of Enforcement charged that Respondent Texas E&P Partners, Inc. ("Firm" or "Chestnut"), the placement agent for the joint venture, and Respondent Mark A. Plummer, its president, engaged in a fraudulent, undisclosed scheme to over-charge the joint venturers for anticipated well drilling costs. According to Enforcement, contrary to statements in the offering materials, Respondents intended to charge the investors drilling completion assessments for three prospective oil and gas wells, even if all three wells were never drilled. Later Respondents collected assessments from investors to drill the three wells but never drilled, or attempted to drill, the third one, yet never returned to investors the portion of funds collected for that purpose. Enforcement also charged that the Firm had insufficient supervisory procedures; that Respondents knowingly produced a falsified document to the FINRA staff during its investigation; and that the Firm's president gave false or misleading investigative testimony to the staff about that document.

Respondents denied that they ever harbored a hidden plan to over-charge investors, maintaining, instead, that they properly collected the oil and gas well drilling funds but, as the investors understood, events later developed making it impossible to drill the third prospective well. Respondents further claimed that the portion of funds collected to drill that well could properly be used—and was in fact used—for other purposes that furthered the interests of the joint venture. Also, they argued, the Firm's written supervisory procedures were not inadequate. Finally, as to the investigation-related charges, while Respondents admitted that they produced an altered document to FINRA, they denied that they intended to deceive the staff and further denied that Plummer gave false or misleading testimony about the document.

A hearing was held before an Extended Hearing Panel. After deliberating, we find that Plummer misused oil well completion assessments; that the Firm's written supervisory procedures were inadequate; that Respondents produced an altered document to FINRA staff; and that Plummer gave false and misleading testimony about it during FINRA's investigation. As a result, we conclude that Respondents violated FINRA Rules and impose the sanctions set forth below.

We also find that Enforcement failed to prove that Respondents made material misrepresentations and omissions regarding the completion assessments, or that the Firm improperly collected and misused customer funds or otherwise acted unethically. We therefore dismiss those charges.

## II. Findings of Fact

### A. The Respondents

#### 1. Texas E&P Partners, Inc.

At all relevant times, the Firm[1] was a FINRA member firm and was registered as a broker-dealer with the U.S. Securities and Exchange Commission.[2] The Firm first became registered with NASD as Plummer Securities, Inc. in October 2003 and changed its name three times since then. It became known as Chestnut Energy Partners, Inc. in October 2006;[3] Chestnut Exploration Partners, Inc. in December 2011;[4] and in January 2016 it changed its name to Texas E&P Partners, Inc.[5] The Firm's core business was selling oil and gas and related energy investments offered by its affiliates.[6] On November 4, 2016, its FINRA membership was cancelled for non-payment of fees.[7]

#### 2. Mark A. Plummer

Plummer entered the securities industry in 2002.[8] He controlled the Firm since its inception in 2003 through November 2014, serving in various capacities including chief executive officer, president, chief compliance officer, and registered representative.[9] Plummer resigned as Chestnut's president on or about November 7, 2014,[10] and his registration was

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[1] During the period at issue, the Firm was known as "Chestnut Energy Partners, Inc." and "Chestnut Exploration Partners, Inc." References in this decision to "Chestnut" apply to the broker-dealer and not to its affiliated entities that also contain the word "Chestnut" in their names.

[2] Answer ("Ans.") ¶ 7; Joint Agreed Stipulations ("Stip.") ¶ 1.

[3] Ans. ¶ 7.

[4] Ans. ¶ 7; Stip. ¶ 1.

[5] Stip. ¶ 1.

[6] Complainants' Exhibits ("CX") 4, at 25–27; CX-142, at 33–37; Hearing Transcript ("Tr.") 69–72.

[7] Nevertheless, FINRA has jurisdiction over the Firm for the purposes of this proceeding. Under FINRA By-Laws Article IV, Section 6, a FINRA member firm that has had its membership cancelled is still subject to the filing of a complaint based upon conduct which commenced prior to the effective date of the member's cancellation of its membership as long as the complaint is filed within two years after the effective date of cancellation. Here, the alleged misconduct occurred, and the Complaint was filed, before the effective date of cancellation.

[8] CX-1, at 5.

[9] Stip. ¶ 2; Ans. ¶ 9.

[10] Ans. ¶ 9.

terminated on December 12, 2014.[11] He has not been associated or licensed with Chestnut[12] or with any other FINRA member firm since then.[13]

### B. The Sale of the Joint Venture Interests

From October 2007 through June 2008, the Chestnut 2007 4x4 Joint Venture ("Joint Venture") offered units of joint venture interests for sale (the "Joint Venture Interests").[14] The Firm acted as the placement agent and broker for the sale of the Joint Venture Interests.[15] These interests were sold to Firm customers[16] by the Joint Venture, acting through its Managing Venturer, Chestnut Exploration, Inc. ("CEI"), a Chestnut affiliate owned and controlled by Plummer.[17]

In connection with the offering, and in advance of each sale of Joint Venture Interests, Chestnut caused the Joint Venture to provide prospective investors with the 4x4 Confidential Information Memorandum ("CIM"), the Joint Venture's written offering document dated October 17, 2007.[18] Both Chestnut and Plummer were the "makers" of the statements in the CIM, with ultimate control and authority over the statements in the CIM and the methods by which those statements would be communicated to prospective investors.[19]

The CIM stated that the Joint Venture would use the offering proceeds to buy a minority 13.5% Net Revenue Interest (18% Working Interest) in one existing natural oil and gas well (the "Producing Well") and in three other wells (the "Three Prospective Wells"), each of which was to be operated by a third party.[20] The investors would purportedly benefit from the Joint Venture's share of oil and gas revenues from the four wells, which were to be located on two Texas well sites known as Hopper and Teeter/Crowley. The Producing Well, according to the CIM, was known as the Hopper 1H well. The three anticipated Prospective Wells were: (1) the

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[11] CX-1, at 3.

[12] Stip. ¶ 2.

[13] *See* CX-1, at 2. FINRA has jurisdiction over Plummer for the purposes of this proceeding, under Article V, Section 4 of FINRA's By-Laws because the Complaint was filed within two years after the December 12, 2014 effective date of termination of Plummer's registration with Chestnut and his misconduct occurred while he was associated with Chestnut.

[14] Ans. ¶ 13; Stip. ¶ 4.

[15] Ans. ¶¶ 1, 14; CX-4, at 1, 14; CX-9; Tr. 100. The Joint Venture was organized as a general partnership under Texas law. Ans. ¶ 109.

[16] Ans. ¶ 62.

[17] Ans. ¶¶ 1, 12, 105; CX-4, at 1, 16, 59.

[18] Ans. ¶ 13; Stip. ¶ 6; CX-4, at 2, 7, 11, 55–56.

[19] Ans. ¶¶ 16, 130.

[20] CX-4, at 2–4, 7–12, 28–31, 56; CX-11, at 1, 33; Tr. 127–28.

Hopper 2H well on the Hopper site; (2) the Teeter/Crowley 1H well on the Teeter/Crowley site; and (3) the Hopper 3H well on the Hopper site.[21]

The CIM contained statements regarding certain assessments—known as completion assessments—that would be levied on the investors. These assessments, and the CIM's statements about them, are at the crux of Enforcement's charges. The CIM represented to investors that they would pay a completion assessment of $17,908 per unit of joint venture interest purchases "for each Prospective Well to be completed."[22] In other words, the assessments would be made as follows per unit: $17,908 for one Prospective Well, $35,816 for two Prospective Wells, and $53,724 for all three Prospective Wells. These completion assessments would be made "for the purpose of completing the Prospective Wells" and only "if such Completion attempts are warranted with respect thereto, based on the affirmative Vote of the Venturers."[23] The maximum per unit assessment of $53,724 represented a total completion assessment of $1,934,064 for all 36 units of joint venture interest offered for sale.[24]

The CIM also addressed the payments that would be made to the Joint Venture's Managing Venturer, Chestnut affiliate CEI. The CIM stated that the Joint Venture would enter into a Turnkey Completion Contract with CEI. Under that contract, according to the CIM, the completion payments would be made to CEI by the Joint Venture based on the number of Prospective Wells that were attempted to be completed. The CIM provided that the contract would limit the Joint Venture completion payments to CEI to $17,908 per unit of joint venture interest "for each Prospective Well upon which Completion is attempted."[25] In the event that "completion is attempted upon all Prospective Wells," the CIM limited CEI to receiving no more than a total of $53,724 per unit.[26]

In 2007 and 2008, the investors in the Joint Venture invested a total of $5.6 million, including initial investments of $3.9 million (offering phase) and $1.74 million (completion assessments).[27] All told, 88 investors collectively invested $3,890,266 in the initial investment, prior to the investors' later payment of the additional completion assessments.[28]

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[21] CX-4, at 7–8, 55; Tr. 140–41, 143–44.

[22] CX-4, at 8, 22, 26; Tr. 174–75, 181–82, 205–06.

[23] CX-4, at 8.

[24] CX-4, at 8–9, 26; Tr. 174–75, 181–82, 205–06.

[25] CX-4, at 8, 26.

[26] CX-4, at 8, 26.

[27] Ans. ¶ 62; Tr. 660–64. The customers made their investments in two phases. The customers invested $3,890,266 in the initial investment phase, and $1,741,623 in the well completion phase. Ans. ¶ 62.

[28] Ans. ¶ 25.

### C. Collection of the Completion Assessments

By May 2008, two of the Prospective Wells—Hopper Well 2H and the Teeter/Crowley 1H—were completed.[29] That month, Plummer wrote a letter to each investor asking them to vote their approval of a completion assessment at the maximum level for completion of all three Prospective Wells (Hopper 2H, Teeter/Crowley 1H, and Hopper 3H).[30] In his letter—written on the letterhead of Chestnut Petroleum, Inc., an operating/production company affiliate of Chestnut[31]—Plummer told investors that the Hopper 2H well had been drilled and completed; that the Teeter/Crowley 1H well had been drilled and completion work would begin shortly; and that the Hopper 3H well (the third Prospective Well, i.e. the fourth and final well) "should start drilling . . . in a month."[32] After they received Plummer's letter, most investors voted their approval[33] and paid maximum completion assessment payments of $53,724 per unit of Joint Venture Interest,[34] totaling $1,741,623 in completion assessments for the three Prospective Wells.[35]

As it turned out, the drilling of the Hopper 3H well did not begin "in a month," or, indeed, at any time in 2008 or 2009; nor was any attempt ever made to complete that well,[36] at either the Hopper 3H site or at any other well site.[37] Instead, as discussed below, faced with low oil and gas production from the Hopper 1H and 2H wells, Respondents recommended to investors in 2010 that they approve the auction sale of the Joint Venture's interest in Hopper 1H and 2H wells, along with the Hopper undrilled well sites (including the site for the never-drilled third Prospective Well, i.e., the Hopper 3H well).[38]

### D. The Sale of the Hopper Interests

On May 28, 2010, Plummer conducted a status telephone conference with the Joint Venturers. During the call, he informed them that the Hopper 1H and 2H wells were underperforming because of low prevailing natural gas prices and low production. And, as a result, he raised the possibility of selling the Joint Venture's interest both in these two Hopper wells and in the drilling and leasehold rights for the undrilled well sites (including the undrilled

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[29] Ans. ¶ 46.

[30] CX-158; CX-19; *see also* Tr. 463.

[31] Tr. 61, 72, 92.

[32] CX-158; CX-19.

[33] CX-158; *see also* Stip. ¶ 11.

[34] Ans. ¶ 51.

[35] Ans. 52, 62; CX-12, at 1–3.

[36] Ans. ¶¶ 21, 67.

[37] Ans. ¶¶ 21, 36, 67; *see also* Tr. 859, 1063.

[38] Ans. ¶ 69.

Hopper 3H site.).[39] More specifically, Plummer told the investors that while the earlier plan for the Joint Venture was to drill the fourth well on the Hopper well site (the Hopper 3H well), his new plan was to: (1) sell the Joint Venture's Hopper interest, including the Joint Venture's interest in the existing Hopper 1H and 2H wells and the undrilled Hopper 3H well; and (2) "put this 4th well on the Crowley Teeter lease."[40]

Three months later, in August 2010, Plummer wrote to the investors (on CEI letterhead) and recommended that the Joint Venture sell its interest in the Hopper 1H and 2H wells and in the drilling and leasehold rights for the undrilled Hopper 3H well site on which the fourth well was originally intended to be drilled.[41] Plummer's letter did not inform the investors that he deemed their approval as a forfeiture of (1) the return of the completion funds for the never-drilled fourth well, or (2) the plan to drill and complete the fourth well. The investors approved the sale,[42] which went forward at an auction in December 2010 and sold for $6,500,[43] netting them $5,841.73.[44]

Contrary to Plummer's new plan, a fourth well was not drilled on the Teeter/Crowley site. Following the sale of the Hopper interests, an involuntary bankruptcy petition was filed against the operator for the Teeter/Crowley 1H well; the Joint Venture and Chestnut Exploration and Production, Inc. d/b/a Chestnut Exploration, Inc. [CEI] d/b/a Chestnut Petroleum, Inc. filed proofs of claim in that bankruptcy, which resulted in a settlement;[45] and a third-party well operator—not a Chestnut affiliate—became that well's operator.[46]

### E. Misuse of a Portion of the Completion Funds

Up through the time of the hearing, no fourth well has been drilled. Nor does it appear that any such plans are in the works, as there was no evidence of recent communications by Plummer to the investors regarding the drilling of a Teeter/Crowley well, or any other well.[47] Nevertheless, the $567,110 in completion funds collected from investors for completion of the never-drilled fourth well (i.e., the third Prospective Well) was transferred to CEI,[48] and has not

[39] CX-100, at 6–8.

[40] CX-100, at 6–8; CX-101; *see also* CX-38, at 1; Tr. 1064–68. Plummer and Chestnut brokers repeated this plan to investors during this period in 2010 and into the fall of 2011. CX-37, at 1; CX-40, at 1–2; CX-35, at 1; Tr. 1075–78.

[41] CX-102; CX-24; CX-34; *see also* Tr. 483–89.

[42] CX-102, at 1–3.

[43] CX-103, at 3.

[44] CX-53; Tr. 667; Ans. ¶ 71.

[45] CX-71, at 1–4.

[46] CX-69, at 1; Tr. 474–76, 702–04.

[47] Tr. 550–55, 866.

[48] Ans. ¶ 55.

been returned to the investors,[49] with the exception of payments made to three investors to settle claims they asserted.[50]

Respondents maintain that the Joint Venture Agreement permitted them to retain and use those funds for purposes other than completion of the fourth well. This argument rests on section 4.5 of the Joint Venture Agreement (attached to the CIM), which permits CEI "to charge to the Joint Venture and be reimbursed or pay out of Joint Venture Funds, as and when available, all reasonable expenses incurred by [CEI] in the operation of the Joint Venture."[51] Once the completion assessments were collected, according to Respondents, the funds could be used for "all reasonable expenses" that CEI incurred "in the operation of the Joint Venture." Therefore, Respondents maintain, there was no obligation to return any of the funds, even though the fourth well was never started. Respondents also argue that they cannot be found to have engaged in improper conduct because there is no evidence that they spent the completion assessment funds inappropriately and because Plummer testified that these funds were spent in connection with the Joint Venture.[52]

This argument fails because the Joint Venture Agreement does not authorize funds collected for well completion to be used for other purposes. The CIM expressly limited the amount of completion assessment funds that the Joint Venture was permitted to send to CEI, namely, $17,908 per unit for each Prospective Well that was attempted to be completed.[53] Also, under basic contract interpretation principles we must give greater weight to the section in the Joint Venture Agreement that specifically deals with completion assessments than the more general provision relating to expense payment.[54] Construing the agreement as a whole, it appears to us that the purpose of collecting those funds was to use them to attempt completion of the three Prospective Wells. Thus, not using them for that purpose, and not returning them, constituted an improper use of customer funds. As discussed later in this decision, we find that Plummer engaged in the misuse, but not Chestnut because the evidence did not establish that Plummer engaged in misconduct on Chestnut's behalf.

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[49] Ans. ¶¶ 68, 70; *see also* Tr. 468–69.

[50] The investors who received funds in settlement of claims were: RG, KH, and JS (including his related entities). *See* Tr. 657–59, 1528–29, 1565; CX-1, at 13–16; CX-12, at 1; CX-98, at 1–3; CX-106; CX-108.

[51] CX-4, at 72.

[52] Respondents' Post-Hearing Br. at 29.

[53] CX-4, at 8, 26.

[54] *Aramony v. United Way of Am.*, 254 F.3d 403, 413 (2d Cir. 2001) ("[I]t is a fundamental rule of contract construction that 'specific terms and exact terms are given greater weight than general language.'") (quoting *Restatement (Second) of Contracts* § 203(c) (1981)); Arthur Linton Corbin, *Corbin on Contracts* §§ 545–54, at 521 (1952) ("Words of general description should generally yield to words that are more specific."). "Even where there is no 'true conflict' between two provisions," the Court in *Aramony* noted, "'specific words will limit the meaning of general words if it appears from the whole agreement that the parties' purpose was directed solely toward the matter to which the specific words or clause relate.'" *Aramony*, 254 F.3d at 413–14 (quoting 11 Richard A. Lord, *Williston on Contracts* § 32:10, at 449 (4th ed. 1999)).

### F. The Draft Turnkey Acquisition and Drilling Contract and Related Conduct

Enforcement alleges that not only was it wrong to retain the completion assessments for the third Proposed Well, but that Respondents had planned at the time of the offering to charge the customers completion assessments for all three Prospective Wells, regardless of whether all three were ever drilled or attempted to be completed. Thus, according to Enforcement, the representations in the CIM about the assessments were false because they omitted Respondents' true intentions.

The lynchpin of Enforcement's hidden-intent argument is a document entitled "Turnkey Acquisition and Drilling Contract" ("TADC"). Enforcement claims that the terms of the TADC show that unbeknownst to investors at the time the offering began in October 2007, and contrary to the CIM, Respondents had already decided to charge them the maximum completion amount of $53,724 per unit regardless of whether the fourth well (i.e., the third Prospective Well) was ever attempted to be completed. The TADC is also at the center of the investigation-related charges, as Enforcement alleges that Plummer altered the document in an attempt to deceive the staff about its provenance and then testified falsely about it during his on-the-record testimony ("OTR") before the FINRA staff. So, next we turn to the TADC.

#### 1. The TADC's Provisions

The CIM provided that "[i]f the [Joint] Venture determines that Completion is to be attempted on any Prospective Well, the [Joint] Venture" would enter into a "Turnkey Completion Contract" with CEI. Under that agreement, CEI would, among other things, "pay the [Joint] Venture's share of the costs to Complete such Prospective Well . . . and, if successful, otherwise pay all of the Completion costs associated with the Prospective Wells," among the other costs. The CIM capped the payments by the Joint Venture to CEI under a Turnkey Completion Contract to "$1,934,064 ($53,724 per Unit Subscribed) if Completion is attempted on all Prospective Wells . . . plus the Managing Venturer's capital contribution for Completion (the 'Turnkey Completion Price')."

But "in the event Completion is not attempted upon all Prospective Wells," the CIM stated that the Joint Venture would pay CEI "$644,888 ($17,908 per Unit Subscribed) for each Prospective Well upon which Completion is attempted," plus the Managing Venturer's capital contribution. "The [Joint] Venture's total financial responsibility to the Managing Venturer for the costs relating to Completion of the Prospective Wells," according to the CIM, would "not exceed the Turnkey Completion Price."[55] A "Turnkey Completion Contract" meeting the

[55] CX-4, at 8.

specifications provided in the CIM, however, was not executed;[56] instead, the TADC was prepared,[57] but not given to the investors.[58]

The TADC states that it "was made and entered into on October 17, 2007, by and between" the Joint Venture and CEI, and it bears Mark Plummer's signature on behalf of the Joint Venture (through CEI, the Joint Venture's Managing Partner) and CEI. Above Plummer's signatures, the TADC states: "IN WITNESS WHEREOF, the parties hereto executed this Contract on the date first above written" (October 17, 2007).

We find that the TADC does not conclusively establish Respondents' alleged hidden intent. As explained below, while the TADC can be interpreted as supporting Enforcement's position, there are other, non-inculpatory inferences that can be drawn from it and the related evidence. Our analysis begins with the terms of the TADC, which address the parties' "wishes" and acquisition, drilling, and sales plans for the wells on the Hopper and Teeter/Cowley sites, along with the compensation arrangements between the Joint Venture and CEI.

According to the TADC, the Joint Venture "wishes to" (a) "purchase one (1) completed well on a turnkey basis"; (b) "purchase an interest in one (1) currently drilling well on a turnkey basis"; and (c) "have one (1) well drilled and completed thereon for oil and gas on a turnkey basis." It also recites CEI's wish "to drill and complete a fourth (4th) well or cause it to be completed on a turnkey basis." Alternatively, the TADC states, CEI wishes to "package two (2) Hopper wells after they are drilled and completed with the 4th prospective well along with the leasehold and all other prospective well locations, and cause them to be sold and proceeds distributed to the [Joint Venture] for their benefit."[59] To implement these "wishes," CEI agreed "to purchase one producing, horizontal, Barnett Shale well, the Hopper 1H located in Hood County, Texas along with a second, horizontal, Barnett Shale well on the lease currently being drilled, the Hopper 2H."

Moving from wishes to objectives and intentions, the TADC stated that the "major objective" of the Joint Venture was "to obtain drill rights on the Crowley Teeter lease, Tarrant County, Texas and drill and complete, or cause to be drilled and completed the Teeter IH [Joint Venture] well." And, "[a]fter drilling and completing the second well on the Hopper lease, the Hopper 2H [Joint Venture] well, and the Crowley Teeter 1H," the TADC predicted that "the [Joint]Venture may bundle the Hopper 1H and 2H wells and any other potential drill site locations such as the prospective Hopper 3H, 4H and other Hopper prospective wells and sell them as a package at an industry auction for the benefit of the [Joint] Venture." The TADC expressed the Joint Venture's intention "to sell the two current Hopper wells and prospective

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[56] Ans. ¶ 35.

[57] Ans. ¶ 45.

[58] Stip. ¶ 7.

[59] CX-7, at 1, ¶ 1.

wells and keep the Crowley Teeter well," explaining that the Crowley Teeter well was expected to "account for 80% of the value of the program."[60]

The TADC also set the compensation the Joint Venture agreed to pay CEI. This provision is central to Enforcement's misrepresentation and omissions claims. Under the TADC, the Joint Venture agreed to pay CEI "an amount equal to $4,986,666 if fully subscribed." "The purpose of the payment," according to the TADC, was "to provide working capital to [CEI] for purchase of the Hopper 1H and 2H wells, the drilling of the Crowley Teeter 1H well, and then either the drilling of the Third Hopper well or sale of the two current Hopper wells along with the undrilled 3rd Hopper and the leasehold along with all other prospective wells on the Hopper leasehold."[61]

It also explained that the purpose of the payment was for the "the purchase of the Hopper 1H, the purchase of the currently drilling Hopper 2H, the drilling of the Crowley Teeter 1H, and the possible 4th well, the Hopper 4H, or," according to the TADC, "the packaging and sale of the first Hopper 1H and 2H wells along with the undrilled leasehold locations to the agreed to depths for the Barnett Shale formation."[62] Finally, the TADC obligated the Joint Venture to pay the "Turnkey Drilling Price"—an undefined term, but apparently referring to $4,986,666—"upon execution of" the TADC and was not conditioned on either commencement or completion of performance under the TADC.

According to Enforcement, these provisions of the TADC collectively show that Respondents intended from the outset of the offering to request that the investors pay the maximum completion assessment, regardless of how many wells were actually attempted to be completed. We reject this argument. As a threshold matter, the TADC does not address the subject of completion assessments. Also, while the TADC specifies that the sum of $4,986,666 is payable to CEI, it does not explain how the sum was calculated.[63] The Joint Venture's promise to

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[60] CX-7, at 1, ¶ 2.

[61] CX-7, at 1, ¶ 3.

[62] CX-7, at 1, ¶ 3.

[63] At the hearing, however, Enforcement argued during its closing that this sum represented the "all-in price, less Chestnut's 15 percent [commission and due diligence fee], plus the small $5,000 contribution by the managing venturer." Tr. 1617. Later in the closing, Enforcement explained that it arrived at this figure by taking the "gross offering price, the total well completion assessments—so it's $109,076 plus $53,274—then take out the Chestnut 15 percent commission and due diligence fee, and then add in the managing venturer's contribution to come up with the 4.9 million [.]" This formula yields a sum within $14 of the figure contained in the TADC:

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|---|---|---|
| | $ 3,926,736 | (Fully Subscribed Offering Amount) |
| + | $ 1,934,064 | (Maximum Completion Assessment) |
| | $ 5,860,800 | |
| - | $ 879,120 | (15% of $5,860,800) (Chestnut Commission and Due Diligence Fee) |
| | $ 4,981,680 | |
| + | $ 5,000 | (Managing Venturer Contribution) |
| | $ 4,986,680 | |

Respondents did not dispute Enforcement's computation. *See also* CX-4, at 20.

pay this sum is consistent with a plan to charge investors a completion assessment for three Prospective Wells; however, it does not, by itself, prove that Respondents intended to do so. Moreover, Enforcement's argument rests on the TADC having been created in October 2007. Enforcement, however, failed to establish when the TADC was created, by whom, or whether the TADC was more than a draft agreement never entered into between CEI and the Joint Venture. These issues are more fully addressed below in our discussion about the production of the TADC to the FINRA staff during the investigation and Plummer's investigative and hearing testimony about it.

### 2. Plummer Produces the TADC to FINRA

In connection with the investigation that led to these proceedings, FINRA staff sent a series of document requests to Chestnut and took the OTRs of several individuals, including Plummer.[64] In May 2014, FINRA sent a letter to Chestnut's chief compliance officer, DR, requesting that Chestnut explain why the fourth well, i.e., the Third Prospective Well or the Hopper 3H well, had not been drilled and when the completion funds for that Prospective Well would be returned to investors.[65] The next month, DR, on behalf of Chestnut, responded by letter to FINRA that "[t]he funds raised for the [Joint Venture] were raised pursuant to turnkey drilling and completion contracts."[66]

FINRA followed up on October 30, 2014, and requested that Chestnut produce any turnkey agreements relating to the offering.[67] Over the next several weeks, DR requested additional time to respond, explaining that Chestnut could not find the agreement.[68] Then, on about December 2, 2014, Plummer signed the TADC in DR's presence and, the next day, DR sent it to FINRA as a PDF file attachment to an email.[69] Although the TADC reflected that it had been executed on October 17, 2007, DR's transmittal email did not inform FINRA that Plummer had just signed the TADC one day earlier.[70] Plummer was copied on the December 3, 2014 email sent to the FINRA staff and was aware of the email and its contents.[71] Respondents did not initially indicate that the PDF file attachment of the TADC was signed on or about December 2, 2014, when it was emailed on December 3, 2014.[72] Not until three months later—in a March 2015 response to the staff's request to see the original, signed TADC—did the Firm disclose that

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[64] Ans. ¶ 79. The investigation began as a result of an investor complaint filed with FINRA in March 2014. CX-16; Tr. 862–65, 1258.

[65] CX-89, at 2, ¶¶ 12–13.

[66] CX-92, at 4, ¶¶ 12–13.

[67] Ans. ¶ 80; *see also* CX-138.

[68] CX-140, at 1–3.

[69] Ans. ¶¶ 88–89, 92; CX-137, at 2; CX-140; Tr. 222–23, 246, 352–53, 1229–30.

[70] CX-140.

[71] Ans. ¶ 84.

[72] Ans. ¶ 92.

Plummer had signed the TADC "on or about December 2, 2014."[73] Also, in a later OTR on April 23, 2015, Plummer admitted that he had signed the TADC on or about December 2, 2014,[74] after finding it unsigned in Chestnut's files in late 2014.[75]

#### 3. Plummer Gives False and Misleading OTR Testimony Regarding the TADC

On December 11, 2014, approximately one week after DR produced the TADC to FINRA, the staff took Plummer's sworn OTR.[76] During his OTR, Plummer testified about the TADC, including when it was created, whether it was authentic, whether it had been changed, and the circumstances under which he located it in response to FINRA's request. The signature date for the PDF file attachment of the TADC was not discussed in the interview.[77] But the staff did ask Plummer whether the document was created on October 17, 2007, and he replied, "Yeah, to the best of my knowledge."[78] Continuing, the staff asked him if the TADC had "remained unchanged since October 17, 2007," and he responded: "I have no idea. It's been a long time since I have seen this document."[79] When asked if he had "any reason to believe that the [TADC] was in any way inauthentic," he asked the staff to clarify the meaning of the word "inauthentic."[80] After the staff explained in circular fashion that "inauthentic" meant "not authentic," Plummer responded, "No, not to the best of my knowledge," adding that "[i]t seems authentic because of the fact that it is very specific to this program, which is quite unusual compared to our normal drilling programs."[81] Regarding his discovery of the TADC, he testified that he "scoured my Exploration and Production files and my personal well files, and I found it, I think, in my personal engineering file section . . . after much searching."[82]

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[73] CX-137, at 2 (Chestnut's response to the February 4, 2015 FINRA Rule 8210 request letter, CX-136); *see also* Ans. ¶ 90.

[74] Ans. ¶102; *see also* Ans. ¶ 90.

[75] Ans. ¶ 103.

[76] At the beginning of his OTR, the staff advised Plummer that if he gave false testimony, a disciplinary proceeding could be brought against him that "could result in a bar from the securities industry, suspension, censure, and/or fine." CX-109, at 8. The staff also instructed Plummer that if there came "a time when you recall additional information in response to a question previously asked," then he should tell the staff "so that you may have the opportunity to elaborate on your previous response." CX-109, at 10. Finally, before his testimony began, the staff told him that after the staff completed its questioning, he "will have the opportunity to make an uninterrupted statement in which you can discuss whatever matters you wish to bring to our attention." CX-109, at 10. And, at the completion of his testimony, the staff requested that if he remembered anything that he "did not recall today or think that anything was inaccurate or incomplete you or your counsel" should contact the staff. CX-109, at 48.

[77] Ans. ¶¶ 93, 95.

[78] Tr. 389–90; CX-109, at 17.

[79] Tr. 343; CX-109, at 18; Ans. ¶ 96.

[80] Tr. 325; CX-109, at 19.

[81] CX-109, at 19–20; Tr. 325–28; Ans. ¶ 97.

[82] Tr. 355–56; CX-109, at 15.

Plummer's answers were false and misleading. The TADC had been changed; Plummer signed it just days before his OTR. And it was inauthentic, as it purported to be an agreement executed by Plummer on October 17, 2007, when, in fact, that was untrue. Also, Plummer failed to disclose that (1) the TADC was unsigned when he purportedly found it; (2) that he later signed it one week before it was produced to FINRA; and (3) that the representation on the face of the TADC about when it was signed was, in fact, false. These omissions rendered his testimony misleading, as they perpetuated the misimpression—based on the representations in the TADC—that he had signed it seven years earlier, rather than just one week earlier.

At the hearing, Plummer justified not telling the staff that he had signed the TADC a few days before his OTR because "[t]hat question wasn't asked."[83] And he claimed that he was "told to answer the question that's asked, not to add to the question, just to answer the question" and that was what he was "trying to do."[84] He also denied that he testified falsely. Regarding the staff's question about whether the TADC had been "changed," he claimed that he did not view the document as having been "changed" by virtue of signing it.[85] As for Plummer's response that the TADC was not "inauthentic," it appears from his answer that he interpreted the question as asking whether the TADC was the contract that related to the particular joint venture at issue.[86] Further, he testified at the hearing that he did not understand what the word "inauthentic" meant and that the staff's explanation did not clarify its meaning for him.[87]

Plummer's explanations—even if the Panel believed them, which it does not—do not transform his patently false and misleading answers into truthful, straightforward ones. In any event, his explanations were not credible. Plummer knew that the TADC falsely represented the date on which he had signed it and that neither he nor the Firm had disclosed this to FINRA when producing it. Moreover, it must have been obvious to Plummer that the staff's questions went directly to the legitimacy of the TADC and that his answers would mislead them. Indeed, given that he knew that DR had produced the document without disclosing the truth, and having decided not to volunteer the truth himself, it is likely that he answered the staff's questions in a

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[83] Tr. 326, 330.

[84] Tr. 328–29, 331.

[85] Tr. 342–43.

[86] Tr. 327–28.

[87] Tr. 322–23, 327, 330.

way to avoid disclosing that he had just signed the TADC. Thus, we find that he knew or, at a minimum, recklessly disregarded that his answers were false and misleading.[88]

### 4. Unresolved Issues Regarding the TADC

Although it is undisputed that Plummer signed the TADC in December 2014, many issues about the TADC remain unresolved; it is unclear when the document was created, by whom, whether it was modified over time, and whether it is a draft agreement. Enforcement argues that the evidence shows that the TADC was created in October 2007. And there is evidence supporting Enforcement's position:

- The TADC is dated October 17, 2007;[89]
- Chestnut identified the document as the "Turnkey Agreement between Chestnut Exploration and Chestnut 2007 4x4 Joint Venture" in the transmittal email when it produced the TADC to the staff in December 2014[90] and reaffirmed this identification in a March 2015 letter responding to a Rule 8210 request; [91] these communications did not represent that the TADC was created later than 2007;
- Chestnut represented in the March 2015 letter that neither Chestnut nor its attorneys had other copies of the turnkey contract;[92]
- The language of the TADC correctly describes the status of the drilled and undrilled project wells as of October 2007.[93]
- Consistent with the TADC having been created in 2007, it stated that any decision to sell the Hopper wells and any undrilled well sites (such as the Hopper 3H site for the fourth well) would be made at a later time after completion of the Hopper 2H well.[94]
- At his December 2014 OTR, Plummer confirmed that in October 2007 he had considered not drilling the fourth well and instead considered bundling two Hopper wells and selling the remainder of the lease: "From our very beginning we

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[88] During his hearing testimony, Plummer claimed that heart-related health issues may have affected his December 2014 OTR testimony and caused him to sign the TADC upon locating it. Tr. 248, 272–73, 332, 343. In fact, he testified that he "was in cardiac arrest, really, at this time, don't even remember this OTR." Tr. 332. But we reviewed his OTR testimony and found no evidence of impairment, and Plummer presented no evidence to corroborate his impairment claim; therefore we reject it. Plummer also argued that he answered the staff's questions honestly and to the best of his ability; and, as Enforcement's staff witness agreed, that was all he was required to do. (Respondents' Post-Hearing Br. at 6); Tr.1433–34. This argument misses the point. In fact, Plummer gave false and misleading testimony; omitting information further rendered his testimony misleading.

[89] CX-7, at 1.

[90] CX-140, at 1, 5–6.

[91] CX-137, at 1–2; *see also* Ans. ¶ 88.

[92] CX-137, at 1–2.

[93] *Compare* CX-7, at 1, *with* CX-4, at 55.

[94] CX-7, at 1.

knew that we did not want to hold on to the Hopper leases over the long haul depending on the productivity of the first well . . . ;[95] and
- When asked at his December 2014 OTR if the TADC was created on October 17, 2007, he responded: "Yeah, to the best of my knowledge . . . ." [96]

But there is also evidence—and reasonable inferences from that evidence—that undercuts a finding that the TADC was created in October 2007. After the Firm told FINRA that it collected the completion assessment funds based on turnkey agreements, FINRA requested the agreements. The Firm did not produce the TADC for several weeks, claiming that it could not find the agreements. Finally, when Chestnut produced the TADC to the staff, the Firm did not disclose at that time—and Plummer did not disclose in his OTR testimony—that it had been signed in 2014, not in 2007. Thus, Respondents' implicit and explicit representations that the TADC was created in October 2007 may reasonably be viewed as having been made to further a deception and cover-up, not as credible evidence that the TADC was created at that time.

Stated differently, Respondents had a motive to leave FINRA with the misimpression that the TADC had been created in October 2007. Chestnut had told FINRA that the completion assessment funds were collected under turnkey agreements; then Chestnut produced the TADC, which falsely represented when it was signed; and Respondents did not disclose the falsity to FINRA at the time it was produced. So, any statements to FINRA supporting an October 2007 creation date may have been made to perpetuate the false impression they had already created by producing an altered TADC. Indeed, it is possible that the TADC was falsified for the very purpose of supporting the earlier false statement that the funds had been collected under turnkey agreements. At a minimum, the credible evidence does not negate these inferences.

Further, Plummer was the only witness who testified about the creation of the TADC. And his testimony creates doubt about the TADC's provenance. At the hearing, Plummer testified that he:

- had no idea when the TADC was created;[97]
- doubted that he was one of the people who might have authored it;[98]
- had "no idea" who wrote the terms regarding bundling and selling the Hopper wells and the undrilled Hopper 3H location;[99]

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[95] Tr. 305–06; CX-109, at 28. At the hearing, Plummer recanted his earlier investigative testimony on this point, claiming that he did not begin to consider selling the Joint Venture's interest in the Hopper well and the other well sites until 2009 and 2010. Tr. 306–08.

[96] Tr. 389–90; CX-109, at 17.

[97] Tr. 390.

[98] Tr. 362.

[99] Tr. 289–90.

- doubted whether he may have signed the TADC "in another printout on October 17, 2007;"[100]
- believed that it was prepared at some unknown date well after 2007, possibly 2009, or as late as 2010, when the investors were asked to approve (and did approve) the sale of the Hopper wells and well interests;[101]
- believed that perhaps it may have been initially drafted in October 2007 and later modified to reflect or memorialize events that occurred (e.g. the investors' vote on the assessments)[102] and remained a working copy;[103] and
- did not know whether the Joint Venture and CEI ever entered into an agreement, irrespective of whether or when the TADC was first signed, though he believes the TADC was never in effect.[104]

In weighing Plummer's hearing testimony, certain factors undercut his credibility. As discussed above, Plummer had a motive to testify at his OTR that the TADC was created in October 2007. But by the time of the hearing, the situation had changed. By then, it was apparent that testimony placing the creation date of the TADC in October 2007 would buttress Enforcement's misrepresentation and omissions charges. Thus, Plummer had a motive to claim that it was created much later.

Also, at times, Plummer's hearing testimony conflicted with his OTR testimony, or added new versions of events, or contradicted itself. For example, during the hearing, his testimony changed from one day to the next on an important issue. First, he testified that he had found the TADC in electronic form on a "disk" and that he had "no idea" where the disk was currently located.[105] But the next day, he testified that for some period of time, he had an electronic version of the TADC on a USB thumb drive, which was lost or stolen from him during a vacation.[106] Prior to the hearing, however, he never told the staff that there had been an electronic version of the TADC on a thumb drive.[107] Additionally, he testified that he did not remember signing the TADC; he then testified that he signed it when DR pointed out to him that it was unsigned.

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[100] Tr. 226; *see also* Tr. 277.

[101] Tr. 253–55, 282, 289–90, 296, 306–08.

[102] Tr. 253–54, 291, 321, 323–24.

[103] Tr. 251–53, 272–73, 292, 296, 302.

[104] Tr. 229, 250–53.

[105] Tr. 215–16, 219, 222.

[106] Tr. 255–57.

[107] Tr. 1324–25; CX-136 and CX-137, at 1–2 (Rule 8210 request and response).

Also, Plummer was evasive at times during his testimony; many of his answers were long, rambling,[108] and unresponsive;[109] and he claimed not to recall many important facts and events,[110] including whether or not he actually signed the TADC.[111] And, most importantly, Plummer's credibility was undercut because he engaged in unethical conduct during the investigation by altering a document that was the subject of a FINRA document request—conduct made worse by then giving false and misleading sworn testimony at his OTR about it, as discussed above.

In light of these concerns, we gave Plummer's testimony little weight although we did not completely disregard it; thus, the evidence regarding the creation of the TADC is inconclusive. While there is evidence supporting Enforcement's contention that the TADC was created in its present form by October 2007, other reasonable contrary inferences can be drawn from the evidence, making it unclear when it was created or by whom. In short, the "totality of the evidence suggests an equally or more compelling inference than [Enforcement's] allegation" regarding the creation date of the TADC.[112] Therefore, we conclude that Enforcement failed to prove that the TADC was created at or before the time of the offering.

### G. The Firm's Supervisory Procedures

During the offering (October 2007 through June 2008), while Plummer was the Firm's chief compliance officer,[113] the Firm's written supervisory procedures ("WSPs") gave Plummer due diligence review responsibility that included affiliated offerings, such as the Joint Venture

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[108] Tr. 398–400, 548–50, 613–16, 709–11.

[109] *See, e.g.*, Tr. 212–13, 226–27, 300–01, 559–60, 616–17.

[110] *See, e.g.*, Tr. 214, 216, 243, 262–63, 266, 268, 270–71, 273, 298–99, 304–05, 407–08, 343, 351–54, 361, 402, 470, 586–88, 654, 664–66, 669. Plummer attributed his lack of recollection and his having signed the TADC to the effects of congestive heart failure. *See, e.g.*, Tr. 248, 256, 343. He testified that for the year-and-a-half period before mid-2015, he "was in the middle of congestive heart failure," had a "dead space," and his memory for that period was "just gone." Tr. 78–79. But, like the claim he made about his OTR testimony, he introduced no evidence to support his assertion that heart problems affected his conduct or his memory of the events he testified about at the hearing.

[111] Tr. 343, 346–47.

[112] *Cf. Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *54 (NAC June 25, 2001) (finding that "Enforcement has not met its burden of proof in this instance, where 'the totality of the evidence suggests an equally or more compelling inference than [Enforcement's] allegation.'") (quoting *SEC v. Moran*, 922 F. Supp. 867, 892 (S.D.N.Y. 1996). Respondents argue that the TADC could not have been created before 2010 because it references actions that did not occur until that year. Rather, according to Respondents, it must have been created sometime between the vote to sell the leases (August 2010) and the actual sale itself (December 2010). Respondents' Post-Hearing Br. at 1–2, 4. But Respondents do not explain—and it is not otherwise apparent to the Panel—what "actions" contained in the TADC only occurred after 2007.

[113] CX-1, at 5. Plummer served as Chief Compliance Officer at the time of the offering, Tr. 564–65, CX-166, at 9, and until November 2008. CX-3, at 7; *see also* Tr. 96–97.

offering, in which Plummer personally controlled both the seller of the investment (CEI) and the placement agent and broker (Chestnut).[114]

The structure of the offering was rife with potential conflicts of interest. Plummer controlled Chestnut and its affiliates (including CEI); CEI was the Managing Venturer and seller of the Joint Venture Interests; and each entity stood to benefit financially from its role in the offering and Joint Venture. Yet the WSPs did not provide for anyone other than Plummer to review the due diligence for Firm-affiliated offerings, such as the Joint Venture offering.[115] Also, in connection with the Joint Venture offering, the record does not reflect that Plummer created any due diligence summary documents reflecting any due diligence review he performed pertaining to conflicts of interest.[116] Indeed, the record does not reflect that Plummer conducted any due diligence review for conflicts of interest, and, in particular, issues relating to the fact that the Joint Venture was an offering by a Chestnut affiliate, CEI, and that Plummer controlled both CEI and Chestnut.[117]

## III. Conclusions of Law

### A. Misrepresentations and Omissions Charges (Causes One, Two, and Three)

Enforcement brought three alternative causes of action against Respondents based on alleged misrepresentations and omissions in connection with the sale of the Joint Venture Interests. The Complaint alleges that Respondents committed securities fraud by making misstatements and omissions in the CIM intentionally or recklessly (Cause One) or, alternatively, negligently (Cause Two). On the other hand, if the Panel determines that the Joint Venture Interests are not securities, the Complaint alleges that Respondents' misrepresentations and omissions nevertheless violated FINRA's just and equitable principles of trade rule (Cause Three).[118] But as explained below, each of these charges fails because Enforcement did not prove that Respondents made the alleged misrepresentations or omissions.

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[114] CX-164, at 11, 74–76; CX-165; Tr. 578–81; CX-132, at 66–68.

[115] CX-164, at 74–76; Tr. 625.

[116] Tr. 1298, 1361–62.

[117] Chestnut argues that its procedures were adequate because they show that other individuals who worked solely for Chestnut were involved in the due diligence in connection with the offering. Tr. 575–78. But Plummer testified that he could not recall who assisted him, Tr. 581; and, in any event, he remained responsible under the WSPs. CX-164, at 74–76; Tr. 580–85, 625.

[118] The Complaint does not specify whether this charge is based on intentional, reckless, or negligent conduct.

**1. Enforcement Failed to Prove that Respondents Violated Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110 (Cause One)**

Enforcement charges that Respondents made the following six material misrepresentations and omissions to investors in connection with their purchase of Joint Venture interests:

i. misrepresentations regarding what the investors would be charged in completion assessments in the event that only two of the three Prospective Wells were attempted to be completed;

ii. misrepresentations regarding the amount Chestnut affiliate CEI would be paid by the Joint Venture in the event that only two of the three Prospective Wells were attempted to be completed;

iii. omissions relating to Respondents' plan to require investors to pay the maximum completion assessment of $53,724 per unit irrespective of whether the third Prospective Well would be attempted to be completed, and then have the Joint Venture transfer all of these funds to CEI, contrary to the provisions of the 4x4 CIM;

iv. omissions relating to Respondents' undisclosed plans to sell off Joint Venture's interest in two Hopper wells (Hopper Well 1H and Hopper Well 2H) and the well site for the undrilled Hopper Well 3H (the third Prospective Well);

v. misrepresentations in the CIM that CEI and the Joint Venture would enter into a Turnkey Completion Contract with terms consistent with the representations set forth in the CIM; and

vi. omissions in failing to inform investors that, contrary to the express representations in the CIM regarding the required Turnkey Completion Contract, the only turnkey agreement that the Joint Venture and CEI had ever drafted (but not yet executed) contained terms—as reflected in the TADC—regarding CEI's receipt and use of the completion assessment funds that were in direct conflict with the mandated terms set forth in the CIM.[119]

According to the Complaint, by virtue of these alleged material misrepresentations and omissions, Respondents willfully violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder.

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[119] Complaint ("Compl.") ¶¶ 61, 128.

Exchange Act Section 10(b) and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with the purchase or sale of a security.[120] To establish that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, Enforcement must prove by a preponderance of the evidence that they made material misrepresentations or omissions in connection with the purchase or sale of a security and that they acted with scienter.[121] "Whether information is material 'depends on the significance the reasonable investor would place on the ... information.'"[122] "Information is material 'if there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to [invest]...[and] the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'"[123] "Scienter is defined as 'a mental state embracing intent to deceive, manipulate, or defraud'"[124] and "is established if a respondent acted intentionally or recklessly."[125] "Reckless conduct includes 'a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'"[126]

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[120] Securities Exchange Act of 1934 Section 10(b) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe..." 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful "[t]o employ any device, scheme, or artifice to defraud; to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

[121] *Dep't of Enforcement v. Fillet*, No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *18 (NAC Oct. 2, 2013), *aff'd in relevant part*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142 (May 27, 2015). Enforcement must also prove that Respondents used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. *Dep't of Enforcement v. Gonchar*, No. CAF040058, 2008 FINRA Discip. LEXIS 31, at *27–28 & n.18 (NAC Aug. 26, 2008), *aff'd*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797 (Aug. 14, 2009), *petition for review denied*, 409 F. App'x 396 (2d Cir. Dec. 17, 2010).

[122] *Dep't of Enforcement v. Kenny Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *32 (NAC Dec. 29, 2015) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016).

[123] *Fillet*, 2013 FINRA Discip. LEXIS 26, at *29 (quoting *Basic*, 485 U.S. at 240).

[124] *Akindemowo*, 2015 FINRA Discip. LEXIS 58, at *33 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)).

[125] *Id.* (citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007)); *see also Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *77 n.78 (NAC Sept. 25, 2015) ("Scienter also is established through a heightened showing of recklessness" (citing *Tellabs*, 551 U.S. at 319 n.3)), *appeal docketed*, No. 3-16900 (SEC Oct. 13, 2015).

[126] *Fillet*, 2013 FINRA Discip. LEXIS 26, at *35 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted)).

The Complaint also charges that Respondents violated NASD Rules 2120 and 2110. "NASD Rule 2120 (now FINRA Rule 2020) is FINRA's anti-fraud rule. It is similar to Rule 10b-5 and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device."[127] A violation of NASD Rule 2120 also requires a showing of scienter.[128]

A violation of the SEC's or FINRA's anti-fraud rules also violates NASD Rule 2110.[129] Rule 2110 was, at the relevant time, FINRA's ethical standards Rule and stated that "[a] member, in the conduct of [his] business, [shall] observe high standards of commercial honor and just and equitable principles of trade."[130]

A failure to establish any element of a Section 10(b) or Rule 10b-5 charge is fatal.[131] We found above that Enforcement failed to prove the TADC existed in its present form at or before the offering. And Enforcement did not otherwise prove that Plummer harbored a hidden intention at the time of the offering to charge the investors the maximum completion assessment—and to transfer the funds to CEI—regardless of how many Prospective Wells were drilled. Therefore, Enforcement did not establish that Respondents made the alleged misstatements and omissions; it thereby also failed to establish that Respondents violated the federal and FINRA anti-fraud provisions. Accordingly, those charges—as well as the NASD Rule 2110 charge based on those alleged violations—are dismissed. Because Enforcement failed to demonstrate that Respondents made the alleged misrepresentations or omissions, we need not address other elements of the

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[127] *Dep't of Enforcement v. The Dratel Grp., Inc.*, No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *26 (NAC May 2, 2014), *aff'd*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035 (Mar. 17, 2016). While similar to Rule 10b-5, NASD Rule 2120 "captures a broader range of activity." *See Fillet*, 2013 FINRA Discip. LEXIS 26, at *38 (referencing FINRA Rule 2020, the successor to NASD Rule 2120). Effective December 15, 2008, NASD Rule 2120 was renumbered, without material change, as FINRA Rule 2020. *See* FINRA Regulatory Notice 08-57, 2008 FINRA LEXIS 50, at *32–33 (Oct. 2008).

[128] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *31 n.31 (NAC Apr. 26, 2013).

[129] *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *26 n.29 (July 2, 2013) (holding that "a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [NASD] Rule 2110"), *aff'd sub nom. Birkelbach v. SEC*, 751 F.3d 472 (11th Cir. 2014); *The Dratel Grp., Inc*, 2014 FINRA Discip. LEXIS 6, at *28 n.25 ("Conduct that violates Commission rules or FINRA rules is inconsistent with high standards of commercial honor and just and equitable principles of trade and therefore also violates NASD Rule 2110....") (citing *Joseph Abbondante*, 58 S.E.C. 1082, 1103 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006)); *Dep't of Enforcement v. Cipriano*, No. C07050029, 2007 NASD Discip. LEXIS 23 at *30 n.20 (NAC July 26, 2007) (finding that a violation of NASD Conduct Rule 2120 is also a violation of NASD Conduct Rule 2110.).

[130] Effective December 15, 2008, NASD Rule 2110 was re-codified, without change, as FINRA Rule 2010. FINRA Regulatory Notice 08-57, 2008 FINRA LEXIS 50, at 32–33 (Oct. 2008). "NASD Rules that apply to an NASD 'member,' like 2110, apply to all members and to persons associated with a member. NASD Rule 115(a)." *Dep't of Enforcement v. Meyers*, No. C3A040023, 2007 NASD Discip. LEXIS 4, at *18 n.6. (NAC Jan. 23, 2007).

[131] *In re Fairway Grp. Holdings Corp. Secs. Litig.*, No. 14CV0950(LAK)(AJP), 2015 U.S. Dist. LEXIS 109941, at *25 (S.D.N.Y. Aug. 19, 2015) ("The failure to establish any element is fatal to a § 10(b)/Rule 10b-5 claim.").

10b-5 charge, including whether the Joint Venture interests are securities.[132] We dismiss the first cause of action.

### 2. Enforcement Failed to Prove that Respondents Violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 and NASD Conduct Rule 2110 (Cause Two)

As an alternative to the scienter-based SEC and FINRA anti-fraud charges in Cause One, Enforcement charged Respondents in Cause Two with violating Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act") and NASD Conduct Rule 2110 (predicated on a finding of liability under these two Securities Act sections). Section 17(a)(2) makes it unlawful in the offer or sale of securities "to obtain money or property by means of any untrue statement" or omission of a material fact. And Section 17(a)(3) makes it unlawful, in the offer or sale of securities, to engage in any transaction, practice or course of business that operates as a fraud or deceit upon the purchaser. "Sections 17(a)(2) and 17(a)(3) of the Securities Act do not require a showing of scienter, negligence is sufficient."[133] Because Enforcement failed to prove that Respondents made the misrepresentations and omissions alleged in the Complaint, and do not otherwise find that Respondents engaged in any transaction, practice or course of business that operates as a fraud or deceit upon the investors, we dismiss Cause Two.

### 3. Enforcement Failed to Prove that Respondents Violated NASD Conduct Rule 2110 (Cause Three)

Finally, based on the above-referenced alleged misrepresentations and omissions, the Complaint charges Respondents with violating NASD Conduct Rule 2110. "Misrepresentations and omissions are inconsistent with just and equitable principles of trade and therefore violate NASD Conduct Rule 2110."[134] This charge is an alternative to the First and Second Causes of Action charges and is predicated on a finding by the Extended Hearing Panel that the Joint Venture interests are not securities. Also, "[p]roof of intent or scienter is not necessary to show a

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[132] *Cf. First N.Y. Sec. LLC v. United Rentals Inc.*, 391 F. App'x 71, 74 (2d Cir. 2010) (finding it unnecessary to address materiality where plaintiff failed to establish scienter); *Wilson v. Comtech Telecomm. Corp.*, 648 F.2d 88, 94 (2d Cir. 1981) ("Because we find that [plaintiff] has failed to demonstrate his reliance on any actions by appellees, we need not reach the other elements of his 10b-5 claim."); *Dep't of Enforcement v. Wilson*, No. 2007009403801, 2011 FINRA Discip. LEXIS 67, at *42 n.25 (NAC Dec. 28, 2011) (declining to reach the issue of whether alleged misstatements and omissions were material in light of finding that Enforcement failed to prove that respondent acted with scienter).

[133] *Dennis Navarra*, Securities Act Release No. 10114, Investment Advisers Act of 1940 Release No. 4460, 2016 SEC LEXIS 3008, at *8 (July 21, 2016) (citing *Aaron v. SEC*, 446 U.S. 680, 697, 701–02 (1980)).

[134] *Dep't of Enforcement v. Taylor*, No. 20070094468, 2011 FINRA Discip. LEXIS 17, at *20 (NAC Aug. 5, 2011) (quoting *Alvin W. Gebhart, Jr.*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at *39 n.39 (Nov. 14, 2008)).

violation of NASD Rule 2110."[135] Enforcement failed to establish a violation of NASD Rule 2110 for the same reason it failed to prove violations under Causes One and Two: Enforcement failed to prove that Respondents made misrepresentations and omissions as alleged. Therefore, this charge is dismissed.

## B. Misuse of Customer Funds and Other Unethical Conduct Charges (Cause Four)

### 1. Plummer Violated NASD Conduct Rules 2110 and 2330(a) and FINRA Rules 2010 and 2150(a)

NASD Rule 2330(a) prohibits persons associated with members from making improper use of a customer's securities or funds. FINRA Rule 2150 states that "[n]o member firm or person associated with a member firm shall make improper use of a customer's securities or funds." FINRA Rule 2150(a) superseded NASD Rule 2330(a), without change, on December 14, 2009.[136] "An associated person misuses customer funds when he or she fails to apply the funds, or uses the funds for some purpose other than, as directed by the customer."[137] That failure need not involve the intent to deprive the customer of the funds permanently; the prohibition includes a delay in repaying funds owed to the customer.[138]

Above, we found that Plummer misused the portion of the completion assessment attributable to the third Prospective Well. He collected funds for one purpose—well completion—following a vote by the investors and did not use that portion of the funds pertaining to the third Prospective Well for that purpose. He never received permission to use that portion of the assessed funds for other purposes. And, to date he has not repaid those funds to investors (except for settlement payments made to three investors). Therefore, he violated NASD Conduct Rule 2330(a) and FINRA Rules 2150(a).

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[135] *Dep't of Enforcement v. Tomlinson*, No. 2009017527501, 2014 FINRA Discip. LEXIS 4, at *20 (NAC Mar. 5, 2014) (citing *Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 SEC LEXIS 54, at *18 (Jan. 6, 2012)), *aff'd*, Exchange Act Release No. 73825, 2014 SEC LEXIS 4982 (Dec. 11, 2014), *aff'd*, 637 F. App'x 49 (2d Cir. 2016).

[136] *See* FINRA Regulatory Notice 09-60 (Oct. 2009), http://www.finra.org/sites/default/files/NoticeDocument/p120229.pdf.

[137] *Dep't of Enforcement v. Mielke*, No. 2009019837302, 2014 FINRA Discip. LEXIS 24, at *43 (NAC July 18, 2014) (citing *Dep't of Enforcement v. Patel*, No. C02990052, 2001 NASD Discip. LEXIS 42, at *24–26 (NAC May 23, 2001)) (affirming hearing panel's finding of misuse where respondent improperly withdrew investor funds that were intended for investment by a company and diverted them to the manager of that company), *aff'd*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927 (Sept. 24, 2015); *Dep't of Enforcement v. Triggs*, No. C04020006, 2002 NASD Discip. LEXIS 20, at *8 (Dec. 13, 2002) (use of customer funds for any purpose not directed by the customer violates Rule 2330(a)).

[138] *Alderman v. SEC*, 104 F.3d 285, 289 (9th Cir. 1997) (misuse found where funds mistakenly transferred to wrong account were then deliberately withheld for two months); *Bernard D. Gorniak*, 52 S.E.C. 371 (1995) (misuse found when representative retained customer funds indefinitely without applying them to intended purpose); *Robert L. Johnson*, 51 S.E.C. 828 (1993) (misuse found where principal failed to apply funds for intended purpose or to return them for almost two years).

Plummer also violated NASD Conduct Rule 2110 and its successor, FINRA Rule 2010. A violation of any NASD rule is inconsistent with NASD Rule 2110,[139] and a violation of any FINRA Rule constitutes a violation of FINRA Rule 2010.[140] Additionally, improper use of customer funds constitutes a separate violation of NASD Rule 2110 and FINRA Rule 2010.[141] As the Securities and Exchange Commission has recognized, the misuse of customer funds is "patently antithetical to the 'high standards of commercial honor and just and equitable principles of trade' that the NASD seeks to promote."[142]

### 2. Enforcement Failed to Prove that Chestnut Violated NASD Conduct Rules 2110 and 2330(a) and FINRA Rules 2010 and 2150(a)

Enforcement did not prove that Chestnut improperly collected and misused customer funds, as alleged. Plummer solicited the investors to vote for, and to pay, the completion assessments by sending them a letter on Chestnut Petroleum, Inc.'s—not Chestnut's—letterhead; the funds at issue were then deposited into the Joint Venture's bank account and transferred to CEI. No other Chestnut connection to the wrongdoing was established. Thus, because the

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[139] *Alvin W. Gebhart*, Exchange Act Release No. 53136, 2006 SEC LEXIS 93, at *54 n.75 (Jan. 18, 2006), *rev'd and remanded in part on other grounds*, 2007 U.S. App. LEXIS 27183 (9th Cir. Nov. 21, 2007), *writ of certiorari denied*, 561 U.S. 1008 (2010); *see also Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *42 (June 29, 2007); *Mission Sec. Corp.*, Exchange Release No. 63453, 2010 SEC LEXIS 4053, at *2 (Dec. 7, 2010) (citing *Stephen H. Gluckman*, 54 S.E.C. 175, 185 (1999) (finding a violation of NASD Rule 2110 by virtue of a violation of NASD Rule 2330). NASD Rule 2110 applies to Plummer through NASD General Rule 115 (re-codified as FINRA Rule 140), which provides that persons associated with a member have the same duties and obligations as a member.

[140] *The Dratel Grp., Inc.*, 2015 FINRA Discip. LEXIS 10, at *6 n.3 (citing *Murphy*, 2013 SEC LEXIS 1933, at *26 (noting that the violation of another Commission or FINRA rule or regulation constitutes a violation of FINRA Rule 2010)).

[141] *Dist. Bus. Conduct Comm. v. Roach*, No. C02960031, 1998 NASD Discip. LEXIS 3, at *14 (NBCC Jan. 20, 1998) (discussing NASD Rule 2110).

[142] *Joel Eugene Shaw*, 51 S.E.C. 1224, 1226–27 (1994) (quoting *Wheaton D. Blanchard*, 46 S.E.C. 365, 366 (1976) (*internal quotation marks omitted*)); *see also Patel*, 2001 NASD Discip. LEXIS 42, at *10, 24–26 (affirming a hearing panel decision barring a representative for misusing customer funds by using them for his own purposes rather than investing them as directed by the customers).

evidence did not show that Plummer engaged in the wrongful conduct on Chestnut's behalf, these charges against Chestnut are dismissed.[143]

### C. Supervision Charges—Chestnut Violated NASD Conduct Rules 3010 and 2110 (Cause Five)

NASD Rule 3010(a) provides that "[e]ach member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." The rule also states that "[f]inal responsibility for proper supervision shall rest with the member." The supervisory system must also include written procedures to supervise the types of business in which the firm engages and to supervise the activities of its registered representatives, registered principals, and other associated persons.[144] "Assuring proper supervision is critical to operating a broker-dealer. 'Regardless of its size or complexity, each member must adopt and implement a supervisory system that is *tailored specifically to the member's business* and must address the activities of all its registered representatives and associated persons.'"[145]

Chestnut's business involved acting as a placement agent in connection with investment offerings involving its affiliates. In light of our finding that its supervisory system failed to address conflicts of interest in such offerings, we conclude that the Firm violated NASD Rule 3010, and, by virtue of that violation, NASD Rule 2110.[146]

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[143] The Complaint charges Respondents with violating NASD Rule 2110 and FINRA Rule 2010 by conduct that included, but was not limited to, the misuse of customer funds. *See* Compl. ¶¶ 149 (i)–(vi). The non-misuse allegations included allegations that Respondents requested the maximum completion assessment when they knew that the third Prospective Well was not close to being attempted to be completed, Compl. ¶ 149 (i); made false representations and material omissions to Chestnut customers in the May 2008 completion call letters, Compl. ¶ 149 (ii); hid from investors the existence and terms of the TADC that conflicted with the CIM, Compl. ¶ 149 (iv); and made false statements to Chestnut customers regarding the purported plans for the drilling and completion of the third Prospective Well. Compl. ¶ 149 (vi). Because we find that Plummer violated NASD Rule 2110 and FINRA Rule 2010 by misusing customer funds, we need not address whether he also violated these rules by engaging in this other alleged misconduct. As to the Firm, we conclude that it did not violate these Rules because Enforcement failed to prove that, to the extent Plummer committed this alleged wrongdoing, he was acting on behalf of the broker-dealer, Chestnut, as opposed to one of its affiliates.

[144] *See* NASD Rule 3010(a)(1), (b)(1). The provisions of NASD Rule 3010 pertinent to this case were adopted as FINRA Rule 3110, effective December 1, 2014. *See* Regulatory Notice 14-10, 2014 FINRA LEXIS 17 (Mar. 2014).

[145] *Dep't of Enforcement v. North Woodward Fin. Corp*, No. 2011028502101, 2016 FINRA Discip. LEXIS 35, at *27–28 (NAC July 19, 2016) (citations omitted) (quoting NASD Notice to Members 99-45, 1999 NASD LEXIS 20, at *5 (June 1999) (emphasis in original)), *aff'd*, Exchange Act Release No. 74913, 2015 SEC LEXIS 1867 (May 8, 2015).

[146] *Dep't of Enforcement v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *47 n.31 (NAC Jan. 4, 2008) ("[T]he Commission has determined that a violation of another NASD rule, in this case [NASD] Rule 3010, constitutes a violation of [NASD] Rule 2110.") (quoting *Robert J. Prager*, Exchange Act Release No. 51974, 2005 SEC LEXIS 1558, at *2 n.3 (July 6, 2005)), *aff'd*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843 (Dec. 19, 2008).

### D. Investigation-Related Charges (Cause Six)

#### 1. Producing a Falsified Document to FINRA—Chestnut and Plummer Violated FINRA Rule 2010

As discussed above, FINRA Rule 2010 requires that FINRA members and associated persons "observe high standards of commercial honor and just and equitable principles of trade." A respondent violates these principles when he engages in unethical conduct.[147] This Rule applies to the obligation of members and associated persons to provide accurate information to FINRA.[148] Hence, providing false documents to FINRA is "inconsistent with just and equitable principles of trade,"[149] and violates FINRA Rule 2010.[150] To establish this violation, the "most that is required is a finding of bad faith or unethical conduct."[151]

It is undisputed that when Plummer signed the TADC in December 2014, he knew that it was going to be produced to FINRA. Plummer claimed, however, that he had no recollection of signing the TADC and blamed both signing it and his lack of recollection on heart problems.[152] We gave little weight to this testimony—and therefore do not excuse his misconduct—as the

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[147] *Dep't of Enforcement v. Pierce*, No. 2007010902501, 2013 FINRA Discip. LEXIS 25, at *58 (NAC Oct. 1, 2013) (citing *Dep't of Enforcement v. Skiba*, No. E8A2004072203, 2010 FINRA Discip. LEXIS 6, at *13 (NAC Apr. 23, 2010)).

[148] *Brian L. Gibbons*, 52 S.E.C. 791, 795 (1996), *aff'd*, 1997 U.S. App. LEXIS 8875 (9th Cir. Apr. 21, 1997).

[149] *Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 SEC LEXIS 2401, at *17, 22–23 (Aug. 22, 2008); *see also Dep't of Enforcement v. Taylor*, No. C8A050027, 2007 NASD Discip. LEXIS 11, at *22–23 (NAC Feb. 27, 2007) ("Falsifying documents is a prime example of misconduct that adversely reflects on a person's ability to comply with regulatory requirements and has been held to be a practice inconsistent with just and equitable principles of trade."). See also *Keilen Dimone Wiley*, Exchange Act Release No. 76558, 2015 SEC LEXIS 4952, at *22–23 (Dec. 4, 2015) ("Providing false or misleading information to FINRA constitutes conduct inconsistent with just and equitable principles of trade and violates FINRA Rule 2010"), *petition for review denied*, 2016 App. LEXIS 19051 (5th Cir. Oct. 19, 2016); *Dep't of Enforcement v. Masceri*, No. C8A040079, 2006 NASD Discip. LEXIS 29, at *35 (NAC Dec. 18, 2006) ("Providing false or misleading information to NASD is conduct inconsistent with just and equitable principles of trade.").

[150] *Wiley*, 2015 SEC LEXIS 4952, at *22–23; *Dep't of Enforcement v. Springsteen-Abbott*, No. 2011025675501, 2016 FINRA Discip. LEXIS 39, at *36 n.22 (NAC Aug. 23, 2016) (citing *Ortiz*, 2008 SEC LEXIS 2401, at *23–24), *appeal docketed*, No. 3-17560 (SEC Sept. 20, 2016).

[151] *Robert E. Kauffman*, Exchange Act Release No. 33219, 1993 SEC LEXIS 3163, at *4 n.5 (Nov. 18, 1993), *petition for review denied*, 40 F.3d 1240 (3d Cir. 1994). "In determining whether a person has violated FINRA's ethical rule," the NAC recently explained, "the pertinent inquiry is the person's conduct rather than their state of mind or intent." More specifically, "[a]lthough bad faith is one indicia of determining whether the conduct at issue was unethical and thus violated FINRA's ethical rule, . . . bad faith in the sense of 'malicious intent' or 'deceitfulness' need not be established." Rather, "unethical conduct alone without scienter or bad faith can constitute a just and equitable principles of trade rule violation." In other words, the "analysis that is employed is a flexible evaluation of the surrounding circumstances with attention to the ethical nature of the conduct." *Dep't of Enforcement v. Tysk*, No. 2010022977801, 2016 FINRA Discip. LEXIS 36, at *20–21 (NAC May 16, 2016) (citations and internal quotations omitted), *appeal docketed*, No. 3-17294 (SEC Jun. 14, 2016).

[152] Tr. 345–47.

alleged impact of his purported medical problems on his conduct and recollection was uncorroborated, as noted above.[153] Also, this testimony was inconsistent with his other more credible hearing testimony in which he did recall signing the TADC; he specifically recounted that after locating the TADC, he showed it to DR, who commented that it was unsigned. Then, according to Plummer, "I said 'Oh.' I didn't think anything of it. I signed it just like another document and turned it over."[154] He claimed he did not "remember very well" the events surrounding his signing of the document, but did recall that when it was pointed out to him that the TADC was unsigned, he responded "just off the top of [his] head . . . 'I'll sign it.'"[155]

Accordingly, we find that Plummer acted unethically or in bad faith by falsifying, and thereby rendering misleading, a document that he knew the Firm was going to provide to FINRA in connection with an investigation. And, similarly, DR, acting on behalf of Chestnut, acted in bad faith or unethically because he knew that the TADC had been altered—indeed, he had witnessed the alteration—and nevertheless produced the document to FINRA without disclosing its falsity. Therefore, we conclude that Chestnut and Plummer violated FINRA Rule 2010.[156]

#### 2. False and Misleading Testimony—Plummer Violated FINRA Rules 8210 and 2010

"FINRA Rule 8210 requires members and their associated persons to provide information and documents requested in FINRA investigations."[157] This Rule "provides a means, in the absence of subpoena power, for [FINRA] to obtain from its members information necessary to conduct investigations"[158] and "is at the heart of the self-regulatory system for the securities

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[153] *Cf. Dep't of Enforcement v. Jarkas*, No. 2009017899801, 2015 FINRA Discip. LEXIS 50, at *40–41 (NAC Oct. 5, 2015) (finding that respondent "provided no evidence showing that his medical condition prevented him from testifying several months earlier on the two requested dates and thus his nonappearance for testimony cannot be excused"), *aff'd in relevant part*, Exchange Act Release No. 77503, 2016 SEC LEXIS 1285 (Apr. 1, 2016); *Lee Gura*, 57 S.E.C. 972, 977 (2004) (holding that "unsubstantiated personal and medical problems do not excuse [a respondent's] failure to respond"); *see also Curtis Steven Culver*, Exchange Act Release No. 75774, 2015 SEC LEXIS 3541, at *11 (Aug. 27, 2015) (dismissing application for review of bar issued under Rule 9552(h) because "[w]ithout medical records or other proof that medical or personal problems prevented Culver from responding to the Rule 8210 requests, there is no basis for excusing his failure to exhaust available administrative remedies" before FINRA).

[154] Tr. 252.

[155] Tr. 248.

[156] *See Dist. Bus. Conduct Comm. v. Pelaez*, No. C07960003, 1997 NASD Discip. LEXIS 34, at *10 (NBCC May 22, 1997) (concluding that respondents violated Section 1 of the NASD Rules of Fair Practice, precursor to NASD Rule 2110, because they knew false documents had been submitted to NASD and they did not take any steps to advise NASD of this fact).

[157] *North Woodward Fin. Corp.*, 2016 FINRA Discip. LEXIS 35, at *9–10 (citing FINRA Rule 8210(a)). FINRA Rule 8210(a) provides that "FINRA staff shall have the right to . . . require a member, person associated with a member, or any other person subject to FINRA's jurisdiction to provide information orally . . . and to testify at a location specified by FINRA staff, under oath or affirmation . . . with respect to any matter involved in the investigation, complaint, examination, or proceeding . . . ."

[158] *Richard J. Rouse*, 51 S.E.C. 581, 584 (1993).

industry."[159] An associated person's obligation to comply with Rule 8210 information requests is unequivocal,[160] as the Rule states that "[n]o member or person shall fail to provide information or testimony or to permit an inspection and copying of books, records, or accounts."[161]

Providing false and misleading information to FINRA staff during an investigation "mislead[s] [FINRA] and can conceal wrongdoing" and thereby "subvert[s] [FINRA's] ability to perform its regulatory function and protect the public interest."[162] Thus, as the National Adjudicatory Council ("NAC") has stressed, "it is axiomatic that Procedural Rule 8210 prohibits an associated person from providing false or misleading information to [FINRA] in connection with an examination or investigation."[163] And providing false or misleading information—including false or misleading testimony at an OTR[164]—in response to requests issued under the Rule violates FINRA Rules 8210[165] and 2010.[166] Plummer gave false and misleading testimony

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[159] *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *13 (Nov. 14, 2008), *petition for review denied*, 347 F. App'x 692 (2d Cir. 2009); *see PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008) ("[C]ompliance with Rule 8210 [is] essential to enable [FINRA] to execute its self-regulatory functions."), *petition for review denied*, 566 F.3d 1172 (D.C. Cir. 2009).

[160] *Howard Brett Berger*, 2008 SEC LEXIS 3141, at *13; *Dep't of Enforcement v. The Keystone Equities Grp., LP*, No. 2010024889501, 2015 FINRA Discip. LEXIS 54, at *40 (NAC Dec. 17, 2015).

[161] FINRA Rule 8210(c).

[162] *Geoffrey Ortiz*, 2008 SEC LEXIS 2401, at *32 (quoting *Michael A. Rooms*, 58 S.E.C. 220, 229 (2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006)) (internal quotes omitted).

[163] *Masceri*, 2006 NASD Discip. LEXIS 29, at *36 (discussing NASD Rule 8210, the predecessor to FINRA Rule 8210).

[164] *John Montelbano*, Exchange Act Release No. 47227, 2003 SEC LEXIS 153, at *36–38 (Jan. 22, 2003) (sustaining NASD's finding that respondents violated Rule 8210 by giving false testimony during an OTR); *Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *64–68 (NAC May 1, 2012) (finding that respondents violated NASD Rules 8210 and 2110 by providing false and misleading information and testimony to FINRA).

[165] *The Keystone Equities Grp., LP*, 2015 FINRA Discip. LEXIS 54, at *40 (referencing the predecessor rule, NASD Rule 8210) (citing *Dep't of Enforcement v. Ortiz*, No. E0220030425-01, 2007 FINRA Discip. LEXIS 3, at *32 (NAC Oct. 10, 2007), *aff'd*, 2008 SEC LEXIS 2401 (Aug. 22, 2008)).

[166] A violation of FINRA Rule 8210 also constitutes a violation of FINRA Rule 2010. *See CMG Inst. Trading, LLC*, Exchange Act Release No. 59325, 2009 SEC LEXIS 215, at *29–30 (Jan. 30, 2009); *Dep't of Enforcement v. Ballard*, No. 2010025181001, 2015 FINRA Discip. LEXIS 52, at *24 n.19 (NAC Dec. 17, 2015), *petition for review dismissed*, Exchange Act Release No. 77452, 2016 SEC LEXIS 1151 (Mar. 25, 2016). Also, providing false or misleading information to FINRA is an independent violation of FINRA Rule 2010, separate and apart from a violation of Rule 8210. *The Keystone Equities Grp., LP*, 2015 FINRA Discip. LEXIS 54, at *41.

concerning the TADC at his December 2014 OTR, which was taken under Rule 8210, and did so intentionally or, at a minimum, recklessly. Thus, he violated FINRA Rules 8210 and 2010.[167]

## IV. Sanctions

In considering the appropriate sanctions to impose on Respondents, the Extended Hearing Panel looked to FINRA's Sanction Guidelines ("Guidelines").[168] The Guidelines contain General Principles Applicable to All Sanction Determinations ("General Principles"), overarching Principal Considerations in Determining Sanctions ("Principal Considerations"), as well as guidelines for specific violations. The General Principles explain that "sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct."[169] Adjudicators are therefore instructed to "design sanctions that are meaningful and significant enough to prevent and discourage future misconduct by a respondent and deter others from engaging in similar misconduct."[170] Further, sanctions should "reflect the seriousness of the misconduct at issue,"[171] and should be "tailored to address the misconduct involved in each particular case."[172]

### A. Improper Use of Customer Funds

For misuse of customer funds, the Guidelines recommend that a hearing panel impose a fine of $2,500 to $73,000 and consider imposing a bar. Where the improper use resulted from the respondent's misunderstanding of his or her customer's intended use of the funds or securities, or other mitigation exists, the panel is directed to consider suspending the respondent in any or all capacities for a period of six months to two years and thereafter until the respondent pays restitution.[173]

In considering the appropriate sanctions against Plummer, we took into account the presence of numerous aggravating facts. First, Plummer has not accepted responsibility for his misuse of customer funds.[174] To the contrary, at the hearing he asserted (for the first time) that the Joint Venture Agreement authorized him to use the completion assessment funds to pay for

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[167] *See also Dep't of Enforcement v. Dieffenbach*, No. C06020003, 2004 NASD Discip. LEXIS 10 (NAC July 30, 2004) (affirming hearing panel's finding that respondents violated NASD Rules 2110 and 8210 by obstructing NASD's examination or investigation by, among other things, backdating documents and by pressuring their customers to sign inaccurate and backdated documents, central to an NASD examination or investigation knowing that the Firm would produce those falsified documents to NASD), *aff'd sub nom. Michael A. Rooms*, Exchange Act Release No. 51467, 2005 SEC LEXIS 728 (Apr. 1, 2005).

[168] FINRA Sanction Guidelines ("Guidelines") (2016), http://www.finra.org/industry/sanction-guidelines.

[169] Guidelines at 2 (General Principles Applicable to All Sanction Determinations, No. 1).

[170] *Id.*

[171] *Id.*

[172] Guidelines at 3 (General Principles, No. 3).

[173] Guidelines at 36.

[174] Guidelines at 6 (Principal Considerations, No. 2).

any permissible expense incurred by the Joint Venture, an interpretation that we rejected, as discussed above. Second, he has not repaid to over 80 customers the portion of their completion assessment attributable to the third Prospective Well.[175] Third, the failure to repay the funds for over seven years has resulted in direct and extensive injury to numerous customers.[176] Fourth, the misconduct was intentional: Plummer knew the purposes for which the completion assessment was collected; knew that he had not used a portion of the assessed funds for its intended purpose; and knew that he did not return that portion to most of the affected customers.[177] Finally, the misconduct resulted in potential monetary gain for Plummer, as the funds were received and retained by his company, CEI.[178]

Based on the egregiousness of the misconduct, and the lack of mitigation, we find that Plummer poses too great a risk to the investing public to remain in the securities industry. We will therefore permanently bar him in all capacities from associating with any FINRA member firm.[179] We will also order Plummer to pay restitution, plus pre-judgment interest,[180] to the injured customers. The Guidelines explain that restitution "is a traditional remedy used to restore the status quo ante where a victim otherwise would unjustly suffer loss" and "is an appropriate sanction where necessary to remediate misconduct." We "may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss proximately caused by a respondent's misconduct."[181] While recognizing that neither "the Commission nor the courts have adopted a single approach to proximate causation,"[182] the NAC has awarded restitution when the losses at issue "were the foreseeable, direct, and proximate result of" the

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[175] Guidelines at 6 (Principal Considerations, No. 4).

[176] Guidelines at 6, 7 (Principal Considerations, Nos. 11 & 18).

[177] Guidelines at 7 (Principal Considerations, No. 13).

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

[179] In the exercise of our discretion we decline to impose a fine because we find that the other sanctions imposed are sufficient and appropriately tailored to remediate the misconduct at issue. *See* Guidelines at 3 (General Principles, No. 3) ("Adjudicators should tailor sanctions to respond to the misconduct at issue. Sanctions in disciplinary proceedings are intended to be remedial and to prevent the recurrence of misconduct. Adjudicators therefore should impose sanctions tailored to address the misconduct involved in each particular case.") & 10 ("Adjudicators may exercise their discretion in applying FINRA's policy on the imposition and collection of monetary sanctions as necessary to achieve FINRA's regulatory purposes."). Further, the Guidelines direct Adjudicators to generally "not impose a fine if an individual is barred and the Adjudicator has ordered restitution . . . as appropriate to remediate the misconduct in cases involving . . . improper use of funds." Guidelines at 10.

[180] The Guidelines direct us to consider requiring the payment of interest on the base amount of the restitution, running "from the date(s) of the violative conduct and should be calculated at the rate established for the underpayment of federal income tax in Section 6621 of the Internal Revenue Code, 26 U.S.C. Section 6621(a)(2)." Guidelines at 11.

[181] Guidelines at 4 (General Principles, No. 5).

[182] *Dep't of Enforcement v. McGee*, No. 20120343892022016, 2016 FINRA Discip. LEXIS 33, at *79 (NAC July 18, 2016), *appeal docketed*, No. 3-17402 (SEC Aug. 17, 2016).

respondent's misconduct.[183] By collecting the completion funds and transmitting them to CEI, and then not causing it to return those funds, the customer losses "were the foreseeable, direct, and proximate result of" Plummer's actions; thus, he proximately caused those losses.

The restitution amount, according to the Guidelines, should be calculated based on the amount of loss sustained, as demonstrated by the evidence.[184] Accordingly, Plummer will be ordered to pay back to customers one-third of the completion assessments paid by each customer (except for the three investors who reached settlements with Respondents)[185]—this amount representing the portion of the assessment attributable to the fourth, never-drilled, well (the third Prospective Well)—plus pre-judgment interest from the date each investor paid their completion assessment.

### B. Investigation-Related Violations

Under the Guidelines, a bar is the standard sanction for an individual who did not respond in any manner to an information request. Where mitigation exists, the Panel should consider suspending the individual in any or all capacities for up to two years. In egregious cases, the Guidelines recommend an expulsion of the firm. But if mitigation exists, the Panel should consider suspending the firm with respect to any or all activities or functions for up to two years.

For failing to respond or to respond truthfully, the Guidelines recommend a fine of $25,000 to $73,000. In determining the appropriate sanction, the Guidelines identify as a principal consideration the importance of the information requested as viewed from FINRA's perspective.[186] "The failure to respond truthfully to a FINRA Rule 8210 request is as serious and harmful as a complete failure to respond, and comparable sanctions are appropriate."[187]

Plummer intentionally falsified the TADC knowing that it was about to be produced to FINRA. And, according to the FINRA examiner, this was "an important document based on the protection it provided to investors and its prominence in the CIM" and because it "was being quoted by Mr. Plummer in his OTR as the agreement that allowed him to keep the drilling and completion funds."[188]

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[183] *Id.*; *Dep't of Enforcement v. Brookstone Sec., Inc.*, No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *147–53 (NAC Apr. 16, 2015), *petition for review dismissed*, Exchange Act Release No. 75615, 2015 SEC LEXIS 3204 (Aug. 5, 2015).

[184] Guidelines at 4 (General Principles, No. 5).

[185] Those investors were RG, KH, and JS (including the S's entities: S Family Trust and W Enterprises). *See* Tr. 657–59, 1528–29, 1565; CX-1, at 13–16; CX-12, at 1; CX-98, at 1–3; CX-106; CX-108.

[186] Guidelines at 33.

[187] *Dep't of Enforcement v. Harari*, No. 2011025899601, 2015 FINRA Discip. LEXIS 2, at *31 (NAC Mar. 9, 2015).

[188] Tr. 1316; *see also* 1432–33.

After intentionally altering an important document, Plummer acted in concert with the Firm's chief compliance officer, DR, who produced it to the staff without explaining that the document was not what it purported to be; the alteration was material as it caused the document to be misleading; and not only did Plummer fail to rectify the non-disclosure at his December 2014 OTR, but he compounded his wrongdoing by intentionally or, at a minimum, recklessly, giving false and misleading testimony about it during that OTR. Regarding the Firm, its misconduct—committed through its owner and its chief compliance officer—was egregious. Also, there is no mitigation applicable to either Plummer or to the Firm.[189] Accordingly, we will bar Plummer[190] and expel the Firm.

### C. Supervision

The Guidelines provide a fine range of $1,000 to $37,000 for deficient written supervisory procedures. Also, in egregious cases, the Guidelines direct the Hearing Panel to consider suspending the firm regarding any or all relevant activities or functions for up to 30 business days and thereafter until the supervisory procedures are amended to conform to rule requirements.[191] The Guidelines for this violation contain two principal considerations: whether the deficiencies allowed violative conduct to occur or to escape detection, and whether the deficiencies made it difficult to determine the individual or individuals responsible for specific supervision or compliance.[192]

We do not find that the misconduct was egregious. Nor do we find that the deficiencies allowed violative conduct to occur or to escape detection, or that the deficiencies made it difficult to determine the individual or individuals responsible for specific supervision or compliance. Therefore, were we to impose sanctions against the Firm, we would order a censure and a fine in the mid-range under the Guidelines, $20,000. But in light of the expulsion, we will not assess any sanctions against the Firm for its supervisory violations.

## V. Order

The Extended Hearing Panel orders the following:

1. Texas E&P Partners, Inc. is expelled from FINRA membership for violating FINRA Rule 2010 by producing a falsified document to FINRA during an investigation

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[189] At the hearing, Plummer testified that he signed the TADC "on a whim" (Tr. 272); "didn't know this was a big deal" (Tr. 380–81); and he now realizes it was "obviously a mistake" (Tr. 248); and if faced with the same situation today, he "would not act the same way" (Tr. 379–81). But this acknowledgement came far too late to constitute mitigation.

[190] *See Dep't of Enforcement v. Kapara*, No. C10030110, 2005 NASD Discip. LEXIS 41, at *29 (NAC May 25, 2005) ("Deliberately falsifying documents to mislead NASD staff in their investigations is an egregious offense warranting a bar.").

[191] Guidelines at 103.

[192] *Id.*

(Sixth Cause of Action). In light of the expulsion, no further sanctions are imposed for the Firm's violation of NASD Rules 3010 and 2110 (Fifth Cause of Action) by having deficient supervisory systems and procedures.

2. Plummer is barred from association with any FINRA member firm in any capacity for violating NASD Conduct Rules 2110 and 2330(a) and FINRA Rules 2010 and 2150(a) by misusing customer funds (Fourth Cause of Action). He is also barred for violating FINRA Rules 8210 and 2010 by producing a falsified document to FINRA during an investigation and by giving false and misleading testimony about it to FINRA during that investigation (Sixth Cause of Action). The bars shall become effective immediately if this decision becomes FINRA's final action in this disciplinary proceeding.

3. Subject to the exceptions contained in paragraph 4 below, Plummer is also ordered to pay restitution to the affected customers, namely, one-third of the amount paid by each customer listed under the "C&E Paid" column on CX-12,[193] plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2).[194] Interest on the restitution owed to each customer shall be calculated from the dates on which they paid their completion assessment until paid.

4. Plummer is not required to pay restitution to those customers who received payments as part of settlements with Respondents,[195] or to those customers who did not pay any completion assessment.[196]

5. In the event that any customer who is due restitution under this order cannot be located, unpaid restitution plus accrued interest should be paid to the appropriate escheat, unclaimed-property, or abandoned-property fund for the state of that customer's last-known address. Satisfactory proof of payment of the restitution, or of reasonable and documented efforts undertaken to effect restitution, shall be provided to the staff of FINRA's Department of Enforcement, District 6, no later than 90 days after the date this decision becomes final.

6. Respondents are ordered jointly and severally to pay hearing costs in the amount of $15,752.82, consisting of an administrative fee of $750 and the cost of the hearing transcript. The assessed costs shall be due on a date set by FINRA, but not sooner

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[193] *See* CX-12, at 1–3; Tr. 660–64.

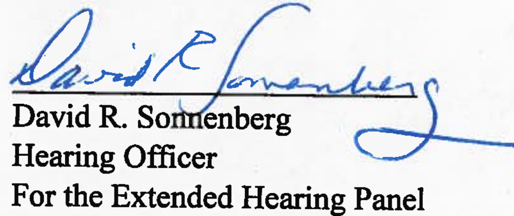
[194] *See* Guidelines at 11 (directing that this provision applies to calculating interest on restitution).

[195] *See* n.193, above.

[196] Customers AC, JH, KH, JM, ML/GP Properties LLC, and CW). *See* CX-12, at 1–3.

than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.

7. The First, Second, and Third Causes of Action are dismissed in their entirety.[197] The Fourth Cause of Action, as to Texas E&P Partners, Inc., is also dismissed.



David R. Sonnenberg
Hearing Officer
For the Extended Hearing Panel

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Jeffrey D. Pariser, Esq. (*via email*)

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