

**STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION**

IN THE MATTER OF DETERMINING) Order No.: S-11-0755-13-FO01
Whether there has been a violation of the)
Securities Act of Washington by:) ENTRY OF FINDINGS OF FACT AND CONCLUSIONS
) OF LAW AND FINAL ORDER TO CEASE AND DESIST,
PetroGates, Inc.; Davis Gates Smith,) TO CHARGE COSTS, AND TO IMPOSE FINES
)
Respondents.)

On March 11, 2013, the Securities Administrator of the state of Washington issued Statement of Charges and Notice of Intent to Enter Order to Cease and Desist, to Charge Costs, and to Impose Fines, S-11-0755-12-SC01, hereinafter referred to as "Statement of Charges," against PetroGates, Inc. and Davis Gates Smith.

The Statement of Charges, together with a Notice of Opportunity to Defend and Opportunity for Hearing, hereinafter referred to as "Notice of Opportunity for Hearing" and an Application for Adjudicative Hearing, hereinafter referred to as "Application for Hearing," was served on Respondents PetroGates, Inc. and Davis Gates Smith on March 15, 2013. The Notice of Opportunity for Hearing advised the Respondents that a written application for an administrative hearing on the Statement of Charges must be received within twenty days from the receipt of the notice. On March 26, 2013, the Securities Division received an Application for Adjudicative Hearing from Respondent Davis Gates Smith. Respondent Davis Gates Smith waived the right to a hearing in this matter, and in lieu thereof, submitted a written statement for consideration by the Securities Administrator. Respondent PetroGates, Inc. failed to request an administrative hearing within twenty days of receipt of the Statement of Charges and Notice of Opportunity for Hearing, either on the Application for Hearing provided, or otherwise.

After considering the written statement, the Securities Administrator will adopt as final the following Findings of Fact and Conclusions of Law as set forth in the Statement of Charges and enter a final order against Respondents PetroGates, Inc. and Davis Gates Smith to cease and desist from violations of the Securities Act.

The Securities Administrator makes the following Findings of Fact and Conclusions of Law:

1 **FINDINGS OF FACT**

2 Respondents

3 1. PetroGates Inc. (“PetroGates”) is a Delaware corporation formed in 2006 that is in the business of oil
4 and gas exploration and development. PetroGates uses a business address in Midland, Texas.

5 2. Davis Gates Smith (“Smith”) was the President and CEO of PetroGates. During the time period
6 discussed below Smith resided in Washington.

7 Nature of the Offering

8 3. Between 2009 and 2010, Respondent Smith sold \$180,000 worth of oil and gas investments in
9 PetroGates, Inc. to an investor in Washington. In July 2009, Smith met a Washington resident (hereinafter, “the
10 investor”) and later told the investor that he was founder of an oil and gas company named PetroGates, which
11 owned four oil wells in Texas. A few months later, Smith solicited the investor to make an investment in a Texas
12 oil drilling program. The Washington investor had no prior experience investing in oil and gas, and was not an
13 accredited investor at the time of the solicitation.

14 4. Smith told the investor she would earn a return of five times the amount she invested within six
15 months. Smith stated that drilling had already commenced on one of the four oil wells. In November 2009, Smith
16 directed the investor to wire \$90,000 to a bank account in the name of PetroGates. Smith later provided a signed
17 letter regarding their “recent investment in the oil and gas industry through PetroGates Inc.” The letter indicated
18 that the investor had purchased 1 unit in PetroGates Inc.’s “Andrews County Texas drilling program” for \$90,000.
19 Smith later provided the investor with a private placement memorandum.

20 5. In approximately April 2010, Smith informed the investor that they would not receive a return on her
21 investment because another individual had misappropriated funds from the PetroGates bank account. Smith then
22 solicited the investor to invest in another oil and gas investment that involved the mineral rights for a property in
23 Winkler County, Texas that was owned by another individual. Smith stated that the property was already being
24 drilled and would start producing oil shortly. Smith told the investor that she would receive a return on her
25 investment within a month, that her principal would be repaid within two to three months, and that the investment

1 would pay her monthly returns of thousands of dollars. Smith also represented that the investor could expect
2 monthly returns for 15 to 20 years. The investor withdrew funds from a 401(k) retirement account in order to make
3 her investment. Between April and May 2010, the Washington investor deposited an additional \$90,000 into a bank
4 account in the name of PetroGates for the purchase of their investment.

5 6. Smith later provided the investor with a “Confidential Memorandum” regarding the investment as
6 well as a handwritten letter acknowledging the investor’s prior investments with PetroGates. The letter indicated
7 that when the “projects” were completed, the investment would be worth “more than five times the original outlay
8 by mid 2011.” [sic]

9 7. In July 2011, Smith sent an e-mail to the investor that stated that “Petrogates will return the funds you
10 invested and where [sic] wired into the Petrogates Inc account.”

11 8. In September 2011 the investor filed a civil action against Smith and PetroGates alleging violations
12 of the Securities Act among other allegations. That matter is still pending. As of the date of this Statement of
13 Charges the Respondents have not paid the investor any return on her investment nor have they repaid any principal.

14 Misrepresentations and Omissions

15 9. In connection with the offer and sale of the oil and gas investments, the Respondents failed to provide
16 material information regarding the company, the Andrews County oil and gas venture, and the Winkler County oil
17 and gas venture, including, but not limited to, financial statements, financial condition, and operational history.

18 10. In soliciting the investor’s first investment, Respondents failed to disclose the general and specific
19 risks of investing in oil and gas investments including wells that may not produce oil or gas, changes in prices and
20 demand, failure to comply with government regulations, changing regulations, and operational hazards.
21 Respondents also failed to disclose the risk that the investor could lose her entire investment.

22 11. The Respondents’ projection that the investor’s \$90,000 investment in the Andrews County oil and
23 gas venture would result in a return of five times the amount invested within six months was misleading. The
24 Respondents failed to provide a reasonable basis for the projection and failed to provide any limitations on the
25 projection.

12. The Respondents' projections that the investor would receive a return on her investment in the Winkler County oil and gas venture within a month, that PetroGates would pay back her principal within two to three months, and that the investment would pay her monthly returns of thousands of dollars for 15 to 20 years was misleading. The Respondents failed to provide a reasonable basis for the projections and failed to provide any limitations on the projections.

Based upon the above Findings of Fact, the following Conclusions of Law are made:

CONCLUSIONS OF LAW

1. The offer or sale of the investments described above constitutes the offer or sale of a security as defined in RCW 21.20.005 (14) and (17).
2. The offer or sale of the stock described above was made in violation of RCW 21.20.010 because, as set forth in the Tentative Findings of Fact, Respondents PetroGates Inc. and Davis Gates Smith each made misstatements of material facts or omitted to state material facts necessary in order to make the statements made, in light of circumstances under which they were made, not misleading.

FINAL ORDER

Based upon the foregoing and finding it in the public interest:

IT IS HEREBY ORDERED that the Respondents, PetroGates, Inc.; Davis Gates Smith, their agents and employees, each shall cease and desist from violating RCW 21.20.010, the anti-fraud section of the Securities Act of Washington.

IT IS FURTHER ORDERED that Respondent Davis Gates Smith shall be liable for and shall pay a fine of \$10,000.

IT IS FURTHER ORDERED that Respondent Davis Gates Smith shall be liable for and shall pay investigative costs of not less than \$2,500.

AUTHORITY AND PROCEDURE

This FINAL ORDER is entered pursuant to the provisions of RCW 21.20.390, and is subject to the provisions of RCW 21.20.120 and Chapter 34.05 RCW. Respondents have the right to petition the superior court for judicial review of this agency action under the provisions of Chapter 34.05 RCW. For the requirements for Judicial Review,

1 see RCW 34.05.510 and sections following. Pursuant to RCW 21.20.395, a certified copy of this Order may be filed
2 in Superior Court. If so filed, the clerk shall treat the Order in the same manner as a Superior Court judgment as to
3 the fine, and the fine may be recorded, enforced, or satisfied in like manner.

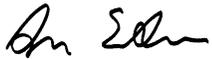
4 WILLFUL VIOLATION OF THIS ORDER IS A CRIMINAL OFFENSE.

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6 SIGNED and ENTERED this 9th day of April 2013.

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11 _____
12 William M. Beatty
13 Securities Administrator

14 Approved by:

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16 _____
17 Suzanne Sarason
18 Chief of Enforcement

19 Presented by:

20 

21 _____
22 Jack McClellan
23 Financial Legal Examiner