

STATE OF ARKANSAS
SECURITIES DEPARTMENT

IN THE MATTER OF

CADDO RESOURCES, Ltd.,
CADDO OPERATING, INC., RICHARD W.
McFARLAND, GLEN GIBSON
and ALL PERSONS
EMPLOYED BY OR OTHERWISE
AFFILIATED WITH THAT ENTITY OR THOSE PERSONS

No. 00-7-S

CEASE AND DESIST ORDER

The Staff of the Arkansas Securities Department (the Staff) has received information and has in its possession certain evidence which indicates that CADDO RESOURCES, Ltd., CADDO OPERATING, INC., RICHARD W. McFARLAND and GLEN GIBSON have violated provisions of the Arkansas Securities Act (the Act), codified at Ark. Code Ann. §§ 23-42-101, *et seq.* (Repl. 1994).

FINDINGS OF FACT

An ongoing investigation has revealed the following facts:

1. Caddo Resources, Ltd., (Caddo) is a limited liability company organized in Texas on 25 January 1993 with its principal office located at 514 South Fannin, Tyler, Texas 75702.
2. Caddo Operating, Inc., (Caddo Operating) is a corporation incorporated in Texas on 13 May 1994 with its principal office located at the same address as Caddo.
3. Richard W. McFarland is the president of Caddo and Caddo Operating, as well as the registered agent for service for both companies.

4. Glenn Gibson (Gibson) is an employee of and salesman for Caddo. He is not registered as an agent for a broker-dealer, the issuer or in any other capacity in the securities industry in Arkansas.

5. On 7 February 1996 a cease and desist order was issued by the South Dakota Department of Commerce & Regulation, Division of Securities, ordering respondents Caddo, McFarland and Randy Matthews, a soliciting agent employed by Caddo, to cease offering or selling in South Dakota working interests in an oil and gas lease in Coleman County, Texas. It was determined that Matthews had offered a South Dakota resident a 6.5% working interest and a 4.87% net revenue interest in the wells of the project for \$14,900. These working interests were found to be securities under South Dakota law. Because these securities were not registered in accordance with South Dakota law, the offer for sale of these securities was found to be illegal, and the respondents were ordered to cease and desist from marketing the securities in South Dakota.

6. On 9 June 1999 the Pennsylvania Securities Commission issued a summary cease and desist order against respondents Caddo and McFarland to halt the sale in Pennsylvania of fractional, undivided working interests in the Welder Ranch Lease, a three-well drilling project in Victoria County, Texas. These interests were being sold for \$20,800 each. They were found to be securities under Pennsylvania law. The order was issued because these securities were unregistered, a violation of Pennsylvania law, and because Caddo had not revealed to prospective Pennsylvania investors the existence of the South Dakota cease and desist order, discussed *supra* in ¶ 5, which was held to be an instance of securities fraud by non-disclosure.

Subsequent violation of this order led to further legal action against McFarland and Caddo in the Pennsylvania courts, which led to a permanent injunction and order of contempt with Caddo's and McFarland's consent. On 27 December 1999 Caddo and McFarland were permanently enjoined from selling the securities that were the subject of the cease and desist order and from violating the Pennsylvania Securities Act of 1972, fined \$6,000 and assessed costs of \$779.

7. On 17 February 2000 Gibson sent an Arkansas resident (Prospect) a packet of printed sales materials regarding the offer and possible sale of working interests in a natural gas well in Maverick County, Texas. Although it was not entirely clear, it appears that this would be a reworking or redrilling of an existing well and envisions horizontal drilling. These materials contained no mention of the registration or exemption from registration requirements of this investment with the Arkansas Securities Department (the Department) or of any other securities regulatory authority.

8. On 23 February 2000 Gibson telephoned Prospect to discuss the printed materials previously sent to Prospect. The following is a summary of the significant portions of that telephone conversation. The parts that are italicized are notes from the investigation of the Staff of the Arkansas Securities Department (the Staff).

a) Gibson said that Caddo originally had ten units for sale, but had two units left. These units were each a 1.1% working interest in a natural gas well to be drilled in Maverick County, Texas, which would include horizontal drilling at 2,500 feet in depth. Because this well would be drilled among other wells that were producing and because Caddo was using the services of a

geologist who was described as “super-sharp,” Gibson said that there was risk, “but it’s not compared to just going out here drilling a well.”

There is no assurance that an oil or gas well drilled in close proximity to other wells that are already drilled and producing will also be successful and producing. Horizontal drilling can be among the riskiest methods of oil and gas exploration.

b) To reduce the risk to Prospect, Gibson offered to insert a clause in the contract that if this well should turn out to be dry, Prospect’s 1.1% working interest would be transferred “over to the next producing well, not just the next well, but a good well, . . . so you’re protected.”

When Prospect asked how he, Prospect, could ascertain that Caddo could afford to take that loss with no financial information included in the materials, Gibson simply assured Prospect that Caddo was financially able to take such losses. When asked whether Gibson did that for every investor and why Gibson was willing to do that for Prospect, Gibson stated that this guarantee was not done for every investor and that it was being offered to Prospect because Caddo was trying to obtain several new investors every week.

c) Citing the printed materials already sent to Prospect, Gibson stated that the costs of drilling this well would be \$220,000.

The Staff could not verify that this was a reasonable or unreasonable cost.

d) Gibson stated that although the printed materials stated that Prospect could reasonably expect a return of \$1,577 per month, a more realistic estimate would be somewhere around \$2,000, which would return Prospect’s entire investment within the first year. Although the life of the well could be expected to be eight to ten years, Gibson said, Prospect could expect a return of around \$2,000 per month only during the first five years.

The Staff could not verify that this was a reasonable return or not.

e) Prospect noted that no where in the printed materials he received was there any mention of filings or registration with the federal Securities and Exchange Commission or any state securities regulator. Gibson affirmed that there had been no filings with any securities regulator in connection with this investment and represented further that Caddo did not have to register this or any other investment it had offered over the eight years of its life. Gibson was not sure of the law that exempted Caddo from compliance with securities laws, but opined that Caddo was exempt because it was a relatively small company.

f) Gibson said nothing about and did not inform Prospect of the South Dakota cease and desist order, the Pennsylvania cease and desist order or the contempt finding and the permanent injunction resulting from Caddo's violation of the Pennsylvania order.

CONCLUSIONS OF LAW

9. Ark. Code Ann. § 23-42-102(15)(A)(xv) (Supp. 1999) in pertinent part defines a security as a "certificate of interest or participation in an oil, gas, or mining title or lease".

10. Ark. Code Ann. § 23-42-501 (Repl. 1994) provides that it is unlawful for any person to offer or sell any security which is not registered or which is not exempt from registration under the terms of the Act.

11. Ark. Code Ann. § 23-42-301(a) (Repl. 1994) prohibits as unlawful the transaction of business as a broker-dealer or agent by any person who is not registered with the Arkansas Securities Department as such.

12. Ark. Code Ann. § 23-42-507(2) (Repl. 1994) provides that it is unlawful for any person in connection with the offer or sale of any security to make any untrue statement or omit

to state a material fact necessary in order to make the statements made not misleading in light of the circumstances under which they are made.

OPINION

13. This matter has been properly brought before the Arkansas Securities Commissioner in accordance with Ark. Code Ann. §§ 23-42-201 and 209 (Repl. 1994).

14. The respondents have offered to sell working interests in a gas well without prior registration of those securities in violation of Ark. Code Ann. § 23-42-501 (Repl. 1994).

15. The respondents offered to sell securities in the form of working interests in a gas well without any one of them first being registered with the Department as a broker-dealer, an agent of a broker-dealer or an agent of the issuer in violation of Ark. Code Ann. § 23-42-301(a) (Repl. 1994).

16. The representations made in the printed materials sent to Prospect and the oral representations made to Prospect that the risks involved in this project were minimal were misleading in light of the failure to inform Prospect of the risks involved in any oil or gas exploration and particularly of horizontal drilling. This was the omission of material facts that were necessary to make the statements made about the risks involved not misleading in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 1994).

17. The failure to inform Prospect about the South Dakota cease and desist order and the Pennsylvania cease and desist order and the permanent injunction and contempt finding was the omission of material facts in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 1994).

18. In regard to Gibson's guarantee of Prospect's investment noted in ¶ 8(b), *supra*, by placing a clause in the contract that, should this well turn out to be dry, Prospect's working

interest would be transferred to the next producing well, Gibson's failure to provide financial records showing that Caddo had the financial means to make that guarantee was the omission of material facts in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 1994).

19. The printed sales materials sent to Prospect making this offer represented that the drilling cost for this well would be \$200,000, but it offered no information from an independent source showing that this was a reasonable cost or the current cost of drilling a well of that nature in that locality at this time. The failure to include such information was the omission of material facts in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 1994).

20. Gibson told Prospect that although the printed materials contained the representation that Prospect could expect a return on his investment of \$1,577 per month, it was more realistic to expect a return of around \$2,000 a month, at least for the first five years of the well's life, which could be expected to be eight to ten years. No information from an independent source verifying that this was a reasonable expectation was provided Prospect, and the failure to provide such information was the omission of material facts in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 1994).

21. Gibson's statement that this investment did not have to be registered with any securities regulatory agency, state or federal, was a misrepresentation of fact in violation of Ark. Code Ann. § 23-42-507(2) (Rep. 1994).

22. Pursuant to Ark. Code Ann. § 23-42-209(a)(1) (Supp. 1997), the Arkansas Securities Commissioner can and should order the respondents to immediately cease and desist from the further solicitation and sale of the securities described above, to immediately cease and desist

from the collection of additional funds from any current investors and to immediately cease and desist from further violations of the Arkansas Securities Act.

23. This order is in the public interest.

ORDER

IT IS THEREFORE ORDERED that CADDO RESOURCES, Ltd., CADDO OPERATING, INC., RICHARD W.McFARLAND and GLEN GIBSON, as well as others whose identities are not yet known who are in positions of control of CADDO RESOURCES, Ltd. or CADDO OPERATING, INC. and who are employed by or otherwise affiliated with CADDO RESOURCES, Ltd., CADDO OPERATING, INC. or enterprises associated with those business entities, RICHARD W.McFARLAND or GLEN GIBSON, directly or through other companies, **CEASE AND DESIST** from any further actions in the State of Arkansas in connection with the offer and sale of the securities described above until such time as the securities are properly registered or exempted from registration pursuant to the Arkansas Securities Act and the persons offering them for sale are properly registered pursuant to the Arkansas Securities Act.

WITNESS MY HAND AND SEAL this 3th day of April, 2000.



Mac Dodson
ARKANSAS SECURITIES COMMISSIONER