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Wm. Lane Pennington

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OIL AND GAS TRANSACTIONS UNDER THE OKLAHOMA SECURITIES ACT—A SCHEME OF INVESTORS' INSURANCE?

I. INTRODUCTION

In 1976 the Oklahoma legislature amended the Oklahoma Securities Act¹ to include oil and gas interests within the definition of a security.² This amended definition, however, has two important exclusions. First, it excludes those transactions between persons engaged in the exploration for or production of oil and gas.³ The amended definition also excludes the execution of leases by the owners of land, mineral, or royalty interests, but only so long as the execution is in favor of persons engaged in the exploration for or production of oil and gas.⁴ The obvious purpose of these exclusions was to except from the purview of the Act intra-industry transactions, presumably because investors in these type transactions were seen as not requiring the protection of the Act.⁵

Notwithstanding the breadth of these two exclusions, the amended definition includes several other situations in which the investor also does not need the protection of the Act. In failing to address these situations, the Oklahoma legislature has created a virtually risk-free avenue into speculation on oil, gas, and other mineral interests. If, for example, an unregistered oil and gas transaction not involving the exclusions were to transpire and subsequently prove unfruitful, the Act would, under some circumstances, allow the purchaser to rescind the entire transaction and recover any consideration tendered.⁶ By providing this avenue through which investors can avoid the economic risks normally accompanying oil and gas development, the legislature has

1. OKLA. STAT. tit. 71, §§ 1-504 (1971).

2. 1976 Okla. Sess. Laws, ch. 89 § 1, (codified at OKLA. STAT. tit. 71, § 2(20)(R) (Supp. 1979).

3. OKLA. STAT. tit. 71, § 2(20)(R) (Supp. 1979).

4. *Id.*

5. The Oklahoma courts have long held that the intent of the securities laws was "to prevent stockholders and promoters from perpetrating frauds and impositions on unsuspecting investors in hazardous undertakings; [and] to protect credulous and incompetent persons from their own inclinations to speculate in hazardous enterprises" *Hornaday v. State*, 21 Okla. Crim. 354, 361-62, 208 P. 228, 231 (1922).

6. See notes 59-78 *infra* and accompanying text.

effectively provided such investors with an insurance scheme to protect their investment.

This note initially presents a general overview of the Act and briefly discusses the importance of avoiding security classification. Second, an examination of the types of oil and gas transactions included within the definition of a security under the Oklahoma Securities Act and the reasons for their inclusion is presented. Concurrent with this examination, the exclusions described above will be analyzed.

II. BACKGROUND

A. Overview of the Oklahoma Securities Act

The Oklahoma Securities Act⁷ is generally patterned after the Uniform Securities Act⁸ which has been adopted by thirty-four states.⁹ The Oklahoma Act is divided into six articles. Article One includes a definitional section¹⁰ and created the Oklahoma Securities Commission.¹¹ Numerous lengthy definitions are codified in this article. These include the definitions of "agent,"¹² "broker-dealer,"¹³ "investment adviser,"¹⁴ "issuer,"¹⁵ "nonissuer,"¹⁶ and "security."¹⁷

Article Two consists of two sections which define "fraudulent practices" within the meaning of the Act. Section 101 of Article Two is nearly identical to Securities and Exchange Commission Rule 10b-5¹⁸

7. OKLA. STAT. tit. 71, §§ 1-504 (1971). For a detailed discussion of the Oklahoma Act see Dorwart & Holden, *An Overview of the Oklahoma Securities Act*, 25 OKLA. L. REV. 184 (1972).

8. Annot., 7A U.L.A. 561 (1978).

9. *Id.* at 81 (Supp. 1980).

10. OKLA. STAT. tit. 71, § 2 (1971).

11. OKLA. STAT. tit. 71, § 3 (1971).

12. OKLA. STAT. tit. 71, § 2(4) (Supp. 1979).

13. OKLA. STAT. tit. 71, § 2(5) (Supp. 1979).

14. OKLA. STAT. tit. 71, § 2(8) (Supp. 1979).

15. OKLA. STAT. tit. 71, § 2(9) (Supp. 1979).

16. OKLA. STAT. tit. 71, § 2(11) (Supp. 1979).

17. OKLA. STAT. tit. 71, § 2(20) (Supp. 1979).

18. Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1979).

and renders it unlawful for any person to make any fraudulent misrepresentations or omissions, or to otherwise engage in any type of fraudulent activities in connection with the offer, sale, or purchase of a security.¹⁹ Section 102 makes it unlawful for an investment adviser compensated by another person to engage in fraudulent practices against that other person.²⁰

The registration requirements for broker-dealers, agents, and investment advisers are found in Article Three,²¹ while the registration requirements of a security and the procedure for doing so are contained in Article Four.²² If a security is exempt from registration then, of course, the registration requirements of Article Four need not be met.²³ The various securities and transactions which are exempt from registration are enumerated in Section 401 of Article Five.²⁴ The exemptions are numerous and closely resemble the exemptions under the federal securities laws.²⁵ Article Five also contains general provisions for the

19. Compare § 101 with Rule 10b-5. Section 101 states:

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

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading,

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

OKLA. STAT. tit. 71, § 101 (1971).

20. Section 102 provides in pertinent part:

(a) It is unlawful for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise,

(1) to employ any device, scheme, or artifice to defraud the other person, or

(2) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

OKLA. STAT. tit. 71, § 102 (1971).

21. OKLA. STAT. tit. 71, § 201 (1971) makes it unlawful for any broker-dealer, agent, or investment adviser to transact business in that capacity without first registering with the Securities Administrator. The procedure for registration is found in OKLA. STAT. tit. 71, § 202 (Supp. 1979); post-registration provisions are in OKLA. STAT. tit. 71, § 203 (1971); and denial, revocation, suspension, cancellation, and withdrawal of registration are in OKLA. STAT. tit. 71, § 204 (1971).

22. OKLA. STAT. tit. 71, §§ 301-306 (1971 & Supp. 1979).

23. OKLA. STAT. tit. 71, § 301 (1971). See generally Dorwart & Holden, *An Overview of the Oklahoma Securities Act*, 25 OKLA. L. REV. 184 (1972); Long, *Exemptions Under the Oklahoma Securities Act. Part I: The Governmental and Financial Institutional Exemptions*, 28 OKLA. L. REV. 235 (1975); Mabey & Smith, *The Elusive Limited Offering Exemption of the Utah Uniform Securities Act*, 1976 B.Y.U. L. REV. 825.

24. OKLA. STAT. tit. 71, § 401 (Supp. 1979).

25. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976), and Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78hh (1976). Section 401 of the Oklahoma Act exempts eleven types of securities and sixteen types of transactions. OKLA. STAT. tit. 71, § 401 (Supp. 1979). By comparison, the Securities Act of 1933 exempts eleven types of securities and five types of transactions, 15

administrative, injunctive, criminal, and civil remedies created by the Act.

Of paramount importance is Section 408 of Article Five, which creates civil liabilities for those who offer or sell securities in violation of the Act²⁶ or who materially participate in, or aid, a person who offers or sells securities in violation of the Act.²⁷ A purchaser of securities sold in violation of the Act has a private cause of action in either of two situations. First, if the securities sold were not registered then the purchaser can rescind the transaction.²⁸ Rescission is also available if material, untrue statements or omissions are made in connection with the offer or sale of the securities.²⁹ Neither reliance by the plaintiff nor intent to defraud by the defendant need be proved.³⁰ This section also contains the statute of limitations applicable to a civil action pursuant to the Act.³¹ Finally, this section provides that no person may bring a cause of action under the Act if that person knew at the time the cause of action arose that the defendant was violating the Act.³² For the purposes of this article this section will be viewed as providing a defense of *in pari delicto* to defendants.

B. *Sanctions for Violation of the Act*

If a transaction is classified as a security under the Oklahoma Act, then a host of problems is in store for the seller. First, the seller has the task of complying with all registration requirements of the Act, unless the security is exempt from registration.³³ Registering a security with the Administrator can prove to be expensive, especially for a transaction involving a relatively low purchase price.³⁴

U.S.C. §§ 77c-77d (1976) while the Securities Exchange Act exempts five types of securities. 15 U.S.C. § 78c(12) (1976).

26. OKLA. STAT. tit. 71, § 408(a) (Supp. 1979).

27. OKLA. STAT. tit. 71, § 408(b) (Supp. 1979).

28. OKLA. STAT. tit. 71, § 408(a) (Supp. 1979).

29. *Id.*

30. *Id.* See Dorwart & Holden, *An Overview of the Oklahoma Securities Act*, 25 OKLA. L. REV. 184 (1972).

31. OKLA. STAT. tit. 71, § 408(e) (Supp. 1979). This period is two years after the contract of sale.

32. OKLA. STAT. tit. 71, § 408(f) (Supp. 1979). Prior to the adoption of the Oklahoma Act in 1959, it was unsettled whether a purchaser of securities had recourse via the Oklahoma courts in a cause of action arising out of a transaction in which he was *in pari delicto*. See L. LOSS, SECURITIES REGULATION 973 (1951). Undoubtedly, the intent of section 408(f) is to bar those potential plaintiffs who had knowledge of the alleged violation at the time of the sale of the securities.

33. OKLA. STAT. tit. 71, § 301 (1971).

34. See generally Comment, *The One-Two Combination: Will Federal and State Securities Regulation Knock Out Small Business?*, 14 TULSA L.J. 132 (1978).

If the seller fails to register the offering, the Act grants the purchaser a prima facie cause of action to rescind the entire transaction regardless of the presence or absence of any fraudulent practices committed by the seller.³⁵ The injured purchaser can recover all consideration³⁶ and will most likely be entitled to include all amounts expended in connection with the post-purchase development of the interests.³⁷ Thus, if a disgruntled purchaser of an oil and gas interest can establish that the transaction was a security within the meaning of the Act and that the security was not registered, then, absent any applicable exemption from registration, the purchaser can recoup the consideration paid for the interests plus all costs incurred in developing the interest.

Even though the security is registered or exempt from registration, additional problems may be encountered. Exemption from registration does not exempt the security or the transaction from the antifraud provisions of the Act.³⁸ The elements of a cause of action for securities fraud are much less stringent than those associated with common law fraud.³⁹ As previously mentioned, the elements of reliance and intent need not be proven.⁴⁰ All that must be shown is that the seller made a

35. OKLA. STAT. tit. 71, § 408(a) (Supp. 1979).

36. OKLA. STAT. tit. 71, § 408(a) (Supp. 1979) allows for recovery of consideration, reasonable attorneys' fees, costs, and interest at ten percent per year from the date of payment less the amount of any income received on the security. Damages are recoverable if the purchaser no longer owns the security, and are equal to "the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at ten percent (10%) per year from the date of disposition." *Id.*

37. *See* *Cross v. Pasley*, 270 F.2d 88 (8th Cir. 1959); *Whittaker v. Wall*, 226 F.2d 868 (8th Cir. 1955). In *Whittaker* the court held that where a purchaser of working interests in oil and gas leases prevailed in an action against the seller under Section 12(1) of the Securities Act of 1933, 15 U.S.C. § 771(1) (1976), by virtue of the seller's failure to register the offer and sale of the interests, the purchaser was entitled to recover all amounts expended in connection with the development of the interests in addition to the consideration paid in the first place. 226 F.2d at 872. The same result was reached under the Missouri Securities Act in *Cross*. 270 F.2d at 95. Oklahoma courts would most likely follow these results because decisions under the federal securities laws are looked to in interpreting state securities laws. *See, e.g., State ex rel. Day v. Petco Oil & Gas, Inc.*, 558 P.2d 1163 (Okla. 1977); *see generally* Dorwart & Holden, *An Overview of the Oklahoma Securities Act*, 25 OKLA. L. REV., 184 187 n.19 (1972); Loss, *supra* note 21, at 44-48. Further, it is the statutory policy under the Oklahoma Act to construe the Act in conformity with other states. OKLA. STAT. tit. 71, § 501 (1971); *State v. Hoephner*, 574 P.2d 1079 (Okla. Crim. 1978).

38. OKLA. STAT. tit. 71, §§ 407-408 (Supp. 1979).

39. To prove actionable fraud under Oklahoma law the plaintiff must prove that the defendant made a material misrepresentation that was false; the defendant knew at the time of making the misrepresentation that it was false, or that it was made recklessly without any knowledge of its truth and made as a positive assertion; the defendant made the misrepresentation with the intention that it should be acted upon by the plaintiff; and the plaintiff acted in reliance upon the misrepresentation and thereby suffered injury. *D&H Co., Inc. v. Shultz*, 579 P.2d 821, 824 (Okla. 1978); *State ex rel. Southwestern Bell Tel. Co. v. Brown*, 519 P.2d 491 (Okla. 1974); *Lenn v. Miller*, 403 P.2d 458 (Okla. 1965).

40. *See* note 30 *supra* and accompanying text.

material, untrue statement or omission in connection with the offer or sale of the interest. It is unlikely that a seller of an interest in oil and gas who is lacking knowledge of the securities laws would recognize his duty to disclose every detail of the interest. Rather, a good faith seller would only feel compelled to temper his puffing sufficiently to take him out of the realm of common law fraud.

Finally, the Oklahoma Act provides for criminal sanctions against a person who willfully violates the provisions of the Act. Section 407 of the Act makes it a felony to violate the Act and subjects the violator to a possible five thousand dollar fine and imprisonment for up to three years.⁴¹ An average of twelve sanctions a year under this section are successfully prosecuted by the Administrator.⁴² Obviously it is in the best interests of the seller of an oil and gas interest to avoid having the interest classified as a security.

III. CLASSIFYING OIL AND GAS INTERESTS AS SECURITIES

A. Pre-1976

Prior to 1976 Oklahoma did not expressly classify interests in oil and gas leases as securities.⁴³ This did not, however, restrain Oklahoma courts from holding that the sale of oil and gas interests could be securities under Oklahoma law. In *State ex rel. Day v. Petco Oil & Gas, Inc.*,⁴⁴ the Oklahoma Securities Commission sued an oil and gas company which had developed an investment transaction package consisting of various undivided interests in an oil and gas lease. The Securities Commission claimed that the investment package constituted an unregistered security and sought to enjoin Petco from selling the interests. The package was coupled with an operating agreement providing that the seller was to be the operator of the lease. Consequently, the purchasers were deprived of control over the management of the project. The Oklahoma Supreme Court held that the involvement of oil and gas interests in the investment package did not exempt the transaction from the purview of the Oklahoma Securities Act. The court found that the package was an investment contract

41. OKLA. STAT. tit. 71, § 407(a) (Supp. 1979).

42. Letter from Mary Copeland, Administrative Assistant to the Oklahoma Securities Commission, to Wm. Lane Pennington (Jan. 31, 1980).

43. OKLA. STAT. tit. 71, § 2(l) (1971) (current version at OKLA. STAT. tit. 71, § 2(20)).

44. 558 P.2d 1163 (Okla. 1977).

and hence a security covered by the Act.⁴⁵ In reaching this decision, the court focused on the contribution of risk capital by the purchasers and the purchasers' lack of direct control over the project. The court stated:

The package sold by Petco requires the investment of money.

The package sold by Petco takes investor's money and subjects it to the risk of the venture, thus constituting risk capital.

The package sold by Petco offers to the investors an expectation of a benefit, in this instance a profit.

The package sold by Petco provided that the investors would have no direct control over the investment or policy decision of the venture. It is clear from the operation agreement, that any profit or benefit to be derived from a leaseholder's investment is to be the product of the actions and decisions of the operator and that the investors do not participate in the decisions and actions involved.⁴⁶

Several tests have been developed for ascertaining whether a transaction constitutes an investment contract.⁴⁷ But regardless of the test adopted by the Oklahoma court, pre-1976 oil and gas transactions

45. *Id.* at 1167. The definition of a security within the meaning of the Act includes an investment contract. OKLA. STAT. tit. 71, § 2(20)(K) (Supp. 1979).

46. 558 P.2d at 1167.

47. The term "investment contract" was first construed in 1920, *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 177 N.W. 937 (1920), and has since gained wide recognition as a type of security. Long, *State Securities Regulation—An Overview*, 32 OKLA. L. REV. 541, 559 (1979). It is perhaps the most frequently used of the general terms within the definition of a security, *id.*, particularly under the federal securities laws. At least four definitions of an investment contract have been adopted by various state and federal courts. *Id.* The most widely accepted of these is the *Howey* test handed down by the United States Supreme Court in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946). An investment contract under the *Howey* test is: "(1) the investment of money, (2) in a common enterprise, (3) with the expectation of a profit, (4) with that profit to be realized through the efforts of someone other than the investor." Long, *supra*, at 560.

In 1973 Oklahoma adopted a codification of the *Howey* test defining a security as any "investment of money or money's worth including goods furnished and/or services performed in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy decision of the venture." 1973 Okla. Sess. Laws, ch. 162 § 1 (codified at OKLA. STAT. tit. 71, § 2(20)(P) (Supp. 1979)).

The analysis utilized by the Oklahoma Supreme Court in *Petco Oil & Gas, Inc.*, however, closely resembles the "risk-capital" test handed down by the California Supreme Court in *Silver Hills Country Club v. Sobieski*. 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961). The risk-capital test consists of three elements: an investment, of risk capital in an enterprise, and the expectation of a benefit. *Id.* at —, 361 P.2d at 908, 13 Cal. Rptr. at 188.

Another of the investment contract definitions which has gained wide acceptance, particularly in state courts, is a combined risk-capital-*Howey* test. *See, e.g.*, *Schultz v. Rector-Phillip-Morse, Inc.*, 552 S.W.2d 4 (Ark. 1977); *State v. George*, 50 Ohio App. 2d 297, 362 N.E.2d 1223 (1975); *Pratt v. Kross*, 555 P.2d 765 (Or. 1976). *See generally* Long, *State Securities Regulation—*

were safe from the reach of the Oklahoma Act as long as the transaction did not take on the character of an investment contract. Individuals and companies were free, with the above noted qualification, to sell or purchase oil and gas interests without worry of the sanctions of the Act. Investments in oil and gas interests remained a risk-capital venture⁴⁸ for both the initial purchaser of the interest and the investors in the development of the interest. The Act allowed restraint-free trading of oil and gas interests while simultaneously protecting investors, through the definition of an investment contract as a security, from fraudulent schemes of unscrupulous promoters.

B. *The 1976 Amendment*

The Oklahoma Act was amended in 1976 to include within the definition of a security certain oil and gas transactions.⁴⁹ This present definition states that a security includes any:

interest in oil, gas, or mineral lease except that transactions involving leases or interests therein, between parties, each of whom is engaged in the business of exploring for or producing oil and gas or other valuable minerals as an ongoing business, and the execution of oil and gas leases by land, mineral and royalty owners in favor of a party or parties engaged in the business of exploring for or producing oil and gas or other valuable minerals shall be deemed not to involve a security.⁵⁰

An Overview, 32 OKLA. L. REV. 541, 559 (1979). In *State v. Hawaii Market Center, Inc.*, 485 P.2d 105 (Hawaii 1971), the Hawaii Supreme Court said an investment contract is created whenever:

- (1) An offeree furnishes initial value to an offeror, and
- (2) a portion of this initial value is subjected to the risks of the enterprise, and
- (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
- (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

Id. at 109.

One commentator states that the combined risk-capital-*Howey* test will eventually replace the *Howey* test as the leading test for investment contracts. He argues that "[t]he test in general appears more clearly to define investment contracts, as well as the very essence of [what] a 'security' is than does its *Howey* counterpart." Long, *State Securities Regulation—An Overview*, 32 OKLA. L. REV. 541, 559 (1979).

48. A risk-capital venture has been defined by the Oklahoma Supreme Court as being a venture wherein one takes an investor's money and subjects it to the risks of the venture. *State ex rel. Day v. Petco Oil & Gas, Inc.*, 558 P.2d 1163 (Okla. 1977).

49. See notes 1-2 *supra* and accompanying text.

50. OKLA. STAT. tit. 71, § 2(20)(R) (Supp. 1979). By comparison, the Securities Act of 1933 includes within the definition of a security a "fractional undivided interest in oil, gas, or other mineral rights." 15 U.S.C. § 77(b)(1) (1976). The Uniform Securities Act includes a "certificate of

The exception created by this definition is two-pronged. First, a transaction between parties engaged in the oil and gas business on an ongoing basis is not a security. Second, leases by land, mineral, and royalty owners to those engaged in the oil and gas business on an ongoing basis are also excepted. On its face, however, this definition appears not to except from the definition the execution of oil and gas leases by a land, mineral, or royalty owner in favor of one not engaged in the exploration for or production of oil and gas and other valuable minerals on an ongoing basis; sales by persons not engaged in the exploration for or production of oil and gas on an ongoing basis and not a land, mineral, or royalty owner; or execution of a coal lease by a land, royalty, and mineral owner in favor of one engaged in the coal industry on an ongoing basis.

Moreover, the availability of the exclusion could very well turn on the interpretation granted the phrase "as an ongoing business." A literal reading of the definition might include as a security the sale of a mineral leasehold by a person who had purchased the lease with the intent of exploring for or producing oil and gas, but who, for any number of reasons, did not reach that plateau and decided to sell out. Or, a company engaged in the production of or exploration for oil and gas utilizing a blind commission⁵¹ technique of selling its interest to another similarly situated business, could find itself liable as a material participant⁵² in the sale of unregistered securities if the third party salesman was not engaged in an ongoing business of producing or exploring for oil and gas.

The amendment also apparently includes within the definition of a security the sale of a royalty interest if both parties to the transaction are not engaged in the exploration and production of oil and gas. In doing so, the coverage of the Act extends beyond those oil and gas transactions which come within the purview of the federal securities laws.⁵³ While the federal laws require fractionalization of an interest owned by the seller before the interest sold will be deemed a security,⁵⁴

interest or participation in an oil, gas, or mining title or lease or in payments out of production under such title or lease." 7A U.L.A. § 401(l) (1978).

51. A blind commission entails a situation where a salesman, not wanting the owner of the interests to know the amount of commission that he will receive on any given sale, will agree to locate a purchaser for the owner. The owner agrees that once a suitable purchaser is found, the owner will transfer the interests to the salesman for a pre-negotiated price. The salesman then sells his newly-obtained interests to the purchaser.

52. OKLA. STAT. tit. 71, § 408(b) (Supp. 1979).

53. See note 25 *supra* and accompanying text.

54. 15 U.S.C. § 77b(1) (1976). The Court of Appeals for the Tenth Circuit has held that "[t]o

the Oklahoma Act does not contain such a requirement. Thus, any royalty owner, other than those who fit within the exploration and production company exception, who sells his interest in whole, or in part, will have sold a security within the meaning of the Oklahoma Act.

Contemporaneously with the adoption of the definitional amendment to the Act, the Oklahoma legislature enacted an exemption aimed exclusively at the offer or sale of an oil and gas interest.⁵⁵ This private placement exemption was an attempt by the legislature to alleviate some of the hardships incurred by having oil and interests classified as securities. As will be discussed later,⁵⁶ the exemption does provide some relief, but like its definitional counterpart,⁵⁷ it includes within the purview of the Act certain oil and gas transactions in which the purchaser does not need the protection of the Act.

1. Execution of Oil and Gas Leases by Land, Mineral, or Royalty Owners

As previously noted,⁵⁸ the definition of a security under the Oklahoma Act excludes the execution of oil and gas leases by land, mineral, or royalty owners so long as the execution is in favor of one

be an 'issuer' of fractional interests, hence the 'issuer' of a security within [15 U.S.C. § 77b(1)], the [sellers of fractional interests in oil and gas leases] must have been the owners of the oil and gas rights and they must have created fractional interests therein for the purpose of a public offering." *Woodard v. Wright*, 266 F.2d 108, 114 (10th Cir. 1959).

55. OKLA. STAT. tit. 71, § 401(b)(15)A (Supp. 1979). This section exempts certain transactions including

A. Any sale from or in this state to not more than thirty-two persons of a unit consisting of: interests in oil, gas or mining title(s) or lease(s) . . . if

1. The seller above reasonably believes that all buyers are purchasing for investment;

2. No commission or other remuneration is paid or given directly or indirectly for the solicitation of any such sale excluding any commission or remuneration paid or given by and between parties each of whom is engaged in the business of exploring for or producing oil and gas or other valuable minerals;

3. No public advertising or public solicitation is used in any such solicitation or sale; and

4. Sales are effected only to persons the seller has reasonable cause to believe are capable of evaluating the risk of the prospective investment and able to bear the economic risk of the investment; but the Administrator may, by rule or order, as to any specific transaction, withdraw or further condition this exemption or decrease the number of sales permitted or waive the conditions and clauses 1, 2 and 3, with or without substitution of a limitation on remuneration.

B. For the purpose of the foregoing transactional exemption, no units by the issuer or associates shall be integrated, however this exemption cannot be combined or used in conjunction with any other transactional exemption.

Id.

56. See notes 64-65 *infra* and accompanying text.

57. See notes 5-6 *supra* and accompanying text.

58. See notes 48-50 *supra* and accompanying text.

engaged in exploration or production of oil and gas on an ongoing basis. This exclusion, however, does not insure that the execution of a lease by a landowner will, in all circumstances, be outside the purview of the Act. Suppose a lease broker purchases a lease from a landowner with the intent of selling this interest to an exploration and production company. A literal reading of the definition would include this transaction within the definition of a security. First, the definition makes no attempt to define "in the business of exploring for or producing oil and gas"⁵⁹ One must question whether a lease broker, when not acting within the employment of an exploration or production company,⁶⁰ can be said to be exploring for or producing oil and gas when he merely is procuring leases from landowners with no intent to recover the minerals thereunder.⁶¹

Further, even if the leasebroker is determined to be in the exploration or production business, this situation could be interpreted to be a transaction involving the sale of a security if the purchase by the lease broker is the only exposure that he has had or intends to have with the oil and gas industry. It is unlikely he would be deemed to be engaged in an ongoing business as that term is used in the definition of a security under the Act. While "ongoing business" is undefined by the Act, common sense indicates that the term should refer to doing business over some extended time and not to a one-time transaction. Absent statutory clarification or judicial interpretation, the one-time or first-time transaction by a lease broker should not render his actions ongoing. Thus, independent of whether a lease broker is interpreted to be in the business of producing or exploring for oil and gas, any one-time or first-time purchase by a lease broker would not entitle the transaction to be excluded from the definition of a security.

59. OKLA. STAT. tit. 71, § 401(b)(15)(A) 2 (Supp. 1979).

60. The presently controlling Oklahoma law concerning the agency relationships of a lease broker dates back to 1917 when the Oklahoma Supreme Court held:

Where a person, knowing of lands upon which an oil and gas mining lease can be obtained, and knowing the price at which he can obtain it, offers to sell it to another at a fixed sum, which offer is accepted by the other, and he then procures the lease, the transaction is not one of agency, and the person offering the lease occupies the position of an assignor of the lease, though the lease is made direct from the landowner to the person to whom he has offered to sell it.

Jameson v. Goodwin, 66 Okla. 146, 148, 170 P. 241, 243 (1917) (quoting *King v. Combs*, 36 Okla. 396, 122 P. 181 (1912)). Both *Jameson* and *King* were cited with approval by the Court of Appeals for the Tenth Circuit in 1960 in *Appleby v. Kewanee Oil Co.*, 270 F.2d 334, 337 (10th Cir. 1960).

61. At least one attorney with the Oklahoma Securities Commission Department of Securities has indicated that under these circumstances a lease broker would not be considered to be engaged in the business of exploring for or producing oil and gas. Telephone interview with David Boxeur (Jan. 23, 1980).

Assuming that this transaction was not registered with the Administrator, the landowner would be liable to the lease broker in an action for rescission under either of the above two theories. A disgruntled lease broker could not only recover the consideration, ten percent interest, legal costs, and attorneys' fees,⁶² he might also be entitled to recoup any costs incurred in developing the interest.⁶³ While the landowner would have available at least two defenses to the lease broker's cause of action, establishing these defenses unduly burdens the landowner.

One defense available to the landowner is the private placement exemption provided by section 401(b)(15) of the Act.⁶⁴ To gain this defense the landowner would have to show that he reasonably believed that the lease broker was purchasing the lease with investment intent. To date, however, neither the Administrator of the Department of Securities of the Oklahoma Securities Commission nor the Oklahoma courts have defined the concept of "purchasing for investment." Presumably, an administrative or judicial interpretation would closely reflect federal criteria of investment intent. These criteria have generally required that the purchaser not intend to speculate on the security and sell it immediately on the market.⁶⁵ Second, if the landowner could demonstrate that the lease broker knew at the time of the sale that the interests being conveyed were securities and that they were not registered, then the *in pari delicto* defense would be available.⁶⁶

It is doubtful that in most transactions these defenses could be successfully raised. First, because the lease broker is not engaged in explo-

62. OKLA. STAT. tit. 71, § 408 (Supp. 1979).

63. *Id.*

64. OKLA. STAT. tit. 71, § 401(b)(15) (Supp. 1979).

65. J. LONG, STATE SECURITIES (BLUE SKY) REGULATION 268 (3d ed. 1978). Under federal law "[i]t is generally considered that holding the securities purchased for two years will show the necessary investment intent." Long, *State Securities Regulation—An Overview*, 32 OKLA. L. REV. 541, 560 (1979). For many years prior to the adoption of this approach

the SEC took the approach that a person taking for investment purposes could not have any present intent to subsequently resale [*sic*] the securities purchased. In other words this investment intent element was not present unless at the moment of purchase the purchaser had the intent to retain the purchased securities permanently. . . .

Recognizing the difficulties here the SEC developed what they [*sic*] called the "change of circumstance" doctrine to help objectively prove this subjective intent existed at the time of purchase. The doctrine basically had two parts. First it recognized that if the purchaser held the acquired securities for a period of time then there ought to arise a very high presumption that the proper intent was present. . . .

Second the SEC required that there be some change of circumstances on the part of the investor which was not foreseeable at the time of the purchase which caused him to change his investment intent.

STATE SECURITIES (BLUE SKY) REGULATION, *supra*, at 268.

66. See note 32 *supra* and accompanying text.

ration and production it is unlikely that he would be purchasing for investment. Thus, the private placement exemption would probably be unavailable. A second reason is that the knowledge of the Oklahoma Securities Act is minimally spread throughout nonlawyer oilmen and it is therefore doubtful that a lease broker would be aware that the interest being purchased by him was a security. Hence, the lease broker would probably be held not to have been *in pari delicto* with the landowner.⁶⁷

2. Transactions Between Two Parties, One of Whom is Not Engaged in the Oil and Gas Business

To carry the hypothetical situation outlined above one step further, suppose the lease broker in turn transferred his recently obtained interest to a business engaged in exploring for or producing oil and gas on an ongoing basis. Whether the initial lease execution by the landowner in favor of the lease broker is deemed to be the sale of a security becomes immaterial at this point. Regardless of the outcome of the landowner-lease broker dispute, the transfer by the lease broker to the exploration and production company is a security.⁶⁸ This is true because, as in the above situation, one of the parties to the transaction, the lease broker, was not engaged in the exploration for or production of oil and gas on an ongoing basis. Unproductive development efforts by the purchaser could be salvaged by an action for rescission. Here again, the consideration, ten percent interest, legal costs, attorneys' fees, and possibly all money expended in attempting to develop the property could be recaptured.⁶⁹

The lease broker would have available the same defenses which could be raised by the landowner in the landowner-lease broker dispute, the private placement exemption⁷⁰ and *in pari delicto*.⁷¹ The former would again hinge on the interpretation of "investment intent." For example, if the purchaser company retained all its interest and subsequently developed the property, the lease broker would likely prevail

67. One additional argument which could be advanced by the landowner is that it was he who was offered and sold a security. It seems that this transaction would fall within either of the two definitions of an investment contract discussed earlier. See notes 44-49 *supra* and accompanying text. The landowner is investing something of value ($\frac{1}{8}$ ths mineral interest), in a common enterprise, with the expectation of a profit (royalties), to come solely from the efforts of others.

68. OKLA. STAT. tit. 71, § 2(20)(R) (Supp. 1979).

69. OKLA. STAT. tit. 71, § 408 (Supp. 1979).

70. See notes 63-66 *supra* and accompanying text.

71. See note 32 *supra* and accompanying text.

on his assertion that he reasonably believed that the purchaser company was purchasing for investment.⁷² On the other hand, conveyance of the interest, in whole or in part, by the purchaser company would tend to defeat the "purchasing for investment" element of the private placement exemption. The position of the purchaser company would be further enhanced if, upon selling part of its interest, it did not act as operator of the venture.⁷³

An additional defense that could be relied on by the lease broker is the argument that the assignment of his leasehold interest to the exploration and production company does not fall within the definition of a security. As noted throughout this article, the Oklahoma Act excludes from the definition of a security the execution of leases by land, mineral, or royalty owners in favor of persons engaged in exploration and production of oil and gas. Strictly speaking, a leasehold owner is not a land, mineral, or royalty owner and an assignment of a lease is not the same as an execution of a lease. The leasebroker is, however, like the land or mineral owner, assigning away all his executory rights. Surely, at least for the purpose of defining a security, the assignment should be held to be the functional equivalent of an execution of a lease by a mineral owner. It is hoped that any court confronted with this issue would so hold. To hold otherwise would greatly hinder leasebrokering, an integral part of the oil and gas industry in Oklahoma.

It is important to note that the exemption from registration afforded by the private placement⁷⁴ exemption will be defeated if any sales are transacted through a salesperson who receives any remuneration for his efforts.⁷⁵ Suppose, for example, that in the situation posed above, the purchaser company ultimately transferred its interest to third party investors not engaged in the exploration for or production of oil and gas. If salespersons are used in transferring the interest and

72. Again, recourse to the federal securities laws is helpful in defining "investment intent." See note 64 *supra*. The two year holding standard presents an anomaly in the sense that the statute of limitations is also two years. OKLA. STAT. tit. 71, § 408(e) (Supp. 1979). Presumably, the two year holding standard would not be determinative in this particular situation, rather, the reasonableness of the seller's knowledge of investment intent would control. See note 64 *supra*.

73. If the purchaser company were the operator of the venture, then the lease broker would be in a good position to argue that the primary intent of the purchaser company was investment. On the other hand, the absence of the purchaser company as operator would allow the purchaser company to assert that its primary interest in the purchase was to fractionalize and resell. This would be true even if the purchaser company were to retain a fraction of the interest, so long as it was not the operator of the project.

74. OKLA. STAT. tit. 71, § 401(b)(15) (Supp. 1979).

75. *Id.*

are compensated on a cash basis or by retaining an overriding royalty interest the exemption would not be available.⁷⁶

The second possible defense, *in pari delicto*, also takes on the same character as it did in the landowner-lease broker dispute. It should be pointed out that this subsection is worded in terms of "knew" rather than the broader standard of "knew or should have known." Again, the defendant would be given the dubious task of proving the subjective knowledge of the purchaser company.⁷⁷

3. Execution of Coal Leases by Land, Mineral, or Royalty Owners

Another situation wherein the transaction would unwisely be included within the definition of a security and thus would apparently fall within the purview of the Act is the mere execution of a coal lease by a land, mineral, or royalty owner. The definition of a security excludes "the execution of *oil and gas* leases in favor of a party or parties engaged in the business of exploring for or producing oil and gas or other valuable minerals."⁷⁸ By this language, a coal lease would not be covered by this exclusion. Perhaps this was merely an oversight on the part of the drafters of the definition. Nevertheless, it could subject one who executes a coal lease to the expense of proving either that the definition should be interpreted to exclude the execution of coal leases from the purview of the Act or proving the defenses heretofore discussed. Again, rescission would be available to a purchaser, whether engaged in the coal business or not, if and when the purchaser became disgruntled with his purchase. Arguably, coal leases can be inferred to be within the exclusion provision of the definition. For the sake of the innocent and unsuspecting landowner, the definition should be inter-

76. The Oklahoma Supreme Court recently had before it a case concerning indirect remuneration within the meaning of the private placement exemption. In *Petroleum Resources Dev. Corp. v. State ex rel. Day*, 585 P.2d 346 (Okla. 1978), the petitioner, a promoter of oil and gas drilling ventures, sought the safe harbor provided by the private placement exemption. The court found that the exemption was defeated because supervisory fees were retained by the promoter. These supervisory fees, actually the excess over costs of a turnkey drilling agreement, were viewed by the court to be other remuneration and thus prohibited if the exemption were to be applicable. The import of this decision is the breadth granted to the exemption's forbearance of commissions paid for the solicitation of sales. See also *Schultz v. Rector-Phillips-Morse, Inc.*, 552 S.W.2d 4 (Ark. 1977).

77. The burden of proving an exemption from registration is on the one claiming the exemption. *State v. Hoephner*, 574 P.2d 1079 (Okla. Crim. 1978).

78. OKLA. STAT. tit. 71, § 2(20)(R) (Supp. 1979) (emphasis added).

puted to exclude the execution of coal leases in the same manner it excludes oil and gas leases.

IV. CONCLUSION

The Oklahoma Securities Act excludes from the definition of a security two types of transactions in which the parties to the transaction do not, for the most part, need the protection of the Act. Three commonly occurring transactions are, however, not covered by the exclusions in the definition. In all three the Act affords protection for those least likely to need the protection of the Act. In the landowner-leasebroker transaction, the leasebroker is afforded protection; in the leasebroker-oil company transaction, the oil company is afforded protection; and in the execution of a coal lease to either a leasebroker or an exploration and production company, the leasebroker or the exploration and production company is afforded protection. This is unfair and could subject the seller to the expense of proving either that no security existed or that the transaction was exempt from registration. At the worst, unsuspecting sellers could find themselves liable to their purchasers for the consideration, all costs expended by the purchaser in developing the interests, plus both parties' litigation expenses. The result is that a scheme of investors' insurance has been created by the Act. The purchase and subsequent development of mineral leaseholds is, at least in the hypothesized transactions, a virtually risk-free venture. Lease brokers, promoters, and oil businesses can purchase oil and gas or coal leaseholds, explore for minerals thereunder, and, if the purchased property proves to be nonproductive; sue for rescission of the purchase price and for all amounts expended in developing the property. If the definition is interpreted literally, purchase, exploration, and development of properties could be done with the knowledge that if the property were not to produce, all costs could be recouped. Surely this was not the purpose of the Act. It has been held by many courts that "the securities laws are aimed at qualifying the doctrine of caveat emptor—not to establish a scheme of investor's insurance."⁷⁹

It is hoped that the courts, and preferably the Oklahoma legislature, will remedy these problems. Through judicial interpretation, legislative amendment, or Securities Commission rules, the red carpet

79. *List v. Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965); *Lane v. Midwest Bank Shares Corp.*, 337 F.Supp. 1200 (E.D. Ark. 1972); *Shultz v. Rector-Phillips-Morse, Inc.*, 552 S.W.2d 4 (Ark. 1977).

should be rolled up. Unfortunately, several may suffer before corrections are made.

Wm. Lane Pennington