1	STATE OF WASHINGTON		
2	DEPARTMENT OF FINANCIAL INSTITUTIONS SECURITIES DIVISION		
3	IN THE MATTER OF DETERMINING Order Number S-11-0755-12-SC01 Whether there has been a violation of the		
4 5	Securities Act of Washington by: STATEMENT OF CHARGES AND NOTICE OF INTENT TO ENTER ORDER		
6	PetroGates Inc.; Davis Gates Smith;		
7	Respondents)		
8 9	THE STATE OF WASHINGTON TO: PetroGates Inc. Davis Gates Smith		
10	STATEMENT OF CHARGES		
11	Please take notice that the Securities Administrator of the state of Washington has		
12 13	reason to believe that Respondents, PetroGates Inc. and Davis Gates Smith; have each violated the Securities Act of Washington and that their violations justify the entry of an order of the		
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15	Securities Administrator under RCW 21.20.390 to cease and desist from such violations and to		
16	charge costs, and under RCW 21.20.395 to impose fines. The Securities Administrator finds as		
17	follows:		
18	TENTATIVE FINDINGS OF FACT		
19	Respondents		
20	1. PetroGates Inc. ("PetroGates") is a Delaware corporation formed in 2006 that is		
21	in the business of oil and gas exploration and development. PetroGates uses a business		
22	address in Midland, Texas.		
23			
2425	TO CHARGE COSTS, AND TO IMPOSE FINES DEPARTMENT OF FINANCIAL INSTITUTIONS Securities Division PO Box 9033 Olympia, WA 98507-9033 360-902-8760		

STATEMENT OF CHARGES AND NOTICE OF INTENT TO ENTER ORDER TO CEASE AND DESIST, TO CHARGE COSTS, AND TO IMPOSE FINES

2. Davis Gates Smith ("Smith") was the President and CEO of PetroGates. During the time period discussed below Smith resided in Washington.

Nature of the Offering

- 3. Between 2009 and 2010, Respondent Smith sold \$180,000 worth of oil and gas investments in PetroGates, Inc. to an investor in Washington. In July 2009, Smith met a Washington resident (hereinafter, "the investor") and later told the investor that he was founder of an oil and gas company named PetroGates, which owned four oil wells in Texas. A few months later, Smith solicited the investor to make an investment in a Texas oil drilling program. The Washington investor had no prior experience investing in oil and gas, and was not an accredited investor at the time of the solicitation.
- 4. Smith told the investor she would earn a return of five times the amount she invested within six months. Smith stated that drilling had already commenced on one of the four oil wells. In November 2009, Smith directed the investor to wire \$90,000 to a bank account in the name of PetroGates. Smith later provided a signed letter regarding their "recent investment in the oil and gas industry through PetroGates Inc." The letter indicated that the investor had purchased 1 unit in PetroGates Inc.'s "Andrews County Texas drilling program" for \$90,000. Smith later provided the investor with a private placement memorandum.
- 5. In approximately April 2010, Smith informed the investor that they would not receive a return on her investment because another individual had misappropriated funds from the PetroGates bank account. Smith then solicited the investor to invest in another oil and gas investment that involved the mineral rights for a property in Winkler County, Texas that was

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owned by another individual. Smith stated that the property was already being drilled and would start producing oil shortly. Smith told the investor that she would receive a return on her investment within a month, that her principal would be repaid within two to three months, and that the investment would pay her monthly returns of thousands of dollars. Smith also represented that the investor could expect monthly returns for 15 to 20 years. The investor withdrew funds from a 401(k) retirement account in order to make her investment. Between April and May 2010, the Washington investor deposited an additional \$90,000 into a bank account in the name of PetroGates for the purchase of their investment.

- 6. Smith later provided the investor with a "Confidential Memorandum" regarding the investment as well as a handwritten letter acknowledging the investor's prior investments with PetroGates. The letter indicated that when the "projects" were completed, the investment would be worth "more than five times the original outlay by mid 2011." [sic]
- 7. In July 2011, Smith sent an e-mail to the investor that stated that "Petrogates will return the funds you invested and where [sic] wired into the Petrogates Inc account."
- 8. In September 2011 the investor filed a civil action against Smith and PetroGates alleging violations of the Securities Act among other allegations. That matter is still pending. As of the date of this Statement of Charges the Respondents have not paid the investor any return on her investment nor have they repaid any principal.

Misrepresentations and Omissions

9. In connection with the offer and sale of the oil and gas investments, the Respondents failed to provide material information regarding the company, the Andrews

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STATEMENT OF CHARGES AND NOTICE OF INTENT TO ENTER ORDER TO CEASE AND DESIST, TO CHARGE COSTS, AND TO IMPOSE FINES

County oil and gas venture, and the Winkler County oil and gas venture, including, but not limited to, financial statements, financial condition, and operational history.

- In soliciting the investor's first investment, Respondents failed to disclose the general and specific risks of investing in oil and gas investments including wells that may not produce oil or gas, changes in prices and demand, failure to comply with government regulations, changing regulations, and operational hazards. Respondents also failed to disclose the risk that the investor could lose her entire investment.
- 11. The Respondents' projection that the investor's \$90,000 investment in the Andrews County oil and gas venture would result in a return of five times the amount invested within six months was misleading. The Respondents failed to provide a reasonable basis for the projection and failed to provide any limitations on the projection.
- 12. The Respondents' projections that the investor would receive a return on her investment in the Winkler County oil and gas venture within a month, that PetroGates would pay back her principal within two to three months, and that the investment would pay her monthly returns of thousands of dollars for 15 to 20 years was misleading. The Respondents failed to provide a reasonable basis for the projections and failed to provide any limitations on the projections.

Based upon the Tentative Findings of Fact, the following Conclusions of Law are made:

CONCLUSIONS OF LAW

1. The offer or sale of the investments described above constitutes the offer or sale of a security as defined in RCW 21.20.005 (14) and (17).

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2. The offer or sale of the stock described above was made in violation of RCW 21.20.010 because, as set forth in the Tentative Findings of Fact, Respondents PetroGates Inc. and Davis Gates Smith each made misstatements of material facts or omitted to state material facts necessary in order to make the statements made, in light of circumstances under which they were made, not misleading.

NOTICE OF INTENT TO ORDER THE RESPONDENT TO CEASE AND DESIST

Pursuant to RCW 21.20.390(1), and based on the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Respondents PetroGates Inc. and Davis Gates Smith, and their agents and employees, each cease and desist from violations of RCW 21.20.010.

NOTICE OF INTENT TO IMPOSE FINES

Pursuant to RCW 21.20.395, and based upon the Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that Respondent Davis Gates Smith shall be liable for and shall pay a fine of \$10,000.

NOTICE OF INTENT TO CHARGE COSTS

Pursuant to RCW 21.20.390(5), and based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator intends to order that the Respondent Davis Gates Smith shall pay the Securities Division the costs, fees, and other expenses incurred in the conduct of the administrative investigation and hearing of this matter, in an amount not less than \$2,500.

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AUTHORITY AND PROCEDURE

This Order is entered pursuant to the provisions of RCW 21.20.390 and is subject to the provisions of RCW 34.05. The Respondents may each make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND AND OPPORTUNITY FOR HEARING accompanying this order. If a Respondent does not request a hearing, the Securities Administrator intends to adopt the above Tentative Findings of Fact and Conclusions of Law as final, enter a permanent order to cease and desist permanent as to that Respondent, and impose the fines and costs sought. Dated and Entered this <u>11th</u> day of <u>March</u>, 2013.

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Approved by:

Suzanne E. Sarason

Chief of Enforcement

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STATEMENT OF CHARGES AND NOTICE OF INTENT TO ENTER ORDER TO CEASE AND DESIST, TO CHARGE COSTS, AND TO IMPOSE FINES

WILLIAM M. BEATTY Securities Administrator

Presented by:

Jack McClellan

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Financial Legal Examiner

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