ADMINISTRATIVE PROCEEDING
FILE NO. 3-4305

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SECURITIES AND EXCHANGE COMMISSION

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

COOPERATIVE OIL INVESTMENTS, INC.

File No. 20-180644

INITIAL DECISION

October 18, 1973
Washington, D.C.

Ralph Hunter Tracy
Administrative Law Judge

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In the Matter of	:	
COOPERATIVE OIL INVESTMENTS, INC.	:	INITIAL DECISION
File No. 20-1806A4	:	

APPEARANCES: Mary E. T. Beach, Donald J. Myers, Karl A. Stewart, for the Division of Corporation Finance.

Carl F. Bauersfeld and John C. Hendricks for Cooperative Oil Investments, Inc.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

Cooperative Oil Investments, Inc., (Cooperative or Offeror), incorporated in West Virginia in 1971, filed with the Commission on January 22, 1973, an Offering Sheet for the purpose of obtaining an exemption from the registration requirements of the Securities Act of 1933 (Securities Act) pursuant to Section 3(b) thereof and Regulation B thereunder, with respect to a public offering of 96 fractional undivided non-producing working interests in an oil and gas lease at $525.00 per interest.

The Commission on April 30, 1973, issued an order (Order) pursuant to Rule 334(a) of Regulation B temporarily suspending the exemption. On May 17, 1973, Offeror requested a hearing, which was held on June 18, 1973, to determine whether the Order should be vacated or made permanent.

Offeror was represented by counsel throughout the proceedings and proposed findings of fact and conclusions of law were filed by the parties. The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

OFFEROR

Ned W. Easley (Easley) graduated from the University of Illinois as a civil engineer in 1931 and his earliest activities in the oil and gas business were in 1938 and 1939. In 1940 he accepted a position as a civil engineer with the U.S. War Department and did not return to the

oil and gas business until 1965 when he relocated in Spencer, West Virginia. He began operating in oil and gas exploration under the name of Ned W. Easley doing business as Cooperative Oil Investments, a sole proprietorship. Offeror was incorporated in 1971 and took over the activities of the former sole proprietorship with Easley remaining as principal. Between 1965 and January 1, 1973, Easley, either as sole proprietor or on behalf of Offeror, has engaged in 23 oil and gas ventures with outside investors. During this period he has prepared and filed with this Commission approximately 15 offering sheets on Schedule D.

On January 22, 1973, Easley, on behalf of Offeror, filed an offering sheet pursuant to Regulation B for a proposed offering of non-producing working interests in an oil and gas lease known as the Charles Kemper No. 1 well. Amendments to the offering sheet were filed on February 20, and 26, 1973, and it was declared effective on February 27, 1973. On April 30, 1973 the Commission ordered the temporary suspension of the exemption pursuant to Rule 334(a).

DEFICIENCIES IN REGULATION B FILING

Incomplete Offering Sheet

The Order charges that no exemption is available for this offering under Regulation B because the Offering Sheet used fails to comply with Rules 326, 328(a), 332, and the requirements of Schedule D in that a map marked Exhibit A was not included in material sent to potential investors.

Rule 326 prescribes the form and contents of Offering Sheets and specifies schedules for various types of offerings. Schedule D is prescribed

if the interests offered are, as here, working interest in tracts represented to be nonproducing at the time of the offering.

Rule 328 governs the preparation of the Offering Sheet and subsection (a) states that it shall contain the information called for by all of the applicable items and required exhibits of the appropriate schedule according to the instructions thereto.

Rule 332 provides that each offering sheet used, distributed, or delivered by the person making the filing with the Commission or by any other person shall be an exact copy of the offering sheet filed with the Commission (as amended, if amended).

Schedule D, which is the offering sheet used in this offering, requires that Exhibits A and B must be incorporated in and included as part of the Offering Sheet. Exhibit A is a plat, or map, of the tract involved and the surrounding area with certain other designated information. Exhibit B is a copy of the conveyance with a legal description of the tract.

The Offering Sheet on file with the Commission, which was declared effective on February 27, 1973, includes the required Exhibit A. The charge that the Offering Sheet sent to potential investors was incomplete in that it did not include Exhibit A is based entirely on evidence produced by one recipient. In fact, all the charges in the order stem from this one individual who, as the only outside witness in this proceeding, testified that he had been receiving materials in the mail from Easley since 1969 and that when he received this material "I thought about it as a former investor and felt that * * * I ought to forward it to the Commission."

The material which he sent to the Commission included, among other things, a Schedule D Offering Sheet but no Exhibit A.

The witness testified that although he did not participate in this particular offering he had been previously involved in oil and gas investments offered by Easley, that he had received literature since 1969 andthat "the information matter would include a letter covering the offering, then the specific offering sheet and then a copy of the prospectus, a form which signified what your optional participation was, and a map. And those would be standard enclosures. The information matter was always the same."

When questioned more closely about the contents of the packet he received he testified that "in all probability it included a map, because that was standard. What became of the map, I don't know."

Easley testified that Exhibit A was definitely included with Schedule D. He testified, also, that all other material which the Order charges was improperly used was mailed to potential investors. In other words, his testimony is consistent in that everything was mailed out and there is no apparent reason why the map would be deliberately omitted.

Upon consideration of all of the circumstances it is concluded that the preponderance of the evidence supports a finding that Exhibit A was included as part of the Schedule D Offering Sheet sent to potential investors.

Use of Sales Material

The Order alleges, further, that no exemption is available under Regulation B because the Offeror used written communications in connection

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*/ This material refers to Exhibit A as part of Schedule D.

with the offering that failed to comply with Rule 318.

Inasmuch as this is the first proceeding brought pursuant to the Commission's adoption of amendments to Regulation B under Section 3(b) of the Securities Act a brief review of the background leading to such adoption might be helpful in understanding the current requirements for obtaining an exemption from registration pursuant to Regulation B, particularly with respect to Rule 318.

On February 14, 1972, the Commission announced that it was considering amendments to Regulation B. One of the principal revisions proposed involved the use of sales literature. The Commission noted that there had been frequent abuses in the use of sales literature and advertising material in connection with purported Regulation B offerings and therefore proposed that as a condition for using the Regulation B exemption, advertising and sales material be limited to the offering sheet, "tombstone" advertisements and any material required by state law. 1/ This requirement was incorporated into proposed Rule 318. On October 11, 1972, the Commission adopted amendments to Regulation B, effective January 1, 1973. The final version of Rule 318 was identical with the proposed rule except for one addition allowing reference in the sales literature to the type of well to be drilled. 2/

1/ Securities Act of 1933 Release No. 5233 (February 14, 1972).

2/ Securities Act of 1933 Release No. 5314 (October 11, 1972). The final version of Rule 318 is as follows:

Rule 318. Use of Sales Material

(a) Any written advertisement or other written communication, or any (continued)

In early March, 1973, shortly after the Offering Sheet was declared effective, Offeror mailed approximately 1,000 Schedule D's to prospective investors. Included with the Schedule D was a two page undated letter signed by Easley, referring to the offering. This letter was not filed with the Commission. The letter refers to two enclosed maps marked Exhibits A-1 and A-2, which, also, were not filed with or referred to in Schedule D.

The letter indicates that a potential investor may pay only one-half of the drilling costs at the time of purchase and the remainder when notified that the drilling contract is to be signed. There is no discussion of any such arrangement in the material filed with the Commission.

The letter discusses tax benefits resulting from an oil and gas investment, but there is no such discussion in the Schedule D or other material filed with the Commission.

2/ (Cont'd.)
radio or television broadcast, which states from whom an offering sheet meeting the requirements of this Regulation may be obtained and, in addition, contains no more than the following information, may be published, distributed, or broadcast at or after the commencement of the public offering to any person prior to sending or giving such person a copy of the offering sheet:

(i) the name of the offeror of the interests;
(ii) the identity or type of interests to be offered;
(iii) the number of such interests to be offered;
(iv) the location (country and state) of the tract or tracts involved;
(v) the price of the interest to be offered; or
(vi) the type of well to be drilled, such as an exploratory or development well.

(b) Except for the offering sheet required by this Regulation and any material permitted by paragraph (a) of this rule, no other advertisement, radio, or television broadcast, or written communication shall be used in connection with the offering of securities under this Regulation, except as required by state law.

The letter states that "with the new raise in gas prices and the increasing demand, which will further increase gas prices, we hope you will join us in Charles Kemper #1." The letter concludes by stating that "[s]ince we already have drilled 22 producers out of 22 tries, we hope you will join us in what we think will be a big #23." The Schedule D does not include any discussion of rising gas prices and increasing demand and the possible effect such alleged increased demand will have on gas prices. Also, there is no reference in the Offering Sheet to the number of wells Offeror has drilled nor to the number of "producers".

Also, included with the Offering Sheet sent to prospective investors, but not filed with the Commission, was a Request for Interest and Participation Agreement. A statement in the Agreement providing for payment of one-half of the cost with the returned signed Agreement and one-half when the drilling contract is signed is not contained in Schedule D.

In addition to the material discussed above, which was all included in one evelope with the Offering Sheet, the Offeror at or about the same time, mailed a newsletter on its letterhead, dated March 2, 1973, to potential investors. The outside witness previously mentioned testified that he received the Schedule D and the newsletter simultaneously. Easley testified that the newsletter was a monthly report of operations sent out around the first of each month to investors to keep them apprised of conditions concerning all of his wells. The letter of March 2, 1973, lists the production or status of Offeror's wells for the month of

February, 1973. The last paragraph states:

> We have acquired a small, one-well lease in the center of a group of gas producing wells. The gas is produced in this new area from Benson Sand at a depth of about 4,400 feet; this is once again as deep as most of the wells we report to you in this newsletter. We have just received S.E.C. approval on this well and hope to get the information to you early next week. It will be called Charles Kemper #1 - Lewis Co.

Offeror concedes that the sales literature used was prohibited by Rule 318 of Regulation B but asserts that the statements made therein were not erroneous, misleading or inaccurate; and that no one was harmed, damaged or mislead by the use of such material.

The arguments advanced by Offeror do not exonerate it from responsibility. The exemption from the necessity of complying with the registration requirements is a conditional one based on compliance with express provisions and standards.[3/] The one claiming an exemption has the burden of proving its applicability.[4/]

The broad prohibition of Rule 318 is not conditioned upon a showing that the forbidden statements were also inaccurate or misleading. By clearly limiting the use of written communications or advertisements, with certain exceptions, to the offering sheet required by Regulation B, the rule precludes an analysis of the probity of the statements to determine whether the rule was violated.

Although Offeror repeatedly asserts that no harm has resulted

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3/ Selevision Western, Inc., 37 S.E.C. 411, 415 (10-18-56).

4/ U.S. v. Custer Channel Wing, 376 F.2d 675, 678, cert den. 398 U.S. 850 (1967); S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953).

from the use of the prohibited sales literature there is nothing in the record to substantiate its claim that investors were not in fact injured as a result of these violations. In any event, since the Commission has decided to deal with abuses in the area of sales literature [5/] in a preventive and prohibitory manner, to require a showing of loss or injury would be contrary to the language of the rule and the Commission's intent in adopting it. [6/]

It is found that in connection with this offering Offeror used written communications that failed to comply with Rule 318. Accordingly, no exemption was available under Regulation B.

Violation of Anti-Fraud Provisions

The Order charges, and Rule 334(a)(iii) provides, that no exemption is available under Regulation B if the offering has been, or is being, made in violation of the anti-fraud provisions of Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The statement in the newsletter, previously quoted herein (page 8), that S.E.C. approval had been received is in direct violation of Rule 322 of Regulation B and Section 23 of the Securities Act. It is, also, contrary to the required admonition on the cover page of the Offering Sheet. [7/]

The utilization of the newsletter as sales literature was, also

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5/ Securities Act Release No. 5314 (10-11-72).

6/ Hughes v. S.E.C., 174 F.2d 969, 974 (D.C. Dir., 1949); Berko v. S.E.C., 316 F.2d 137, 143 (2d Cir., 1963).

7/ The required language on the cover page, which is set forth in (Cont'd)

misleading in that it attempted to convey the impression that past successes or expectation of success for a well about to be completed were related to the probability of success for Charles Kemper #1, but there is no basis stated for such alleged connection.

The letter sent with the offering sheet states that "[a]fter we drill a successful producer in the Charles Kemper #1, each participant will pay his proportionate share of the completion costs." This statement is contrary to paragraph 4(c) of the Offering Sheet where it is stated that only if the offeror is of the opinion that the well merits an attempt at completion will the purchasers have to pay additional costs. The letter is misleading in that it suggests that only after Charles Kemper #1 is a successful producer will completion costs be paid. In fact, as paragraph 4(c) points out, the completion costs merely ready the well for production, and despite these additional expenditures, the well may never be successful.

While the letter predicts Charles Kemper #1 will be a successful producer, there is no basis given for making such a projection. The reference to "22 tries" also suggests success by virtue of past performance but there is not sufficient explanation about the 22 "producers" to determine their relevance to the success of Charles Kemper #1.

7/ (Cont'd)
Division I of Schedule D, revised as August 1, 1943, is as follows:

THE SECURITIES AND EXCHANGE COMMISSION HAS NEITHER APPROVED NOR DISAPPROVED THE INTERESTS HEREBY OFFERED AND IT IS A CRIMINAL OFFENSE TO REPRESENT THAT THE COMMISSION HAS APPROVED SUCH INTERESTS OR PASSED UPON THEIR MERITS OR VALUE OR HAS MADE ANY FINDING THAT THE STATEMENTS IN THIS OFFERING SHEET ARE CORRECT.

The use of projections without adequate basis and the use of the production figures of other unrelated wells in offering these interests was materially misleading with regard to the ability of Charles Kemper #1 to become a successful producer. The Commission has expressed its concern with the use of projections and has had a long standing policy "not to require and generally not to permit projections to be included in . . . reports filed with the Commission." 8/

Offeror concedes that certain misleading statements were made through innocence or inadvertence. As to other allegedly misleading statements Offeror asserts that they subsequently turned out to be true, or that they were technically correct, or that they were not misleading to the sophisticated investors to whom they were sent. All of these contentions are rejected as not being relevant.

It is found that the offering was made in violation of the anti-fraud provisions of Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Accordingly, no exemption was available under Regulation B.

Conclusion

In addition to the arguments thus far advanced Offeror urges that the sanction of permanent suspension of the Regulation B exemption should not be applied because Easley was not familiar with the new rules and that, therefore, the temporary suspension already served should be

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8/ Securities Act of 1933 Release No. 5362 (February 2, 1973).

sufficient.

The record shows that Easley received a copy of Securities Act Release No. 5233, dated February 14, 1972, calling for comments concerning proposed changes to Regulation B; that he, also, received a copy of Securities Act Release No. 5314, dated October 11, 1972, announcing the changes to become effective on January 1, 1973; and that he had several telephonic communications with members of the staff with respect to questions he had concerning the new rules. However, he insists that while he was aware of some of the changes and conformed to them he was unaware of certain other changes, specifically the changes relating to the use of advertising material in conjunction with the offering sheet.

This excuse is unacceptable particularly in view of the fact that two amendments to the Offering Sheet were filed after consultation with the staff. This indicates that Easley was fully aware of the requirements of Regulation B, as amended. The Offering Sheet was filed on January 22, 1973 and the amendments on February 20 and 26, 1973 which was 3 or 4 months after Securities Act Release No. 5314 and approximately one year after Securities Act Release No. 5233. During this period Easley had filed three other offering sheets which became effective on May 12, 1972, May 19, 1972, and December 26, 1972. He also filed one on April 16, 1973, for which no exemption is available because of the temporary suspension in the present case. All of this activity indicates that Easley knew or should have known about the amended Regulation B exemption requirements.

Offeror states that its Regulation B exemption has been temporarily suspended since April 30, 1973, and that this suspension has already done great harm to Offeror's ability to conduct business and drill new wells and that the preparation of a full registration statement is not a feasible alternative for such a small producer. Therefore, he argues, the temporary suspension should be lifted.

Offeror typifies the type of activity which the Commission has endeavored to bring under manageable supervision by the first material amendment of Regulation B since 1937. During the period from 1937 to January 1, 1973, it has been Commission practice under Regulation B to issue a temporary suspension order routinely until appropriate amendments have been filed. Hence such orders do not have the same stigma as stop orders or temporary suspension orders under Regulation A. 9/

Rule 306(a) of Regulation B, as amended, provides that no exemption shall be available to any offeror which is under an order of temporary suspension or which is and has been under an order of permanent suspension within 5 years prior to the filing or use of an offering sheet. However, Rule 306(c) provides:

> (c) Notwithstanding the foregoing, this rule shall not apply to any offering if the Commission determines, upon filing of an application and showing of good cause, that it is not necessary in the public interest and for the protection of investors that the exemption be denied. Any such relief granted by the Commission may be either general or on a specific filing basis. Any such determinations by the Commission shall be without prejudice to any other action by the Commission in any other proceeding or matter with respect to the offeror or any other persons.

9/ I Loss 637, 2d Ed. 1961.

Accordingly, there is nothing to prevent Offeror from making application for relief at anytime. As the Court has said in Vanasco v. S.E.C., 395 F.2d 349, 353 (C.A. 2, 1968):

> We would think, that if satisfied after a period of suspension that Vanasco could be trusted to comply with the law's requirements, the Commission might, upon an application made to it, modify this sanction. See, also, Fink v. S.E.C., 417 F.2d 1058, 1060 (C.A. 2, 1969); Hanley v. S.E.C., 415 F.2d 598.

Each one of the violations found is sufficient to suspend the exemption. As previously stated, the obligation to comply with the terms and conditions of Regulation B rests with the one seeking to take advantage of it, in this case Cooperative Oil Investments, Inc. It is clear that Cooperative Oil Investments failed to comply with the terms and conditions of Regulation B. Therefore, it is concluded that the exemption provided by Regulation B should be permanently suspended, accordingly,

IT IS ORDERED, pursuant to Rule 306(a) of Regulation B under the Securities Act of 1933, that the exemption of Cooperative Oil Investments, Inc. under Regulation B is permanently suspended.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines

on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 10/

Ralph Hunter Tracy
Administrative Law Judge

October 18, 1973
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10/ To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected.