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Oil and Gas Programs and Broker-Dealer Securities Registration Ramifications Symposium - Selected Topics on Oil and Gas Law.

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OIL AND GAS PROGRAMS AND BROKER-DEALER SECURITIES REGISTRATION RAMIFICATIONS

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I. OIL AND GAS PROGRAMS

Funds raised under public oil and gas programs have increased dramatically since 1975, with a total 1980 fund raising of $1.822 billion as compared to a total 1975 fund raising of $322 million.[1] The major raisers of funds were exploratory and development drilling programs and oil income programs.[2] The oil and gas pro-

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1. *See* Resource Programs Inc., *The RPI Survey—A Report on the Oil and Gas Program Industry, reprinted in* 1 INSTITUTE FOR ENERGY DEVELOPMENT, OBTAINING DRILLING CAPITAL FROM TAX-ORIENTED INVESTORS 5 (L. Mosburg, Jr., ed. 1981). The figures cited do not include amounts raised through privately-offered oil and gas programs; nor do they include amounts raised by oil and gas programs exempted from registration pursuant to regulation A, 17 C.F.R. § 230.251 (1981), or amounts raised by fractional undivided interests exempted from registration pursuant to regulation B, 17 C.F.R. § 230.300 (1981). *See* Resource Programs Inc., *The RPI Survey—A Report on the Oil and Gas Program Industry, reprinted in* 1 INSTITUTE FOR ENERGY DEVELOPMENT, OBTAINING DRILLING CAPITAL FROM TAX-ORIENTED INVESTORS 4 (L. Mosburg, Jr., ed. 1981).

2. *See* Resource Programs Inc., *The RPI Survey—A Report on the Oil and Gas Program Industry, reprinted in* 1 INSTITUTE FOR ENERGY DEVELOPMENT, OBTAINING DRILLING CAPITAL FROM TAX-ORIENTED INVESTORS 3-4 (L. Mosburg, Jr., ed. 1981). Oil income programs are not operating interests. Rather, they purchase producing properties for future

gram originated around 1960 as a device to pass tax benefits of the oil and gas industry on to the individual investor.[3] An "oil program" is generally formed by an oil company or management company as a limited partnership or joint venture for the purpose of exploring, developing, or purchasing an unspecified number of oil and gas properties.[4]

These programs offer many tax benefits,[5] the most important of which is the intangible drilling costs (IDCs) deduction from gross income.[6] IDCs include almost all drilling costs other than expenditures for salvagable items.[7] Since IDCs are immediate expenses, they do not have to be amortized but can be deducted in full during the tax year in which they are incurred. Similarly, the cost of a well abandoned as a dry hole is deductible as a business loss in the year in which the well is declared dry.[8] Because of these tax benefits, oil and gas programs are usually formed as partnerships or joint ventures which allow the immediate flow through of profits and losses to the investor.[9] The limited partnership form of organization is preferred since it avoids double taxation, allows the flow

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income. *Id.* at 4.

3. *See generally* Berner & Scoggins, *Oil and Gas Drilling Programs—Structure and Regulation*, 41 GEO. WASH. L. REV. 471, 473 (1973); Close, *Tax Aspects Of Public Oil And Gas Drilling Funds*, SW. LEGAL FOUNDATION 23D INST. ON OIL & GAS LAW & TAX. 249 (1972); Ryan, *Public Financing of Oil and Gas Ventures*, 19 TUL. TAX INST. 466 (1970); Sullivan, *Oil and Gas Investment Programs: A Brief Survey*, 26 BUS. LAW. 1027, 1029 (1971).

4. Resource Programs Inc., *The RPI Survey—A Report on the Oil and Gas Program Industry, reprinted in* 1 INSTITUTE FOR ENERGY DEVELOPMENT, OBTAINING DRILLING CAPITAL FROM TAX-ORIENTED INVESTORS 4 (L. Mosburg, Jr., ed., 1981).

5. *See, e.g.*, I.R.C. § 263(c) (intangible drilling costs deduction) (Supp. 1979); *id.* § 613A (statutory, or percentage, depletion deduction) (1976 & Supp. 1979); *id.* §§ 701-708 (limited partnership flow-through of deductions and losses) (1976 & Supp. 1979).

6. *See id.* § 263(c) (Supp. 1979). Intangible drilling costs include "all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc. incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas." Treas. Reg. § 1.612-4(a); *see* Rev. Rul. 70-414, 1970-2 C.B. 132.

7. *See* Treas. Reg. § 1.612-4(a); Berner & Scoggins, *Oil and Gas Drilling Programs—Structure and Regulation*, 41 GEO. WASH. L. REV. 471, 473 (1973); Breun, *Federal Income Tax Aspects of Investing in Oil and Gas Properties*, 1968 OIL & GAS TAXES (P-H) ¶ 1015.

8. *See* Treas. Reg. § 1.612-4(b)(4). In addition, the taxpayer is allowed a deduction from gross income for the depletion of mineral resources through production. *See* I.R.C. §§ 611-613 (1976 & Supp. 1979). The taxpayer must deduct the larger of either depletion based on cost or percentage depletion in the amount of 22% of gross income, but not more than 50% of net income. *See id.* § 613(a)-(b) (1976).

9. *See* Phillip G. Larson, 66 T.C. 159, 185-186 (1976); I.R.C. §§ 701-708 (1976 & Supp. 1979).

through of deductions and losses, provides for utilization of the depletion allowance, and is managerially effective.[10]

II. Oil and Gas Program Securities

For the most part, oil and gas securities are sold as preorganization subscriptions in an annual program. A registration statement is filed based upon the aggregate number of units offered in an annual period.[11] As a stipulated number of units are sold, the initial limited partnership is formed. The subscribers to that point become participants in the partnership. Under both federal and state securities law, limited partnership interests are securties.[12]

10. Bloomenthal, *A Baedeker to Oil and Gas Programs* (pt. 1), 3 Sec. & Fed. Corp. L. Rep. 33, 33 (1981).

11. Because of the expertise the SEC has acquired in regulating oil and gas programs, certain requirements have been formulated regarding the processing of registration statements. *See* SEC Securities Act Release No. 33-5036, 35 Fed. Reg. 1233 (1970). The prior activities of program sponsor or its affiliate must be set forth in tabular form, indicating these activities for at least the past ten years. *See id.* Each program must state the results of any drilling activity, as well as the total public investment, the total investment of the sponsor, and the respective recoveries of each on their investments. *See id.* The table affords great opportunity to ascertain the sponsor's profit from the investor's capital, as well as the chances of future return for investors.

12. *See* Hirsch v. duPont, 396 F. Supp. 1214, 1226-27 (S.D.N.Y. 1975), *aff'd on other grounds*, 553 F.2d 750, 753 n.3 (2d Cir. 1977); Feldberg v. O'Connell, 338 F. Supp. 744, 746 (D. Mass. 1972). *Compare* Goldberg v. Paramount Oil Co., 300 P.2d 329, 332 (Cal. App. 1956) (exemption from registration of security not allowed when no bonafide joint venture existed since some investors contributed no services and took no active participation in business) *with* Vicioso v. Watson, 325 F. Supp. 1071, 1074-75 (C.D. Cal. 1971) (bonafide joint venture exempted from securing permit to sell securities when two investors contributed no services but exercised some control over drilling). Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b (1976) defines "security" to include an "investment contract . . . [and a] fractional undivided interest in oil, gas, or other mineral rights." *Id.* § 77b. In SEC v. W.J. Howey Co., 328 U.S. 293 (1946) the Supreme Court defined "investment contract" as a scheme whereby a person invests money in a common enterprise and is led to expect profits solely from the efforts of others. *See id.* at 299. The *Howey* test has been used ever since as the federal test of "security," *see* SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 477 (5th cir. 1974) (liberalizing term "solely from the efforts of others"), while various states, particularly California, have employed a "risk-capital" test. *See, e.g.*, Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908, 13 Cal.Rptr. 186, 188 (1961); State *ex rel* Comm'r of Securities v. Hawaii Mkt. Center, Inc., 485 P.2d 105, 109-10 (Hawaii 1971); State *ex rel* Healy v. Consumer Business Sys., Inc., 482 P.2d 549, 552-554 (Or. Ct. App. 1971), *cert. denied*, 406 U.S. 974 (1972). Under the "risk-capital" test, an interest is a "security" if the investor has subjected his money to the risk of an enterprise over which he exercises no managerial control. *See* SEC v. Glenn Turner Enterprises, Inc., 348 F. Supp. 766, 773-74 (D. Or. 1972), *aff'd on other grounds*, 474 F.2d 476, 483 (9th Cir.), *cert. denied*, 414 U.S. 82 (1973); Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908, 13 Cal.Rptr. 186, 188 (1961).

Whether various oil and gas interests are securities has been a constant source of litigation and differing opinion.[13] The four principle types of oil and gas interests are mineral rights in general, the landowner's royalty, the overriding royalty, and the leasehold interest. The owner of each of these types of interests often divides his interest into fractional undivided interests and sells them to purchassrs who are thereby entitled to that fractional part of the production. Although there are a number of oil royalty dealers who buy and resell such interests to the public, the sale of royalty and mineral rights interests are not devices for financing the drilling of a well.[14] Rather, financing is commonly accomplished by the sale of "working interests," which are fractional undivided interests in the lease.[15] The holder of a working interest obtains a fractional part of proceeds gained from sales of oil and gas produced.[16] Are working interests in an oil and gas lease securities? The weight of authority is in the affirmative.[17]

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13. *See, e.g.*, SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943); Roe v. United States, 287 F.2d 435, 437 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961); Woodward v. Wright, 266 F.2d 108, 110 (10th Cir. 1959).

14. *See* Bloomenthal, *SEC Aspects of Oil and Gas Financing*, 7 WYO. L.J. 49, 50 (1953).

15. Sometimes oil and gas leases are purchased with the intention of arranging a subsequent "farm-out" agreement. Under a farmout, the lease owner assigns a lease if the drilling party drills a well to a certain depth at the drilling party's expense. Whether or not the drilling party may earn the assignment if the well is a dry hole is a contractural issue. Usually, the lease owner reserves an overriding royalty to himself. *See* Scott, *How to Prepare an Oil and Gas Farmout Agreement*, 33 BAYLOR L. REV. 63, 64 (1981).

16. *See* 1 L. LOSS, SECURITIES REGULATIONS 469-70 (2d ed. 1961); H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 441.1, at 544 (1973); Bloomenthal, *SEC Aspects of Oil and Gas Financing*, 7 WYO. L.J. 49, 53 (1953); Comment, *Oil Interests As Securities: The Enumerated vs. The General Definition*, 6 ST. MARY'S L.J. 151, 154 (1974).

17. *See* Nor-Tex Agencies v. Jones, 482 F.2d 1093, 1098 (5th Cir. 1973); Gilbert v. Nixon, 429 F.2d 348, 354 (10th Cir. 1970); SEC v. McBride, 143 F. Supp. 562, 563 (M.D. Tenn. 1956); Wall v. Wagner, 125 F. Supp. 854, 857 (D. Neb. 1954), *aff'd sub nom.* Whittaker v. Wall, 226 F.2d 868 (8th Cir. 1955). *Compare* Roe v. United States, 287 F.2d 435, 437 (5th Cir.) (not every sale of entire oil lease involves transfer of security), *cert. denied*, 368 U.S. 824 (1961) *and* Woodward v. Wright, 266 F.2d 108, 114 (10th Cir. 1959) (mere transfer of entire working interest in oil lease not sale of security) *and* Lynn v. Caraway, 252 F. Supp. 858, 864 (W.D. La. 1966) (sale of entire working interest in lease not a security), *aff'd*, 379 F.2d 943, 945-46 (5th Cir. 1967) *with* Kadane v. Clark, 135 Tex. 496, 500, 143 S.W.2d 197, 199 (1940) (sale of oil lease involved sale of security) *and* Creswell-Keith, Inc. v. Willingham, 160 F. Supp. 735, 739 (W.D. Ark. 1958) (transfer of entire ⅛ working interest involved a security), *rev'd on other grounds*, 264 F.2d 76, 82 (8th Cir. 1959). This confusion arises from testing the transaction against the "fractional undivided interest in oil, gas, or other mineral rights" definition of a security apart from the "investment contract" defini-

The partnership interests may be sold by the program sponsor selling through its own sales organization, or by any broker-dealer who is a member of the National Association of Securities Dealers (NASD). Frequently, a distribution is made by a major securities dealer who acts as the principal underwriter by selling the program itself and/or through dealers who become members of a selling group.[18] Many programs, however, take advantage of the private placement exemption of rule 146[19] and section 4(2) of the Securities Act of 1933.[20] Although an *offering* or *transaction* may be ex-

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tion of a security in section 2(1) of the Securities Act of 1933.

18. Although an underwriter must comply with the prospectus registration requirements of section 5 of the Securities Act of 1933, a "dealer" or "broker" need not. The dealer or broker, however, may need to register itself under section 15 of the Securities Exchange Act of 1934, 15 U.S.C. § 78o (1976). *See* Securities Act of 1933, § 4(1),(3),(4), 15 U.S.C. § 77d(1),(3),(4) (1976). The 1933 Act regulates *issues* to the public. Once the shares are distributed through the regular registration process, there should be free trading amongst professionals. This is the impetus for sections 4(3) and 4(4) of the Securities Act of 1933. *See In re* Ira Haupt & Co., 23 S.E.C. 589, 603-04 (1946); 17 C.F.R. § 230.144 (1981).

19. 17 C.F.R. § 230.146 (1980).

20. 15 U.S.C. § 77d(2) (1976). Under section 4(2), the prospectus requirements of the 1933 Act do not apply to "transactions by an issuer not involving any public offering." *Id.* Rule 146 was adopted by the SEC in response to the decision of the Supreme Court in SEC v. Ralston Purina Co., 346 U.S. 119 (1953) and subsequent interpretations of section 4(2) by the Fifth Circuit in SEC v. Continental Tobacco Co., 463 F.2d 680 (5th Cir. 1972) and Hill York Corp. v. American Int'l Franchises, 448 F.2d 680 (5th Cir. 1971). In *Ralston Purina*, the Court held that the applicability of subsection 4(2) depends upon whether the particular class of offerees require the protection afforded by the registration requirements of the 1933 Act, and whether the offerees have access to the same type of information that registration would disclose. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 125-27 (1953). The Court further held that the number of offerees and the limitating of the offering to a distinct class of persons were not determinative. *See id.* at 125. Approximately twenty years later, the Fifth Circuit further limited the availability of the statutory exemption. *See* SEC v. Continental Tobacco Co., 464 F.2d 137, 160 (5th Cir. 1972); Hill York Corp. v. American Int'l Franchises, 448 F.2d 680, 688-89 (5th Cir. 1971). *Continental Tobacco* and *Hill York* established that the private offering exemption was lost unless: 1) the offerees were limited in number; 2) the offerees were sophisticated investors with a relationship with one another—as well as the issuer; 3) the offerees had the same access to information that a registration statement would have otherwise disclosed; and 4) the offerees were given an opportunity to inspect the issuer's financial records. *See* SEC v. Continental Tobacco Co., 463 F.2d 137, 160 (5th Cir. 1972); Hill York Corp. v. American Int'l Franchises, 448 F.2d 680, 688-89 (5th Cir. 1971). This led one commentator to note that the exemption was lost unless all of the offerees had "insider" status. *See* Kripke, *Revolution in Securities Regulation, Wrap Up*, 29 Bus. Law. (special issue) 185, 187 (March 1974).

In April of 1974, the SEC adopted rule 146 to provide more objective standards in ascertaining when an offering was "non-public." Specifically, rule 146 provides that an offering is non-public under section 4(2) if:

(1) there are no more than 35 purchasers (as opposed to offerees), *see* 17 C.F.R. §

empt from registration, the *person* acting as a broker or dealer relative to the offering may not be exempt.[21] The Securities Act of 1933 sets forth requirements for the *securities* and transactions which must be registered; the Securities Exchange Act of 1934 de-

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230.146(g) (1980);

(2) there is no general advertising and no solicitation of ineligible offerrees, *see id.* § 230.146(c);

(3) before offering the security, the issuer has reasonable grounds to belive, and does in fact believe, that the offerees are sophisticated investors or are able to bear the risk of an entire loss, *see id.* § 230.146(d)(1);

(4) before selling the security, the issuer has made a reasonable investigation, determining that the offeree is a sophisticated investor, or is aided by an offeree representative who is a sophisticated investor and the offeree is able to bear the risk of an entire loss, *see id.* § 230.146(d)(2);

(5) each offeree is provided access to or provided with the same type of information that a registration statement would disclose, *see id.* § 230.146(e); and

(6) the issuer ensures that the security will not be resold by the purchaser except as provided by the 1933 Act. *See id.* § 230.146(h).

Rule 146 is not the exclusive definition of a private offering under section 4(2). *See* Doran v. Petroleum Management Corp., 545 F.2d 893, 906 (5th Cir. 1977); Woolf v. S.D. Cohn & Co., 515 F.2d 591, 611-12 n.14 (5th Cir.), *vacated on other grounds*, 426 U.S. 944 (1975). Thus, an offering which fails to satisfy the requirements of rule 146 may nonetheless qualify under section 4(2). For an analysis of the impact of rule 146 on the statutory exemption under section 4(2), see *A Position Paper of the Federal Regulation of Securities Committee Section of Corporation, Banking, and Business Law of the American Bar Association*, *reprinted in* 31 Bus. Law. 485 (1975). In August of 1981, the SEC proposed certain amendments to rule 146. *See* SEC Securities Act Release No. 33,639, 46 Fed. Reg. 41,791 (1981).

21. Rule 146, C.F.R. § 230.146 (1981) exempts *transactions* from section 5 of the 1933 Securities Act, 15 U.S.C. § 77e (1976), while rule 147, 17 C.F.R. § 230.147 (1981) exempts *issues* therefrom. *See* 17 C.F.R. § 230.147 (1979). The federal requirements for registration of brokers and dealers, however, arise from the Securities Exchange Act of 1934. *See* Securities Exchange Act of 1934 § 15, 15 U.S.C. § 78o (1976). *See generally* Glazier, *Securities Registration Exemption Structures And The Texas Real Estate Syndicator: Providing A Ladder Of Professional Development*, 20 S. Tex. L.J. 49, 68 (1980).

Some or all of the issuer's securities may be grouped together as an integrated offering for the purposes of either rule 146 or rule 147. Offerings made under separate exemptions may be treated by the SEC as one offering with a resultant loss of both or either exemptions. Factors used by the SEC to determine integration include: (1) whether the offerings part of a single plan of financing; (2) whether the offerings involve issuance of the same class of security; (3) whether the offerings made at or about the same time; (4) whether the same type of consideration to be received; and (5) whether the offerings made for the same general purpose. SEC Securities Act Release No. 4434, 26 Fed. Reg. 11,896 (1961); *see* Glazier, *Securities Registration Exemption Structures And The Texas Real Estate Syndicator: Providing A Ladder Of Professional Development*, 20 S. Tex. L.J. 49, 64-67 (1980). Texas cases have held that the Texas Securites Act, Tex. Rev. Civ. Stat. Ann. arts. 581—1 to 581—39 (Vernon 1964 & Supp. 1982), regulates sellers as well as sales. *See, e.g.*, Brown v. Cole, 155 Tex. 624, 628-29, 291 S.W.2d 704, 708 (1956); Lewis v. Davis, 145 Tex. 468, 473, 199 S.W.2d 146, 149 (1947); Fowler v. Hults, 138 Tex. 636, 643, 161 S.W.2d 478, 481 (1942).

termines the class of *persons* who must register.[22]

Private offering disclosures are made via confidential private placement memoranda or brochures which provide essentially the same information included in a registration statement.[23] The principal advantages of a private placement are that it is not subject to administrative processing delays of the SEC and that it avoids the guidelines applicable to oil and gas programs established by the National Association of Securities Administrators (NASA).[24] Because some state jurisdictions do not have a blue sky equivalent of rule 146, however, a private offering may not be possible, and the NASA guidelines will apply.[25]

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22. *See generally* Augustine & Fass, *Broker-Dealer Licensing in the Field of Real Estate Syndication*, 29 BUS. LAW. 369 (1974).

23. *See* 17 C.F.R. § 230.146 (1980).

24. *See* NASA, *Guidelines, Registration of Oil and Gas Programs, adopted on September 22, 1976, reprinted in* 1 BLUE SKY L. REP. (CCH) ¶¶ 5222-32. The guidelines "apply to the registration and qualification of oil and gas programs in the form of limited partnerships . . . and . . . by analogy to oil and gas programs in other forms, including general partnerships formed solely to invest as a limited partner in an affiliated program." *Id.* ¶ 5222. Under the guidelines, "the general partner of its chief operating officer must have at least 3 years of relevant oil and gas experience." *Id.* ¶ 5223. In addition, "[i]f . . . affiliates of the general partner provide services to the partnership, the affiliate must have not less than 4 years of relevant experience in the kind of services being rendered." *Id.* ¶ 5222. Finally, "[t]he . . . general partner must have a net worth of $100,000 or 5% of the participant's capital in all existing programs organized by the general partner plus 5% in the programs being offered, whichever is the greater, but in no event is a net worth of in excess of $1 million required." *Id.* ¶ 5223. Suitability standards are also established; investors must have "a net worth of $225,000 or more (exclusive of home, furnishings, or autos), or a net worth of $60,000 and taxable income of $60,000 or more per annum," and "[a] minimum investment of $5,000 is required, which is reduced to $2,500 for a production program." *Id.* ¶ 5225.

25. *See, e.g.*, R.I. GEN LAWS § 7-11-9 (Supp. 1981); S.D. CODIFIED LAWS ANN. § 47-31-82 (Supp. 1981); TEX. REV. CIV. STAT. ANN. art. 581—5(I) (Vernon Supp. 1982); UTAH CODE ANN. § 61-1-14(2) (h)-(i) (Supp. 1981). Rhode Island primarily exempts offerings to institutional investors. *See* R.I. GEN LAWS § 7-11-9 (Supp. 1981). South Dakota provides an exemption for isolated sales, under which no one person or entity can make more than one sale of the same issue during any twelve month period. *See* S.D. CODIFIED LAWS ANN. § 47-31-82 (Supp. 1981). Texas permits a private offering so long as the total number of the issuer's security holders do not exceed thirty-five. *See* TEX. REV. CIV. STAT. ANN. art. 581—5(I) (Vernon Supp. 1982). Utah exempts only sales to institutional investors and sales to a limited number of incorporators. *See* UTAH CODE ANN. § 61-1-14(2) (h)-(i) (Supp. 1981).

III. Sales of Oil and Gas Securities

A. *Broker-Dealer Registration*

An oil and gas program which sells its securities under an exemption of the Securities Act often sells the interests through employees of the sponsor. The major and immediate securities question is whether the sponsor (or its salesman-employee) must register *itself* (or himself) as a broker or dealer under the Securities Exchange Act to satisfy federal law requirements.[26] Moreover, and because of the increased likelihood of specific state regulation, the sponsor may need to comply with broker or dealer registration requirements of various blue sky acts.[27]

1. Federal Intricacies

At least one commentator has maintained that an issuer selling its own securities is neither a broker nor a dealer under the federal securities laws.[28] The issuer is not a broker since it is not engaged in the sale of securities for another;[29] nor is it a dealer because it does not both buy and sell securities.[30] Nonetheless, the employees or other affiliates of the sponsor may be "brokers" because they are "effecting transactions in securities for the account of others."[31]

26. *See* 15 U.S.C. § 78o (1976).

27. *See, e.g.,* N.Y. GEN. BUS. LAW § 359-e(1)(a) (McKinney 1968); OHIO REV. CODE ANN. § 1707.14(e) (Baldwin 1979); TEX. REV. CIV. STAT. ANN. art. 581—4(C) (Vernon 1964).

28. *See* 3A H. BLOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 6.19[2][a], at 6-54 (1981 rev. ed.).

29. *See id.* Section 3(a)(4) of the Securities Exchange Act of 1934 defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78c(a)(4) (1976).

30. Section 3(a)(50) of the Securities Exchange Act of 1934 defines "dealer" as "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise . . . . " 15 U.S.C. § 78c(a)(5) (1976). For purposes of determining whether a *transaction*, as opposed to the *issuer* itself, is exempt from federal registration requirements, the definitions of the Securities Act of 1933 (rather than the Securities Exchange Act of 1934) must be applied. *See* Securities Act of 1933 § 4, 15 U.S.C. § 77d (1976). An issuer selling its own securities will be an "underwriter" under the 1933 Act because the term "underwriter" means "any person who . . . sells for an issuer in connection with, the distribution of any security . . . . " 15 U.S.C. § 77b(11) (1976). As such, there will be no exemption for the *transaction* under section 4(1) of the Securities Act of 1933. *See id.* § 77d(1). The private offering exemption under section 4(2) of the Securities Act, however, is still available to the issuer's transaction. *Id.* § 77d(2); *see* 17 C.F.R. § 230.146 (1979).

31. *See* Securities Exchange Act of 1934 § 3(4), 15 U.S.C. § 78c(a)(4) (1976).

The employees, however, must also be "engaging in the business of selling securities" for others to meet the statutory definition of broker.[32]

Various factors are used by the SEC to determine whether the sellers of securities are brokers or dealers, including: (1) whether the salesmen are employees of the issuer or independent contractors (employees being less likely to be classified broker-dealers than independent contractors);[33] (2) whether the salesmen are paid salaries or commissions (the payment of a commission being less suggestive of employee status);[34] and (3) whether the salesmen are also selling, or have previously sold, securities of other issues (prior experience indicating broker-dealer status).[35]

Essentially, an oil and gas program sponsor has four options relative to federal registration requirements.[36] He can obtain a federal broker-dealer exemption for himself.[37] Alternatively, he can regis-

32. *Id.*; *see* SEC v. United Fin. Group, Inc., 474 F.2d 354, 356-57 (9th Cir. 1973); UFITEC, S.A. v. Carter, 571 P.2d 990, 994, 142 Cal. Rptr. 279, 283 (1977). *See generally* 2 L. Loss, Securities Regulation 1295 (1961); Loomis, *The Securities Act of 1934 and the Investment Advisor's Act of 1940*, 28 Geo. Wash. L. Rev. 214, 246 (1959).

33. *See* SEC No-Action Letter, Stratford of Texas, Inc., (Oct. 6, 1972), *reprinted in* [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 70,099 (officers of corporation selling cattle management contracts with substantial duties other than effecting sales who did not receive special compensation not broker-dealers).

34. *See* SEC No-Action Letter, DeMaheis Dev. Corp. (Sep 2, 1971), *reprinted in* [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,415 (general partner selling limited partnership interests not broker-dealer since no direct compensation).

35. *See* SEC No-Action Letter, Stratford of Texas, Inc. (Oct. 6, 1972), *reprinted in* [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,099; SEC No-Action Letter, DeHameis Dev. Corp. (Sep. 2, 1971), *reprinted in* [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,415.

36. *See* S. Glazier, *Securities Registration Exemption Structures And The Texas Real Estate Syndication: Providing A Ladder Of Professional Development*, 20 S. Tex. L.J. 49, 68-69 (1980).

37. Section 15(a)(1) of the Securities Exchange Act of 1934 exempts a "broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange." 15 U.S.C. § 78o(a)(1) (1976). In 1971, the SEC determined that all of the broker-dealer's activity must be "exclusively intrastate" in order to take advantage of the intrastate exemption, notwithstanding the fact that the *securities* were exempt from registration under the Securities Act of 1933. *See* SEC No-Action Letter, D.H. Burlage (Nov. 17, 1971), *reprinted in* 130 Sec. Reg. & L. Rep. (BNA) C-3. The Texas Securities Act applies if any act in the process of selling securities covered by the act occurs in Texas; it is not necessary that the purchaser reside in the state, and the seller may be any link in chain of selling process. *See* Brown v. Cole, 155 Tex. 624, 629, 291 S.W.2d 704, 708 (1956); Rio Grande Oil Co. v. State, 539 S.W.2d 917, 921-22 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.).

ter himself under federal law as a broker or dealer.[38] Thirdly, he can operate his business in such a manner as to circumvent the federal definitions of broker[39] and dealer.[40] Lastly, he may distribute the securities through a registered securities broker or dealer. Although the oil program sponsor may avoid the federal definitions of broker or dealer on his first project, by the time his enterprises have expanded he will probably require the services of a registered broker or dealer or will have registered himself as a broker or dealer to avoid expenses or litigation.[41]

In January of 1977, the SEC proposed a rule which defined the status of employees selling securities for the issuer.[42] The purpose of the rule was to provide guidance in determining the broker status of promoters of oil and gas drilling programs who had often sought to distribute securities.[43] The proposed rule excluded em-

38. *See* Securities Exchange Act of 1934 § 15(b), 15 U.S.C. 78o(b) (1976). Because it is more desirable to register one broker rather than register each person selling the security, sponsors who do register should register a separate subsidiary as the broker. Bloomenthal, *A Baedeker to Oil and Gas Programs* (pt. 1), 3 SEC. & CORP. L. REP. 39 (1981). The sponsor may register the subsidiary as a member of the National Association of Securities Dealers (NASD) or as a SECO dealer. *See* 17 C.F.R. § 240.15b8-1 (1980). A dealer not a member of the NASD must register with the SEC as a SECO registrant, pay a registration fee, and comport with "just and equitable principles of trade" adopted by the SEC which are similar to NASD requirements. A "SECO registrant" is designated as such because he or she must file one of the three "SECO" forms required by the SEC. *See* 17 C.F.R §§ 249.502a, 249.504n, 249.505 (1981). Employees of the broker who sell the program interests must take an exam similar to the NASD exam. *See* 15 U.S.C. §§ 78o(b)(7)-(9); 17 C.F.R. § 240.15b8-1 (1981).

39. 15 U.S.C. § 78c(a)(4) (1976). The sponsor/general partner who is selling the program's securities may be able to remove himself from this definition because he is not engaged in the business of selling securities for another (since he is selling for his own account) or because he is not conducting the sale as his trade or business (which may be management of partnership property as an ancillary duty to his task or business). *But see* UFITEC, S.A. v. Carter, 571 P.2d 990, 994, 142 Cal. Rptr. (1977). In *Carter* the court held the phrase "engaged in the business" connotes a certain regularity of participation in purchasing and selling securities, but there is no requirement this activity be a person's principal business or principal source of income. *See id.* at 994, 142 Cal Rptr. at 283.

40. 15 U.S.C. § 78c(a)(5) (1976). The sponsor/general partner who is selling the program's securities may be able to remove himself from this definition because he is not engaged in the business of buying *and* selling securities since he is only selling securities, not buying them.

41. *See* Glazier, *Securities Registration Exemption Structures And The Texas Real Estate Syndicator: Providing A Ladder Of Professional Development*, 20 S. TEX. L.J. 49, 69 (1980).

42. *See* SEC, Securities Exchange Act Release No. 13,195, 42 Fed. Reg. 5084 (1977).

43. *See id.*

ployees meeting certain criteria from the federal broker-dealer definition. Employees who had not engaged in a distribution of securities for two years and received no additional, special compensation for selling were excluded. These employees, however, were required to have additional duties to the issuer after the distribution of the securities. Moreover, they had to limit their activities in the offering to delivering the prospectus, conducting administrative work, and communicating with investors in the manner prescribed by rule 134.[44] Although the rule was never officially adopted by the SEC, it provides objective guidelines in determining whether employees of the issuer are in fact brokers or dealers.

2. Federal Requirements of Broker-Dealers

If an issuer is ultimately classed as a broker-dealer under federal law, it must possess a minimum net capital, as well as satisfy regulations which restrict the amount of indebtedness allowed in relation to the issuer's net worth.[45] In addition, the broker-dealer's employees who sell the securities must obtain a state blue sky salesman license and register with the national stock exchange of which their employers are members.[46] After the initial registration, federal requirements continue to apply to the broker-dealer. Detailed record keeping and reporting requirements must be met.[47] The ability of the broker-dealer to extend credit is also curtailed by regulations promulgated by the Federal Reserve Board and en-

44. *See id.* Rule 134, 17 C.F.R. § 230.134 (1980), was adopted by the SEC pursuant to the authority vested in the Commission by section 2(10) of the Securities Act of 1933, 15 U.S.C. § 77b(10) (1976). Under rule 134, a prospectus is not deemed to include notices, circulars, advertisements, letters, or other communications if they contain only stipulated information. *See* 17 C.F.R. § 230.134 (1980).

45. *See* C.F.R. § 240.15c3-1 (1979). *See generally* Augustine & Fass, *Broker-Dealer Licensing in the Field of Real Estate Syndication*, 29 BUS. LAW. 369, 388-91 (1974).

46. *See* 15 U.S.C. §§ 78o(b)(7)-(9); 17 C.F.R. § 240.15b8-1 (1979); *see also* H. BLOOMENTHAL, 1980 SECURITIES LAW HANDBOOK 204 (Securities Law Series 1980).

47. *See* 17 C.F.R. § 240.17a-5 (1981). Monthly, quarterly, and annual reports must be filed with the Commission. The annual report must detail the broker-dealer's financial condition. *See id.* § 240.17a-5(d). The annual audit reports must include statements of financial condition, income (or loss), changes in financial position, changes in stockholders' equity or partners' or sole proprietors' capital, and changes in liabilities subordinated to claims of general creditors. The audit must also contain net capital computation and reserve requirements computation schedules. *See id.* § 240.17a-5(d). Moreover, the broker-dealer must furnish the customers various statements, including a balance sheet, a footnote indicating his actual net capital, and notices that his most recent annual audit report is available for inspection at the SEC's regional office. *See id.* § 240.17a-5(c).

forced by the SEC.[48]

By virtue of their "broker-dealer" status, issuers of securities become amenable to fraud suits.[49] Broker-dealers are subject to general fraud provisions of sections 15(c) and 10(b) of the Exchange Act,[50] and section 17(a) of the Securities Act.[51] Sections 15(c)(1) and (2) of the Exchange Act authorize the SEC "to proscribe, as to broker-dealers effectuating or attempting to effectuate the purchase or sale of a security, . . . practices which are manipulative, deceptive or otherwise fraudulent."[52] Rule 15(c)(1-2), promulgated to enforce section 15(c),[53] is limited to actions against *broker-dealers* who are selling and purchasing securities. Section 10 of the Exchange Act, however, is a proscription against *any person* selling or purchasing.[54] Section 17 of the Securities Act proscribes only fraud in offers or *sales* (not purchases).[55]

By entering the securities business, broker-dealers impliedly warrant they will deal fairly with their customers. This is the so-called "shingle theory."[56] As a result, broker-dealers are prohibited

48. *See* Securities Exchange Act of 1934 §§ 7(c), 11(d), 15 U.S.C. §§ 78g(c), 78k(d) (1976); 12 C.F.R. § 220 (1981). It is unlawful for a broker or dealer to extend credit to or for a customer on any security (other than an exempted security) which was part of a new issue he participated in as a member of a selling sponsor within thirty days prior to the transaction. 15 U.S.C. § 78k(d) (1976).

49. *Id.* § 78o(c).

50. *Id.* § 78j(b).

51. *Id.* § 77q(a).

52. *Id.* §§ 78o(c)(1), (2). Section 15(c)(1) and rule 15c1-2 are applicable to "exempted securities," but section 15(c)(2) is not. Rather, section 15(c)(2) is applicable to "acts" and "practices"; section 15(c)(1) is applicable to "devices" and "continuances." Section 15(c)(1), therefore, is probably broader in its regulation of exempted securities. Rule 15c1-2 defines the proscribed practices of section 15(c)(1) as:

(1) an untrue state of a material fact,

(2) a statement misleading because of omission of a material fact, or

(3) a practice which operates or would operate as a fraud or deceit upon any person.

17 C.F.R. § 240.15c1-2(a)-(b) (1979).

53. *See id.* § 240.15c1-2 (1979).

54. *See* Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 12 (1971); 15 U.S.C. § 78j (1976).

55. In the sale or offer for sale of securities, it is unlawful to (a) make an untrue statement of a material fact; (b) make a statement which is misleading because of the omission of a material fact; (c) employ any device, scheme, or artifice to defraud; or (d) engage in any practice which operates as a fraud or deceit. Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (1976); *see* Dyer v. Eastern Trust & Banking Co., 336 F. Supp. 890, 903-905 (D. Me. 1971).

56. *See* H. BLOOMENTHAL, 1980 SECURITIES LAW HANDBOOK 206 (Securities Law Series 1980).

from charging prices unreasonable compared to the market price;[57] making recommendations without a reasonable basis;[58] excessively trading customer's accounts;[59] recommending purchases unsuitable for the particular customer;[60] and selectively disclosing inside information to favored customers.[61]

B. General Blue Sky Considerations

Oil and gas programs sold in reliance on a private offering or intrastate exemption often have to meet applicable blue-sky laws. Because of the exemption of oil and gas programs from the requirements of the Investment Company Act of 1940[62] and the Commission's position that NASD lacks authority to regulate oil and gas programs, NASA guidelines[63] are a powerful tool in state blue-sky administrator's workshops.

The Uniform State Securities Act expressly excludes an "issuer" from the definition of a broker-dealer.[64] In no less than four states, however, an issuer selling its own securities is a "dealer" or "issuer dealer."[65] In some of these states, a dealer-issuer selling under a limited-offering exemption is exempt from the dealer registration.[66]

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57. *See* Charles Hughes & Co. v. SEC. 139 F.2d 434, 436 (2d Cir. 1943).

58. *See* Hanley v. SEC, 415 F.2d 589, 596 (2d Cir. 1969); MacRobbins & Co., 40 S.E.C. 497 (1962).

59. *See* Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 431-37 (C.D. Cal. 1968).

60. *See* 17 C.F.R. § 240.15b10-3 (1979) (proscription of SECO dealers).

61. *See* Shapiro v. Merill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235-36 (2d Cir. 1974).

62. 15 U.S.C. § 80a-3(c)(11) (1976).

63. *See* NASA, *Guidelines, Registation of Oil and Gas Programs, adopted on September 22, 1976, reprinted in* 1 BLUE SKY L. REP. (CCH) ¶¶ 5222-32.

64. *See* Uniform State Securities Act § 401(c); *see also* L. LOSS, COMMENTARY OF THE UNIFORM SECURITIES ACT 91, 96-97 (1976) (setting forth the Act's definitions of "Broker-Dealer" and "Issuer"). There are thirty-nine (39) jurisdictions which have adopted significant portions of the Uniform Act: Alabama, Alaska, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Guam, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New Jersey, North Carolina, Oklahoma, Oregon, Pennsylvania, Puerto Rico, South Carolina, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. *See* 1 BLUE SKY L. REP. (CCH) ¶ 1503.

65. *See* NEB. REV. STAT. § 8-1101(3)(a) (Supp. 1980); N.Y. GEN. BUS. LAW § 359-e(1)(a) (McKinney 1968); OHIO REV. CODE ANN. § 1707.01 (E) (Baldwin 1979); TEX. REV. CIV. STAT. ANN. art. 581—4(C) (Vernon 1964).

66. *See* NEB. REV. STAT. § 8-1111(9) (Supp. 1980); TEX. REV. CIV. STAT. ANN. art.

If an issuer is subject to the dealer provisions of the state, he must comply with the relevant *dealer* registration provisions, which in all cases requires extensive filing. In some states, dealer registration is required in addition to registration of the securities.[67] In other states, even though the *securities* need not be registered, the *issuer* must register as a dealer because he is selling his own securities.[68] Some states, moreover, exclude the issuer-dealer from the bond and net capital requirements otherwise applicable to dealers.[69]

C. *Texas Blue Sky Law and Regulation*

An issuer of securities who meets the statutory definition of "dealer" or "salesman," but who does not register as such in Texas, violates section 12 of the Texas Securities Act (TSA)[70] and is subject to liability under section 33(a)(1)[71] unless the transaction can be exempted under section 5.[72] If the issuer is not a dealer, execu-

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581—4 (Vernon 1964).

67. *See* NEB. REV. STAT. §§ 8-1103, 8-1104 (1977); N.J. STAT. ANN. §§ 49:3-56(a) (West 1970); OHIO REV. CODE ANN. §§ 1707.07, 1707.14 (Baldwin 1979); TEX. REV. CIV. STAT. ANN. arts. 581—7 (Vernon 1964 & Supp. 1982), 581—12 (Vernon 1964).

68. *See* N.Y. GEN. BUS. LAW § 359-e(3) (McKinney 1968); TEX. REV. CIV. STAT. ANN. art. 581—12 (Vernon 1964).

69. *See* N.Y. GEN. BUS. LAW § 352-k(3) (McKinney 1968). Some states, including Texas, make no provision for bonding. *See, e.g.*, 2 BLUE SKY L. REP. (CCH) ¶¶ 37,052 (New York), 40,051 (Ohio); 3 BLUE SKY L. REP. (CCH) ¶ 49,052 (Texas).

70. TEX. REV. CIV. STAT. ANN. arts. 581—1 to 581—39 (Vernon 1964 & Supp. 1982) "Except as provided in Section 5 of this Act, no person . . . shall, directly or through agents or salesman, offer for sale, sell or make a sale of any securities in this state without first being registered . . . . No salesman or agent shall, in behalf of any dealer, sell, offer for sale, or make sale of any securities within the state unless registered as a salesman or agent of a registered dealer . . . . " *Id.* art. 581—12 (Vernon 1964).

71. *See id.* art. 581—33. "A person who offers or sells a security in violation of Section . . . 12 . . . is liable to the person buying the security from him, who may sue at law or in equity for recission or for damages if the buyer no longer owns the security." *Id.* art. 581—3(A)(1) (Vernon Supp. 1982); *see* Bierschwale v. Oakes, 497 S.W.2d 506, 522 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 516 S.W.2d 125, 130 (Tex. 1974).

72. The Act is not applicable to certain transactions. *See* TEX. REV. CIV. STAT. ANN. art. 581—5 (Vernon Supp. 1982). Exempt transactions can be broadly classified as *issuer* and *non-issuer* exemptions. The issuer exemptions include:

(1) *Private, Limited Offerings. Id.* art. 581—5(I)(a) & (c) (so long as total number of security *holders*—not offerees or purchasers—does not exceed 35); *see, e.g.*, Dean v. State, 433 S.w.2d 173, 177-78 (Tex. Crim. App. 1968); Birchfield v. State, 401 S.W.2d 825, 828 (Tex. Crim. App. 1966); Sibley v. Horn Advertising, Inc., 505 S.W.2d 417, 419 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.), *cert denied*, 420 U.S. 929 (1975).

tives and employees of the issuer actually selling the securities their employers have authorized them to sell do not have to be licensed as salesmen.[73] If an issuer is a registered dealer, however,

(2) *Sales to Existing Security Holders.* TEX. REV. CIV. STAT. ANN. art. 581—5(E) (Vernon Supp. 1982).

(3) *Sales in the Course of Certain Reorganizations and Acquisitions. Id.* art. 581—5(F)-(G); *see* Maddox v. Flato, 423 S.W.2d 371, 376 (Tex. Civ. App.—Corpus Christi 1967, writ ref'd n.r.e.).

(4) *Sales to Certain Financial Institutions.* TEX. REV. CIV. STAT. ANN. art. 581—5(H) (Vernon Supp. 1982).

(5) *Sales Pursuant to Qualified Employee Stock Option and Pension Plans. Id.* art. 581—5(I)(b).

(6) *Sales to Security Dealers. Id.* art. 581—5(H) (so long as dealer is registered and "actually engaged in buying and selling securities"); *see, e.g.,* Gerschscheimer v. American Heritgage Bank & Trust Co., 437 F.2d 1332, 1334 (5th Cir. 1971); Development Inv. Corp. v. Diversa, Inc., 393 S.W.2d 653, 657 (Tex. Civ. App.—Texarkana 1965, no writ); Dunham v. Dillingham, 345 S.W.2d 314, 319 (Tex. Civ. App.—Austin 1965, no writ).

(7) *Sales of Exempt Securities.* TEX. REV. CIV. STAT. ANN. art. 581—5(R) (Vernon Supp. 1982). *See generally* Bromberg, *Civil Liability Under Texas Securities Act § 33 (1977) And Related Claims,* 32 Sw. L.J. 867, 896-97 n.102 (1978).

(8) *Sales of Securities of a Nonprofit Issuer.* TEX. REV. CIV. STAT. ANN. art. 581—5(K) (Vernon Supp. 1982).

The non-issuer exemptions apply to sales of securities by person other than the issuer. The major exemptions include:

(1) *Sales of Outstanding Securities by Owners.* TEX. REV. CIV. STAT. ANN. art. 581—5(C)(1) (Vernon Supp. 1982); *see* Bierschwale v. Oakes, 497 S.W.2d 506, 521-22 (Tex. Civ. App.—Houston [1st Dist.] 1973), *rev'd on other grounds sub nom.* Meadows v. Bierschwale, 519 S.W.2d 125 (Tex. 1974); Prokop v. Krenek, 374 S.W.2d 265, 268-71 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.).

(2) *Sales of Outstanding Securities by Registered Dealers.* TEX. REV. CIV. STAT. ANN. art. 581—5(0) (Vernon Supp. 1982).

(3) *Sales of Outstanding Securities by Dealers Pursuant to Unsolicited Purchase Orders. Id.* art. 581—5(P).

(4) *Private, Limited Offerings of Oil and Gas Interests. Id.* art. 581—5(Q).

(5) *Sales to Security Dealers. Id.* art. 581—5(H) (available to both issuers and non-issuers).

73. *See* TEX. REV. CIV. STAT. ANN. art. 581—4(d) (Vernon 1964). A salesman includes "every person or company employed or appointed or authorized by a dealer to sell, offer . . . or deal in any other manner, in securities within this state, whether by direct act or through subagents." *Id.* If the issuer *is* a registered dealer, his salesman must be registered. *See id.* 581—12 (Vernon 1964). There is some argument that a salesman of securities which his employer has *not* authorized him to handle may in fact be a dealer and responsible for registering himself as a dealer as opposed to being registered as a salesman. *See* Bromberg, *Civil Liability Under Texas Securities Act § 33 (1977) And Related Claims,* 32 Sw. L.J. 867, 939 (1978). There is also an argument that an employer has absolute vicarious liability for his salesman's securities transactions even though the employer did not authorize the salesman to conduct sales of a particular security—e.g., sales of a personal nature. This argument stems from the essence of the "Agreement by Employer" signed by a dealer in a

he may be liable under section 33(A)(1) for a sale made by his unregistered salesman or agent.[74]

In order for the civil liability section of the TSA[75] to apply, the plaintiff must allege and prove that he purchased and the defendant sold, by himself or via salesmen, a security to the plaintiff in Texas, and that the defendant was a person, firm, corporation, or dealer unregistered under section 12.[76] Whether the issuer was registered under federal law or other state law as a dealer is irrelevant.[77] In addition, it does not matter whether the security itself was registered.[78]

Section 4(c) is the statutory definition of "dealer."[79] The term

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salesman's registration application. *See* TEX. REV. CIV. STAT. ANN. art. 501—18 (Vernon 1964). The agreement provides that the dealer will be responsible for all securities transaction performed by the salesman/applicant. Legal questions of "apparent authority" of an agent pertain in such instances. *Cf.* Christie v. Brewer, 374 S.W.2d 908, 913 (Tex. Civ. App.—Austin 1964, writ ref'd n.r.e.) (agent held to have possessed apparent authority to solicit plaintiff for purchase of stock). Officers or partners of a dealer apparently need not register as salesmen. *See* TEX. REV. CIV. STAT. ANN. art. 581—4(D) (Vernon 1964); *cf. id.* arts. 581—15, 581—17 (dealer registration certificate issued with the names of "principals, officers, directors or managing agents" and must be changed with change in their personnel). *See generally* Bromberg, *Civil Liability Under Texas Securities Act § 33 (1977) And Related Claims*, 32 Sw. L.J. 867, 937 n.304 (1978).

74. *Cf.* TEX. REV. CIV. STAT. ANN. art. 581—14(D) (Vernon 1964). Article 581—14(D) provides that a dealer's registration may be revoked for using an unregistered salesman. For such violation, dealer liabilities can be reached by alleging a registration violation under article 581—33(A)(1) (providing for rescission or damages for offer or sale in violation of article 581—12) or by alleging a control person relationship under article 581—33(F)(1) (providing for joint and several liability). *See id.* art. 581—33(A)(1), (F)(1).

75. *Id.* art. 581—33.

76. *See id.* art. 581—12 (Vernon 1964); *see also* Bromberg, *Civil Liability Under Texas Securities Act § 33 (1977) And Related Claims*, 32 Sw. L.J. 867, 924-25 (1978).

77. *See* Shappley v. State; 520 S.W.2d 766, 768 (Tex. Crim. App. 1974) (immaterial whether anyone required securities dealers to register because Texas Blue Sky Laws apply).

78. *Cf.* TEX. REV. CIV. STAT. ANN. art. 581—12 (Vernon 1964) (which speaks in terms of registering the dealer unless the particular transaction is exempt for registration).

79. *See id.* art. 581—4(C) (Vernon 1964).

> The term "dealer" shall include very person or company, other than a salesman, who engages in this state, either for all or part of his or its time, directly or through an agent, in selling, offering for sale or delivery or soliciting subscriptions to or orders for, or undertaking to dispose of, or to invite offers for, or rendering services as an investment adviser, or dealing in any other manner in any security or securities within this state. Any issuer other than a registered dealer of a security or securities, who, directly or through any person or company, other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer and shall be required to comply with the provisions hereof; provided, however, this section or provision shall not apply to such issuer when such security or securities are offered for sale or sold either to a registered dealer or only by or through a registered

includes individuals, partnerships, corporations, and any other issuer[80] selling it's own securities.[81] The issuer can escape classification as a "dealer" only by selling its securities through a registered dealer or by conducting the transaction in such a manner to exempt the transaction from registration under section 5.[82]

In *Cosner v. Hancock*,[83] for example, a seller of the defendant's oil payment sued to recover a commission.[84] The seller/plaintiff was held to be a dealer by his actions.[85] Because he had failed to register as a dealer, he was denied recovery of his commission.[86] *Cosner*, however, was a 1941 suit for a salesman's commission in which the defense of failure to register as a dealer was proferred. Non-existent at the time were the civil liability provisions of section 33, which allow a separate cause of action for failure to register as a dealer.[87] From 1941 to 1963 the *civil* liability provisions of the TSA provided the sale of a security or a contract made in violation of any section of the Act was voidable.[88] This included a *criminal* penalty for failure to register as a dealer, salesman, or agent.[89] In 1963, section 33 was added, providing for an express civil remedy against an unregistered person selling or offering securities in Texas.[90]

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dealer acting as fiscal agent for the issuer; and provided further, this section or provision shall not apply to such issuer if the transaction is within the exemptions contained in the provisions of Section 5 of this Act.

Id. art. 581—4(C).

80. Article 581—4(B) states that "person" and "company" include "a corporation, person, stock company, partnership, limited partnership, association, company, firm, syndicate, trust, incorporated or unincorporated . . . . "*Id.* art. 581—4(B) (Vernon Supp. 1982).

81. *See id.* art. 581—4(C) (Vernon 1964).

82. *See id.* art. 581—4(C).

83. 149 S.W.2d 239 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.).

84. *See id.* at 239-40.

85. *See id.* at 243.

86. *See id.* at 243; *see also* Kadane v. Clark, 135 Tex. 406, 500, 143 S.W.2d 197, 199-200 (1940) (having undertaken to sell oil and gas leases, seller was a dealer).

87. *Compare* 1941 Tex. Gen. Laws, ch. 363, § 1, at 593 (any sale or contract of sale of any security made in violation of TSA shall be voidable at election of purchaser) *with* TEX. REV. CIV. STAT. ANN. art. 581—33(A)(1) (Vernon Supp. 1982) (person selling without registering in accordance with TSA section 12 liable for rescission or damages).

88. *See* 1957 Tex. Gen. Laws, ch. 269, § 33, at 600-01; 1955 Tex. Gen. Laws, ch. 67, § 34, at 344; 1941 Tex. Gen. Laws, ch. 363, § 1, at 593.

89. *See* 1957 Tex. Gen. Laws, ch. 269, § 29, at 598; 1955 Tex. Gen. Laws, ch. 67, § 30, at 342; 1935 Tex. Gen. Laws, ch. 100, § 30, at 276.

90. *See* 1963 Tex. Gen. Laws, ch. 170, § 12, at 478.

In *Breeding v. Anderson*,[91] (also a pre-section 33 civil liability suit) the plaintiff sued for wrongful conspiracy to defraud him of earned compensation for services rendered in the sale of oil and gas leases.[92] The defense was that plaintiff had not obtained a license as a dealer. The court held that because the plaintiff was not the owner of the securities he was offering for sale, he was required to be licensed.[93] The supreme court, moreover, ruled that one engaging in a *single* or *isolated* transaction is not exempt from the license requirements of the Act.[94] *Breeding v. Anderson* is powerful precedent but must be distinguished from modern cases concerning original suits for civil liabilities against a defendant who sells securities without registering as a dealer. *Breeding* and *Cosner* were suits *by* an alleged dealer for a commission, not suits *against* an issuer for failure to register as a dealer. The plaintiffs in both cases were *not issuers* of securities, but merely agents or salesman of the issuer. Finally, at the time *Anderson* and *Cosner* were decided, the TSA excluded *owners* of securities from the definition of "dealers"; persons employed to aid the *owner* or *seller* were required to obtain dealer or broker licenses.

The leading Texas case on the "dealer" issue is *Enntex Oil & Gas Co. v. State*,[95] a prosecution by the Attorney General of Texas for an injunction under section 32.[96] The Attorney General alleged that four defendants had offered, sold, issued, and dealt with interests in oil, gas, and mining leases without registering or licensing either themselves or the securities.[97] Three of the four corporations were organized for the purpose of selling undivided interests in oil and gas leases located in Texas through telephone solicitations

91. 152 Tex. 92, 254 S.W.2d 377 (1953).

92. *See id.* at 94, 254 S.W.2d at 378.

93. *See id.* at 97, 254 S.W.2d at 379.

94. *See id.* at 97, 254 S.W.2d at 380. *Breeding* was a suit for a seller's commission. Persons subject to "dealer" status, however, must be mindful of *Dean v. State*, 433 S.W.2d 173 (Tex. Crim. App. 1968), in which criminal penalties were sanctioned because of the seller's four prior attempts at solicitation as well as limited activity in the disputed transaction. Although a conviction was reversed on other grounds, the court held the seller was criminally liable for failure to register as a dealer. *See id.* at 176-77, 179.

95. 560 S.W.2d 494 (Tex. Civ. App.—Texarakana 1977, writ ref'd n.r.e.), *appeal dism'd*, 439 U.S. 961 (1978).

96. *See* TEX. REV. CIV. STAT. ANN. art. 581—32 (Vernon 1964).

97. *See* Enntex Oil & Gas Co. v. State, 560 S.W.2d 494, 495 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.), *appeal dism'd*, 439 U.S. 961 (1978).

originating in Texas.[98] These three defendants sold undivided interests in oil and gas leases located in Texas to non-residents of Texas, "scrupulously" avoiding sales to Texas residents. The fourth defendant, Spindletop Oil & Gas Co., argued that it had not violated the TSA because it had not engaged in any sales activities.[99] The court of civil appeals disagreed. Spindletop had owned all of the issued and outstanding stock of Enntex.[100] Prior to litigation, however, Enntex was dissolved, with Spindletop acquiring its assets, including producing wells.[101] Enntex was a Schedule "D" Co. actively engaged in selling undivided interests in oil and gas leases located in Texas to non-residents.[102] By merely acquiring management of the wells drilled by Enntex, Spindletop became a "dealer" under section 4(c).[103] The court stated that Enntex should have registered the securities when it originally disposed of them. The securities were originally, and remained, subject to registration. Accordingly, the court held that regulation cannot be avoided by a wrongdoer's transfer of its assets.[104] Perhaps this case can be distinguished from future cases since Spindletop and Enntex were closely connected. A leading commentator has stated the holding is questionable and should not be expanded to different fact situations.[105]

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98. *Id.* at 495.

99. *See* Enntex Oil & Gas Co. v. State, 560 S.W.2d 494, 498 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.), *appeal dism'd*, 439 U.S. 961 (1978).

100. At the commencement of litigation, Spindletop owned all of the issued and outstanding stock of Enntex Oil & Gas of Nevada. *Id.* at 498. Enntex Oil & Gas of Texas, dissolved prior to litigation, was also owned by Spindletop. *Id.* at 498.

101. The producing wells were co-owned by out of state investors. *Id.* at 498.

102. *Id.* at 495-96. Schedule D issuers derive their designation from the name of the form they are required to file with the SEC. *Id.* at 496. Pursuant to regulation B promulgated by the SEC under the 1933 Act, 17 C.F.R. §§ 230.300-230.346 (1981), an offeror of fractional undivided interests must file an offering sheet with the SEC. *Id.* § 230.101. Schedule D applies if "the interests offered are nonproducing overriding royalty interests, working interests, or are oil payments, gas payments, or oil and gas payments to be made from tracts represented to be producing at the time of the offering." *Id.* § 230.101(a)(4).

103. Enntex Oil & Gas Co. v. State, 560 S.W.2d 494, 498 (Tex. Civ. App.—Texarkana 1977, writ ref'd n.r.e.), *appeal dism'd*, 439 U.S. 961 (1978). Spindletop, however, had not attempted to *sell* any securities.

104. *Id.* at 498.

105. A. Bromberg, *Civil Liability Under Texas Security Act § 33 (1977) And Related Claims*, 32 Sw. L.J. 867, 930 (1978). Cases prior to *Enntex* were more lenient. In Mackenzie v. Newton, 341 S.W.2d 498 (Tex. Civ. App.—San Antonio 1960, writ ref'd n.r.e.), the court held that a dealer's license was not required before a person could enter into a contract of joint venture with another to acquire oil leases and royalties for their joint ownership. *See*

Issuers beset by possible liabilities may have a valid argument that a "dealer" is only one who is "in the business" of selling securities. Cases supporting such an argument include *Cosner v. Hancock*,[106] *Anderson v. Eliot*,[107] and *Stone v. Eastham*.[108] Professor Bromberg, the principal drafter of the 1977 revisions to section 33 feels that before "dealer" status attaches, the person must be engaged in "activity with the investing public for the purposes of making profit from the services (as distinguished from profit from the ownership of the securities)."[109] Bromberg, however, feels that a 'person who actively sells securities to other investors and, for compensation, aids investors in selling to third persons—all without intervention of a registered dealer—is in the securities business . . . and should be regarded as a dealer.[110]

The Texas State Securities Board provides specific guidelines for registering of oil and gas drilling programs.[111] Officers and directors of sponsors who sell participation units must be licensed as broker-dealers "when required by statute,"[112] and officers and directors may be paid no commissions in any form in connection with the sale of the units.[113] The broker-dealer, moreover, must take all ac-

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id. at 501; *see also* Fitz-Gerald v. Hull, 150 Tex. 39, 43, 237 S.W.2d 256, 258 (1951) (sellers not protected against buyers). In Herren v. Hollingsworth, 140 Tex. 263, 167 S.W.2d 735 (1943), the court required no dealer license of a real estate broker who procured a drilling contract, the terms of which were agreed upon by the landowner and driller. *See id.* at 270-71, 167 S.W.2d at 739. Likewise, in Fowler v. Hults, 148 Tex. 636, 161 S.W.2d 478 (1942) the court ruled that a secretary/treasurer of a farm loan association was not a dealer in securities. The secretary/treasurer was employed under an oral contract with a prospective purchaser to assist the purchaser in procuring oil and gas leases from a landowner. *See id.* at 644-45, 161 S.W.2d at 482. The epitome of *criminal* liability in the broker-dealer registration issue is *Shappley v. State*, 520 S.W.2d 766 (Tex. Crim. App. 1975). In *Shappley* a telephone conversation between a salesman in Arizona and a securities buyer in Texas was deemed an "offer" to a person within Texas. The fact that the sale was to be finalized in Arizona was immaterial. Criminal liability for selling securities without being registered as a dealer or salesman in Texas attached. *Id.* at 768; *accord* People v. Augustine, 204 N.W. 747, 748 (Mich. 1925).

106. 149 S.W.2d 239, 243 (Tex. Civ. App.—El Paso 1941, writ dism'd judgmt cor.).

107. 333 S.W.2d 654, 658 (Tex. Civ. App.—Eastland 1960, writ ref'd).

108. 541 S.W.2d 473, 479 (Tex. Civ. App.—Dallas 1976, no writ).

109. Bromberg, *Civil Liability Under Texas Securities Act § 33 (1977) And Related Claims*, 32 Sw. L.J. 867, 930-31 (1978).

110. *Id.* at 931.

111. *See* TEX. ADMIN. CODE ANN. tit. 7, §§ 121.1-121.4 (McGraw Hill 1979). The minimum purchase in a drilling program is $5,000.00. *Id.* tit. 7, § 121.3(a).

112. *See id.* tit. 7, § 121.3(d)(1).

113. *See id.* tit. 7, § 121.3(d)(1).

tion reasonably required to assure that oil and gas program interests are sold only to suitable purchasers.[114] Thus, officers and directors of issuers of oil and gas programs are considered broker-dealers, consonant with statutory interpretation.

If registration as a broker-dealer is ultimately decided upon, it may be done by either general or restricted registration.[115] A restricted registration of oil and gas program interests exists only for "the sale of interests in oil, gas, and mining leases, fees or titles, or contracts relating thereto."[116] The issuer of limited partnership interests in oil and gas, however, must register as a general securities dealer.[117] A specific registration entitles the dealer to take a less rigorous examination[118] and allows him to keep much less detailed records.[119]

IV. Conclusion

The practicing attorney confronted with the complexities of the securities laws must present cogent advice to the oil and gas operator who seeks an external source of funds for drilling capital. In our opinion, the best course for an operator to follow is to secure both state and federal registrations for broker-dealer status, including membership in the NASD. This conclusion is based on the following points:

1. Federal and state law arguably require registration.
2. Because of the growing amount of public funds invested into drilling programs, federal and state authorities who are charged with enforcement of broker-dealer registration requirements will probably increase enforcement efforts.
3. Registration as a broker-dealer is relatively inexpensive to

114. *See id.* tit. 7, § 121.3(d)(3). This requires the sponsor to make a reasonable investigation of the investor's financial capacity to absorb the risk of the investment. *See id.* tit. 7, § 121.3(d)(3)(A). The Texas State Securities Board, moreover, requires the sponsor to retain all records necessary to substantiate the sponsor's assertion of investor suitability. *See id.* tit. 7, § 121.3(d)(3)(B).

115. *See id.* tit. 7, § 115.1(a)-(b) (McGraw Hill 1981).

116. *Id.* tit. 7, § 115.1(b)(1)(A).

117. *See id.* tit. 7, § 115.1(b)(1)(A).

118. *See id.* tit. 7, § 115.3(c)(3)(E).

119. *Compare id.* tit. 7, § 115.5(a)(1) (general dealer requirements) *with id.* tit. 7, § 115.5(a)(3) (restricted dealer requirements). Restricted dealers in oil and gas programs need only "keep and maintain records adequate to reflect customer transactions, and [the] dealer's financial condition." *Id.* tit. 7, § 115.5(a)(3).

achieve in terms of time and money.

4. Subjecting operators raising funds to securities regulation will result in a better market place for the investors by reducing the number of fraudulent operators and increasing public and investor confidence.

5. Compliance with securities regulations affords an operator protection from lawsuits based on technicalities which have a significant chance of success without such compliance.