

BEFORE THE ARKANSAS SECURITIES COMMISSIONER

Case No. S-15-0047

Order No. S-15-0047-16-OR02

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ARKANSAS SECURITIES DEPT.

IN THE MATTER OF
DRAGONFLY INDUSTRIES INTERNATIONAL, LLC and
JODY DOUGLAS DAVIS

CEASE AND DESIST ORDER

On August 8, 2016, the staff of the Arkansas Securities Department (Staff) filed its Request for a Cease and Desist Order stating that it has information and certain evidence that indicates Dragonfly Industries International, LLC (Dragonfly) and Jody Douglas Davis have violated provisions of the Arkansas Securities Act (Act) codified at Ark. Code Ann. §§ 23-42-101 – 509. The Arkansas Securities Commissioner (Commissioner) has reviewed the Request (Request), and based upon representations made therein, finds that:

FINDINGS OF FACT

1. The Request asserts the following representations of fact:
 - a. Dragonfly is a limited liability company formed in Texas. According to its website, diiturbines.com, Dragonfly is involved in electricity generating wind turbines (wind turbines) and has the “first true innovation of a wind turbine design in thirty-five years” that replaces the three-blade wind turbine that Dragonfly states is now familiar to most. Dragonfly’s website shows the address of its main office to be 2591 Dallas Parkway, Suite 300, Frisco, Texas 75034.
 - b. Davis was a resident of Farmington, Arkansas during the times of the relevant events

detailed herein. He is now believed to be a resident of Florida. Davis is a managing member and chief executive officer of Dragonfly.

- c. In a sixty-five count indictment delivered in the United States District Court for the Northern District of Oklahoma in January 2009 Davis was indicted on charges of wire fraud (forty-four counts) and money laundering (twenty-one counts). Central to this indictment was a scheme to defraud which consisted of Davis's diversion of funds to a bank account he owned and controlled. Two Oklahoma companies maintained funds that were used to provide payment assistance for home purchasers through a third Oklahoma company. Upon closing of a home purchase, the seller was required to return these funds to the appropriate company. Often, this repayment was arranged through the closing companies. Davis was alleged to have contacted many of the purchasers, sellers and closing companies and given them wiring instructions that he led them to believe would wire funds to bank accounts of the company which was entitled to the funds. In reality, the funds—over \$1.1 million— went into an account owned and controlled by Davis.
- d. On August 10, 2009, Davis pleaded guilty pursuant to a plea agreement to one count of wire fraud and one count of money laundering, and the other counts were dismissed. Davis admitted his guilt in the entire scheme. On December 11, 2009, he was sentenced to a term of thirty-seven months in prison and ordered to make restitution of \$1,153,627.
- e. Dragonfly's articles of formation list Phillip Ridings as a managing member, and a certification of managing members includes as managing members Davis and Craig M. Cook. Article 5 provides that Dragonfly can establish "one or more series of limited liability company interests" (LLC Interests) which would be separately accounted for and

would be liable only for debts and expenses associated with that series of LLC Interests. Under Article 7 only managing members would have the power to alter or amend the company agreement of Dragonfly.

- f. The company agreement referred to in the articles of organization is the operating agreement of Dragonfly, and both were filed simultaneously with the Texas Secretary of State. The operating agreement provides that Dragonfly “shall be manager managed,” and that “Members holding a majority of the capital interests in the Company may elect Managers as the Members determine.” The role of members is clearly stated: “Members shall not take part in the operation of the Company’s affairs, unless they are appointed by Managers for a stated time period.” Managing members listed in the articles of organization and in the operating agreement “will serve as Managers of this company until a meeting of members is held and new Manager(s) elected.”
- g. The operating agreement of Dragonfly set out the basic principle of profit or loss: “[N]et profits or net losses shall be determined on an annual basis and shall be allocated to the Members in proportion to each Member’s relative capital interest in the Company.”
- h. Arkansas Wind Power, LLC, (AWP) is a limited liability company formed in Arkansas by Ridings. According to the Arkansas Secretary of State, AWP’s address is 7444 Brooklyn Avenue, Springdale, AR 72762.
- i. According to the Dragonfly website, Ridings is the inventor of the new Dragonfly design for wind turbines.
- j. According to the Dragonfly website for most of 2015, AWP was developing a wind farm (a piece of land containing a number of wind turbines used to generate electricity) near

Elm Springs, Arkansas which was to be called Arkansas One:

Arkansas Wind Power, LLC (AWP) is developing an 80 MW land-based wind energy facility near Elm Springs, Arkansas. The new AWP wind energy facility, Arkansas One, will be developed on 131 acres in 3 Phases over 36 months. Arkansas One will be the first utility scale wind energy facility in the state of Arkansas. The new wind energy facility will consist of an office with secure operations station, warehouse, energy storage system, substation and 35+ turbine towers. Each turbine tower, a lattice tripod design that is approximately 150 feet tall, will house 2 wind turbines that will generate approximately 1 MW of power per turbine. It is expected that the new turbine systems will utilize only 1 acre per turbine system.

- k. The city of Elm Springs, Arkansas annexed the land on which Arkansas One was to be built with the intention of zoning the property more favorably for the operation of a wind farm.
- l. AR1 is a resident of northwest Arkansas. AR2 is a resident of both northwest Arkansas and Florida. AR3 is a resident of northwest Arkansas. All three (collectively, the AR Investors) are investors in Dragonfly. All had experience in some business matter, but no experience or expertise in the technology of wind turbines or the rarefied business and regulatory aspects of the business of generating electricity using wind, i.e., wind energy.
- m. Davis first told AR2 about Arkansas One and Dragonfly's wind turbines. The technology behind the wind turbines was described as revolutionary and cutting edge and said to be a vast improvement over the readily recognized three-bladed wind turbines found all over the world. AR2 then told AR1 what Davis had told him about Arkansas One and Dragonfly and introduced him to Davis.
- n. AR1 and AR2 became quite involved in Dragonfly and worked to help it make Arkansas One a reality. On February 17, 2015, Davis on behalf of Dragonfly signed what was

entitled a consulting agreement with a limited liability company formed by AR1 and AR2 (AR-LLC). AR1 signed the consulting agreement on behalf of AR-LLC. This agreement provided that the consultant, AR-LLC, would use its “best efforts to locate an investor to make a capital investment into Dragonfly Industries International, LLC.” In return, AR-LLC would be paid on a sliding scale, as follows:

- i. For each \$1 million invested up to \$5 million, AR-LLC would be paid \$50,000 and a .25% interest in the annual net profits of Arkansas One for five years.
 - ii. For each \$1 million invested over \$5 million and up to \$10 million, AR-LLC would be paid \$50,000 plus a .25% interest in the annual net profits of Arkansas One for ten years with a cap of 2.5% interest in the annual net profits.
 - iii. For each \$10 million invested of between \$11 million and \$100 million, AR-LLC would receive a \$100,000 fee plus a .25% equity interest in Dragonfly, not to exceed a 2.5% total equity interest in Dragonfly, and a 2.5% interest in the annual net profits of Arkansas One until such time as AR-LLC’s equity interest in Dragonfly exceeds the value of AR-LLC’s 2.5 % interest in the annual net profits of Arkansas One.
- o. AR1 and AR2 each had an equal ownership of AR-LLC, and each was a managing member empowered to make most decisions for AR-LLC. Each would split any profits. The stated purpose of AR-LLC was to “engage in investing in wind generated electricity projects and all activities related thereto.”
- p. AR1 and AR2 became quite encouraged by projected balance sheets provided to them by Cook and Davis showing the projected income of Arkansas One. In March 2015 they received a projected balance sheet showing the net income of Arkansas One at approximately \$14.4 million for 2016 and \$53.1 million for each of the years 2017 through 2019. Later, in April 2015 they received a second projected balance sheet, this one showing net income for Arkansas One at approximately \$7.7 million for 2016 and

\$12 million for each of the years 2017 through 2019.

- q. In May 2015 Davis informed AR1 and AR2 that Dragonfly had applied for a \$10 million grant from the United States Department of Energy (DOE). The application had been moved to “Phase III,” which was represented to be a final phase before approval. Davis stated that the grant writer was supposed to be in Washington, D.C. in the last part of June 2015 to meet with the DOE, and there was no reason it would not be approved by the end of July 2015.
- r. Also in May 2015, Davis received a letter dated May 14, 2015, from the director of the Advanced Research Projects Agency-Energy (ARPA-E), a part of the DOE that deals with research projects concerning energy and limited funding of them by the DOE. This letter acknowledged that Dragonfly had submitted a concept paper and advised against further submissions to ARPA-E:

Upon evaluation of your Concept Paper, ARPA-E has determined to **discourage** the submission of a Full Application.

* * *

By discouraging the submission of a Full Application, ARPA-E intends to convey its lack of programmatic interest in the proposed project. . . . the purpose of the Concept Paper phase is to save Applicants the considerable time and expense of preparing a Full Application that is unlikely to be selected for award negotiation. [Boldface in original.]

After the receipt of this letter, Dragonfly made no further submissions—including no formal application—to ARPA-E, and no grant from the DOE was made. The file on Dragonfly at ARPA-E was comprised of the concept paper submitted by Dragonfly and this letter dated May 14, 2015. Davis did not inform AR1, AR2 or AR3 of this letter.

- s. Although Davis told AR1 and AR2 that the technology had been tested several times and

found to be effective, no testing results were provided. It became apparent that testing results showing the technology to be effective would be necessary to proceed. Davis told AR1 and AR2 about a large engineering company with offices throughout the United States with which it had been discussing testing. That company had quoted Dragonfly a price for three stages of testing. The first stage, called the validation stage, involved the performance of computer fluid dynamics (CFD), a computer simulation of the Dragonfly wind turbines in a wind tunnel. Its price was quoted at \$60,000. The second stage, called the final engineering stage, would result in final design specifications of the Dragonfly wind turbines. Its price was set at \$500,000. The third stage, called the prototype stage, would result in the manufacture of a full scale prototype of a Dragonfly wind turbine. Its price was set at \$300,000.

- t. AR1 worked with Davis and Dragonfly extensively to get the project moving and involved several prospective investors. Convinced of the need for technological validation, AR1 was frustrated because Dragonfly could not afford to pay for the even the first stage of engineering. Eventually, in July 2015, AR1 and AR2, after having been given quite optimistic income projections for a completed Arkansas One and told that Dragonfly was about to come into \$10 million from a DOE grant, decided that they would split the cost of the first stage, each investing \$30,000. AR2 mentioned this matter to a friend of his, AR3, repeating all he had been told about the matter which is set out above.
- u. AR3 decided that he could invest \$60,000. AR1 and AR2 asked Davis if they and AR3 could invest in Dragonfly in exchange for equity interests in Dragonfly in order to get the engineering testing that all agreed was needed to go forward with the commercial

development of Dragonfly's technology and the Arkansas One project. Davis agreed. The three investors wrote their checks to Dragonfly for the amounts they had decided to invest, and Davis gave them certificates that resemble stock certificates showing ownership of units of ownership in Dragonfly, 1 unit for AR1, 2 units for AR2 and 2 units for AR3. The checks were written and the certificates showing ownership in Dragonfly were issued at the end of July 2015. Each unit represented a 1% equity interest in Dragonfly. AR1 was also given an agreement signed by Davis providing that AR1's \$30,000 investment would be repaid "when future funding rounds allow, while still maintaining your 1% equity in Dragonfly" and that AR1 would have a seat on the Dragonfly board of directors. AR1 was never invited to or was aware of a board of directors meeting.

- v. The other equity owners of Dragonfly and their percentage of ownership are as follows:
 - i. Phillip Ridings - 57.25%
 - ii. Jody Davis - 16.25%
 - iii. Craig Cook - 13.25%
 - iv. Richard Cook - 8.25%
- w. Davis did not reveal to the AR Investors his prior convictions for wire fraud and money laundering set out in ¶¶ 1.c and 1.d, *above*, before they invested.
- x. Opposition to Arkansas One materialized among the residents of Elm Springs and the area surrounding the land on which Arkansas One was planned to be built. This opposition was quite organized and determined. It resulted in an election by the citizens of Elm Springs to annul the annexation of the land on which Arkansas One was to be

built on March 1, 2016. The election resulted in the annexation of the Arkansas One land being reversed.

- y. On March 2, 2016, Davis announced in the news media that Dragonfly was abandoning the Arkansas One project and would have no other projects in Arkansas.
- z. The records of the Arkansas Securities Department (Department) show no registrations or proofs of exemption for any securities being offered by Dragonfly or AWP, and the website of the United States Securities and Exchange Commission show no filing of a registration or a Form D in furtherance of an exemption from state registration requirements pursuant to Regulation D, Rule 506, promulgated under the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* See 17 CFR § 230.506.
- aa. The records of the Department show no registrations of any person connected with Dragonfly or AWP as an agent of the issuer.

CONCLUSIONS OF LAW

SALES OF UNREGISTERED SECURITIES

ARK. CODE ANN. § 23-42-501

- 2. The investors identified as the AR Investors all purchased securities issued by Dragonfly in the form of limited liability company units, each representing a 1% equity share in Dragonfly. These units qualify as securities as investment contracts. In accordance with Ark. Code Ann. § 23-42-102(17)(A)(xi) and Arkansas case law, an investment contract is the investment of money into the risk capital of a common enterprise or venture with the expectation of benefit or profit with no effective control over the venture. The AR Investors all invested funds in a venture with Dragonfly, specifically Arkansas One, as well as the common enterprise of

Dragonfly and its much-hyped wind turbine technology. Dragonfly's articles of organization and operating agreement entitled the AR Investors Dragonfly's net profits according to their "relative capital interests" but placed all control in the managing members of Dragonfly, who included Davis and not the AR Investors. Ultimately, all control was in the hands of Ridings, who owned 57.25% of Dragonfly. The authorization of one or more series of limited liability company interests in the Dragonfly articles of organization shows that the sale of securities at some point was contemplated. The reservation of all control in the managers in the articles of organization and the operating agreement shows that the managers and ultimately those owning a majority of the equity in Dragonfly would be in control. Between them, the AR Investors owned 5% of Dragonfly's equity. Even though AR1 was trying to help get this project off the ground and get working capital in any way possible, he and the other two AR Investors were ultimately dependent on Davis and the other managers of Dragonfly for the success or failure of Arkansas One and Dragonfly. The venture was a wind farm and the business of Dragonfly was wind energy, both of which would involve knowledge of new technology and special expertise needed to navigate the regulatory and business challenges peculiar to wind farms, none of which was possessed by any of the AR Investors.

3. Because these securities were not registered in accordance with the Act, their sales were violations of Ark. Code Ann. § 23-42-501.

EMPLOYMENT OF UNREGISTERED AGENT
ARK. CODE ANN. § 23-42-301(b)(1)

4. AR1 and AR2 formed AR-LLC and signed an agreement to represent Dragonfly in the offer and sale of securities to be issued by Dragonfly in return for compensation, thus agreeing to

act as the agent of an issuer (Dragonfly) as defined at Ark. Code Ann. § 23-42-102(1)(A)(i).

5. Because AR-LLC has never been registered in any capacity, Dragonfly's employment of AR-LLC to act as an agent of Dragonfly in the offer and sale of securities to be issued by it was a violation of Ark. Code Ann. § 23-42-301(b)(1), which makes the employment of unregistered agents unlawful.

SECURITIES FRAUD

Ark. Code Ann. § 23-42-507

6. Davis's prior criminal conviction of wire fraud and money laundering which involved a quite elaborate scheme to defraud in which some \$1.1 million was diverted to a bank account owned and controlled by Davis would have been significant to any reasonable investor contemplating investment in a venture or company controlled by Davis. Davis's failure to inform any of the AR Investors of this prior conviction was the omission of a material fact made in connection with the offer or sale of a security, an instance of securities fraud and a violation of Ark. Code Ann. § 23-42-507(2).
7. Davis's statements to the AR Investors that Dragonfly's application was in the second or third phase of approval and that Dragonfly would more than likely receive a \$10 million grant from the United States Department of Energy around the end of July 2015 was a material misstatement of fact, an instance of securities fraud and a violation of Ark. Code Ann. § 23-42-507(2).
8. The letter dated May 14, 2015 from ARPA-E strongly discouraging Dragonfly from filing a full application for a grant from the Department of Energy because there was a lack of "programmatic interest in the proposed project" and it would be "unlikely to be selected for

award negotiation” would have been significant to any reasonable investor in Dragonfly.

Davis’s failure to share this letter with the AR Investors was the omission of a material fact made in connection with the offer or sale of a security, an instance of securities fraud and a violation of Ark. Code Ann. § 23-42-507(2).

ORDER

IT IS THEREFORE ORDERED that Dragonfly Industries International, LLC and Jody Douglas Davis, as well as others whose identities are not yet known who are employed by or otherwise affiliated with Dragonfly or Davis who receive actual notice of the order, CEASE AND DESIST from:

- 1) any actions in the state of Arkansas in connection with offering and selling securities, including the hiring of an agent of the issuer, until such time as any securities offered or sold are properly registered, shown to be exempt from registration pursuant to the Act or covered securities under federal law and any agent of the issuer is properly registered as such, and
- 2) from engaging in any actions constituting securities fraud.

A hearing on this Order shall be held if requested by any Respondent in writing within thirty days of the date of the entry of this Order, or if otherwise ordered by the Arkansas Securities Commissioner. Such request should be addressed to the Commissioner and submitted to the following address:

Arkansas Securities Commissioner
201 East Markham, Suite 300
Little Rock, Arkansas 72201

If no hearing is requested and none is ordered by the Commissioner, this Order will remain in effect until it is modified or vacated by the Commissioner. Ark. Code Ann. §23-42-209(a)(2)(B).

IT IS SO ORDERED.



B. Edmond Waters
Arkansas Securities Commissioner

8-11-16
Date