

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES ACT OF 1933  
Rel. No. 9417 / July 12, 2013

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 69982 / July 12, 2013

Admin. Proc. File No. 3-14266

In the Matter of  
  
JOHNNY CLIFTON  
c/o Pace & Pace, LLP  
Meadows Building, Suite 940  
5646 Milton Street  
Dallas, TX 75206

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

**Grounds for Remedial Action**

**Fraud in the Offer and Sale of Securities**

**Failure to Supervise**

Respondent, who was president, chief executive officer, and principal of a former registered broker-dealer, made material misrepresentations and omissions in the offer and sale of oil-and-gas limited partnership interests, and failed reasonably to supervise at least one registered representative with a view towards preventing his securities law violations. *Held*, it is in the public interest to: (i) bar respondent from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; (ii) enter a cease-and-desist order; and (iii) assess a third-tier civil money penalty.

APPEARANCES:

*Jonathan Pace* and *William Pace*, of Pace & Pace, LLP, for Johnny Clifton.

*Toby M. Galloway* and *D. Dee Raibourn III*, for the Division of Enforcement.

Appeal filed: December 29, 2011  
Last brief received: March 6, 2012

**I.**

Johnny Glen Clifton, who was the president, chief executive officer, and principal of MPG Financial, LLC, a former Commission-registered broker-dealer, appeals from an administrative law judge's initial decision.<sup>1</sup> The law judge found that from 2009 to 2010 Clifton willfully violated §§ 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act of 1933<sup>2</sup> by engaging in fraud in connection with the offer and sale of oil-and-gas limited partnership (LP) interests. The law judge also found that Clifton violated § 15(b) of the Securities Exchange Act of 1934<sup>3</sup> by failing reasonably to supervise MPG Financial sales representatives with a view towards detecting and preventing their securities law violations. For this violative conduct, the law judge (i) barred Clifton from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, but not from association with any municipal advisor or nationally recognized statistical rating organization (NRSRO); (ii) entered a cease-and-desist order; and (iii) assessed a single third-tier civil money penalty of \$130,000.

We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. We find that Clifton violated Securities Act §§ 17(a)(1), 17(a)(2), and 17(a)(3) because he made material misrepresentations and omissions in the offer and sale of LP interests and, through those misrepresentations and omissions and other misconduct, engaged in a fraudulent scheme and course of business that operated as a fraud on prospective investors.<sup>4</sup> We further find that Clifton failed reasonably to supervise at least one MPG Financial sales representative<sup>5</sup> with a view towards detecting and preventing his Securities Act violations. Consistent with our recently issued decision in *John W. Lawton*,<sup>6</sup> we conclude that it is in the public interest on the facts of this case to impose a full collateral bar on Clifton, in addition to a cease-and-desist order and a third-tier civil money penalty. We have increased the amount of the civil money penalty from \$130,000 to \$150,000 to reflect the statutory maximum that may be assessed against an individual for one third-tier violation occurring during the relevant period.<sup>7</sup>

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<sup>1</sup> *Johnny Clifton*, Initial Decision Rel. No. 443, 2011 WL 7444649 (Nov. 29, 2011).

<sup>2</sup> 15 U.S.C. §§ 77q(a)(1), 77q(s)(2), 77q(a)(3)..

<sup>3</sup> *Id.*, § 78o(b).

<sup>4</sup> The Order Instituting Proceedings charged Clifton with making or, in the alternative, causing material misrepresentations and omissions in the offer and sale of LP interests, in violation of Securities Act §§ 17(a)(1), 17(a)(2), and 17(a)(3). *See Johnny Clifton*, Securities Exchange Act Rel. No. 63926, 2011 WL 553587, at \*3 (Paragraphs 14 and 18 of OIP) (Feb. 17, 2011). In light of our finding that Clifton committed primary violations of Securities Act § 17(a), we do not address his liability for causing material misrepresentations and omissions.

<sup>5</sup> Because the registered representative was not named as a respondent in this proceeding, we refer to that representative throughout this opinion as "Registered Representative No. 1."

<sup>6</sup> *Investment Advisers Act Rel. No. 3513*, 2012 WL 6208750, at \*10-13 (Dec. 13, 2012).

<sup>7</sup> *See 17 C.F.R. § 201.1004* (adjusted maximum penalty amounts for violations occurring after March 3, 2009).

## II.

### A. Clifton

Clifton entered the securities industry in May 1990. Over the ensuing years, he obtained several securities licenses, including supervisory licenses.<sup>8</sup> Before April 2009, Clifton worked in the financial services industry, primarily in the insurance business. From April 2009 to April 2010, he was the president, chief executive officer, and principal of MPG Financial, a registered broker-dealer located in Richardson, Texas.<sup>9</sup> MPG Financial was owned by, and shared office space with, Managed Petroleum Group, Inc., a Texas corporation engaged in the oil-and-gas exploration business.<sup>10</sup>

In August 2007, FINRA censured and fined Clifton \$7,500 for publishing a securities-related website without prior approval.<sup>11</sup> As part of the settlement, Clifton consented to findings that his website "contained unfair, unbalanced, misleading and exaggerated statements; and utilized testimonials without making required disclosures."<sup>12</sup>

### B. MPG Financial offered and sold LP interests in a six-well oil-and-gas drilling project.

Most of the facts are not in dispute.<sup>13</sup> Prior to April 2009, MPG Financial, on behalf of Managed Petroleum, began offering LP interests in a six-well oil-and-gas drilling project in Osage County, Oklahoma.<sup>14</sup> Specifically, the broker-dealer offered fifteen units at \$71,250 each, for a total offering of \$1,068,750. According to the Osage project's private placement memorandum

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<sup>8</sup> His securities licenses included Series 6, 7, 24, 26, 27, 63, 65, and 66 licenses.

<sup>9</sup> MPG Financial filed a Form BD withdrawing its registration on December 31, 2010. *See* <http://brokercheck.finra.org/Support/ReportViewer.aspx?SearchGroup=Firm&FirmKey=146670&BrokerKey=-1>.

<sup>10</sup> Managed Petroleum is not registered with the Commission in any capacity and has no securities registered with the Commission.

<sup>11</sup> Letter of Acceptance, Waiver and Consent No. 2005002947301: Re: Johnny Glen Clifton (Aug. 8, 2007). *See* FINRA Rule 9216(a). AWCs are the means through which many FINRA disciplinary actions are settled prior to the filing of a complaint. *Notice of Filing of a Proposed Rule Change by the NASD, Inc. to Proposed Changes in the By-Laws of the NASD, NASD Reg., Inc., the NASDAQ Stock Mkt., Inc., the Plan of Alloc. and Deleg. of Functions by the NASD to Subs., Membership Application Procedures, Discip. Proceedings, Other Proceedings, and Other Conforming Changes*, Exchange Act Rel. No. 38545, 1997 WL 211525, at \*38 (Apr. 24, 1997) (Part 1 of 6).

<sup>12</sup> Letter of Acceptance, Waiver and Consent No. 2005002947301, at 3. Although Clifton neither admitted nor denied FINRA's findings for purposes of the AWC, he specifically agreed that the "AWC will become part of [his] permanent disciplinary record and may be considered in any future actions brought by [FINRA] or any other regulator against him." *Id.* at 2. In addition, Clifton testified during the hearing that the website did, in fact, contain unfair, unbalanced, misleading, and exaggerated statements.

<sup>13</sup> In his petition for review, Clifton "admitted he made omissions and misrepresentations of material fact" during a December 23, 2009 conference call; admitted that "[t]he Division's Exhibits show a number of emails from two brokers [under his supervision] that are misleading and omit material facts"; and "admitted he did not follow the procedures instituted for supervision of the brokers." Pet. for Review at 1, 2.

<sup>14</sup> The six wells, in the order drilled, were Osage 1-5, Osage 1-1, Osage 1-4, Osage 1-6, Osage 1-2, and Osage 1-3.

(PPM) dated April 15, 2009, the minimum investment was one-half a unit, or \$35,625, although investments for as little as one-eighth a unit, or \$8,906, were accepted. In total, MPG Financial raised approximately \$500,000 from twenty-two retail investors by the time the offering closed at the end of 2009. In February 2010, Managed Petroleum notified investors that it was shutting down the project and refunded twenty-five percent of their principal.

### C. Project developments

Managed Petroleum began drilling on the Osage project using seed money provided by industry partners.<sup>15</sup> Drilling on the first well, Osage 1-5, was completed in early April 2009. Well testing data showed an initial production of twenty to thirty barrels of oil per day (BOPD), but after completion actual oil production was only one to five BOPD due to excess salt water in the well. This meant that the well was not commercially viable because the salt water had to be transported approximately seventy-five miles to a salt water disposal well (SWDW) at substantial additional cost.

Drilling on the second well, Osage 1-1, began in May 2009 and was completed in June 2009. Well testing data showed some potential to produce gas, but it turned out that Osage 1-1, like Osage 1-5, produced too much salt water to be commercially viable. Managed Petroleum decided to convert Osage 1-1 into an SWDW to eliminate water transportation costs for Osage 1-5 and nearby wells. Because obtaining a permit to convert Osage 1-1 into an SWDW would take several months, in August 2009, Managed Petroleum decided to "shut in," or turn off, Osage 1-5 until it could secure the conversion permit. Ultimately, Osage 1-5 was never reopened, and Managed Petroleum never obtained an SWDW permit for Osage 1-1.

In early October 2009, Managed Petroleum's president, Brian Anderson, attended a meeting at MPG Financial at which Clifton and MPG Financial's sales representatives were present.<sup>16</sup> Anderson updated the sales representatives on the Osage project's status, informing them that the first well had been drilled and was "shut in," the second well would be converted into an SWDW, and drilling on the third well would begin in the "next few months."<sup>17</sup> Anderson testified that no one at MPG Financial was "surprised or alarmed" by this news.<sup>18</sup>

Managed Petroleum did not drill again until December 2009. Drilling on the third well, Osage 1-4, began on December 17, 2009. On December 20, Managed Petroleum asked the geologists to evaluate Osage 1-4's oil production potential because it was not showing promising results. That same day, Managed Petroleum decided to temporarily suspend drilling on the fourth

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<sup>15</sup> The PPM defined "industry partner" as "[a] person who shall own a portion of the Working Interest in the Lease outside of the Partnership." Div. Ex. 4 at 000179. Managed Petroleum raised \$1.4 million from industry partners. No LP interest was sold until at least June 8, 2009, after the first two wells had been drilled.

<sup>16</sup> In his brief on appeal, Clifton stated that all of the sales representatives were present at this meeting.

<sup>17</sup> Tr. 261.

<sup>18</sup> *Id.*

well, Osage 1-6, because of its close proximity to Osage 1-4, pending the geologists' evaluation. On December 28, 2009, Clifton learned from Anderson that Osage 1-4 was unproductive—a "dry hole"—and would be plugged and abandoned. Drilling on Osage 1-6 did not resume.

Drilling on the fifth and sixth wells, Osage 1-2 and Osage 1-3, began in January 2010 and was finished that same month. Both wells were deemed to be dry holes and not commercially viable; they were plugged and abandoned. The Osage project was shut down in February 2010.

#### **D. Clifton's timeline**

Clifton stipulated that Managed Petroleum timely informed him of all project developments.

On March 1, 2010, Clifton prepared a timeline for Commission staff that set forth when he received information about the Osage project and from whom.<sup>19</sup> Its contents are as follows:

<b>Date</b>	<b>Event</b>
April 20, 2009	Clifton learned from Anderson that Osage 1-5 had been drilled and that geologists believed it could produce between twenty-seven and twenty-nine BOPD.
June 1, 2009	Clifton learned from Anderson that Osage 1-1 was drilled.
June 8, 2009	Clifton learned from Anderson that Osage 1-5 was having mechanical difficulties and producing at a "very low rate of 1-4 BOPD."
August 2, 2009	Clifton learned from Anderson that Osage 1-1 was not commercially viable as an oil-and-gas well and would be converted into an SWDW.
August 24, 2009	Clifton learned from Anderson that Osage 1-5 would be "shut in" pending the SWDW permit for Osage 1-1.
December 16, 2009	Clifton learned from Anderson that drilling on Osage 1-4 would begin on December 19, 2009.
December 28, 2009	Clifton learned from Anderson that the geologists confirmed that Osage 1-4 was not commercially viable as an oil-and-gas well and would be plugged and abandoned. <sup>20</sup>
February 1, 2010	Clifton learned from Anderson that Osage 1-2 and Osage 1-3 were dry holes and that there was "little hope" that Osage 1-6 would be viable.

<sup>19</sup> Div. Ex. 11. In a notation at the bottom of the timeline, Clifton wrote that he could not say "with certainty" that the dates and times within it were "exactly correct" and that they could be relied upon "only as estimates to the best of [his] recollection." *Id.* at 2.

<sup>20</sup> Although Clifton's timeline indicated that he received Anderson's call in the afternoon of December 28, 2009, Clifton testified at the hearing that he believed he received the call while driving to work in the morning, before 9:00 a.m. Clifton's testimony was corroborated by Anderson's testimony that he called Clifton before lunch and by MPG Financial sales representative Steve Allen's testimony that Clifton told him that MPG Financial received notice of the dry hole that morning.

Date	Event
February 4, 2010	Clifton received a copy of a letter to be sent to investors informing them that the Osage project would be shut down and they would be refunded a percentage of their investment.

### E. Clifton's misrepresentations and omissions and other misconduct

On December 23, 2009, Clifton conducted a twenty-minute conference call for investors and prospective investors in the Osage project. As few as two, and as many as four, investors or prospective investors listened in. The call was recorded by MPG Financial, and no questions were allowed. During the call, Clifton omitted material information relating to the status of Osage 1-5 and Osage 1-1, and the information he provided concerning the six wells and potential pay zones was inaccurate.<sup>21</sup> Additionally, Clifton made several misrepresentations about the overall status of the project.

Clifton admitted during the hearing that by December 23, 2009, he knew that three of the six wells had been drilled; that the first well, Osage 1-5, had been "shut in"; that the second well, Osage 1-1, was going to be converted into an SWDW if a permit could be obtained; that the commercial viability of the third well, Osage 1-4, was uncertain; and that none of the wells was then producing any oil. He admitted that all of these facts were material to investors.<sup>22</sup> Nevertheless, he admitted that he did not disclose any of these facts during the call.

Clifton suggested during the call that drilling on the Osage project had not yet begun. He told those listening in that the Osage project was a new, "year-end" project when, in fact, drilling had already begun and the offering was soon to end.<sup>23</sup> He further told investors that he and others at the firm were "putting [their own] money in this deal" when, contrary to his representation, they did not have "skin in the game."<sup>24</sup>

<sup>21</sup> "Pay zone" refers to each of the ten different depths of a well at which oil could be present. For the Osage project, with six wells, there were a total of sixty potential pay zones.

<sup>22</sup> Tr. 42, 63-64, 154-55. In *Matrixx Initiatives, Inc. v. Siracusano*, the Supreme Court stated that the materiality requirement is satisfied when there is "a substantial likelihood that 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." 131 S. Ct. 1309, 1318 (2011) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

<sup>23</sup> Clifton said, "We've got a *year-end* project that we're excited about." Div. Ex. 54 at 3 (emphasis added). At another point, he said, "[W]e've decided to put together here *at the end of the year* a six-well package located in Northeast Oklahoma in Osage County." *Id.* at 4 (emphasis added).

<sup>24</sup> Clifton said, "[Y]ou got to understand, we're putting our money in this deal, too. So, you know, we make money, our investors make money, and everyone's happy." *Id.* at 6. He also said, "[W]e have our own money involved in the deal." *Id.* at 15. At the hearing, Clifton explained that "[t]he point of saying that was to let the investors know that [MPG Financial sales representatives] also have skin in the game," *i.e.*, they invested their own personal funds in the project. Tr. 147.

Clifton misrepresented the production potential of the six wells, touting oil figures that were based on six producing wells when, in fact, the decision to convert Osage 1-1 into an SWDW left, at most, five potentially producing wells, and Osage 1-5 had been "shut in." He stated, "with six wells, that's . . . 60 opportunities that we have to . . . hit on this particular project."<sup>25</sup> He also stated, "each one of these wells can generate 10, 15, 20 barrels a day."<sup>26</sup> Clifton conceded in testimony that, in addition to omitting information relating to the status of Osage 1-5 and Osage 1-1, he did not communicate the uncertainty of Osage 1-4's viability as a commercial well.

Clifton also participated in misleading other prospective investors in the Osage project. At approximately 11:46 a.m. on December 28, 2009, Clifton e-mailed a hyperlink to the recording of the December 23 call to an MPG Financial sales representative who wanted to send it to other prospective investors. After that date, MPG Financial completed the transfer of funds from three or four additional investors who had submitted subscription paperwork pursuant to the PPM, without disclosing to those investors that, among other things, Osage 1-4 was a dry hole. In the last few days of December 2009, Clifton advised Registered Representative No. 1 that the Osage project was the "best deal" MPG Financial was offering and a "good place" for customers to invest money.<sup>27</sup> Based on Clifton's advice and encouragement, Registered Representative No. 1 had his customer, Nelson Wheeler, invest in the Osage project.

#### **F. Registered Representative No. 1's misrepresentations and omissions**

Registered Representative No. 1 was hired by Clifton in June or July 2009 and worked at MPG Financial as a sales representative until he resigned in July 2010.<sup>28</sup> In sworn investigative testimony, Registered Representative No. 1 stated that he learned in July 2009 that the first well, Osage 1-5, had been "shut in." At the hearing, however, Registered Representative No. 1 contradicted his sworn investigative testimony and stated that he did not learn about Osage 1-5's "shut in" status until February 2010.<sup>29</sup> He also testified at the hearing that he learned sometime between June and August 2009 that the second well, Osage 1-1, would be converted into an SWDW.

In e-mails to prospective investors between August and December 2009, Registered Representative No. 1: failed to disclose that Osage 1-5 had been "shut in" or that Osage 1-1 would be converted into an SWDW; misrepresented Osage 1-5's oil production rate as between 22 and 25

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<sup>25</sup> Div. Ex. 54 at 4-5. *See also supra* note 21. In his hearing testimony, Clifton admitted that, for sixty pay zones to be true, all six wells would have to "hit" on all ten pay zones, and up until that point, there was no production from the first three wells. Div. Ex. 54 at 4-5.

<sup>26</sup> *Id.* at 8-9.

<sup>27</sup> *Id.*

<sup>28</sup> A search of FINRA's BrokerCheck indicates that Registered Representative No. 1 is not currently registered with FINRA.

<sup>29</sup> As previously discussed, Managed Petroleum's Anderson testified that MPG Financial sales representatives knew in early October 2009 that Osage 1-5 had been "shut in." *See supra* notes 16-18 and accompanying text.

BOPD when it actually was one to five BOPD;<sup>30</sup> falsely stated that drilling on the first two wells had been "complete[d] and [was] successful";<sup>31</sup> and misrepresented potential investment returns by basing his projections on the production of six wells when the decision to convert Osage 1-1 into an SWDW left, at most, five potentially producing wells. Registered Representative No. 1 testified that when he sent these e-mails he believed them to be accurate and truthful based on information received from Clifton and others.<sup>32</sup> But he also admitted that he left out material facts and that he could have been more careful with the content of his e-mails. MPG Financial's chief compliance officer ("CCO") Brad Simmons testified that when, in February 2010, he confronted Registered Representative No. 1 about his e-mails, particularly those sent in December 2009, Registered Representative No. 1 told Simmons that he knew that the information contained in those e-mails was wrong.<sup>33</sup>

In early December 2009, Registered Representative No. 1 contacted Tony Caudill, a part owner and president of a family-owned aerospace machine shop located in Grove, Oklahoma, about investing money in the Osage project. Caudill testified that Registered Representative No. 1 did not inform him that drilling had already begun or that Osage 1-5 had been "shut in"; instead, Registered Representative No. 1 led him to believe that none of the wells had been drilled. Caudill invested \$14,000 in the Osage project on December 3, 2009. His investment resulted in a loss of about \$12,000 by the time the project closed.<sup>34</sup>

## **G. Supervision of the sales representatives**

MPG Financial had written supervisory procedures (WSPs) in place when Clifton was hired. Clifton testified that he received a copy and was familiar with them. CCO Simmons updated the WSPs in October 2009, and associated persons signed statements that they had received, read,

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<sup>30</sup> For example, in an e-mail sent on December 28, 2009, Registered Representative No. 1 wrote that the "1st well of the six came in @ 22 bopd." Div. Ex. 25. In another e-mail sent on December 29, 2009, he wrote that the "1st well of the six well project has initial production of 22-25 bopd." Div. Ex. 27.

<sup>31</sup> Div. Exs. 21, 22. E-mails sent during this period by another MPG Financial registered representative (hereinafter "Registered Representative No. 2") also contained misrepresentations and omissions regarding the Osage project and status of the wells. Though subpoenaed by Clifton's counsel, Registered Representative No. 2 did not appear at the hearing.

<sup>32</sup> Indeed, in an e-mail sent on December 28, 2009, Registered Representative No. 1 emphasized that there were "6 wells—10 pay zones EACH!!" Div. Ex. 25. This statement mimicked a similar statement that Clifton made during the December 23, 2009 conference call. Registered Representative No. 1 testified that he listened to Clifton's December 23 conference call while it was taking place.

<sup>33</sup> When asked by Division staff on direct examination, "What do you think your mistake was, if any, in sending out e-mail," Registered Representative No. 1 replied, "By making sure—if I had to do it again, to make sure that everything I received from the parties. . . you know, from Johnny Clifton, from my supervisors, . . . was in writing and handed to me." Tr. 436.

<sup>34</sup> Other than Caudill, only one other Osage project investor testified in this proceeding. Investor Melinda Mulcare testified that she and her brother jointly invested \$17,000 based on misrepresentations and omissions made by a third MPG Financial registered representative (hereinafter "Registered Representative No. 3). Mulcare testified that she and her brother received a refund of only \$4,000 of their principal after the project closed.

and understood the updated procedures. The WSPs assigned responsibility for supervising sales representatives to Clifton and for supervising "persons not involved in sales" to Simmons.<sup>35</sup>

### **1. Outgoing written and electronic correspondence**

The WSPs specified that Clifton review and approve all outgoing written and electronic correspondence of the sales representatives because he was their designated supervisor. Clifton testified that MPG Financial's unwritten policy required random review of e-mail to ensure that correspondence sent by the sales representatives was truthful and not exaggerated.<sup>36</sup> Clifton drafted sample e-mails that the sales representatives could send without his pre-approval. The sales representatives sent approximately fifteen to twenty such e-mails each day. The sales representatives sent another five to twenty e-mails each day that required Clifton's pre-approval. The WSPs required the firm to retain records of the sales representatives' outgoing written and electronic correspondence.

Before Simmons joined MPG Financial, e-mails went directly into Clifton's in-box for review. Thereafter, Simmons implemented a new e-mail system that archived all outgoing e-mails in a central in-box to which both he and Clifton had access. Simmons also recommended a system to ensure that unapproved e-mails were not sent, but Clifton never implemented such a system because of its cost.

Although the WSPs specified that Clifton was responsible for reviewing and approving e-mails sent by the sales representatives, Clifton testified that he delegated to Simmons, as CCO and creator of the e-mail archive system, primary responsibility for reviewing e-mails sent by the sales representatives. But Simmons testified that Clifton was responsible for reviewing and approving those e-mails because Simmons worked part-time and Clifton "didn't feel that it was feasible" for Simmons "to be doing reviews and approvals."<sup>37</sup> Simmons testified that he only conducted keyword searches of e-mails that had already been sent.

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<sup>35</sup> Div. Ex. 46 at 8.

<sup>36</sup> The WSPs stated:

All communication must be truthful and balanced. Items to consider when preparing and reviewing outgoing correspondence include: truthfulness; exaggerated, unwarranted, or misleading statements or claims are prohibited; promises or guarantees: past performance may not be used to promise, guarantee, or imply future profits or income from securities; projections and predictions are not permitted; tax advice must not be provided; the customer should be referred to the Private Placement Memorandum or his or her tax adviser for such issues; [and] photocopying and distributing copyrighted material may violate copyright laws.

*Id.* at 14.

<sup>37</sup> Tr. 320.

The Division adduced considerable documentary evidence showing that e-mails sent by Registered Representative No. 1 and Registered Representative No. 2<sup>38</sup> provided prospective investors with misleading information. As discussed, among other things, those e-mails misrepresented Osage 1-5's actual oil production rate, falsely stated that Osage 1-1 was producing "oil and gas,"<sup>39</sup> and falsely stated that drilling on Osage 1-5 and Osage 1-1 had been "complete[d] and [was] successful."<sup>40</sup> In his petition for review, Clifton referred to Registered Representative No. 1 and Registered Representative No. 2 as "rogue" brokers.<sup>41</sup> But Registered Representative No. 1 and Registered Representative No. 2 were supervised by Clifton, and Clifton admitted that he did not review their e-mails to prospective investors.

## 2. Project updates

Shortly after joining MPG Financial, Clifton established a "flow of information" system pursuant to which information about the Osage project was to flow from MPG Financial project manager Laura Elwell to Anderson, from Anderson to Clifton, and from Clifton to the sales representatives. Clifton updated the sales representatives about the Osage project during weekly meetings. His updates were oral, and he did not provide the sales representatives with any written materials, apart from the PPM. Although he instructed the sales representatives to use the PPM and the information he provided orally to market the Osage project, Clifton admitted that the PPM was not updated to reflect the drilling activities, negative developments, or status of individual wells.

Testimony established that Clifton did not always provide complete or timely information to sales representatives and at times sought to conceal information from them. On December 28, 2009, for instance, Allen learned from a customer that Osage 1-4 had been drilled and was a dry hole. Allen testified that Clifton asked him not to tell other sales representatives about it. Clifton corroborated Allen's testimony but claimed that he told Allen not to disclose the dry hole because Allen was "negative" and Clifton wanted to deliver the information himself.<sup>42</sup>

In January 2010, Registered Representative No. 3, not Clifton, told Allen that Osage 1-2 and Osage 1-3 were dry holes. Upon receiving this information, Allen approached Clifton, who indicated that he had not heard anything about the status of Osage 1-2 and Osage 1-3. Later that day, Clifton stopped by Allen's office, admitted that Osage 1-2 and Osage 1-3 were dry holes, and asked him and Registered Representative No. 3 not to share the updated information with the other sales representatives.

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<sup>38</sup> See *supra* note 31.

<sup>39</sup> Div. Ex. 19.

<sup>40</sup> Div. Exs. 21, 22.

<sup>41</sup> Pet. for Review at 2.

<sup>42</sup> Tr. 491-92.

### 3. Oral communications

MPG Financial did not have procedures in place to monitor the sales representatives' telephone calls with customers.<sup>43</sup> Nevertheless, Clifton claimed that he listened to the sales representatives' calls with customers "every single day."<sup>44</sup> But Allen testified that Clifton listened to calls "very infrequently."<sup>45</sup> Registered Representative No. 1 testified that Clifton listened to one of his calls with a prospective investor. After the call, Clifton told Registered Representative No. 1 that he did a "good job."<sup>46</sup> Registered Representative No. 1 testified that the substance of the call was consistent with a December 29, 2009 follow-up e-mail he sent to the same investor containing inaccurate information about the Osage project.<sup>47</sup>

#### H. The staff's examination and proceeding below

In February 2010, Commission staff conducted an onsite examination of MPG Financial, focusing on the Osage project offering. A staff accountant who participated in the examination testified that the staff was concerned about whether investors had been given all material information about the project; he interviewed Clifton twice and stated that Clifton gave inconsistent information about the drilling dates for the first two wells.<sup>48</sup> The examination developed into an investigation by the Division of Enforcement. On February 17, 2011, the Commission issued an Order Instituting Proceedings against Clifton, alleging that he engaged in fraud in the offer and sale of LP interests in the Osage project and failed to exercise reasonable supervision over MPG Financial sales representatives.<sup>49</sup> In September 2011, the law judge conducted a two-day hearing. The Division called nine witnesses, including Clifton. Clifton testified on his own behalf but did not call additional witnesses. In November 2011, the law judge

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<sup>43</sup> NASD Rule 3010 requires each member firm to establish and maintain a reasonably designed system, including written procedures, to supervise the activities of its registered representatives, principals, and associated persons and achieve compliance with the federal securities laws and FINRA Rules. Rule 3010(c)(1) specifically requires member firms to periodically examine customer accounts to detect and prevent irregularities and abuses. Among the things that firms may consider doing to meet such obligation is reviewing a registered representative's customer contacts by "monitoring selected telephone conversations between the registered representative and both existing and potential customers or attending meetings between the representative and his or her clients." NASD Notice to Members 97-19, 1997 WL 1909783, at \*9 (Apr. 1997) (discussing heightened supervisory procedures for registered representatives with a history of customer complaints).

<sup>44</sup> Tr. 491.

<sup>45</sup> *Id.* at 285.

<sup>46</sup> *Id.* at 432.

<sup>47</sup> Registered Representative No. 1's e-mail referred to the Osage project as a "6 well project"; made projections about the amount of oil the project could produce based on all six wells; and overstated potential investment returns. Div. Ex. 26.

<sup>48</sup> During the first interview, Clifton stated that the first well, Osage 1-5, was drilled in August or September 2009, rather than April 2009, and that the second well, Osage 1-1, was drilled in November 2009, rather than June 2009. Clifton provided correct dates at the second interview.

<sup>49</sup> *See Johnny Clifton*, Exchange Act Rel. No. 63926, 2011 WL 553587 (Feb. 17, 2011).

issued an initial decision finding that Clifton committed the securities law violations alleged in the OIP and imposing sanctions.<sup>50</sup>

### III.

#### A. Securities Act § 17(a) violations

Under Securities Act § 17(a), it is

unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud; or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.<sup>51</sup>

#### 1. The LP interests were "securities" under the *Howey* test.

As an initial matter, there is no dispute that the LP interests in the Osage project were "securities." Section 2(a)(1) of the Securities Act<sup>52</sup> and § 3(a)(10) of the Exchange Act<sup>53</sup> define the term "security" to include an "investment contract." In *SEC v. W.J. Howey Co.*,<sup>54</sup> the Supreme Court defined an "investment contract" as "a contract, transaction, or scheme whereby a person invests his or her money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."<sup>55</sup> The evidence establishes that MPG Financial, on behalf of

<sup>50</sup> *Clifton*, 2011 WL 7444649.

<sup>51</sup> 15 U.S.C. § 77q(a).

<sup>52</sup> 15 U.S.C. § 77b(a)(1).

<sup>53</sup> *Id.*, § 78c(a)(10).

<sup>54</sup> 328 U.S. 293 (1946).

<sup>55</sup> *Id.* at 298-99. The law judge ruled that a common enterprise was present because investors' funds were pooled. *Clifton*, 2011 WL 7444649, at \*11; see generally THOMAS HAZEN, LAW OF SECURITIES REGULATION § 1.6[2][B] (6th ed. 2009) (stating that "[a] pooling of interests among more than one investor is the clearest example of a common enterprise"), available at Westlaw LAWSECREG. While we agree with the law judge's finding, we have held that a common enterprise is not a distinct requirement under *Howey*. See *Anthony H. Barkate*, Exchange Act Rel. No. 49542, 57 SEC 488, 2004 WL 762434, at \*3 n.13 (Apr. 8, 2004), *aff'd*, 125 F. App'x 892 (9th Cir. 2005); *Joseph Abbondante*, Exchange Act Rel. No. 53066, 58 SEC 1082, 2006 WL 42393, at \*6 n.40 (Jan. 6, 2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). In any event, Clifton does not dispute the existence of a common enterprise here.

Managed Petroleum, sold investors LP interests in the Osage project, and investors expected their financial returns to come through the managerial efforts of Managed Petroleum and others, and not through their own participation. Accordingly, we conclude that the LP interests were "investment contracts" and therefore "securities" under § 17(a).

**2. Clifton used means and instrumentalities of interstate commerce in offering the LP interests.**

The jurisdictional requirements of § 17(a) are interpreted broadly, so as to be satisfied by intrastate telephone calls and ancillary mailings.<sup>56</sup> There is no dispute that the jurisdictional requirements have been satisfied in this proceeding. Clifton and MPG Financial sales representatives communicated with prospective investors by written and electronic correspondence and by telephone to offer and sell LP interests in the Osage project.

**3. Clifton's conduct violated Securities Act § 17(a)(2).**

To establish a claim under § 17(a)(2), the staff was also required to show that Clifton (i) directly or indirectly (ii) obtained money or property (iii) by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.<sup>57</sup> *Scienter* is not an element of the offense; a showing of negligence is sufficient.<sup>58</sup> The evidence establishes that Clifton committed primary violations of § 17(a)(2) by making material misrepresentations and materially misleading omissions to prospective investors in selling and offering to sell LP interests, earning commissions on the sales.

Clifton admitted that he personally made misrepresentations during the December 23, 2009 conference call.<sup>59</sup> He misled prospective investors into believing that the Osage project was a new, "year-end" project when, in fact, he knew that the project had been underway for eight months.<sup>60</sup> He falsely claimed that "we're putting our money in this deal" so they would believe that he and others at MPG Financial were personally invested in the success of the project.<sup>61</sup> He overstated the production potential of the Osage project by claiming that there were six producing wells, each with ten pay zones, for a purported "60 opportunities" to "hit" oil when he knew that there were, at best, five viable wells, even including Osage 1-5, which had been "shut in" since August 2009.<sup>62</sup>

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<sup>56</sup> *SEC v. Softpoint, Inc.*, 958 F.Supp. 846, 865 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

<sup>57</sup> 15 U.S.C. § 77q(a)(2); *Aaron v. SEC*, 446 U.S. 680, 696 (1980). *See generally* 3 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.22 (5th ed. 2005) (discussing the elements).

<sup>58</sup> *Aaron*, 446 U.S. at 697, 701-02.

<sup>59</sup> *See supra* note 13.

<sup>60</sup> *See supra* note 23 and accompanying text.

<sup>61</sup> *See supra* note 24 and accompanying text.

<sup>62</sup> *See supra* note 25 and accompanying text.

Clifton also admitted that he failed to disclose critical information during the December 23, 2009 conference call. He knew that three of the six wells had already been drilled. He knew that the first well, Osage 1-5, had been "shut in" since August 2009. He knew that the second well, Osage 1-1, was going to be converted into an SWDW if a permit could be obtained. He knew that the commercial viability of the third well, Osage 1-4, was uncertain. He knew that drilling on the fourth well, Osage 1-6, had been suspended. And he knew that the Osage project was not then producing any oil. But Clifton did not disclose this information during the conference call. Furthermore, after learning that the third well, Osage 1-4, was a dry hole on December 28, he accepted funds from three or four investors without disclosing this negative development to them.

Each of Clifton's misrepresentations and omissions was material. The test for materiality is whether a reasonable investor would have considered the information important in deciding to invest.<sup>63</sup> There can be no doubt that information about the development of the Osage project, the status of individual wells, and their oil production capacity was the type of information that a reasonable investor would consider important in deciding whether to invest in an oil-and-gas drilling project.

Clifton compounded these misrepresentations and omissions in the remaining days of December 2009 when he forwarded a hyperlink of the December 23, 2009 conference call for distribution to prospective investors, without correcting or updating any of the information discussed during the call. He further advised that Registered Representative No. 1 should have Wheeler invest in the Osage project, affirming that it was a "good place" for an investment, without discussing the fact that the third well, Osage 1-4, was a dry hole.<sup>64</sup>

Clifton directly or indirectly obtained money by means of his material misstatements and omissions. After learning on December 28, 2009 that the third well, Osage 1-4, was a dry hole, Clifton, through MPG Financial, accepted funds from three or four investors who had submitted subscription paperwork, pursuant to the terms of the PPM, without disclosing this negative development to them. In addition, he earned an "override" of around 3.75 percent of the commissions generated by MPG Financial sales representatives on the sales of LP interests,<sup>65</sup> or \$18,750, based on approximately \$500,000 worth of units sold. As a result, each sale of a unit or fraction of a unit resulted in money paid to Clifton.

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<sup>63</sup> See *supra* note 22.

<sup>64</sup> Tr. 440.

<sup>65</sup> *Id.* at 477.

#### 4. Clifton's conduct also violated Securities Act §§ 17(a)(1) and 17(a)(3).

We also find that Clifton violated §§ 17(a)(1) and 17(a)(3) of the Securities Act by engaging in a fraudulent scheme and a course of business that operated as a fraud on prospective investors. That misconduct involved the misrepresentations and omissions to investors discussed above and Clifton's affirmative actions, both to conceal material, adverse information about the project from the sales representatives and to ensure that sales representatives who learned such information also withheld it from prospective investors—all in order to keep the offering fraud going.<sup>66</sup>

In carrying out this fraudulent scheme, Clifton acted with a high degree of scienter.<sup>67</sup> He made statements to prospective investors that he knew were false. He knowingly omitted information about the Osage project that made his statements about the project materially misleading. He sent an e-mail to an MPG Financial sales representative that linked a recording of the December 23 conference call, knowing or recklessly disregarding that the recording contained materially misleading information, and knowing that the sales representative intended to distribute the link to the public. He encouraged Registered Representative No. 1 to have Wheeler invest in the Osage project in the face of the status of the first two wells and when he knew or was reckless in not knowing that Registered Representative No. 1 did not know that the third Osage well was a dry hole. He intentionally concealed material adverse information about the project from the sales representatives. And he sought to ensure that sales representatives who learned such information also withheld it from prospective investors.<sup>68</sup> That Clifton stood to gain financially from his fraudulent conduct further reinforces our finding that he acted with a high degree of scienter.<sup>69</sup>

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<sup>66</sup> See *United States v. Naftalin*, 441 U.S. 768, 774 (1976) (stating that each succeeding prohibition under § 17(a) is meant to cover additional illegalities, not to narrow the reach of the prior section).

<sup>67</sup> To establish a Securities Act § 17(a)(1) violation, the Division must establish scienter; no such showing is necessary to establish a violation of Securities Act § 17(a)(3). *Aaron*, 446 U.S. at 689-700; *Steadman*, 967 F.2d at 641 & n.3. Scienter is a mental state consisting of an intent to deceive, manipulate, or defraud, and includes recklessness, commonly defined as "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it." *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 704 (7th Cir. 2008) (quoting *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 76 (2d Cir.), *cert. denied*, 534 U.S. 1071 (2001)). Because the evidence establishes that Clifton acted with scienter, a negligence analysis is unnecessary.

<sup>68</sup> See, e.g., *SEC v. Seghers*, 298 F. App'x 319, 334 (5th Cir. 2008) (motive to conceal problems with investments, "although not alone sufficient, is relevant to showing scienter"); *Robert D. Tucker*, Exchange Act Rel. No. 68210, 2012 WL 5462896, at \*11 n.56 (Nov. 9, 2012) (stating that "efforts to conceal violative conduct demonstrate scienter").

<sup>69</sup> See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 325 (2007) (stating that "motive can be a relevant consideration" [in making the scienter determination], and "personal financial gain may weigh heavily in favor of a scienter inference").

On appeal, Clifton admits that he made material misrepresentations and omissions during the December 23, 2009 conference call, but argues that they "did not lead to any pecuniary loss" because no one invested based on the call.<sup>70</sup> The fact that none of the prospective investors who listened to the call subsequently purchased LP interests does not insulate Clifton from liability under Securities Act § 17(a). The Commission, unlike a private litigant, is not required to prove that an investor relied on the misrepresentations or that they caused an investor to lose money.<sup>71</sup>

Nor can Clifton avoid liability by claiming that information for the December 23, 2009 conference call came from the PPM. As discussed, Clifton knew that the PPM contained stale information and did not provide accurate disclosure about the current status of the wells when later investments in the project were solicited. His use of the PPM in connection with the December 23, 2009 call does not excuse the materially false and misleading statements that he made.

Clifton argues that the evidence was insufficient to sustain a finding that he knew that the third well was a dry hole when he forwarded to a sales representative a hyperlink to the recorded December 23, 2009 conference call. But Clifton's own sworn testimony, corroborated by the testimony of Anderson and Allen, supports a finding that Clifton knew about the dry hole on the morning of December 28, 2009, before he forwarded the hyperlink.<sup>72</sup> The only contradictory evidence was a single entry in Clifton's self-serving and unsworn timeline, and even there, he disclaimed the accuracy of dates and times, referring to them as only "estimates."<sup>73</sup> Although the law judge made no explicit finding as to Clifton's credibility, the substantial corroborating effect of Anderson's and Allen's testimony is persuasive evidence that Clifton forwarded the hyperlink knowing the third well was a dry hole.

For all of the foregoing reasons, we conclude that the preponderance of the evidence<sup>74</sup> establishes that Clifton willfully<sup>75</sup> violated Securities Act § 17(a).<sup>76</sup>

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<sup>70</sup> Clifton's Br. at 2.

<sup>71</sup> See, e.g., *SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1244 (11th Cir. 2012); *SEC v. Pirate Investor LLC*, 580 F.3d 233, 239 n.10 (4th Cir. 2009), *cert. denied*, 130 S. Ct. 3506 (2010); *SEC v. Wolfson*, 539 F.3d 1249, 1256 (10th Cir. 2008); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *Schellenbach v. SEC*, 989 F.2d 907, 913 (7th Cir. 1993); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985).

<sup>72</sup> See *supra* note 20 and accompanying text.

<sup>73</sup> See *supra* note 19.

<sup>74</sup> See generally *Steadman v. SEC*, 450 U.S. 91 (1981) (applying preponderance of the evidence standard in Commission administrative proceedings).

<sup>75</sup> A willful violation under the federal securities laws simply means "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

<sup>76</sup> See, e.g., *Jay Houston Meadows*, Exchange Act Rel. No. 37156, 52 SEC 778, 1996 WL 218638 (May 1, 1996) (sales representative violated Securities Act § 17(a), Exchange Act § 10(b), and Exchange Act Rule 10b-5 by misrepresenting to investors the risk of investing in shares of two companies, the likelihood that the ventures would be profitable, and the speed with which investors would recoup their investments), *aff'd*, 119 F.3d 1219 (5th Cir. 1997); *Thomas J. Fittin Jr.*, Exchange Act Rel. No. 29173, 50 SEC 544, 1991 WL 292516 (May 8, 1991) (firm president  
(continued...))

## B. Exchange Act § 15(b)

Exchange Act § 15(b)(6), incorporating Exchange Act § 15(b)(4)(E) by reference, allows us to sanction a person associated with a broker-dealer if that person "has failed reasonably to supervise, with a view to preventing [securities law] violations . . . , another person who commits such a violation, if such other person is subject to his supervision."<sup>77</sup> Exchange Act § 15(b)(4)(E) contains a "safe harbor" provision that protects supervisors from liability if the broker-dealer has "(i) . . . established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with."<sup>78</sup>

### 1. Registered Representative No. 1 violated Securities Act § 17(a).

Registered Representative No. 1 violated Securities Act § 17(a) by making untrue statements of material fact and/or misleading omissions of material fact to investors and prospective investors in the offer and sale of LP interests, earning commissions on the sales.<sup>79</sup> Between June and August 2009, Registered Representative No. 1 learned that Osage 1-1 would be converted into an SWDW, but he did not disclose that fact to prospective investors in his December 2009 e-mails. He falsely stated that drilling on the first two wells had been "complete[d] and [was] successful" when he knew, at a minimum, that the second well, Osage 1-1, was not producing oil and would be converted into an SWDW. He misrepresented potential investment returns because he based projections on six wells when he knew that the decision to convert Osage 1-1 into an SWDW left, at most, five potentially producing wells. He misled Caudill into believing that drilling on the wells had not yet begun when he knew that Osage 1-1 had been drilled and was not producing oil. As previously discussed, the information that Registered Representative No. 1 misrepresented and/or failed to disclose was material to investors.

Registered Representative No. 1 acted at least negligently when he failed to disclose in e-mails to prospective investors that the second well, Osage 1-1, would be converted into an SWDW, and falsely stated that drilling on the first two wells had been "complete[d] and [was] successful." We conclude that Registered Representative No. 1 willfully<sup>80</sup> violated Securities Act § 17(a).

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(...continued)

violated antifraud provisions in connection with firm's sale of three private offerings of oil-and-gas limited partnerships; finding that the characterization of certain drilling programs as involving developmental wells, when they were actually exploratory, was materially misleading).

<sup>77</sup> 15 U.S.C. §§ 78o(b)(4)(E), 78o(b)(6).

<sup>78</sup> *Id.*, § 78o(b)(4)(E).

<sup>79</sup> Registered Representative No. 1 acknowledged at the hearing that he personally obtained commissions on his sales of LP interests, but the record is silent as to the exact amount of money that he made.

<sup>80</sup> *See supra* note 75.

## 2. Clifton failed reasonably to supervise Registered Representative No. 1

As the president of MPG Financial, and under the firm's WSPs, Clifton was responsible for supervising Registered Representative No. 1.<sup>81</sup> As part of his supervisory duties, the WSPs required Clifton to review Registered Representative No. 1's outgoing e-mails. The WSPs also required that all correspondence be truthful and not exaggerated.<sup>82</sup> By Clifton's own admission, he did not review Registered Representative No. 1's e-mails to prospective investors. By failing to review Registered Representative No. 1's e-mails, Clifton failed to detect or prevent Registered Representative No. 1's violations of Securities Act § 17(a).

Clifton also acted unreasonably because he did not correct Registered Representative No. 1's misstatements during a late December 2009 telephone call with a prospective investor. Clifton heard the misstatements and therefore knew about them, yet failed to ensure that the prospective investor was provided with information that was truthful. Instead, he told Registered Representative No. 1 that he did a good job in marketing the Osage project, thereby placing his imprimatur on those misstatements.

We conclude that Clifton violated Exchange Act § 15(b)(6) by failing reasonably to supervise Registered Representative No. 1 with a view towards preventing and detecting his Securities Act § 17(a) violations. Clifton cannot establish an affirmative defense to his violation of Exchange Act § 15(b)(6) because, as he concedes,<sup>83</sup> he did not fulfill the duties charged to him by the WSPs that included reviewing and approving Registered Representative No. 1's e-mails.

Clifton does not dispute that the WSPs charged him with supervisory duties over Registered Representative No. 1 and required him to review Registered Representative No. 1's e-mails to ensure that they were truthful and not exaggerated. Rather, Clifton claims that he delegated to CCO Simmons the task of reviewing and approving sales representatives' e-mails. The weight of the evidence, however, fails to support his claim. As discussed, the WSPs identified Clifton as the supervisor responsible for reviewing and approving sales representatives' e-mails, and he drafted sample e-mails that could be sent without his pre-approval. At all times, Registered Representative No. 1 understood that Clifton was supposed to review and approve his e-mails before they were sent to the public. And Simmons testified that Clifton was responsible for reviewing and approving e-mails sent by the sales representatives. Furthermore, even if we accepted his claim that he delegated to CCO Simmons the authority to review and approve e-mails,

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<sup>81</sup> See *John B. Busacca III*, Exchange Act Rel. No. 63312, 2010 WL 5092726, at \*10 (Nov. 12, 2010) ("We have frequently emphasized that 'the president of a brokerage firm is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties.'") (quoting *Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 WL 1892137, at \*8 (June 29, 2007)), *pet. denied*, 449 F. App'x 886 (11th Cir. 2011).

<sup>82</sup> See *supra* note 36.

<sup>83</sup> See *supra* note 13.

Clifton, as president, retained a duty to follow-up on that delegation, which he failed to do by not ensuring that Simmons was reviewing Registered Representative No. 1's e-mails.<sup>84</sup>

#### IV.

##### A. Collateral bar

The law judge barred Clifton from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, but did not bar him from association with any municipal advisor or nationally recognized statistical rating organization. Those last two forms of relief were authorized by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010.<sup>85</sup> As Clifton's misconduct occurred before the passage of that Act, the law judge believed applying those sanctions would be impermissibly retroactive,<sup>86</sup> though noting that the Commission had yet to decide the issue.<sup>87</sup> The law judge found no retroactive effect in barring Clifton from associating with investment advisers, municipal securities dealers, or transfer agents.<sup>88</sup>

In the interim, we decided *John W. Lawton*, which held that collateral bars (*i.e.*, bars from associating in capacities other than those in which the respondent was associated at the time of the misconduct) imposed pursuant to § 925 of Dodd-Frank are not impermissibly retroactive as applied in follow-on proceedings addressing pre-Dodd Frank conduct.<sup>89</sup> We see no basis for confining our holding in *Lawton* to follow-on proceedings and believe that our reasoning applies with equal force in the context of original proceedings.<sup>90</sup>

The law judge's pre-*Lawton* ruling that barring Clifton from associating with a municipal advisor or NRSRO would be impermissibly retroactive is erroneous for the reasons we explained in *Lawton*.<sup>91</sup> The Dodd-Frank Act amended Exchange Act § 15(b)(6)(A) to authorize us to bar industry members from association with municipal advisors and NRSROs – bars that were not previously available under the securities laws. Although Congress enacted the Dodd-Frank amendment after

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<sup>84</sup> *Cf. Midas Sec., LLC*, Exchange Act Rel. No. 66200, 2012 WL 169138, at \*13 (Jan. 20, 2012) (stating that even if firm's president delegated line-supervision, he still retained a duty to follow up on that delegation) & nn.75-77 (citing cases).

<sup>85</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>86</sup> *Clifton*, 2011 WL 7444649, at \*21.

<sup>87</sup> *Id.* at 19.

<sup>88</sup> *Id.* at 21. Before the law judge, Clifton objected generally to the imposition of a collateral bar under Dodd-Frank but did not argue the issue of retroactivity.

<sup>89</sup> Investment Advisers Act Rel. No. 3513, 2012 WL 6208750, at \*10 (Dec. 13, 2012).

<sup>90</sup> Although the Division did not appeal the law judge's decision against imposing a bar from association with any municipal advisor or NRSRO, and neither party addressed that issue on appeal, we determined, on our own initiative, to review the sanctions imposed in this case pursuant to Rule of Practice 411(d). *Johnny Clifton*, Admin. Proc. File No. 3-14266, Order Granting Petition for Review and Scheduling Briefs (Jan. 3, 2012).

<sup>91</sup> *Lawton*, 2012 WL 6208750, at \*6-10.

Clifton committed his misconduct, we held in *Lawton* that imposing bars from associating with municipal advisors or NRSROs "are not impermissibly retroactive as applied to . . . proceedings addressing pre-Dodd-Frank conduct because such bars are prospective remedies whose purpose is to protect the investing public from future harm."<sup>92</sup>

In assessing the need for sanctions in the public interest, we consider, among other things, the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his conduct, and the likelihood that the respondent's occupation will present opportunities for future violations.<sup>93</sup> Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."<sup>94</sup> Based on these factors, we conclude that a bar from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO is warranted here.

Clifton's conduct was egregious and recurrent. He committed fraud through his material misrepresentations and omissions about the Osage project and through his actions to perpetuate the fraudulent scheme by concealing material, adverse information from sales representatives and ensuring that sales representatives withheld such information from prospective investors. That misconduct violated Securities Act §§ 17(a)(1), 17(a)(2), and 17(a)(3). As we have held, fraud is "especially serious and subject to the severest of sanctions."<sup>95</sup> In addition, Clifton failed to review materially false and misleading e-mails sent by Registered Representative No. 1, and failed to follow the procedures instituted for the supervision of sales representatives.

Clifton acted with a high degree of scienter. For instance, he knew that many of the statements he made during the December 23, 2009 conference call were wrong and that he omitted to disclose material facts. On one occasion, he knowingly sent information (*i.e.*, the hyperlink to the December 23, 2009 conference call) containing material misrepresentations and omissions to a sales representative for distribution to prospective investors. He instructed MPG Financial sales representatives Allen and Registered Representative No. 3 not to share updated material information with the other sales representatives. He encouraged Registered Representative No. 1 to have Wheeler invest in the Osage project when he knew, or must have known, that Registered Representative No. 1 was unaware of certain material adverse information, namely that the third well was a dry hole. After learning about the third well's dry hole on December 28, 2009, he accepted funds from three or investors without disclosing the dry hole to them.

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<sup>92</sup> *Id.* at \*8.

<sup>93</sup> *Scott B. Gann*, Exchange Act Rel. No. 59729, 2009 WL 938033, at \*4 & n.11 (Apr. 8, 2009) (citing *Steadman*, 603 F.2d at 1140), *aff'd per curiam*, *Gann v. SEC*, 361 F. App'x 556 (5th Cir. 2010) (unpublished).

<sup>94</sup> *David Henry Disraeli*, Exchange Act Rel. No. 570727, 2007 WL 4481515, at \*15 (Dec. 21, 2007), *aff'd*, 33 F. App'x 334 (D.C. Cir. 2008), *cert. denied*, 130 S.Ct. 1914 (2010).

<sup>95</sup> *Marshall E. Melton*, Advisers Act Rel. No. 2151, 56 SEC 695, 2003 WL 21729839, at \*9 (July 25, 2003).

We have stated that "[t]he proper functioning of the securities industry and markets depends on the integrity of industry participants and their commitment to transparent disclosure. Securities industry participation by persons with a history of fraudulent conduct is antithetical to the protection of investors."<sup>96</sup> Here, the pattern, self-serving nature, and egregiousness of Clifton's fraud demonstrate his unfitness to participate in the securities industry in any capacity. Indeed, the facts to which Clifton admitted at the hearing, including his admissions regarding the conduct underlying his 2007 settlement of a FINRA disciplinary action,<sup>97</sup> show a disturbing proclivity for fraudulent misrepresentations that transcends his current capacity.

In his petition for review, Clifton "admitted he made omissions and misrepresentations of material fact" during the December 23, 2009 conference call; admitted that "[t]he Division's Exhibits show a number of e-mails from two brokers [Registered Representative No. 1 and Registered Representative No. 2] that are misleading and omit material facts"; and "admitted he did not follow the procedures instituted for supervision of the brokers,"<sup>98</sup> Notwithstanding his willingness to make these admissions, which weighs in his favor in the consideration of appropriate sanctions,<sup>99</sup> Clifton attempts to minimize his misconduct by arguing that his failure to supervise violation was confined to "eight offending e-mails out of thousands."<sup>100</sup> This attempt shows that he does not fully understand the seriousness of his misconduct and how it violated the duties of a securities professional<sup>101</sup> "[F]ailure[] to recognize the wrongfulness of his conduct presents a significant risk that, given th[e] opportunity, he would commit further misconduct in the future."<sup>102</sup> "This risk is particularly significant here because opportunities for similar misconduct arise in each of the associational capacities covered by the collateral bar and [Clifton's] admitted conduct demonstrates fundamental and ongoing unfitness for any such association."<sup>103</sup> Clifton

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<sup>96</sup> *Lawton*, 2012 WL 6208750, at \*11.

<sup>97</sup> *See supra* notes 11-12 and accompanying text. Clifton tries to dilute those admissions by arguing that he "has never had a customer complaint prior to this action." Pet. for Review at 2. Even if true, we have repeatedly held that, while a respondent's relevant disciplinary history is an aggravating factor, the absence of one is not mitigating. *Cf. Siegel v. SEC*, 592 F.3d 147, 156-57 (D.C. Cir. 2010) (upholding Commission's refusal to consider as mitigating respondent's assertion that, among other things, he had no disciplinary history), *cert. denied*, 130 S.Ct. 3333 (2010); *Rooms v. SEC*, 444 F.2d 1208, 1214 (10th Cir. 2006) (holding that lack of disciplinary history is not a mitigating factor).

<sup>98</sup> *See supra* note 13.

<sup>99</sup> *See supra* note 93 and accompanying text. We have held that a respondent's failure to recognize the wrongfulness of his conduct presents "a significant risk that, given the opportunity, he would commit further misconduct in the future." *Lawton*, 2012 WL 6208750, at \*12 & n.64

<sup>100</sup> Clifton's Br. at 12.

<sup>101</sup> Even if he had been more emphatic in assuring future compliance or expressing remorse, we would have good reason to doubt his sincerity, particularly given his empty promise to FINRA, in his 2007 AWC, that he would "act fully above reproach in all of [his] business dealings to insure that no further disciplinary actions would be brought against him." Div. Ex. 58 at 7.

<sup>102</sup> *Lawton*, 2012 WL 6208750, at 12 & n.64 (quoting *Michael J. Markowski*, Exchange Act Rel. No. 44086, 55 SEC 21, 2001 WL 267660, at \*4 (Mar. 20, 2001), *pet. denied*, 2002 WL 1932001 (D.C. Cir. Apr. 25, 2002) (unpublished)).

<sup>103</sup> *Id.*, 2012 WL 6208750 at \*12.

currently is the owner and president of Wall & Company Securities, Inc., a registered broker-dealer, and at the hearing, he confirmed his intent to continue working in the securities industry.

Given the scope and severity of his misconduct, we believe that an appropriate sanction against Clifton should include a bar from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO. His repeated and egregious conduct evidences an unfitness to participate in the securities industry that goes beyond the professional capacity in which he was acting when he engaged in the misconduct underlying these proceedings.<sup>104</sup> Imposing a full collateral bar will protect the investing public from the likelihood that Clifton will commit future violations of the federal securities laws. A bar will also "have the salutary effect of deterring others from engaging in the same serious misconduct."<sup>105</sup> We therefore find that barring Clifton from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO serves the public interest and is remedial.

## **B. Cease-and-desist order**

Securities Act § 8A and Exchange Act § 21C authorize us to impose a cease-and-desist order on any person who is violating, has violated, or is about to violate any provision of those Acts.<sup>106</sup> In determining whether a cease-and-desist order is appropriate, we consider whether a reasonable likelihood of future violations exists, the seriousness of the violations, the isolated or recurrent nature of the violations, the respondent's state of mind in committing the violations, the respondent's recognition of the wrongful nature of their conduct, and the recency of the violations.<sup>107</sup> Absent evidence to the contrary, a single past violation ordinarily suffices to establish a risk of future violations.<sup>108</sup>

Clifton engaged in egregious and repetitive misconduct. He made numerous material misrepresentations and omissions to prospective investors. Given the seriousness of this misconduct and his failure to appreciate his responsibilities as a securities professional, we find that the record presents sufficient risk that Clifton will commit future violations to warrant our

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<sup>104</sup> See, e.g., *Gary M. Kornman*, Exchange Act Rel. No. 59403, 2009 WL 367635, at \*7 (Feb. 13, 2009) (noting that "the importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business") (citing cases), *aff'd*, 592 F.3d 173 (D.C. Cir. 2010).

<sup>105</sup> *Andrew P. Gonchar*, Exchange Act Rel. No. 60506, 2009 WL 2488067, at \*13 (Aug. 14, 2009), *aff'd*, 409 F. App'x 396 (2d Cir. 2010).

<sup>106</sup> 15 U.S.C. §§ 77h-1, 78u-3.

<sup>107</sup> *KPMG Peat Marwick LLP*, Exchange Act Rel. No. 43862, 54 SEC 1135, 2001 WL 47245, at \*23 (Jan. 19, 2001), *aff'd*, 289 F.3d 109 (D.C. Cir. 2002). Such a showing is "significantly less than" that required for an injunction. *Id.* at \*26.

<sup>108</sup> *Id.* at \*24. Clifton does not challenge the imposition of the cease-and-desist order. See *supra* note 13.

imposition of an order requiring him to cease and desist from committing or causing any violations or future violations of Securities Act § 17(a).<sup>109</sup>

### C. Civil money penalty

Securities Act § 20(d) and Exchange Act § 21B authorize us to impose a civil money penalty for misconduct, including willfully violating any provision of the federal securities laws or failing reasonably to supervise another person who has committed such violations.<sup>110</sup> In assessing the civil money penalty required in the public interest, we consider: whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; harm caused to others; the extent to which any person was unjustly enriched; prior violations; the need for deterrence; and such other matters as justice may require. Securities Act § 20(d) and Exchange Act § 21B specify a three-tier system identifying the maximum amount of a civil money penalty. Clifton's conduct occurred between April 2009 and April 2010. During that time, for each "act or omission" by a natural person, the maximum amount in the first tier was \$7,500; in the second tier, \$75,000; and in the third tier, \$150,000.<sup>111</sup> For a second-tier penalty, the act or omission must have "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement."<sup>112</sup> For a third-tier penalty, the act or omission must meet those requirements and also must have directly or indirectly resulted in (i) substantial losses, (ii) created a significant risk of substantial losses to other persons, or (iii) resulted in substantial pecuniary gain to the person who committed the act or omission."<sup>113</sup>

The Division asks us to impose one maximum third-tier penalty. Clifton does not dispute that a penalty is warranted but argues that it should only be a second-tier penalty because the December 23, 2009 conference call did not result in any investor losses and because his misconduct did not result in a "substantial" pecuniary gain.<sup>114</sup>

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<sup>109</sup> A cease-and-desist order is not statutorily authorized for a failure to supervise violation. *See Arthur James Huff*, Exchange Act Rel. No. 29017, 50 SEC 524, 1991 WL 296561, at \*5 ("[T]he statute . . . clearly distinguishes between violations and supervisory deficiencies. We accordingly conclude that . . . deficient supervision was not a 'violation' within the meaning of Section 15(b)(4)(E).").

<sup>110</sup> 15 U.S.C. §§ 77t(d), 78u-2.

<sup>111</sup> 17 C.F.R. § 201.1004 (setting forth maximum penalty amounts for violations occurring after March 3, 2009). The figures used by the Division and administrative law judge erroneously reflected the adjustment for violations occurring from February 15, 2005 to March 3, 2009. *See* 17 C.F.R. § 201.1003. Since Clifton's misconduct occurred between April 2009 and April 2010, the adjusted maximum penalty amounts in 17 C.F.R. § 201.1004 govern here.

<sup>112</sup> 15 U.S.C. §§ 77t(d), 78u-2.

<sup>113</sup> 15 U.S.C. §§ 77t(d), 78u-2.

<sup>114</sup> As previously stated, Clifton earned an "override" of \$18,750 based on roughly \$500,000 worth of units sold.

The record is, for the most part, silent with respect to the amount of losses investors actually incurred in the Osage product.<sup>115</sup> And the Division does not argue that Clifton's misconduct resulted in a "substantial" pecuniary gain. We find, however, that a third-tier penalty is appropriate because Clifton's misconduct (as more fully discussed, above) created a significant risk of substantial losses to investors. Through the stale PPM and Clifton's fraudulent misrepresentations and omissions, Clifton and those he supervised sought to raise as much as \$1,068,750, and actually raised at least \$500,000, in investor funds for the Osage project. Those efforts continued after Clifton conducted the December 23 conference call, after he forwarded a hyperlink to a recording of that call to a sales representative for distribution to prospective investors, and after he instructed two sales representatives to withhold adverse information about the wells from other sales representatives selling LP interests in the project. And even though investors later received a refund of twenty-five percent of their investment after the project was shut down, that refund does not negate the significant risk of substantial losses that Clifton's violations created.

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<sup>115</sup> Though twenty-two investors acquired interests in the project, only two testified about their losses. *See supra note 36.* No summary exhibit or other proof was introduced with respect to the losses of the other investors.

Considering the events at issue, we impose a single, maximum third-tier civil money penalty of \$150,000. A single penalty at the maximum end of the third tier is necessary to deter Clifton from future misconduct and will have an additional remedial effect of deterring others from engaging in similar misconduct.<sup>116</sup>

An appropriate order will issue.<sup>117</sup>

By the Commission (Chair WHITE and Commissioners WALTER and AGUILAR);  
Commissioners PAREDES and GALLAGHER, concurring in part and dissenting with respect to the  
bar from association with municipal advisors and nationally recognized statistical rating organizations.

Elizabeth M. Murphy  
Secretary

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<sup>116</sup> We believe that the conduct here could also support a total second-tier penalty of \$150,000 based on two violations (the Securities Act § 17(a) and Exchange Act § 15(b) violations) at the maximum second-tier amount of \$75,000 each.

Clifton claims that he is financially unable to pay a civil penalty and submits a sworn financial statement in support of this claim. This argument is waived because he did not raise it before the law judge. *See Disraeli*, 2007 WL 4481515, at \*19 (holding that respondent waived inability to pay by failing to present evidence to the law judge, but instead presenting it to the Commission for the first time on appeal; further stating that evidence regarding a newly-claimed inability to pay will be admitted only if it comports with the requirements of Rule of Practice 452, *i.e.*, "that such evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). In any event, under Exchange Act § 21B(c), the ability to pay may be considered, but it is only one factor. Considering it is also discretionary, and where, as here, the conduct is egregious, it may be disregarded. *See, e.g., Gregory O. Trautman*, Exchange Act Rel. No. 61167A, 2009 WL 6761741, at \*24 (Dec. 15, 2009).

Clifton also argues that "[h]e has a family including a wife and children," and "[h]e will not be able to take care of his family and pay the hefty penalty assessed over and beyond his removal from the industry." Pet. for Review at 3. How a respondent collaterally suffers as a result of the violation, or from the disciplinary proceeding that followed (*e.g.*, that he lost money, the amount of time he was out of the industry, or the impact the disciplinary proceeding had on his reputation, career, or finances), is not a mitigating factor. *See, e.g., Janet Gurley Katz*, Exchange Act Rel. No. 61449, 2010 WL 358737, at \*26 & n.66 (Feb. 1, 2010), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011); *Ashton Noshir Gowadia*, Exchange Act Rel. No. 40410, 53 SEC 786, 1998 WL 564575, at \*4 (Sept. 8, 1998).

<sup>117</sup> We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Rel. No. 9417 / July 12, 2013

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 69982 / July 12, 2013

Admin. Proc. File No. 3-14266

In the Matter of  
  
JOHNNY CLIFTON  
c/o Pace & Pace, LLP  
Meadows Building, Suite 940  
5646 Milton Street  
Dallas, TX 75206

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's Opinion issued this day, it is

ORDERED that Johnny Clifton be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and it is further

ORDERED that Johnny Clifton cease and desist from committing or causing any violations or future violations of § 17(a) of the Securities Act of 1933; and it is further

ORDERED that Johnny Clifton pay a civil money penalty in the amount of \$150,000.

Payment of the civil money penalty shall be: (i) made by U.S. postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, 100 F. Street NE, Mail Stop 6042, Washington, DC 20549; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to Toby M. Galloway and D. Dee Raibourn III, Division of Enforcement, U.S. Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Unit 18, Fort Worth, Texas 76102.

By the Commission.

Elizabeth M. Murphy  
Secretary