BEFORE THE ARKANSAS SECURITIES COMMISSIONER
Case No. S-11-0301

IN THE MATTER OF
RANDALL R. LYLE; NORTHWESTERN VENTURES, LLP, and
SOUTH PLATTE ENERGY, LLC.

# REQUEST FOR CEASE AND DESIST ORDER

The Staff of the Arkansas Securities Department (Staff) has received information and has in its possession certain evidence which indicates that Randall R. Lyle, Northwestern Ventures, LLP (Northwestern) and South Platte Energy, LLC (South Platte) (collectively, Respondents) have violated provisions of the Arkansas Securities Act (Act), codified at Ark. Code Ann. §§ 23-42-101 through 23-42-509.

## ADMINISTRATIVE AUTHORITY

1. This matter is brought in connection with violations of the Act, and is therefore properly before the Arkansas Securities Commissioner (Commissioner) in accordance with Ark. Code Ann. § 23-42-209.

## RESPONDENTS

2. Lyle was at all times referred to herein a resident of Texas. Lyle was licensed to practice law in Texas from May 1992 until August 2010, and had an office in Fort Worth, Texas. A part of his practice was devoted to oil and gas matters.

3. Northwestern was a Texas limited liability partnership with its principal place of business located in Fort Worth, Texas. Northwestern was formed and controlled by Lyle. Lyle was the general partner. A search of the Texas Comptroller of Public Accounts website shows

that Northwestern no longer has the right to transact business in Texas because it has ceased to exist or has ceased doing business in Texas.

4. South Platte was a Texas limited liability company formed by Lyle in 1997 with its principal place of business located in Fort Worth, Texas. South Platte was the parent company of Northwestern. A search of the Texas Comptroller of Public Accounts website shows that South Platte no longer has the right to transact business in Texas because its certificate of formation was ended as a result of a tax forfeiture or administrative forfeiture by the Texas Secretary of State.

## FACTS SUPPORTING CEASE AND DESIST ORDER

5. In the summer of 2006, AR1, a resident of Arkansas, met Lyle through AR1's daughter, AR2. Lyle represented to AR1 and AR2 that Cs Solutions, Inc. (CSI), a Texas corporation that has since changed its name to Vapor Solutions, Inc., and Tiger Shark, Ltd. (TS), a Nevada limited liability company, had invested over $30 million in drilling projects in western Texas and in researching and developing drilling prospects in the Gulf of Mexico using a proprietary technology owned by CSI to locate oil and gas reserves (Technology). According to Lyle, the Technology was used to find hydrocarbons in the western Texas wells CSI and TS drilled, which resulted in finding oil in paying quantities and discovering previously unknown productive zones in all cases, resulting in a 100% success rate. Lyle predicted that the Technology would find oil and gas reserves in 90% of the areas CSI was then mapping in the Gulf of Mexico.

6. Lyle told AR1 and AR2 that CSI and TS would be participating in auctions for offshore

leases of mineral rights in the Gulf of Mexico conducted by the Department of the Interior, Mineral Management Service (MMS Auctions), for leases of 9-square-mile blocks (Blocks). Using the Technology, Lyle said CSI had identified several Blocks that would be very productive and would be offered at auctions over the next two years. Lyle explained that by "very productive," he meant the Blocks mentioned contained prolific amounts of hydrocarbons–over 120 million barrels of oil equivalent–located near existing pipelines that would draw little attention in the auctions due to minimal prior activity in the area.

7. As Lyle explained it, Northwestern and CSI were partnering in a lease acquisition program of offshore Blocks as described immediately above. Lyle told AR1 and AR2 that the Blocks could be purchased at auction for less than $100 per acre and that he had commitments from three major American oil and gas companies to buy the Blocks for a minimum of $2,000 per acre. Lyle described the deal he was offering as a real estate lease flip with the right to share in revenue, but not to participate in drilling and testing activities that would lead to production of hydrocarbons.

8. In presenting this offering to AR1 and AR2, Lyle used a booklet bearing the title, "CsSolutions / Gulf of Mexico - Colt Project," and thus named the lease acquisition program he was offering AR1 and AR2 the Colt Project. Although Lyle had represented the Colt Project as a venture in which CSI and Northwestern were partners, this booklet made no mention of Northwestern. The booklet contained geological information such as maps and logs of some of the areas involved in MMS auctions as well as some production records of a well in one of the Blocks which CSI sought to acquire in MMS

auctions. Also included in this booklet was a "Suggested Proposal to all Potential Buyers for Gulf of Mexico Prospects," which set out the amount CSI would ask for all the Blocks it had purchased. The total value of this offering was placed at $193 million.

9. On August 8, 2006, AR1 invested $500,000 with Northwestern. AR1 signed a joint venture agreement (JVA) with Northwestern, and Lyle signed for Northwestern as its general partner. According to the JVA, AR1's investment would be used by CSI and Northwestern in their lease acquisition program to purchase Blocks in the Gulf of Mexico, which would then be sold to the highest bidder. It was recited in the JVA that CSI had received a commitment from a major American oil company to purchase any Blocks purchased by CSI at the MMS Auction to be held on August 16, 2006, for a minimum of $2,000 per acre. Although the option to retain the Block purchased and develop it for the future production of hydrocarbons was still open, the primary purpose of the joint venture was the purchase and sale of Blocks. Although this lease acquisition program was the Colt Project and was explained to AR1 and AR2 with the use of the booklet entitled "CsSolutions / Gulf of Mexico - Colt Project," the word, Colt Project, did not appear in the JVA.

10. According to the JVA, all decisions were to be made by Northwestern and CSI. The JVA stated:

> CSI and NWV [Northwestern] shall have sole authority to package and sell any acquired blocks to the highest bidder. CSI and NWV agree to provide its [*sic*] best efforts to package and sell those blocks which, in its [*sic*] discretion, are the most marketable blocks given the conditions in the industry which may exist at the time of sale.

However, the decision of whether to sell any Blocks purchased, in whole or in part, or to

participate in the future production of hydrocarbons in all or some part of that Block was to be "in CSI's sole discretion." Further, the JVA stated that "CSI and its Board of Directors shall be the sole decision makers for the Gulf of Mexico lease project as to any matters which may be appropriate."

11. Although the JVA represented that this was a joint project, in actuality the Colt Project was a lease acquisition project conducted solely by CSI. Northwestern was an investor in the Colt Project, but not a partner with CSI with management authority.

12. AR1 was to receive a return of 1.5 times her investment by receiving a preference of funds from the sale or sales of Blocks acquired through any MMS Auction until she received 1.5 times her investment. She was also to be assigned a 2.5 % ownership interest in the "Gulf of Mexico Lease Acquisition Project," i.e., the Colt Project, which would allow AR1 "to participate in future auctions." AR1, CSI and Northwestern were to "proportionatly [*sic*] share the proceeds obtained from the sale of the acquired"Blocks. According to the JVA, AR1 received no ownership interest in Northwestern.

13. On September 13, 2006, AR1 invested $500,000 for a membership interest in South Platte representing ownership of 5%. In return for AR1's $500,000 investment, AR1 was to share in the profits and losses of South Platte in proportion to her 5% ownership interest.

14. In July 2007, AR1 invested $150,000 for a 3% ownership interest in South Platte. In return for AR1's $150,000, AR1 was to share in the profits and losses of South Platte in proportion to her new ownership interest of 8%, but she was also to receive a preference of initial distributions until she was paid 1.5 times her investment or $225,000.

15. Each of these investments in South Platte were documented by an amended limited liability company operating agreement for South Platte that recited that when Lyle formed South Platte in 1997 to "engage in any lawful act or activity," Lyle was the sole member, and he was the chief executive manager responsible for the operations of South Platte. The September 2006 investment was memorialized in an amended operating agreement dated February 15, 2007. The June 2007 investment was memorialized in an amended operating agreement dated July 30, 2007. Lyle signed the February 15, 2007, agreement on behalf of South Platte as manager and the July 30, 2007, agreement as chief executive manager.

16. AR2 contributed $25,000 of the $150,000 AR1 invested in South Platte in July 2007, as set out in ¶14, above.

17. After AR1 invested in South Platte, Lyle transferred her Northwestern investments to South Platte, Northwestern's parent company. In July 2008, Lyle adjusted AR1's ownership interest in South Platte to 12.5% to reflect AR1's total investments with him, including the $500,000 AR1 had earlier invested with Northwestern. An amended South Platte operating agreement dated July 2008 recited AR1's investments as "12.5% of the membership interests in two increments of $500,000 and one of $125,000." According to this agreement, AR1 would participate in South Platte's profits or losses in proportion to her 12.5% ownership interest and also receive a preference of initial distributions until she was paid "1.5 times her investment of $1,125,000 for a total initial preference distribution of $1,687,500.00 out of initial distributions made by the company."

18. AR2's $25,000 investment in South Platte was part of the $150,000 investment AR1

made in South Platte in July 2007. The restatement of AR1's total investments in the amended South Platte operating agreement dated July 2008 discussed in ¶17, above, reflects AR2's investment because it restates AR1's investment in South Platte in July 2007 as $125,000, a reduction of $25,000.

19. AR1 and AR2 have received no returns on their investments.

20. Although CSI received investments from Northwestern and South Platte, it has no records of investments on behalf of AR1 or AR2. As a result, neither AR1, nor AR2 was issued any ownership interest in CSI's lease acquisition program known as the Colt Project.

21. Ultimately, the Colt Project was unsuccessful. CSI transferred all the interests held by investors to another CSI project attempting to develop oil and gas interests in Louisiana. AR1 and AR2 own no part of the Louisiana project.

22. Lyle represented to AR1 and AR2 that the money AR1 and AR2 invested with Northwestern and South Platte would be invested with CSI for use in the lease acquisition program being conducted with Northwestern, the Colt Project. Lyle invested most of AR1's and AR2's funds with CSI on behalf of Northwestern and South Platte but also diverted some of those funds to his own business and personal use.

23. A search of the records of the Arkansas Securities Department shows no registration, no proof of exemption from registration and no notice filing indicating a covered security under federal law pertaining to any of the investments made herein by AR1 or AR2 with Northwestern or South Platte.

## APPLICABLE LAW

24. Ark. Code Ann. § 23-42-102(15)(A)(xi) defines a security as an investment contract.

25. Ark. Code Ann. § 23-42-501 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 or federal law.

26. Ark. Code Ann. §23-42-507(2) makes it unlawful for any person in connection with the offer, sale or purchase of any security, directly or indirectly, 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 are made, not misleading.

## VIOLATIONS OF LAW

27. The investments made by AR1 and AR2 in Northwestern and South Platte were investment contracts and therefore securities. In accordance with Ark. Code Ann. § 23-42-102(17)(A)(xi) and Arkansas case law, an investment contract is the investment of money into the risk capital of a common enterprise or venture with the expectation of benefit or profit with no effective control over the venture. The business of Northwestern and South Platte was to purchase Blocks at MMS auctions and sell them at a profit in partnership with CSI. The name of the business venture was the Colt Project. Lyle said that the operation of the Colt Project would be done entirely by Northwestern, which was later replaced by South Platte, both of which were controlled by Lyle, in conjunction with CSI. None of these entities were controlled by AR1 or AR2, and both investors were

totally dependent on Lyle to realize any return on their investments. These were passive investments comprised of the investment of money in the risk capital of a venture with the expectation of benefit from the efforts of others– here Northwestern and South Platte, both controlled by Lyle–with no direct control over the investment by AR1 or AR2. These investments were therefore investment contracts.

28. The facts set out above in ¶¶2 through 23 show that the Respondents offered and sold unregistered securities to AR1 and AR2, the investments made by AR1 and AR2 being securities which were not registered in accordance with the Act, a violation of Ark. Code Ann. § 23-42-501.

29. The representation Lyle made to AR1 and AR2 that the Colt Project was a joint project of Northwestern and CSI, when in reality Northwestern was an investor in the Colt Project without managerial control, was a material misstatement of fact made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2).

30. The representation Lyle made to AR1 and AR2 that the money AR1 and AR2 invested with Northwestern and South Platte would be invested with CSI for use in the lease acquisition program known as the Colt Project allegedly being conducted with Northwestern, when in reality Lyle diverted some of those funds to his own business and personal use, was a material misstatement of fact made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2).

31. The representation Lyle made to AR1 that her investments with Northwestern would result in her obtaining a 2.5% ownership interest in the lease acquisition program which was actually CSI's Colt Project, when in reality Lyle made investments with CSI in the

Colt Project to be held solely in Northwestern's and South Platte's names, was a material misstatement of fact made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2).

## LEGAL AUTHORITY TO ISSUE CEASE AND DESIST ORDER

32. Ark. Code Ann. § 23-42-209(a)(1)(A) provides that whenever it appears to the Commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of the Act, he may summarily order the person to cease and desist from the act or practice.

WHEREFORE, the Staff respectfully requests that the Commissioner summarily issue a cease and desist order against Randall Lyle, Northwestern Ventures, LLP, and South Platte Energy, LLC, as well as others whose identities are not yet known who are employed by or otherwise affiliated with any of the Respondents who receive actual notice of the order, ordering them to cease and desist from any further actions in the state of Arkansas in connection with the offer or sale of securities, as set out in ¶¶2 - 23, until any securities offered or sold are properly registered or shown to be exempt from registration pursuant to the Act.

Respectfully submitted,

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