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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16000

In the Matter of,

HOUSTON AMERICAN ENERGY CORP.,
JOHN F. TERWILLIGER, JR.,
UNDISCOVERED EQUITIES INC., and
KEVIN T. McKNIGHT

Respondents.

MOTION IN LIMINE BY HOUSTON AMERICAN ENERGY CORP. AND JOHN F. TERWILLIGER TO EXCLUDE ALLEGATIONS INCONSISTENT WITH THE ORDER INSTITUTING PROCEEDINGS AND TO EXCLUDE EXPERT REPORTS AND TESTIMONY

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Respondents Houston American Energy Corporation ("Houston American") and John Terwilliger ("Terwilliger") move to exclude arguments inconsistent with the Order Instituting Proceedings ("OIP") and move to exclude the Division's expert witnesses as follows.

INTRODUCTION

The Division is improperly attempting to reverse-engineer a fraud claim by contradicting positions taken in the OIP and relying on experts that lack a sufficient factual and scientific basis for their opinions. As set forth in the OIP, the Division's original theory was that Respondents "failed to disclose, or else baldly mischaracterized, the Operator's volume estimates" for the CPO-4 block.[1] The Operator was SK Energy, a large South Korean energy conglomerate. Houston American consistently disclosed that it was a non-operator on its Colombian projects. The OIP did not challenge the reasonableness of SK Energy's estimates and repeatedly asserted that SK Energy used "standard analytical procedures for estimating quantities of potentially recoverable oil" on CPO-4, based its estimates for CPO-4 on an "extensive evaluation of the CPO-4 block," and "conformed to standard industry practices" when providing estimates for CPO-4.[2] The OIP conceded that SK Energy estimated a "total potential" of 974 million barrels for the CPO block, which was calculated based on an estimated recovery rate of 150 barrels per acre foot ("BAF").[3] The Division's principal theory was that Houston American "failed to disclose" that its 1-4 billion estimate "was much larger than the Operator's volume estimates."[4]

The testimony and documents exchanged in this action have since refuted this theory. In their Motion for More Definite Statement, Respondents pointed out that SK Energy's "total potential" estimate was publicly disclosed in a January 19, 2010 analyst report by Global

[1] OIP ¶ 4.
[2] OIP ¶¶ 3, 29, 32, 75.
[3] OIP ¶ 21.
[4] OIP ¶ 45.

Hunter.[5] In fact, the January 2010 report contained virtually the same "Total Potential" slide from SK Energy's April 2009 presentation to Houston American with the 974 million barrel calculation, with an explanation that SK Energy used a 150 BAF recovery rate and that other Llanos operators used a 500 BAF rate.[6] The Division also acknowledged in response to that motion that Terwilliger sent a memorandum to Phil McPherson of Global Hunter on January 8, 2010, in which Terwilliger voluntarily disclosed SK Energy's sub-1 billion estimate and explained that it would be higher if a 500 BAF recovery rate were used.[7] SK Energy's geophysical interpreter in Colombia, James Fluker (who worked at SK Energy through October 2009), agreed that "the recoverable reserves on this block, if you were going to express it in a range, ***could be between 1 billion and even 5 billion"*** barrels,[8] and that he and others at SK Energy believed the recovery rate "should be closer to 500 [BAF]" or "even higher than that."[9] Even the Division's own expert, Netherland, Sewell & Associates, Inc. ("NSAI"), now admits that the recovery rates in the Deep Llanos province (where CPO-4 is located) can range from 230-500 BAF.[10] The January 2010 Global Hunter report also made clear that Houston American's estimate referred to "unrisked oil potential," not SEC or PRMS "reserves."[11] Despite these disclosures (which the Division asserts were contrary to Houston American's allegedly fraudulent November 2009 presentation), the stock price did not decline in response to the January 2010 presentation and instead rose significantly over the ensuing months.

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[5] Ex. 35 to Motion for Summary Disposition ("MSD"), Jan. 19, 2010 Global Hunter report.

[6] *Compare* page 16 of Ex. 11 to MSD ("Total Potential" slide from April 2009 SK Energy Presentation) *with* page 6 of Ex. 35 to MSD (Jan. 19, 2010 Global Hunter report). The Global Hunter version of the slide lists 977 million instead of 974 million due to a mathematical error in the SK Energy slide.

[7] *See* Statement 8 in Appendix. The "Appendix" refers to the supplemental appendix of alleged misrepresentations that the Division served on Respondents on September 18, 2014. A copy of the Appendix is attached as Exhibit B to Respondents' Motion for Summary Disposition.

[8] Ex. 3 to MSD, Deposition of James Fluker 136:5-12, 147:10-15, 173:10-22 (Nov. 10, 2014) ("Fluker Dep.").

[9] *Id.* 52:4-15, 94:21-25, 95:18-96:2, 164:24-165:4.

[10] Ex. 4 to MSD, NSAI Report ¶ 60(c).

[11] Ex. 35 to MSD, Jan. 19, 2010 Global Hunter report, at 5-6.

These facts eviscerated the Division's fraud claim as pled in the OIP. The fact that Houston American voluntarily revealed SK Energy's sub-1 billion "total potential" estimate to Global Hunter, which disclosed it to the public, is inconsistent with the Division's theory that Houston American was trying to deceive investors by "concealing" SK Energy's estimate. The fact that the stock price continued rising after the January 19, 2010 report, even though the report revealed SK Energy's lower "total potential" estimate and disclosed that the estimate referred to "unrisked oil potential" rather than PRMS or SEC "reserves," likewise undercuts the Division's theory that Respondents materially misled investors about these issues. The January 19, 2010 report also stated that "until the block is drilled we won't know if or how much oil is in place."[12]

Rather than dismiss its claims, the Division has changed its theory and is now blatantly contradicting the assertions in the OIP in a last-ditch effort to salvage its case. The Division is now attempting to attack SK Energy's estimate as unreasonable, even though the OIP repeatedly admitted that SK Energy's estimate was based on "standard analytical procedures for estimating quantities of potentially recoverable oil." One of the Division's new experts even contends that the chance of recovering 1 billion barrels was so low that no company should have made this statement to investors, even though SK Energy itself made this representation to Houston American (using the term "reserves") when soliciting Houston American's investment.

Motion *in Limine*

Respondents thus move *in limine* to prohibit the Division from making arguments and introducing testimony (including expert testimony) contradicting the admissions in the OIP. It is well-settled that litigants are deemed to have admitted facts pled in their own complaint. Settled law and fundamental fairness prohibits a party from changing their factual theory in derogation of their own pleadings. The issue is particularly egregious here because the Division is bringing

[12] *Id.* at 8.

fraud claims based on an estimate (and a highly preliminary one at that). Estimates, however, are inactionable as long as they have a reasonable basis when made.[13] After investigating for ***more than three years***, the Division obtained an OIP admitting that SK Energy's estimates were reasonable. Given the gravity of a fraud accusation (which connotes deliberate dishonesty), this Tribunal should be particularly reluctant to allow the Division to reverse-engineer a fraud claim based on arguments questioning the reasonableness of SK Energy's estimates less than two months before trial after the Division itself concluded after more than three years of inquiry that SK Energy's work was reasonable.

Motion to Exclude Experts

Respondents also move to exclude the Division's experts because their opinions do not satisfy the requirements of *Daubert v. Merrill Dow Pharms., Inc.*, 509 U.S. 579, 592-93 (1993). It is well-settled that expert testimony must be relevant, must assist the factfinder, and must be based on reliable scientific methodology to be admissible. *Id.*

The Division's expert reports are an impermissible effort to use the mere imprimatur of "expert" status to bridge gaps in the Division's case without a legitimate scientific or factual basis. The Division's "stock market" expert, Branko Jovanovic, made no effort to tie the stock price movements identified in his purported "event study" to the actual statements that the Division claims are false, in violation of settled precedent. The Division's various oil and gas experts make conclusory statements about what "investors" would believe without any factual or

[13] *E.g., In re Oracle Corp. Sec. Litig.*, 627 F.3d 376, 389 (9th Cir. 2010) (affirming summary judgment where plaintiffs were "unable to prove that Defendants lacked at least a reasonable basis for their belief in the 3Q01 forecast"); *In re Merck & Co. Sec. Litig.*, 543 F.3d 150, 166 (3d Cir. 2008) ("We have explained that for misrepresentations in an opinion or belief to be actionable, plaintiffs must show that the statement was issued without a genuine belief or reasonable basis . . . ."); *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 735 F. Supp. 2d 856, 911 (N.D. Ill. 2010) (granting summary judgment where evidence established reasonable basis for defendants' projections); *Eisenstadt v. Allen*, 113 F.3d 1240, 1997 WL 211313, at *4 (9th Cir. 1997) (granting summary judgment because company's past experience provided reasonable basis for future estimates). A company may "reveal the projection it thinks best while withholding others, so long as the one revealed has a 'reasonable basis'. . . ." *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989) (Easterbrook, J.).

scientific foundation. They also make numerous conclusory statements about the PRMS definition of "reserves" without any scientific or factual basis for concluding that the PRMS definition applies in what is clearly a predrill context. Further, as stated above, the opinions attacking SK Energy's estimates should be excluded because they contradict the OIP.

ARGUMENT AND AUTHORITIES

I. THE DIVISION SHOULD BE BARRED FROM CONTRADICTING THE OIP

The Division should be prohibited from making arguments or introducing testimony (including expert testimony) that contradict the admissions in the OIP regarding the reasonableness of SK Energy's estimates (and the reasonableness of Respondents' reliance on those estimates). "'[U]nder federal law, stipulations and admissions in the pleadings are generally binding on the parties and the Court.'" *Am. Title Ins. Co. v. Lacelaw Corp.*, 861 F.2d 224, 226 (9th Cir. 1988) (quoting *Ferguson v. Neighborhood Hous. Servs. of Cleveland, Inc.*, 780 F.2d 549, 551 (6th Cir. 1986)) (alteration in original). "Judicial admissions are formal admissions in the pleadings which have the effect of withdrawing a fact from issue and dispensing wholly with the need for proof of the fact." *Id.* (citation omitted).

Federal cases consistently bar parties from taking positions that contradict their own factual allegations, even in situations where a party later attempts to amend their complaint in contravention of their earlier allegations. *See, e.g.*, *Hopkins v. Cornerstone America,* 545 F.3d 338, 347 (5th Cir. 2008) (noting that the doctrine of judicial admissions may be invoked when "the party's position [is] clearly inconsistent with its previous one"); *Taylor v. Monsanto Company*, 150 F.3d 806, 809 (7th Cir. 1998) ("Judicial admissions are concessions in the pleadings that bind the party making them and that withdraw a fact from contention."); *Soo Line R.R. Co. v. St. Louis Southwestern Ry. Co.*, 125 F.3d 481, 483 (7th Cir. 1997) ("judicial

efficiency demands that a party not be allowed to controvert what it has already unequivocally told a court by the most formal and considered means possible"); *Schott Motorcycle Supply, Inc. v. Am. Honda Motor Co.*, 976 F.2d 58, 62 (1st Cir. 1992) (allegation in plaintiff's complaint regarding existence of written contract between parties was "judicial admission," which foreclosed contract claim based on purported oral promises); *Kaur v. Singh*, No. 2:13-CV-00089-KJM, 2014 WL 2208114, at *8 (E.D. Cal. May 28, 2014) ("Plaintiffs' new evidence directly contradicts the allegations in their complaint. Their opposition abandons the fundamental theory upon which their complaint relies, in an apparent effort to avoid summary judgment. Plaintiffs' attempt is unavailing."); *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 329 (S.D.N.Y. 2003) ("These pleadings then serve as binding judicial admissions that control the plaintiff's case throughout the course of the proceedings."). *Colliton v. Cravath, Swaine & Moore LLP*, No. 08–CV–0400, 2008 WL 4386764, at *6 (S.D.N.Y. Sept. 24, 2008) ("Where a plaintiff blatantly changes his statement of the facts in order to respond to the defendant's motion to dismiss and directly contradicts the facts set forth in his original complaint, a court is authorized to accept the facts described in the original complaint as true.") (alterations and internal quotation marks omitted); *Wallace v. N.Y.C. Dep't of Corr.*, No. 95–CV–4404, 1996 WL 586797, at *2 (E.D.N.Y. Oct. 9, 1996) (accepting as true facts alleged in the original complaint where plaintiff alleged directly contradictory facts in his amended complaint); *Austin v. FordModels, Inc.*, 149 F.3d 148, 155 (2d Cir. 1998) (affirming district court's denial of leave to amend a complaint where plaintiff sought to "erase [ ] admissions [made] in [the previous] complaint") (alteration and internal quotation marks omitted), abrogated on other grounds by *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506 (2002); *Stamas v. Madera*, 2010 WL 2556560, at *2

(E.D. Cal. June 21, 2010) ("district court is not required to accept as true allegations in an amended complaint that, without any explanation, contradict an earlier complaint").

In addition, under 17 C.F.R. § 201.250(a), admissions in the OIP are "taken as true" against the Division on a motion for summary disposition and are thus judicially admitted.

As noted above, the OIP admits that SK Energy used "standard analytical procedures for estimating quantities of potentially recoverable oil" on CPO-4, based its estimates for CPO-4 on an "extensive evaluation of the CPO-4 block," and "conformed to standard industry practices" when providing estimates for CPO-4.[14] With respect to SK Energy's April 2009 presentation, the OIP asserted that "[t]he slide deck also included information ***that was sufficient to show that the Operator had arrived at its estimates of the CPO-4 block's 'total potential' and 'high potential' by using standard analytical procedures for estimating quantities of potentially recoverable oil.***"[15] These statements are summarized in the chart below.

OIP Admissions Regarding SK Energy	
OIP, Paragraph 3	". . . unlike the Operator's volume estimates, which were drawn from extensive regional well data and seismic information for the CPO-4 block, Houston American's multi-billion-barrel reserve estimates were not based on a technical evaluation at all."
OIP, Paragraph 16	". . . the Operator spent several months evaluating the CPO-4 block's oil-bearing potential. . . . the Operator reviewed well log data from the only well that had been drilled on the CPO-4 block and also reviewed well log data from multiple wells drilled on adjacent blocks. . . . The Operator also analyzed approximately 1,825 kilometers of two-dimensional seismic data that previously had been shot over the block, and it evaluated comprehensive reports of the known geological formations in the Llanos Basin."

[14] OIP ¶¶ 3, 29, 32, 75.
[15] OIP ¶ 29.

OIP, Paragraph 17	"The Operator based its evaluation of the CPO-4 block on an analysis of well log and seismic data, which provided important technical information about the block's subsurface structure and its geological characteristics."
OIP, Paragraph 19	"The Operator used the seismic and well log data, in conjunction with standard analytical procedures for estimating volumes of potentially recoverable petroleum, in its evaluation [of] the CPO-4 block."
OIP, Paragraph 29	"The slide deck also included information that was sufficient to show that the Operator had arrived at its estimates of the CPO-4 block's 'total potential' and 'high potential' by using standard analytical procedures for estimating quantities of potentially recoverable oil."
OIP, Paragraph 32	". . . the Operator's estimates were based on an extensive evaluation of the regional well log data and seismic data for the CPO-4 block."
OIP, Paragraph 55	". . . unlike the Operator's estimates, Houston American's multi-billion-barrel estimate was not based on block-specific data and was not calculated in accordance with standard analytical procedures."
OIP, Paragraph 75	". . . the Operator's estimates were based on its extensive evaluation of the CPO-4 block and that its evaluation of the block conformed to standard industry practices."
OIP, Paragraph 77	". . . the Operator's estimate was based on its extensive evaluation of the CPO-4 block. . . ."

The Division should thus be barred from contradicting these admissions. Having specifically admitted after a three-year investigation that SK Energy's April 2009 presentation "was sufficient to show" Houston American that SK Energy's 974 million estimate was based on "standard analytical procedures for estimating quantities of potentially recoverable oil," it would be improper to entertain expert opinions and arguments that SK Energy's estimates were not reasonable and that Houston American could not rely on them. Allowing the Division to take such a contradictory position would be particularly unjust and prejudicial given the severity of a

fraud allegation and the fact that an estimate is not actionable if it has a reasonable basis.[16] How can the Division justify leveling a fraud accusation based on the alleged unreasonableness of SK Energy's estimates after repeatedly admitting after a three-year investigation that the estimates were reasonable? It cannot and should be barred from doing so.

II. JOVANOVIC'S OPINIONS SHOULD BE EXCLUDED IN THEIR ENTIRETY

The Division has filed an initial expert report and rebuttal report by Branko Jovanovic (the "Jovanovic Report" and Jovanovic Rebuttal Report"). Jovanovic is an economist who offers various opinions regarding the change in Houston American's stock price on various selected dates, including the trading day immediately following the November 9, 2009 presentation containing the "1 to 4 billion" estimate as well as numerous other statements.

Jovanovic's opinions should be excluded because he fails to isolate the effect of the alleged misstatements from the other information disclosed on each of the six dates identified on pages 13-15 of his Report (November 10, 2009; February 16, 2010; April 7, 2010; June 28, 2010; August 2, 2010; and October 12, 2010) and provides no scientific basis to conclude that the alleged misstatements had a positive effect on Houston American's stock price. Courts have routinely excluded or disregarded economic experts who fail to link stock price movement to specific alleged misstatements and who fail to isolate the portion of the alleged change that is attributable to the alleged misstatements as opposed to other information released that day. *See In re Williams Sec. Litig.-WCG Subclass*, 558 F.3d 1130, 1132 (10th Cir. 2009) (affirming exclusion of expert because he "could not distinguish between loss attributable to the alleged fraud and loss attributable to non-fraud related news and events"); *Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse First Boston*, 853 F. Supp. 2d 181, 190-191 (D. Mass. 2012)

[16] *E.g., In re Oracle*, 627 F.3d at 389 (affirming summary judgment where plaintiffs were "unable to prove that Defendants lacked at least a reasonable basis for their belief in the 3Q01 forecast").

aff'd sub nom. Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC, 752 F.3d 82 (1st Cir. 2014) ("In sum, Dr. Hakala's failure to isolate the effect of defendants' alleged fraud from other industry and company-specific news reported on event days confounds his event study and renders it unreliable."); *United States v. Schiff*, 538 F. Supp. 2d 818, 838 (D.N.J. 2008), *aff'd*, 602 F.3d 152 (3d Cir. 2010) (rejecting argument that government expert was not required to disaggregate potential causes of stock price change because government was not required to prove loss causation); *In re Xcelera.com Sec. Litig.*, No. CIV.A. 00-11649-RWZ, 2008 WL 7084626, at *2 (D. Mass. Apr. 25, 2008) (excluding expert opinion that "fails to take into consideration other factors that affected Xcelera's stock price in August 2000"); *United States v. Ferguson*, 584 F. Supp. 2d 447, 453 (D. Conn. 2008) ("Because Davis' leakage study attributes all non-market and non-industry related decline in AIG's stock price to the LPT fraud without accounting for other factors that may have contributed to that decline, it is not a reasonable estimate of the loss."); *In re Omnicom Grp., Inc. Sec. Litig.*, 541 F. Supp. 2d 546, 554 (S.D.N.Y. 2008), *aff'd*, 597 F.3d 501 (2d Cir. 2010) (rejecting event study that failed to isolate confounding factors); *In re Imperial Credit Indus., Inc. Sec. Litig.*, 252 F. Supp. 2d 1005, 1016 (C.D. Cal. 2003), *aff'd sub nom. Mortensen v. Snavely*, 145 F. App'x 218 (9th Cir. 2005) (excluding expert that failed to eliminate portion of stock price change that was "unrelated to the alleged wrong"); *In re H.J. Meyers & Co., Inc.*, Release No. 211, 78 S.E.C. Docket 718 (Aug. 9, 2002) ("Neither [the Division's expert] nor the Division attempted to sort out the many factors that contributed to Borealis's long-term price decline. It was their obligation to do so . . . . Consistent with *Daubert*, *Kumho Tire*, *Elliott*, *Peabody Coal*, and *WSF*, I give this aspect of the Division's proof very little weight."); *In re Executive Telecard, Ltd. Sec. Litig.*, 979 F. Supp.

1021, 1026 (S.D.N.Y. 1997) (excluding expert testimony that failed "adequately to distinguish between fraud related and non-fraud related company specific influences on EXTL's stock").

The first date that Jovanovic identifies, November 10, 2009, is the first trading day after Houston American's November 9, 2009 investor presentation. While that presentation contained the "1 to 4 billion" estimate that the Division contends was false, it also contains numerous other pieces of information, including descriptions of SK Energy, an upward revision of the well rates for production on the adjacent Corcel Block (from 2,000 to 10,000 on October 16, 2009 to 2,000 to 14,000 on November 9, 2009), a description of the work plan, maps of the surrounding fields, maps showing the various reservoirs on and near the block, a map showing infrastructure near the block, a map showing three different reservoir plays, detailed maps and information about the adjacent Corcel Block, maps of proposed 3D areas with structure maps, information about the Serrania Block and Los Picachos (another exploration project in which Houston American had an interest), information about other Houston American assets operated by Hupecol, a budget for Houston American's various projects, and financial information.[17]

Jovanovic makes no attempt to show that the $0.40 stock price increase on November 10, 2009 (assuming *arguendo* that this increase has any statistical significance) is attributable to the "1 to 4 billion" statement rather than to the numerous other pieces of information in the presentation. As noted in paragraph 4 of Lucy Allen's Rebuttal Report, "[t]he analysis in the Jovanovic Report does not and cannot address whether the alleged misrepresentations were material. The Jovanovic Report does not analyze the specific alleged misrepresentations, and to the extent the report finds statistically significant price reactions, it does not attempt to determine what information was the cause of the reaction." The cases cited above make clear that an

[17] *See* Ex. 5 to MSD, Nov. 9, 2009 Houston American Form 8-K and Investor Presentation.

economic expert adds nothing to the case and should be excluded if they fail to tie their analysis to the specific alleged misstatements.

None of the other five dates selected in Jovanovic's report correspond with any of the other alleged misstatements identified in the Appendix. As Jovanovic concedes, the February 16, 2010 statement was an article by Jennifer Cummings of Dow Jones and did not contain any statements identified in the Appendix.[18] In fact, the article focused on a statement by another company, Petrominerales, about production at the nearby Candelilla-2 well. The Division has never alleged that the statements by other parties regarding production on adjacent properties were false, let alone that they are attributable to Houston American. The stock price rose by $1.00.[19] The fact that the stock price rose following the Candelilla disclosure confirms why Jovanovic's failure to isolate the alleged effect of the "1 to 4 billion" estimate in the November 10, 2009 presentation is improper, as that presentation also included information about important discoveries on nearby properties (Corcel). Jovanovic provides no basis for imputing any part of this $1.00 increase to any alleged misstatement by Respondents.

The next two dates cited by Jovanovic – April 7, 2010 and June 28, 2010 – involve blog posts by short sellers that contained numerous comments about Houston American. Jovanovic fails to identify what portion (if any) of the stock price declines following the articles (assuming again *arguendo* that they are material) are attributable to the "1 to 4 billion" estimate versus other information discussed in the articles, which contained numerous statements about numerous issues. The stock price fell from $10.88 to $9.95 on June 29, 2010, but the stock had been declining since June 17, 2010, incurred a one-day declines of $1.03 on June 18, 2010, and

[18] *See* Jovanovic Report ¶ 36.
[19] *See* Ex. 37 to MSD, Yahoo! Finance stock price chart.

rose above $10.88 on August 4, 2010. Jovanovic provides no scientific basis for any conclusion that the "1 to 4 billion" estimate itself materially affected the stock price.

Jovanovic also acknowledges that the stock price ***rose*** (by $0.99) on October 12, 2010, after Houston American published an investor presentation containing a sharply lower estimated range of 25-169 million barrels in "unrisked potential resources," with no reserves.[20] Jovanovic openly admits he has no scientific basis to make any conclusion about the impact of this information on the stock price, conceding that "[i]t is unclear how this report would have affected HUSA's stock price."[21] Jovanovic goes on, however, to speculate that "if investors had discounted or disregarded HUSA's statements about estimated recoverable reserves, then based on the articles described above or other information known to investors, an independent engineer's report showing unrisked prospective could have positively affected HUSA's stock price."[22] Jovanovic again offers no scientific basis for assuming that the stock price was ever materially inflated by the "1 to 4 billion" estimate in the first place, let alone any scientific explanation for why the stock price rose after a lower estimate was disclosed.

Jovanovic likewise does not explain why the stock price continued rising after Global Hunter's January 19, 2010 report (which disclosed SK Energy's lower estimate and made clear the estimate did not refer to PRMS reserves) and after Houston American's March 29, 2010 Form 10-K (which made clear there were no SEC reserves, production, or developed acreage on CPO-4).

In his rebuttal report, Jovanovic offers a conclusory opinion that investors' "valuations of HUSA were fundamentally driven by the recoverable reserve estimate put forth by HUSA."[23]

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[20] Ex. 39 to MSD, Oct. 12, 2010 Houston American Form 8-K and Investor Presentation.
[21] Jovanovic Report ¶ 40.
[22] *Id.*
[23] Jovanovic Rebuttal Report ¶ 5(1)(a).

Jovanovic attempts to substantiate this argument in two ways, neither of which affords a reasonable scientific foundation for the opinion. First, Jovanovic points to a Global Hunter analyst report on October 19, 2009, which discussed possible changes in Houston American's stock valuations based on changes to "estimated ultimate recovery" ("EUR," which is a different metric than unrisked resources) and the likelihood of success. Houston American, however, did not provide an EUR or likelihood of success in the November 2009 report. The October 19, 2009 Global Hunter report provides no scientific foundation for Jovanovic's speculation that Houston American's preliminary predrill estimate had any material effect on the stock price.

Second, Jovanovic made a calculation that apparently superimposes the EUR for Petrominerales's nearby fields on Global Hunter's October 2009 valuation calculation, in an effort to show that the "1 to 4 billion" estimate (rather than the Petrominerales discoveries) was the real driving factor behind Houston American's stock price gains.[24] Jovanovic, who is not a geologist, provides no basis for assuming why Houston American's discoveries would be "similar" to those on the Petrominerales fields in light of the relative size and geology of those fields. Moreover, as stated above, Jovanovic cannot explain why the actual stock price far exceeded the numbers in this calculation long after Houston American publicly disclosed much lower estimates than the initial "1 to 4 billion" number. Jovanovic also fails to analyze whether other information may have influenced the stock price, including the numerous geological maps and data disclosed in the January 2010 Global Hunter presentation. Jovanovic fails to use reliable scientific methodology and lacks a factual or experiential foundation for his opinions.

Jovanovic also makes a speculative and legally erroneous argument that Houston American somehow committed fraud by "leveraging" the undisputedly true news about the Petrominerales discoveries "as a way of both adding credibility to its false and misleading

[24] *See id.* ¶ 15.

reserve estimate and demonstrating the likelihood that HUSA would be able to recover the false and misleading estimate of reserves."[25] This argument is again based purely on speculation and fails to account for why the stock price continued to rise after Houston American disclosed lower estimates. Moreover, a party by definition cannot defraud the market by making truthful statements, so the disclosure of truthful information regarding other discoveries provides no basis for imputing liability to Respondents. Jovanovic's "leveraging" argument is simply speculation masquerading as expert testimony: He cannot explain why the stock price continued rising despite the disclosure of lower estimates and has conjured the "leveraging" argument out of whole cloth to conceal his lack of a scientific rebuttal.

Because Jovanovic offers no reliable scientific basis for attributing any material stock price change to any alleged misstatement, his opinions should be excluded in their entirety.

III. THE OIL AND GAS EXPERTS SHOULD BE EXCLUDED

The report of NSAI (the "NSAI Report") and the rebuttal reports of NSAI (the "NSAI Rebuttal Report"), Richard Bishop ("Bishop Rebuttal Report"), Wayne Kelley ("Kelley Rebuttal Report"), and Ronald Harrell ("Harrell Rebuttal Report") likewise fail to employ reliable methodology and instead answer misleading straw-man questions based on artificial and inaccurate assumptions. As a preliminary matter, the Division should be prohibited from introducing any expert testimony challenging the reasonableness of SK Energy's own estimates, methodology, and terminology, given the admissions in the OIP discussed above.

The Division's "industry" expert opinions also violate *Daubert* as follows:

Richard S. Bishop. Bishop, a geologist with no purported experience analyzing public markets or investing in public companies, makes conclusory assertions about what terms like

[25] *See* Jovanovic Report ¶¶ 20-29.

"unrisked" mean "to an investor.[26] Bishop has no factual, scientific, or experiential basis to opine on what "an investor" would believe, and his speculation on what an "investor" would believe is impermissible and inadmissible speculation. As with the Division's other oil and gas experts, Bishop does not claim to have studied the analyst reports about Houston American or to have performed any scientific market research. The balance of his opinion is simply an attack on the reasonableness of SK Energy's estimates, which the Division should be foreclosed from challenging. He asserts, for example, that "Wiggins does not appear to have tested the SK Assessment for reasonableness,"[27] despite the fact that the Division already conceded as a matter of law that SK Energy's methods were reasonable. Bishop also faults Houston American for not disclosing "unstated assumptions," even though Houston American made clear in the presentation that the estimate was "unrisked." Bishop's opinion should be excluded in its entirety.

Wayne L. Kelley. Kelley, an "energy executive" with experience in various energy industry positions, opines that the November 2009 presentation overstated the CPO-4 Block's potential and understated the risk. His opinions should be excluded for several reasons. First, his conclusions should be excluded to the extent it contradicts the Division's admissions about SK Energy. By his assertion, even a 1 billion barrel estimate would apparently be unreasonable, even though the Division conceded SK Energy was reasonable in making that estimate.

Second, Kelley fails to take into consideration the disclosures contained in the November 2009 presentation and the preceding October 16, 2009 press release making clear that the "1 to 4 billion" estimate was a predrill estimate. As set forth on pages 7-11 of Respondents' MSD:

- The October 16, 2009 press release made clear this was a new and undrilled property, stating that "two exploration wells" would be drilled during the "Phase

[26] *See* Bishop Rebuttal Report at 5.
[27] *Id.* at 12.

1 Work Program." The press release also said that the "100 identified leads or prospects" on the block would "be ***detailed*** during the first exploration phase of the concession contract," thus showing that they still needed to be detailed.

- On November 5, 2009 (four days before the presentation), Houston American filed a Form 10-Q, which stated that "two exploration wells" would be drilled as part of Phase 1 and that only $194,584 in past costs had been incurred.[28] Additionally, Global Hunter published reports on October 19 and November 9, 2009, stating that the "first exploration well" on CPO-4 was "expected in 1Q11" and had not been drilled.[29]

- Slide 34 of the November 9, 2009 presentation included a "budget through December 2010" that showed no drilling costs for CPO-4, despite showing drilling costs for wells on other properties. Slide 25 showed that two exploration wells would be drilled as part of Phase 1 ***over the next three years.***

- The presentation also stated that the "1 to 4 billion" estimate came from "leads or prospects," which Houston American previously stated on October 16 still needed to be "detailed." NSAI admits that a prospect is, at best, a "drilling target" rather than an area that has actually been drilled, and that a lead is at an even-earlier stage than a prospect, thus conceding that nothing had been drilled.[30]

- The presentation contained a disclaimer stating that the word "reserves" as used in the presentation were "unrisked."

- The persons at Columbia Wanger and Nokomis who made the decisions to invest in the December 2009 offering (William Doyle and Brett Hendrickson), as well as David Snow and the two Global Hunter representatives, all testified that they knew the property was an exploratory concession and that no wells had ever been drilled other than an early 1960s well (which did not result in the discovery of a known accumulation of commercially viable oil).

- Global Hunter characterized the estimate as referring to "unrisked oil potential" in its January 19, 2010 report.

It is unscientific for Kelley to imply that the use of the word "reserves" in place of "unrisked resources" somehow exaggerated the CPO-4 Block's potential when he makes no effort to control for these facts. Kelley does not address the use of the word "reserves" in a

[28] Ex. 12 to MSD, Nov. 5, 2009 Houston American Form 10-Q, at 13.

[29] Ex. 13 to MSD, Oct. 19, 2009 Global Hunter Analyst Report and Ex. 14, Nov. 9, 2009 Global Hunter Analyst Report.

[30] Ex. 4 to MSD, NSAI Report ¶ 37. While there is no rule requiring companies to use the PRMS definitions cited by NSAI, even those definitions make clear that leads and prospects refer to undrilled locations.

context remotely approaching the predrill context here. He does not cite any empirical research showing that companies are more likely to use the word "reserves" instead of "resources" in a predrill context. At least 88 companies have used the word "reserves" in a predrill context, and the SEC has sent numerous comment letters to companies that did not request them to stop using this terminology in a predrill context.[31] Kelley's assertions that Houston American somehow overstated the prospect for success likewise attacks a straw man, as Houston American specifically stated its estimates were "unrisked" and made no representation about the likelihood of success in actually finding oil.

Moreover, like Bishop, Kelley improperly speculates about what an investor would supposedly understand. For example, he asserts that "[w]ithout the investor being provided Houston American's underlying assumptions in describing the potential reward, the investor would have no concept of how far removed the chance of success" is.[32]

In fact, the five investors in the December 2009 offering were sophisticated oil and gas investors – which actually renders Kelley's opinions poisonous for the Division's case. Kelley asserts that "any experienced oil and gas professional would understand that as geophysical information is acquired and interpreted, what once seemed to be promising leads are discarded as having insufficient potential," and that "[m]any of Houston American's leads and prospects would disappear as more is learned about the block."[33] Kelley then states that "[t]he odds of realizing 'the potential reward' of 1-4 billion barrels is effectively zero, ***as any competent oil and gas professional would know.***"[34] Kelley thus undercuts the Division's argument that it is entitled to disgorgement of the offering proceeds, as he admits that "any experienced oil and gas

[31] Ex. 6 and Ex. 7 to MSD.
[32] Kelley Rebuttal Report at 11.
[33] *Id.* at 8.
[34] *Id.* at 11.

professional" (which includes the investors) would have understood that actual recoveries would likely be far less than the initial unrisked estimate provided by Houston American.

In short, Kelley's opinions are not based on a reliable scientific methodology, are not helpful in showing the elements of a fraud claim, and should be excluded in their entirety.

D. Ronald Harrell. Harrell, a petroleum engineer, offers three opinions in rebuttal of Dr. Michael Wiggins. Respondents move to exclude his second and third opinions. His second opinion,[35] which addresses whether use of the term "recoverable reserves" was misleading, is self-contradictory and fails to address a relevant question through a reliable methodology. Harrell asserts that the PRMS definition of "reserves" requires the discovery of a "known accumulation" of oil, which must have been "confirmed by the penetration and testing of at least one well providing data sufficient to confirm commerciality – a condition not found anywhere among the subject Llanos Basin properties."[36] As stated above, however, Houston American made clear that no wells had been drilled and no "known accumulations" had been found. The relevant test in a securities fraud action is whether the alleged misstatements materially altered the total mix of information. *See In re Morgan Stanley Info. Fund. Sec. Litig.*, 592 F.3d 347, 365-66 (2d Cir. 2010) (corporate statements are considered "holistically and in their entirety" along with surrounding disclosures). Harrell's failure to analyze the total mix of information renders his opinion unreliable and unhelpful. Harrell's third opinion,[37] which addresses the price per barrel of oil "in the ground," addresses a staw-man issue, as Houston American made clear

[35] Harrell Rebuttal Report at 4.
[36] *Id.*
[37] *Id.* at 6.

that this was a hypothetical based on the assumption that oil would be discovered, not a representation that oil had actually been discovered.[38]

Harrell also states that "using the combined term 'leads or prospects' without refinement and/or explanation is virtually meaningless and likely misleading."[39] This begs the question: How can a term that is "virtually meaningless" be materially misleading such as to support a Rule 10b-5 or Section 17 claim? It cannot.

NSAI Reports. NSAI's opinions suffer from the same infirmities discussed above. First, as with the other experts, NSAI's opinions about the use of the terms "reserves" ignore the numerous disclosures that no commercially recoverable oil had been discovered. Indeed, NSAI's assertions in paragraph 84 of its Report that the November 2009 presentation did not state that the CPO-4 was "an exploration project" and that "there are no discoveries or discovered commercial volumes on the Block" are unsupportable for the reasons discussed above, thus rendering NSAI's opinion on "reserves" scientifically unreliable and unhelpful. In fact, Slide 13 specifically states that the project was in an "[e]xploration" period. NSAI also admits the limitations in its analysis by stating that "[s]ince the SEC does not recognize contingent or possible reserves in its reporting standards, we have chosen instead to use the terms and definitions from the PRMS to prepare our opinions . . . ."[40] This case does not involve SEC-filed "reporting," so NSAI's opinion is not reliable or helpful.

Second, NSAI's discussion of "leads and prospects" ignores the definition of "prospects" provided in Houston American's previous Form 10-K[41] as well as Houston American's prior

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[38] *See* MSD at 20-21 (noting testimony by Snow and Hendrickson that they understood Houston American had no oil "in the ground").
[39] *Id.* at 4.
[40] NSAI Report ¶ 25.
[41] *See* MSD at 16 (noting 10-K statement that "[o]ur prospects are in various stages of evaluation ranging from a prospect that is ready to drill to a prospect that will require substantial additional seismic data, processing, and interpretation").

disclosure that the "leads or prospects" still needed to be "detailed." Moreover, as with the definition of "reserves," NSAI provides no scientific analysis of how many companies actually use the PRMS definitions of leads and prospects in a predrill context.

Third, NSAI improperly speculates about how an "investor" would have viewed the statements, claiming that "the use of the term 'reserves' by Houston American would have been confusing."[42]

Fourth, NSAI admits that it did not review "basic well log and seismic data,",[43] thus depriving its conclusions of an adequate scientific or factual basis. All of its opinions should thus be excluded.

Redundancy objection. Finally, Respondents object to the redundancy and overlap of the Division's oil and gas experts, who each make the same basic points and suffer from the same fatal flaws. The Division is using quantity to mask an absence of substance and should not be permitted to use redundant experts.

CONCLUSION

Respondents pray that the Tribunal exclude arguments and testimony inconsistent with the OIP, exclude the experts from testifying or offering their reports in evidence as set forth above, and grant all other relief to which Respondents are justly entitled.

[42] NSAI Report ¶ 97.
[43] *Id.* ¶ 12.

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CERTIFICATION OF WORD COUNT

I, Mark Oakes, counsel of record for Respondents Houston American Energy Corp. and John F. Terwilliger, certify that the word count of this brief is less than 7,000 words.

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Mark Oakes