

COMMONWEALTH OF KENTUCKY  
PUBLIC PROTECTION CABINET  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
AGENCY CASE NO. 2010-AH-011  
ADMINISTRATIVE ACTION NO. 10-PPC-0102

DEPARTMENT OF FINANCIAL INSTITUTIONS

COMPLAINANT

v.

BERRY RESOURCES, INC.  
BERRY PROSPECT #18  
BERRY PROSPECT #19  
RALPH O. BERRY III, MARGARET BERRY and  
ANN DUNNEGAN

RESPONDENTS

\* \* \* \* \*

**FINAL ORDER**

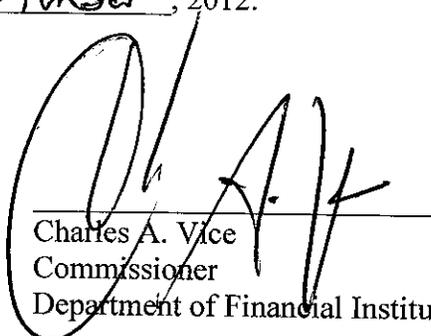
A hearing was held on this case on three separate days: December 9, 2010, May 3, 2011, and May 25, 2011. The parties' counsel submitted post-hearing briefs and the hearing officer, Hon. Michael Head, entered a Recommended Order on July 27, 2012. The parties did not file exceptions to the Recommended Order.

Having considered the entire record in the above-entitled matter and being otherwise sufficiently advised, **IT IS HEREBY ORDERED**, pursuant to KRS 13B.120(2), that the Recommended Order attached hereto is incorporated by reference as if fully set out herein and is accepted and adopted as my Final Order.

**NOTICE OF APPEAL RIGHTS**

Pursuant to KRS 13B.140, you are hereby notified that you have the right to appeal this Final Order of the Commissioner. If you choose to appeal, you must file a petition in the Franklin Circuit Court within thirty (30) days after the Final Order is mailed or delivered by personal service.

**SO ORDERED** on this the 13<sup>th</sup> day of September, 2012.

  
\_\_\_\_\_  
Charles A. Vice  
Commissioner  
Department of Financial Institutions

**CERTIFICATE OF SERVICE**

I hereby certify that on the 14<sup>th</sup> day of Sept., 2012, a copy of this Final Order was served as follows:

By Messenger Mail to:

Hon. Michael Head  
Division of Administrative Hearings  
Office of the Attorney General  
1024 Capital Center Drive, Suite 200  
Frankfort, Kentucky 40601

by certified mail, postage prepaid, to:

Hunter Durham  
Durham & Zornes  
PO Box 100  
Columbia, KY 42729-0100  
*Respondents' Counsel*

By hand delivery to:

Hon. Simon Berry  
Department of Financial Institutions  
1025 Capital Center Dr  
Frankfort, KY 40601  
*Complainant's Counsel*

  
Stephanie Dawson  
Stephanie Dawson  
Department of Financial Institutions

**COMMONWEALTH OF KENTUCKY  
PUBLIC PROTECTION CABINET  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
AGENCY CASE NO. 2010-AH-011  
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DEPARTMENT OF FINANCIAL INSTITUTIONS

COMPLAINANT

vs.

**FINDINGS OF FACT, CONCLUSIONS OF LAW  
AND RECOMMENDED ORDER**

BERRY RESOURCES, INC.  
BERRY PROSPECT # 18  
BERRY PROSPECT # 19  
RALPH O. BERRY, III, MARGARET BERRY, and  
ANN DUNNEGAN

RESPONDENT

\* \* \* \* \*

A hearing was held in this case on three separate days and at three separate locations: on December 9, 2010, at the offices of the Department of Financial Institutions (“the Department”), 1025 Capital Center Dr., Frankfort, KY; on May 3, 2011, at the Bowling Green District Highway office, 900 Morgantown Road, Bowling Green, Kentucky; and on May 25, 2011, at the offices of Scott Bachert, 234 E. 10<sup>th</sup> St., Bowling Green, Kentucky. On all days of the hearing, Simon Berry appeared as counsel for the Department. On each day of the hearing, the Respondents, Ralph O. Berry III, Margaret Berry, and Ann Dunnegan appeared with counsel, Hunter Durham. Michael Head, Hearing Officer and Assistant Attorney General, Administrative Hearings Branch, Office of the Attorney General, conducted the hearing. The hearing was recorded by court reporter.

The Department charges the Respondents with selling unregistered securities that were neither exempt nor “covered” securities under Kentucky’s Securities Act. The Respondents claim their securities were exempt from registration under federal law. The Department also

charges the Respondents with failing to register as agents or dealer-brokers; with making material misrepresentations and omissions when soliciting investors; and with violating prior orders of the Department. The Respondents did not answer these additional charges. The issue is the propriety of the charges and the penalties sought by the Department.

The Department called five witnesses to testify: John Armondo Reggiannini, investor; Marni Rock Gibson, Department examiner; Margaret Mary Berry, Respondent; Ralph O. Berry, Respondent; and Ann Dunnegan, Respondent. The Respondents called two witnesses: Margaret Berry, Respondent; and Ann Dunnegan, Respondent. The parties offered one joint exhibit, the Department offered 34 exhibits, and the Respondent offered one exhibit, all of which were introduced into the record and considered by the Hearing Officer in making this decision.

After considering the record as a whole, and based on a preponderance of the evidence, and for the reasons more particularly set forth in the Findings of Fact and Conclusions of Law below, the Hearing Officer RECOMMENDS that the Department of Financial Institutions issue a final order as follows: order the Respondents, Ralph O. Berry III, Margaret Berry, and Ann Dunnegan, to cease and desist from offering or selling securities, and to pay fines, attorney fees, and costs as more particularly set forth below.

### **FINDINGS OF FACT**

#### **Berry Resources, Inc., Berry Prospect #18 and Berry Prospect #19**

1. The charges in this case arose because the Department of Financial Institutions reviewed sales by the Respondent, Berry Resources, Inc., ("Berry Resources") of interests in oil and gas leases.

2. Berry Resources is a Kentucky Corporation. The Respondent, Ralph O. Berry III, was the sole owner and president of Berry Resources. He also was described in the proof as an employee of the corporation. The Respondents did not object to this characterization.

3. At all relevant times, Respondents Ralph O. Berry III, Margaret Berry and Ann Dunnegan were not registered with the Department of Financial Institutions as securities agents or broker-dealers authorized to sell securities in Kentucky. *See* Hearing Exhibit 1 (“HE 1”), stipulated finding #2.

4. In 2006 Berry Resources leased the right to drill oil and gas wells on four properties in Pickett County, Tennessee. Each of the four properties had a different owner from which Berry Resources leased its rights: Roger Wright, Jimmy King, David Howard, and Mike White. Transcript of Hearing held 5/3/11, p. 45, 46, and 51 (“5/3/11 TH 45, 46, and 51”).

5. Mr. Berry formed two Kentucky limited partnerships, Berry Prospect #18 and Berry Prospect #19, and designated Berry Resources as the general partner of each. HE 1, stipulated finding #6.

6. In order to solicit investors to develop oil and gas wells on the leased properties, Berry Resources assigned all of its lease interests in the King and Wright properties to Berry Prospect #18 and all of its lease interests in the Howard and White properties to Berry Prospect #19.

7. Berry Resources then subdivided 100% of the working interest and 70% of the net revenue interest in two wells on the Berry Prospect #18 properties into 30 units, and it did the same for two wells on the Berry Prospect #19 properties. HE 34-4 and HE 9-4; and 5/3/11 TH 59.

8. The “working interest” entitled the interest holder to conduct drilling and production operations on the leased property and to receive the net revenues after payment of drilling and production costs. *See Respondents’ Amended Post Hearing Brief*, p. 2.
9. Thus, the two limited partnerships, Berry Prospect #18 and Berry Prospect #19 consisted of 30 units, each unit being 3.33% of the working interest owned by the respective limited partnership and 2.33% of the net revenue from the two wells drilled by the respective limited partnership. *See, e.g.*, HE 23-2 and HE 2-2.
10. Each subscription agreement and private placement memorandum for Berry Prospect #18 and Berry Prospect #19 refers to the units as securities. *See* HE 2, HE 9, HE 23, HE 29, and HE 34.
11. Each unit in Berry Prospect #18 and Berry Prospect #19 constituted a fractional undivided interest in oil and gas rights.
12. The units in Berry Prospect #18 and Berry Prospect #19 that were offered to investors were not registered as securities under federal law or state law. *See* HE 34, cover page, and HE 9, cover page.
13. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 stated that the units were being offered to investors pursuant to Rule 506 of Regulation D, which if true, would exempt the securities from the securities registration requirements. HE 34, p. 12 and HE 9, p. 12.
14. At all relevant times, Ralph O. Berry III, Margaret Berry, Ann Dunnegan, and Terry Coltharp were employees of Berry Resources during the time period that they solicited

investors to purchase limited partnerships in Berry Prospect #18 and Berry Prospect #19. HE 1, stipulated finding #1.

15. Ralph O. Berry III, Margaret Berry, Ann Dunnegan, and Terry Coltharp solicited investors to purchase units in Berry Prospect #18 and Berry Prospect #19 in order to raise money to drill and test wells on the four properties leased by Berry Resources. 12/9/10 TH 219 and 232.

16. From January 2007 through June 2007, Berry Resources sold units in Berry Prospect #18 and Berry Prospect #19 to various investors. HE 1, stipulation #7.

17. Berry Resources eventually sold 20½ units of Berry Prospect #18. HE 31; and 5/3/11 TH 189.

#### **Solicitation of Investors from Lead Lists**

18. Berry Resources purchased lead lists from third parties. These lead lists contained names and contact information of individuals whom the third party had identified as potential investors in oil and gas projects. These lead lists provided the names and contact information of the potential investors that Berry Resources employees contacted to invest in Berry Prospect #18 and Berry Prospect #19. 5/3/11 TH 113 and 12/9/10 TH 217.

19. Neither Berry Resources nor its employees had any pre-existing relationship with the potential investors on the lead lists. 5/3/11 TH 118. None of these potential investors had solicited a call from Berry Resources, and none had contacted anyone about Berry Prospect #18 and Berry Prospect #19. 12/9/10 TH 219 and 247.

20. Some of Berry Resources' employees, referred to in the proof as surveyors, phoned potential investors to determine their interest and qualifications to invest in Berry Prospect #18 and

Berry Prospect #19. 12/9/10 TH 216–17 and 219. Because of the lack of any prior relationship, these initial contacts with potential investors were “cold calls.” 12/9/10 TH 215 and 219.

21. A few days after the initial call, another Berry Resources employee called qualified potential investors and attempted to interest them in purchasing a unit in Berry Prospect #18 and Berry Prospect #19. *See* HE 4; and 12/9/10 TH 235–39.

22. Ralph Berry was personally involved in talking with potential investors, providing them with information, answering their questions, and generally, soliciting them to purchase units of Berry Prospect #18 and Berry Prospect #19. 5/3/11 TH 127.

23. While employed by Berry Resources, Ann Dunnegan solicited potential investors in Berry Prospect #18 and Berry Prospect #19. 5/3/11 TH 126.

#### **Sale of Security to John Reggiannini**

24. In January 2007 Terry Coltharp<sup>1</sup> called John Reggiannini to solicit him about investing in Berry Prospect #18 and Berry Prospect #19. Prior to that call, neither Coltharp nor anyone else at Berry Resources had contact with Reggiannini. 12/9/10 TH 247.

25. Following up the Coltharp call, Margaret Berry called John Reggiannini multiple times on several days, soliciting him to make an investment in Berry Prospect #18 and Berry Prospect #19. Margaret Berry spoke to John Reggiannini on January 10, 2007, January 17, 2007, February 8, 2007, and April 2, 2007. HE 8; and 12/9/10 TH 228.

26. Ralph Berry also spoke with John Reggiannini about Berry Prospect #19 prior to Reggiannini investing in the project. 5/3/11 TH 127.

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<sup>1</sup> In the testimony Coltharp is called a “surveyor.”

27. Neither Ralph Berry nor Margaret Berry had ever met or spoke with John Reggiannini prior to January 10, 2007. 12/9/10 TH 49 and 235.

28. On June 15, 2007, John Reggiannini purchased one unit in Berry Prospect #19 for \$17,000. Eleven thousand dollars of that price was to be used for drilling and testing, and \$6000 was for well completion costs. HE 2 and HE 1, stipulation #12.

29. As commission for the sale to John Reggiannini, Berry Resources paid Margaret Berry 15% of the \$17,000 that he invested in Berry Prospect #19. 12/9/10 TH 248-49.

30. Berry Resources eventually sold 22 units of Berry Prospect #19. HE 20; and 5/3/11 TH 185.

#### **Sale of Securities to Robert Wagner**

31. Ann Dunnegan contacted Mr. Wagner and offered him one unit in Berry Prospect #19. 5/3/11 TH 176.

32. On March 6, 2007, Robert Wagner purchased one unit in Berry Prospect #19 for \$17,000. HE 29.

33. Ann Dunnegan then contacted Robert Wagner and told him an investor in Berry Prospect #18 had "backed out," and she offered him the interest in Berry Prospect #18. 5/3/11 TH 176.

34. On April 15, 2007, Robert Wagner, through his company, OPM Investment Properties, Inc., purchased one unit in Berry Prospect #18 for \$15,000. HE 23.

35. Ann Dunnegan spoke to Robert Wagner about Berry Prospect #18 and Berry Prospect #19 knowing that if Wagner purchased an interest in either limited partnership, she would receive a bonus from Berry Resources. 5/3/11 TH 190-91.

36. Berry Resources paid Ann Dunnegan a bonus that was calculated as a percentage of the amount Robert Wagner paid for his unit in Berry Prospect #18 and his unit in Berry Prospect #19. 5/3/11 TH 126 and 178.

#### **Berry Resources' Form D Filings**

37. On March 30, 2007, Berry Resources filed a Form D with the Department for Berry Prospect #18. The filing stated that the securities of Berry Prospect #18 were "covered securities" under Section 18(b)(4)(D) of the Securities Act of 1933. HE 1, stipulation #3.

38. On April 2, 2007, Berry Resources filed a Form D with the Department for Berry Prospect #19. The Form D stated that the securities of Berry Prospect #19 were "covered securities" under Section 18(b)(4)(D) of the Securities Act of 1933. HE 1, stipulation #4.

#### **Material Misstatements of Fact and Omissions**

39. Berry Resources mailed a private placement memorandum for Berry Prospect #18 and for Berry Prospect #19 to individuals soliciting their investment in each project. Monies from the purchase of units in each project would be used to develop oil and gas wells. 5/3/11 TH 36 and 195.

#### **Concerning the Drilling Operations**

40. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 do not disclose the dollar amount of the turnkey price to be paid pursuant to the turnkey agreement that is included with each private placement memorandum as "Exhibit B." See HE 9 and 34.

41. A company named Tenn-Tex operated the natural gas transmission pipe that serviced the Berry Prospect #18 and for Berry Prospect #19 wells. After Tenn-Tex went out of

business, Berry Resources could not sell gas extracted from the wells in Berry Prospect #18 and Berry Prospect #19 because all of the properties involved were landlocked and therefore did not have the means of transporting and selling the gas. 5/3/11 TH 32–33.

42. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 do not disclose that if Tenn-Tex's pipeline was shut down or unavailable then gas from the wells could not be transported and sold. HE 9 and 34; and 5/25/11 TH 113–16.

43. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 state that 32 of the 45 wells previously drilled by Berry Resources were either a gas producer, an oil producer, or a gas and oil producer. HE 9 and 34, pp. 25–27.

44. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 do not provide an explanation of why the wells listed in the well history on pages 25 and 26 are labeled as oil and/or gas producers. HE 9 and 34; and 5/25/11 TH 10–14.

45. The limited partnership agreements included with the private placement memoranda for Berry Prospect #18 and Berry Prospect #19 state that Berry Resources will perform all acts on behalf of each partnership. HE 9 and 34, p. 70.

46. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 do not disclose any financial information about Berry Resources, Inc. HE 9 and 34; and 5/3/11 TH 103–04.

47. The private placement memoranda for Berry Prospect #18 and for Berry Prospect #19 do not disclose whether investors in prior Berry Resources' oil and gas projects received payments from the sale of oil and gas equal to the amount of money the investors paid for their unit in the project. 5/25/11 TH 18–27.

48. Berry Resources gave potential investors in Berry Prospect #18 and for Berry Prospect #19 a brochure that referred to a certificate naming Ralph Berry as the 2003 businessman of the year. HE 32. The 2003 businessman of the year designation was not exclusive to Ralph Berry. 5/25 TH 53–56.

Concerning Disclosure of Past Orders

49. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 disclosed the following: “2002 Kentucky: Program Manager (Berry Resources, Inc.), the officers in various individuals were the subject of an administrative complaint filed by the Kentucky Division of Securities related to the offer and sale of securities . . . .” HE 9-29 and HE 34-29. The disclosure also states, “There were no charges of fraud or misrepresentation . . . .” *Id.*

50. In fact, the 2002 Kentucky Administrative Complaint against Berry Resources, Inc., contains charges of “misrepresentation”: the 2002 complaint charges a violation of KRS 292.320(1)(b), which states, “It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly, to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, not misleading.” HE 26.

51. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 do not disclose any actions by the Pennsylvania Securities Commission against Respondent, Ralph Berry.

52. On June 25, 1997, the Pennsylvania Securities Commission entered a summary order to cease and desist against Respondent, Ralph Berry. HE 25 and 5/3/11 TH 144.

53. The failure to disclose this Pennsylvania order in the private placement memoranda is a material omission.

54. During the period of time that Margaret Berry solicited John Reggiannini to invest in Berry Prospect #18 and Berry Prospect #19, he told her numerous times that he “didn't want to deal with anybody that had any kinds of issues.” 12/9/10 TH 91. Margaret Berry assured him that Berry Resources and Ralph Berry “were clean as can be; that they had no issues against them; that they had never had an issue and that they were totally clean.” *Id.* Margaret Berry did not disclose to Mr. Reggiannini the Pennsylvania Securities Commission’s action against Ralph Berry. *Id.*

55. Failing to tell Mr. Reggiannini about the June 25, 1997, Pennsylvania Securities Commission’s cease and desist order against Ralph Berry is a material omission.

56. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 disclosed the following: “2005 Indiana: The Indiana Securities Commission filed a cease and desist complaint as a result of an alleged sale in Indiana in a program in 2002. . .” HE 9-30 and HE 34-30. The disclosure also states, “There were no allegations of any fraud or misrepresentation in this matter.” *Id.*

57. This is a misstatement in the private placement memoranda because on January 4, 2006, the Indiana Securities Division, Berry Resources, Inc., and Respondent, Ralph Berry, entered into a Consent Agreement, which states, “The Division alleges that Respondents (which include Berry Resources, Inc., and Ralph O. Berry III), directly or indirectly, made material misrepresentations and/or omissions of facts in connection with the offer and/or sale of securities in the State of Indiana, in violation of Ind. Code § 23-2-1-12.” HE 27-2.

58. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 disclosed the following: “2006 The Kentucky Division of Securities issued an administrative complaint against the Program Manager (Berry Resources, Inc.) and Ralph Berry alleging that certain provisions of a previous order had not be (sic) complied with by the parties.” HE 9-30 and HE 34-30. The disclosure also states, “There were no allegations of any fraud or misrepresentation in this matter . . . .” *Id.*

59. This is a misstatement in the private placement memoranda because on or about September 15, 2006, Berry Resources, Inc., the Respondent herein, Ralph Berry, and the Office of Financial Institutions’ Division of Securities entered into a Settlement Agreement, which states, “the original Complaint and the Amended Complaint both contained allegations of sales of interests in oil and gas well exploration programs in violation of KRS Chapter 292, . . . and that such sales were made using offering materials which failed to contain material facts or misstated facts essential to the investment decision . . . .” HE 28, Settlement Agreement, p. 1. The Settlement Agreement also required Berry Resources, Inc., and the Respondent herein, Ralph Berry, to pay a fine totaling \$5000. *Id.* at p. 2.

60. The private placement memoranda for Berry Prospect #18 and Berry Prospect #19 did not reveal that the owner of the only gas line that could receive any natural gas captured by the wells in each project had gone bankrupt and the gas line could not be used to transport and sell the gas from the two limited partnerships’ wells. *See* 5/25/11 TH 116. This is a material omission from each private placement memorandum.

61. Each of the misstatements and omissions from the private placement memoranda for Berry Prospect #18 and Berry Prospect #19 described above is material because an investor

would want to know the truth about these matters in deciding whether to invest in the projects described.

62. The Respondents offered no explanation for the material misstatements and omissions from the private placement memoranda. In the absence of any explanation whatsoever, it is proper to infer that Respondents' motives were improper and, therefore, that the misstatements and omissions were made with fraudulent and deceitful intent.

#### **Respondents' Contacts with Kentucky**

63. Margaret Berry's, Ann Dunnegan's, and Ralph Berry's phone calls to John Regiannini were made from Berry Resources' office in Bowling Green, Kentucky. *See* 12/9/10 TH 245.

64. Investors in Berry Prospect #18 and Berry Prospect #19 sent their checks to Berry Resources' office in Kentucky.

65. Berry Resources deposited the checks from investors in Berry Prospect #18 and Berry Prospect #19 in an account of a bank located in Kentucky. 12/9/10 TH 269.

### **CONCLUSIONS OF LAW**

#### **Choice of Law**

1. The Respondents argue that the Department "attempts to have Kentucky law applied to a Massachusetts resident." Amended Post Hearing Brief, p. 19. Instead, the Respondents argue that "Massachusetts law should govern the matter of agent registration as it (Massachusetts law?) provides for offerings under regulation D are (*sic*) not considered agents by definition." *Id.* at p. 21.

2. The only Massachusetts resident among the participants in this matter is, John Reggiannini. He was the target of the Respondents' solicitations.
3. Respondents' arguments are not easily discerned. While it is true that John Reggiannini, a target of the Respondents' solicitation, was a Massachusetts resident, the Respondents provide no legal citation or rationale for using Massachusetts law to decide whether Respondents' securities should have been registered. The Respondents address no choice of law or conflicts/minimum contacts issues.
4. The facts support application of Kentucky law. The Respondents solicited a Massachusetts resident from within Kentucky. The Respondents are Kentucky residents and Kentucky corporations and limited partnerships. Monies from sales of the unregistered securities involved in this case were deposited in a Kentucky bank account.
5. Kentucky's security registration statute, by its express terms, applies to persons who "offer or sell any [unregistered] security in this state." KRS 292.340. Obviously, this law can apply to people who offer or sell unregistered securities from within this state.
6. For all these reasons, the Respondents subjected themselves to Kentucky law. They may also have subjected themselves to Massachusetts law by soliciting and selling to a Massachusetts resident, but that would not prevent Kentucky from also applying its law to the transaction.
7. Thus, the Respondents' argument that Kentucky law does not apply in this case is rejected.

## **General Law**

8. Pursuant to KRS 292.500, the Department of Financial Institutions is responsible for administering the provisions of KRS Chapter 292, the Securities/Blue Sky Law (“the Act”).
9. The administrative complaint and penalties sought, as well as the hearing conducted herein, are authorized by KRS 292.420, KRS 292.500 and 808 KAR 10:225.
10. Pursuant to KRS 292.420, the Department’s Commissioner “shall have the authority . . . to consider and determine whether any proposed sale, transaction, issue, or security is entitled to an exemption or an exception from a definition” under KRS Chapter 292.
11. Pursuant to 808 KAR 10:225 Sec. 2(5), the administrative hearing in this case was held pursuant to the provisions of KRS Chapter 13B.
12. Pursuant to KRS 13B.090(7), the Department of Financial Institutions has the burden to prove, by a preponderance of the evidence, the propriety of the charges and penalties it seeks.
13. Pursuant to KRS 13B.090(7), the Respondents have the burden to prove their affirmative defenses.

### **Count I: Failure to Register Securities**

#### Burden of Proof

14. In this case, brought by the Department for a violation of Kentucky’s registration requirements, the Department must establish only (1) that the defendant directly or indirectly sold or offered to sell securities; and (2) that no registration statement was in effect for the subject securities.

15. “Once a prima facie case has been made [that the defendant sold or offered securities that were not registered], the defendant bears the burden of proving the applicability of an exemption.” *S.E.C. v. Cavanagh*, 445 F.3d 105, 111 (2d Cir. 2006) (citations omitted).

Kentucky Security Registration Law

16. Kentucky law requires registration of securities offered or sold in this state unless an exemption applies:

It is unlawful for any person to offer or sell any security in this state, unless the security is registered under this chapter, or the security or transaction is exempt under this chapter, or the security is a covered security.

KRS 292.340.

17. Pursuant to KRS 292.310(19), ““Security” means any . . . fractional undivided interest in oil, gas, or other mineral rights . . . .”

18. Based on the findings and conclusions above and the parties stipulations, each unit in Berry Prospect #18 and Berry Prospect #19 constituted a fractional undivided interest in oil and gas rights, that is, “securities” as that term is defined in KRS 292.310(19). *See* HE 1, stipulation #13.

19. The parties agree the Berry Prospect securities were unregistered. The Respondents, instead, argue that these securities were exempt from registration.

Respondents’ Affirmative Defense:  
Registration Exemption Under Regulation D

20. The Respondents in their Amended Post Hearing Brief defend against the lack of registration charge on the grounds the Berry Prospect securities were exempt from registration. Explaining the grounds in their Post Hearing Brief, the Respondents state:

The the (*sic*) method of offering by Berry Resources, Inc. complies with the Securities Exchange Act of 1933, as amended, (SEC) under its Regulation D, Section 506, and such other sections which relate to other exemptions as well as the 506 Section. Included in other exemptions are (based on the private placement exemption under the Securities Exchange Act of 1933, as amended, Section (4) (2)) a private placement exemption. See PPM # 18 and # 19, cover page, “who can purchase section” and risk factors and disclaimers and Definitions. The purpose of the exemption has a double test: 1. Is the investor an Accredited Investor and 2. Did the issuer comply with the basic terms of the exemption to become a ‘covered security’ either at the time of the offering or at the termination of the offering. The term ‘covered security’ actually means that the security is protected by the exemption.

Respondents’ Amended Post Hearing Brief and Recommended Order, p. 11.

21. Thus the Respondents claim they were not required to register the Berry Prospect securities because they were “covered securities” and entitled to a “private placement exemption.” These defenses are interrelated.

22. The Kentucky statutory definition of “covered security” merely points to the definition of “covered security” in a federal statute, and in rules and regulations promulgated under that provision:

“Covered security” means any security that is or upon completion of the transaction will be a covered security under Section 18(b) of the Securities Act of 1933, 15 U.S.C. § 77r(b), or rules or regulations promulgated thereunder.

KRS 292.310(6).

23. 15 U.S.C. § 77r(b) defines several circumstances that create a “covered security.” Pertinently, where a security transaction conforms to SEC rules or regulations concerning “non-public” offerings promulgated under 15 U.S.C. § 77d(2)<sup>2</sup>, the securities involved are

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<sup>2</sup> 15 U.S.C. § 77d(2) lists several transactions exempted from federal registration requirements, including security “transactions by an issuer not involving any public offering.”

“covered securities.”<sup>3</sup> Hence the interrelation of exemptions for covered securities and for security transactions not involving any public offering.

24. The Commission has promulgated regulations that set requirements and limitations for non-public security transactions and that impose filing requirements. *See* 17 C.F.R Chapter II, Part 230, Regulation D.

25. The Respondents rely on the exemption granted in 17 C.F.R. § 230.506(a), which deems those “offers and sales of securities by an issuer” that meet certain regulatory conditions to be “transactions not involving any public offering.”

26. Respondents argue they satisfied these conditions when they filed with the Department a federal Form D for each of the Berry Prospect securities. For this reason, the Respondents argue, the Berry Prospect securities were “covered securities” exempt from the registration requirement in KRS 292.340.

#### Limitation on Regulation D Exemption

27. In opposition, the Department points to 17 C.F.R. § 230.506(b)(1), which requires compliance with 17 C.F.R. § 230.502.<sup>4</sup> The Department argues the Respondents violated the 17 C.F.R. § 230.502 prohibition against using “any form of general solicitation or general advertising.”<sup>5</sup>

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<sup>3</sup> The federal definition of “covered security” in 15 U.S.C. § 77r(b)(4)(D) includes the following:

(b) Covered securities. For purposes of this section, the following are covered securities: . . .

(4) Exemption in connection with certain exempt offerings. A security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to . . .

(D) Commission rules or regulations issued under section 77d(2) of this title. . . .

<sup>4</sup> 17 C.F.R. § 230.506(b)(1) states: “To qualify for an exemption under this section, offers and sales must satisfy all the terms and conditions of . . . [17 C.F.R. §] 230.502.”

<sup>5</sup> 17 C.F.R. § 230.502(c)(1) states: “[N]either the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, . . . [a]ny advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio. . . .”

28. The Department argues that because the Respondents used “lead lists” to cold call prospective investors, the Respondents engaged in “general solicitation or general advertising,” which the Department argues disqualifies the Berry Prospect securities from the state registration exemption granted by 17 C.F.R. § 230.506.<sup>6</sup>

29. In support of its argument, the Department cites a United States District Court case that holds “a nationwide cold-calling campaign constitutes a form of general solicitation for purposes of Rule 502(c).” *S.E.C. v. Tecumseh Holdings Corp., etc.*, 2009 WL 4975263, \*4.

30. The Department’s assertion that “the method used by the Respondents to make offers to sell securities are unequivocally considered general solicitation and therefore a violation of Rule 502(c)” exaggerates the holding of *Tecumseh*. See Department’s Reply Brief, p. 3.

31. In *Tecumseh*, the court granted the S.E.C.’s summary judgment motion. *Tecumseh* at \*4. While the court ruled a nationwide cold-calling campaign constitutes a form of general solicitation, the court noted the genuine issue of material fact concerning the SEC’s allegation that *Tecumseh* used lead sheets to identify prospective investors. *Id.* Thus, *Tecumseh*’s holding is not based on facts identical to the facts of this case. The court in *Tecumseh* decided only that a nationwide cold-calling campaign, which the respondents in *Tecumseh* had not denied they used, was a form of general solicitation that disqualified the respondents from claiming an exemption from New York State security registration requirements. *Id.*

32. In their post-hearing brief the Respondents argue their use of lead lists did not involve cold-calling and did not constitute impermissible general solicitation. Respondents’ Amended Post Hearing Brief, p. 13. The Respondents are incorrect on both counts.

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<sup>6</sup> And granted by KRS 292.310(6) and 15 U.S.C. § 77r(b)(4)(D).

33. The Respondents argue the lead lists their surveyors used to make initial phone calls to potential investors were “obtained from companies who have either received cards of request of information or have indicated that they are interested in oil and gas or other similar investment programs.” Respondents’ Amended to Post Hearing Brief, etc., p. 13. For this reason, the Respondents argue their procedure for identifying interested investors “eliminates cold-calling.” *Id.*

34. The Respondents offered no evidence to support their statements about the companies who provided the lead lists. Even accepting as true the Respondents’ description of the lead lists, the same reasoning used by the court in *Tecumseh* applies in this case.

35. Examining the nationwide cold-calling campaign involved, the court in *Tecumseh* observes:

[A] nationwide cold-calling campaign has many of the same characteristics as the examples listed in 502(c): (1) it has the potential to reach a large number of people; (2) it has the potential to reach people throughout a large geographic area; and, perhaps most importantly, (3) it generally targets people with whom the issuer does not have a prior relationship and who are unlikely to have any special knowledge about the offered security. These similarities are sufficient to support my determination that the cold-calling campaign constituted a form of general solicitation precluding the *Tecumseh* securities from qualifying for a Regulation D exemption.

*Tecumseh* at \*4.

36. In this case, none of the individuals on the lead lists had any prior contact with the Respondents. None of the individuals on the lists had ever expressed interest in the Berry Prospect securities. And prior to being contacted by the Respondents, none of them knew about these securities or the ventures they represented. In *Tecumseh*’s words, the targets of the

Respondents' solicitations were "unlikely to have any special knowledge about the offered security." *Id.*

37. The Respondents asked two questions when contacting potential investors on the lead lists: "Are you qualified to invest?"; and "Do you want to invest?" It does not change the character of the contact with a potential investor to divide these questions between two different people. The initial call to a potential investor on the lead lists by a surveyor was a "cold call." The potential investor, when called initially, was someone "unlikely to have any special knowledge about the offered security." As such, the Respondents' methods constituted cold-calling despite their having used an intermediate "surveyor" to make the initial call.<sup>7</sup>

38. For all these reasons, the Respondents' method of contacting investors was a form of general solicitation which disqualifies the Berry Prospect securities from Regulation D exemption.

#### Good Faith Compliance

39. Citing 17 C.F.R. § 230.508, the Respondents argue their failure to comply with the requirements of 17 C.F.R. § 230.506 should be excused because the failure was "insignificant." Respondents' Amended Post Hearing Brief, p. 17.

40. The regulation upon which the Respondents rely, 17 C.F.R. § 230.508, preserves the covered security exemption if three conditions hold:

- The issuer's failure does not pertain to a condition designed to protect an investor;
- The failure is insignificant; and

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<sup>7</sup> One of the Respondents admitted the method used to solicit potential investors constituted cold-calling. See 12/9/10 TH 215 and 219. But that was a factual admission and not necessarily a knowing statement about the legal definition of cold-calling.

- A good faith reasonable attempt was made to comply.

17 C.F.R. § 230.508(a).<sup>8</sup>

41. The Respondents failed to address the regulation's declaration that "any failure to comply with paragraph (c) of [17 C.F.R.] § 230.502 . . . shall be deemed to be significant," that is, not "insignificant." 17 C.F.R. § 230.508(a)(2). It is 17 C.F.R. § 230.502(c) that prohibits offers or sales "by any form of general solicitation," which the Respondents violated, as detailed above.

42. The Respondents also fail to address 17 C.F.R. § 230.508(b), which states that transactions made relying on 17 C.F.R. § 230.506 must comply with the requirements of Regulation D. This, again, disqualifies the Respondents because Regulation D also compels compliance with 17 C.F.R. § 230.502(c).

#### Other Defenses

43. The Respondents raise other defenses, such as, but not limited to, that federal law "prohibit[s] states from examining merit provisions of an offering and . . . allow[s] . . . 'covered securities' to be exempt from state registration and merit review"; and that "the failure to qualify as 'covered securities' should be determined by the Securities and Exchange Commission and not by various states." Respondents' Amended Post Hearing Brief, p. 18.

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<sup>8</sup> 17 C.F.R. § 230.508 states:

- (a) A failure to comply with a term, condition or requirement of § 230.504, § 230.505 or § 230.506 will not result in the loss of the exemption from the requirements of section 5 of the Act for any offer or sale to a particular individual or entity, if the person relying on the exemption shows:
- (1) The failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity; and
  - (2) The failure to comply was insignificant with respect to the offering as a whole, provided that any failure to comply with paragraph (c) of § 230.502, paragraph (b)(2) of § 230.504, paragraphs (b)(2)(i) and (ii) of § 230.505 and paragraph (b)(2)(i) of § 230.506 shall be deemed to be significant to the offering as a whole; and
  - (3) A good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements of § 230.504, § 230.505 or § 230.506.

44. All of the Respondents' other defenses are not well developed and are rejected without further elaboration.

Respondents' Violation of KRS 292.340

45. For all the foregoing reasons, the Respondents' failure to register the Berry Prospect #18 and Berry Prospect #19 securities before they offered them for sale or sold them in this state is a violation of KRS 292.340, which requires securities to be registered unless the transaction is exempt or the securities are covered securities.

46. The Respondents did not prove an exemption applies or that the Berry Prospect securities were covered securities.

**Count II: Failure to Register as Agents or Broker-Dealers**

47. Under this count, the Department charges the Respondents with violations of KRS 292.330(1) and (7).

48. KRS 292.330(1) requires anyone transacting business in the state as a securities agent or broker-dealer to register with the Department.<sup>9</sup> None of the Respondents were registered with the Department as agents or broker-dealers.

49. Furthermore, under KRS 292.330(7), "It is unlawful for a broker-dealer or an issuer to employ or associate with an agent unless the agent is registered under this chapter or exempt from registration."

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<sup>9</sup> KRS 292.330, in relevant part, states:

- (1) It is unlawful for any person to transact business in this state as a broker-dealer unless the person is registered under this chapter as a broker-dealer or is exempt from registration under subsection (2) of this section. . . .
- (3) It is unlawful for an individual to transact business in this state as an agent unless the individual is registered under this chapter as an agent or is exempt from registration under subsection (4) of this section.

50. Margaret Berry acted as an agent of Berry Resources, as the term "agent" is defined in KRS 292.330(1), by attempting to affect and affecting the purchase and sale of securities in Berry Prospect #18 and Berry Prospect #19.

51. Ann Dunnegan acted as an agent of Berry Resources, as the term "agent" is defined in KRS 292.330(1), by attempting to affect and affecting the purchase and sale of securities in Berry Prospect #18 and Berry Prospect #19.

52. Ralph O. Berry III acted as an agent of Berry Resources, as the term "agent" is defined in KRS 292.330(1), by attempting to affect and affecting the purchase and sale of securities in Berry Prospect #18 and Berry Prospect #19 and by attempting to affect the purchase or sale of securities in Berry Energy and Resources, Inc.

53. Margaret Berry, Ann Dunnegan, and Ralph O. Berry III violated KRS 292.330(1) by acting as agents of Berry Resources in the offer and sale of securities without having registered with the Department as agents.

54. Berry Resources and Ralph O. Berry III violated KRS 292.330(7) by employing Margaret Berry and Ann Dunnegan as agents although they were not registered with the Department as agents.

55. Based on the findings of fact and conclusions of law, all of the Respondents violated both KRS 292.330(1) and KRS 292.330(7).

**Count III: Fraud, Deceit, and Materially False Statements and Omissions**

56. Under this count, the Department charges the Respondents with violations of KRS 292.320(1). That provision states:

(1) It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly:

- (a) To employ any device, scheme, or artifice to defraud;
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

KRS 292.320(1).

57. A failure to provide accurate, complete information about previous actions by state securities regulatory authorities against Respondent, Ralph O. Berry III, constitutes material misstatements and omissions.

58. Based on the findings of fact, the Respondents employed a device, scheme, or artifice to defraud investors into purchasing Berry Prospect securities by providing incorrect and incomplete material information that a reasonable investor would want to know before investing.

59. By failing to provide correct and complete material information that a reasonable investor would want to know before investing, the Respondents made untrue statements of material fact and omitted material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.

60. Based on the findings of fact, the Respondents engaged in acts, practices, and a course of business which operated as a fraud and deceit on investors in the Berry Prospect securities.

61. For all these reasons, each of the Respondents violated KRS 292.320(1).

Count IV: Violation of Final Orders

62. Based on the findings of fact, Ralph O. Berry III and Berry Resources, Inc., violated the Department's February 9, 2007, final order by employing Ann Dunnegan and

Margaret Berry as agents of Berry Resources at a time when neither was registered with the Department as an agent.

63. Based on the findings of fact, Ralph O. Berry III and Berry Resources, Inc., violated the Department's January 13, 2003, final order by failing to disclose Ralph Berry's salary and Berry Resources' employees' compensation in the private placement memoranda for Berry Prospect #18 and Berry Prospect #19.

### **RECOMMENDED ORDER**

Based on the foregoing findings of fact and conclusions of law, the Hearing Officer RECOMMENDS that the Department of Financial Institutions issue a final order as follows:

1. Order the Respondents, Ralph O. Berry III, Margaret Berry, and Ann Dunnegan, to Cease and Desist from engaging in activities governed by KRS Chapter 292.
2. Order that Respondent, Ralph O. Berry III, is permanently banned from engaging in activities governed by KRS Chapter 292.
3. Order Respondent, Berry Resources, Inc., to pay a fine in the amount of \$60,000.
4. Order Respondent, Ralph O. Berry III, to pay a fine in the amount of \$40,000.
5. Order Respondent, Margaret Berry, to pay a fine in the amount of \$15,000.
6. Order Respondent, Ann Dunnegan, to pay a fine in the amount of \$15,000.
7. Order the Respondents, jointly and severally, to pay the Department's costs and attorney fees.

## **NOTICE TO PARTIES OF EXCEPTION AND APPEAL RIGHTS**

Pursuant to KRS 13B.110(4): a copy of the hearing officer's recommended order shall be sent to each party in the hearing and each party shall have fifteen (15) days from the date the recommended order is mailed within which to file exceptions to the recommendations with the agency head.

Pursuant to Kentucky case law (*see Rapier v. Philpot*, 130 S.W.3d 560 (Ky. 2004) and subsequent cases), when a party fails to file exceptions, that party's appeal under KRS 13B.140 is limited to those findings and conclusions contained in the agency head's final order that differ from those contained in the hearing officer's recommended order.

Pursuant to KRS 13B.120(2): the agency head may accept this recommended order and adopt it as the agency's final order, or it may reject or modify, in whole or in part, the recommended order, or it may remand the matter, in whole or in part, to the hearing officer for further proceedings as appropriate.

Pursuant to KRS 13B.120(4): the agency head shall render a final order in an administrative hearing within ninety (90) days after the hearing officer submits a recommended order to the agency head, unless the matter is remanded to the hearing officer for further proceedings.

Pursuant to KRS 13B.140: All final orders of an agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. If venue for appeal is not stated in the enabling statutes, a party may appeal to Franklin Circuit Court or the Circuit Court of the county in which the appealing party resides or operates a place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, in a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

Pursuant to KRS 23A.010(4), "Such review [by the Circuit Court] shall not constitute an appeal but an original action." Some courts have interpreted this language to mean that summons must be served when filing an appeal petition in the Circuit Court.

SO ORDERED this 27 day of July, 2011.

A handwritten signature in black ink, appearing to read 'M. Head', is written over a horizontal line.

MICHAEL HEAD  
HEARING OFFICER  
ADMINISTRATIVE HEARINGS BRANCH  
OFFICE OF THE ATTORNEY GENERAL  
1024 CAPITAL CENTER DRIVE, SUITE 200  
FRANKFORT, KY 40601-8204  
(502) 696-5442  
(502) 573-1009 - FAX

**CERTIFICATE OF SERVICE**

I hereby certify that the original of this RECOMMENDED ORDER was mailed this 30th day of July, 2011, by messenger mail, to

GENERAL COUNSEL  
DEPT OF FINANCIAL INSTITUTIONS  
1025 CAPITAL CENTER DR STE 200  
FRANKFORT KY 40601

for filing; and a true copy was sent by first-class mail, postage prepaid, to:

HUNTER DURHAM  
DURHAM & ZORNES  
130 PUBLIC SQ  
PO BOX 100  
COLUMBIA KY 42729-0100

and, by messenger mail, to:

SIMON BERRY  
OFFICE OF LEGAL COUNSEL  
DEPT OF FINANCIAL INSTITUTIONS  
1025 CAPITAL CENTER DR STE 200  
FRANKFORT KY 40601

  
DOCKET COORDINATOR

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