



SEC

OFFICE of INVESTOR
EDUCATION and ADVOCACY

INVESTOR ALERT

Private Oil and Gas Offerings

The SEC's Office of Investor Education and Advocacy is issuing this alert to educate individual investors about certain risks and possible fraudulent activity involving private offerings of securities for oil and gas ventures.

The number of fraud cases related to private securities offerings for oil and gas ventures has increased over the last few years. From few in 2005 and 2006, the number of SEC cases has averaged more than 20 per year since. State securities regulators have experienced a similar increase in cases over the past five years. All investing involves varying degrees of risk. ***Investing in private offerings, however, carries unique risks, and private oil and gas offerings have additional risks to consider.***

What should I do first?

If you are asked to invest in a private oil and gas offering, you should first consider and investigate who exactly is asking you to invest and think carefully about whether the investment is appropriate for you.

Is the person recommending the investment registered? Most people offering you securities must be registered as a broker with the SEC and must be a member of the Financial Industry Regulatory Authority, or FINRA. You can find out if someone is registered and obtain information about a registered broker by visiting FINRA's [BrokerCheck](#) website or calling FINRA's BrokerCheck hotline at (800) 289-9999. If you are

working with a registered investment adviser, you may be able to obtain information about the adviser by visiting the SEC's [Investment Adviser Public Disclosure \(IAPD\)](#) website. You can also check with your state securities regulator regarding the person soliciting your investment.

What if I'm not working with a registered broker or investment adviser? If someone who is not registered solicits your investment, that person may be violating the law. One exception from broker registration is available to employees of the company offering the securities and who engage in strictly limited sales activities. If you aren't consulting a registered broker or adviser, you should consider doing so. A registered broker or adviser that is familiar with the oil and gas industry and not connected to the offering can help you analyze the investment. ***Most importantly, working with a registered broker or investment adviser affords you certain legal protections.***

Even if you are working with a registered broker or adviser, it is not a seal of approval. Oil and gas offerings present many investment risks, and working with a registered individual is not a guarantee that the offering is a sound investment. Ask about any prior history of selling oil and gas offerings and if those offerings failed, the vetting or due diligence process for such offerings, and the risks of the particular investment you are considering.

Be particularly cautious if the broker or adviser has a relationship with the promoter of the venture, or otherwise has a personal stake in the transaction. A promoter is the person promoting the offering and is usually the founder of the venture. Ask about any current or prior relationship with the promoter, the extent of their business together, and any personal incentive in the offering. These or similar questions should help alert you to any potential conflicts and biases that may exist in recommending the particular offering to you.

Ask for the “due diligence report.” A registered broker that recommends a private oil and gas offering must independently review the investment. The broker may not just rely on the oil and gas promoter for information. Instead, the broker must check the statements and claims about the investment. To know what due diligence your broker performed, ask for a copy of his “due diligence report.” This report should outline how the broker evaluated the venture’s prospects and claims. However, the broker’s investigation is not infallible. See the discussion regarding [*SEC v. Provident Royalties, LLC*](#) below.

Consider whether the investment is appropriate for you. Private securities offerings are generally limited by law to certain institutional and high net worth investors. This limitation exists because of the greater risks involved in private offerings as compared to, for example, investing in publicly traded stock. ***Private offerings—including private oil and gas offerings—may involve a high degree of risk. You should be aware that you could lose your entire investment. They also typically have less liquidity, which means you might have to hold your investment indefinitely.***

What could possibly go wrong?

The oil and gas industry is often in the news. Because of this, some people have used the appeal of “striking it rich” with a gushing well as a basis for fraudulent schemes. The SEC and the states have brought a number of cases involving “great opportunities” that turned out to be scams. Investors lost some or all of their investments. Many scams shared the same themes.

Investing to support drilling and completion operations. The SEC has investigated many oil and gas offerings that claimed they were about to strike oil or gas and they just needed some investment to pay for drilling and completion. The promoter often doesn’t tell you, however, that he owns the drilling company or plans to hire a driller at far less than what he’s told you the drilling costs will be while pocketing the difference. ***The promoter makes money from you even if the well comes up dry.***

In [*SEC v. Hartmut Theodor Rose*](#), the SEC charged the promoters in an oil and gas venture with soliciting investors’ funds to finish drilling while not mentioning that their own geologists said not to go ahead. The SEC alleged the promoters collected over \$10 million from 300 investors nationwide.

Undisclosed use of proceeds. In several cases, the SEC alleged misrepresentations about what the invested funds were going to be used for. Misrepresentations and omissions about uses of investors’ monies included (i) paying big sales fees to brokers, (ii) the nature and size of compensation to the promoter and employees of the venture, (iii) operating and other expenses for unrelated businesses and (iv) using the money to pay for personal items.

To illustrate, in [SEC v. Wellco Energy, LLC](#), the SEC alleged the promoters misrepresented that investors' funds would be used for oil and gas wells when, in fact, 58% of money raised went to pay sales fees as well as the promoter's personal mortgage and child support. In [SEC v. Petroleum Unlimited, LLC](#), the SEC alleged misrepresentations were made about the use of investor funds, since only \$534,000 of the \$2.9 million raised from investors was used for oil drilling. In addition to failing to mention that sales fees equaling 49% and 74% of the investments would be paid, the SEC alleged investor funds also were used to pay the promoter directly and through related companies, like the drilling company. ***The individuals selling the offerings in both these cases were not registered with the SEC.***

In another case, [SEC v. Provident Royalties, LLC](#), Provident raised \$485 million through various offerings from at least 7,700 investors nationwide promising high returns and misrepresenting how investor funds would be used. Investors were told that 86% of their funds would be for oil and gas investments. The SEC alleged that, instead and undisclosed to investors, a portion of the investor funds was used to pay dividends and returns of capital to earlier Provident investors. Retail brokers sold the Provident offerings to retail investors nationwide. A number of these brokers have since been [sanctioned](#) by FINRA for selling the offerings without having a reasonable basis for recommending the securities.

Overinflated or misrepresented prospects and claims.

One common thread among all fraudulent schemes, including those related to oil and gas, are claims that they are about to strike it rich, or that it is likely or even guaranteed that the returns will be too good to pass up. ***When you hear this sales pitch, you should be very skeptical about high returns with little risk that are just around the corner. Higher returns typically mean higher risks of loss.***

In [Hartmut Theodor Rose](#), the SEC alleged that the promoters told investors that oil and gas production was about to start when many of the wells were actually marginal or even dry. They misrepresented the "success" of prior wells to raise funds for new wells and touted the "low-risk" opportunity as "once-in-a-lifetime."

In [Petroleum Unlimited](#), the SEC alleged that investors were told without any reasonable basis that they could expect returns of 14% to 141% a year. Rather, 81% of the money raised was used to pay for expenses other than oil drilling, including huge sales fees.

In [SEC v. Hilton](#), the SEC alleged that the promoter raised \$3.3 million from about 176 investors nationwide in several offerings by falsely portraying the success or prospects of various wells and the expected returns for investors.

Common red flags:

- Sales pitches referring to recent news events like high oil or gas prices.
- “Can’t miss” wells and “guaranteed” returns, including claims that major oil and gas companies are drilling nearby.
- Abnormally high rates of return.
- Unsolicited materials.
- Sales tactics that pressure you to decide, like “limited” or “once-in-a-lifetime” opportunity.
- Sales pitches touting new technology, especially if it relates to getting higher production out of low-producing wells (sometimes called “stripper” wells).
- Salesperson claims to be an investor.
- Being asked to sign documents acknowledging that the securities laws do not apply to the investment.

See our [Investor Alert](#) detailing common red flags in oil and gas scams for more information.

What should I ask?

Analyzing an oil and gas investment may involve highly technical matters, such as geological findings and new drilling technologies, making it difficult for many individual investors to fully understand. Also, the only information that you have may be coming from the promoter. You may receive a private placement memorandum detailing the venture’s management, its drilling prospects and plans, the terms of the venture and investment, and basic financial statements for the usually new

venture. *As a start, if you aren’t given anything in writing, then you should be very skeptical.*

You should ask questions until you are satisfied with the answers. Don’t just accept promises of low risk for high returns. **Remember, it is your money and you shouldn’t let anyone pressure you into purchasing an investment that you don’t understand.** Here are some things to ask about and consider if you’re thinking about investing in an oil and gas venture:

- **Use of proceeds.** *What is my money going to be used for? Can you estimate how much of the money you raise will be used for each of your needs, such as drilling operations, administrative overhead and broker sales fees? If sales fees will be paid, how are those fees calculated?* It is reasonable to expect the company raising the money to have plans for it, particularly if the persons involved have prior industry experience. Otherwise, why are they raising that specific offering amount? If broker sales fees are being paid, you should know that registered brokers are subject to rules and regulations including the amount of sales fees they can charge.
- **Related parties.** *Are you hiring another company to drill or do any other work? Is there any relationship between these companies and the promoters and principals in the venture? How much is the promoter going to make even if we drill a dry hole?* Remember that the persons involved in the offering can do quite well for themselves when the investment funds are used, for example, to pay themselves or to hire a company they own to do the drilling. They get paid even if the well is dry. Remember too that a promoter who makes his money on the front-end of a deal—that is, from selling the investment to you and benefiting from the proceeds—rather than on the fortunes of the venture—namely the actual production from the well—does not have the same interest as investors like you whose only hope to gain is from a successful well. You should be wary of any oil and gas investment where the promoter’s interests are not aligned with yours.

- **Prior experience.** *What is your track record in the oil and gas industry? Have you had experience with this particular well location?* In some cases brought by the SEC involving oil and gas offerings, the promoters have claimed extensive prior experience and success in the industry. These claims were made to stop investors like you from asking questions. Instead, you should try to independently verify any claims. Ask for references.

In *SEC v. Sunray Oil Co.*, the SEC alleged that the promoter touted Sunray's "50 years of experience," but he left out the fact that the company was formed much more recently and his previous company went bankrupt.

- **Well history.** *Is there a prior history of drilling where you are drilling? If someone drilled there before, how much did they get out and what makes you think you can get any more out? If the area proved dry before or has not been drilled, why do you think there's something there?* A lot of new oil and gas is found in the United States today because of improved ways of drilling, such as hydraulic fracturing (*i.e.*, fracking) and horizontal drilling. These improvements often require specialized expertise and may cost a lot.

In *Hilton*, the SEC alleged the promoter falsely told potential investors that Exxon Mobil had previously drilled in and abandoned the oil field because it lacked the technology to exploit it, but the venture now had the necessary technology to extract oil from it.

- **Third-party report.** *Did you get a third-party engineering report for the site? Can I see the report?* Some operators may employ the expertise of independent third-party engineers and geologists to decide whether it makes sense to drill in an area. If the promoter says there is a report, but doesn't allow you to see it, you may want to consider it a red flag. You should also consider whether the engineer or geologist is truly independent. Promoters sometimes use reports prepared by the same engineers that sold them the project or by engineers they employ or use repeatedly.

- **Reserves.** *If the offering materials discuss reserves, what types of reserves are being estimated? Who determined these reserve estimates? Were they audited or reviewed by an independent third party? Can you review the audit?* The use of terms such as "reserves" makes it sound like a sure thing. However, reserves in the oil and gas industry are not so certain and can vary a lot. Reserves can be "proved," "probable" or "possible." Proved reserves are relatively certain. Probable and possible reserves can mean, in short, a 50% to 10% chance of extracting the estimated amount. Though not required, some oil and gas ventures do have their reserve estimates audited.

Keep in mind that if the investment opportunity is an outright fraud, the written materials may look legitimate and every question you have about the opportunity may be answered to your satisfaction, but that doesn't make any of it true. ***It is important to conduct your own independent research. One good way to do that may be to engage an investment professional specializing in oil and gas.***

Where can I go for help?

If you have a question or concern about an investment, or you think you have encountered fraud, please contact the SEC, FINRA or your state securities regulator to report the fraud and to get assistance.

[U.S. Securities and Exchange Commission](#)

Office of Investor Education and Advocacy
100 F Street, NE
Washington, D.C. 20549-0213
(800) 732-0330
www.sec.gov
www.investor.gov

[Financial Industry Regulatory Authority \(FINRA\)](#)

FINRA Complaints and Tips
9509 Key West Avenue
Rockville, Maryland 20850
(301) 590-6500
www.finra.org/Investors/

[North American Securities Administrators Association \(NASAA\)](#)

750 First Street, NE
Suite 1140
Washington, D.C. 20002
(202) 737-0900
www.nasaa.org

If you want to investigate a venture's operations and wells, you can check with the oil and gas regulatory agency in the state where the venture undertakes its operations. Following is contact information for certain state regulatory agencies.

California Department of Conservation
[Division of Oil, Gas & Geothermal Resources](#)
801 K Street, MS 18-00
Sacramento, California 95814
(916) 445-9686
www.conservation.ca.gov/dog/Pages/Index.aspx

Kansas Corporation Commission
[Oil and Gas Conservation Division](#)
Finney State Office Building
130 S. Market, Room 2078
Wichita, Kansas 67202
(316) 337-6200
www.kcc.state.ks.us/conservation/index.htm

[Louisiana Department of Natural Resources](#)
617 North Third Street
LaSalle Building
Baton Rouge, Louisiana 70802
(225) 342-4500
dnr.louisiana.gov

North Dakota Department of Mineral Resources
[Geological Survey Division](#)
1016 E. Calgary Avenue
Bismarck, North Dakota 58503
(701) 328-8000
www.dmr.nd.gov/ndgs/

Oklahoma Corporation Commission
[Oil and Gas Division](#)
2101 N. Lincoln Boulevard
Oklahoma City, Oklahoma 73105
(405) 521-2302
www.occeweb.com/og/oghome.htm

[Railroad Commission of Texas](#)
1701 N. Congress
Austin, Texas 78701
(877) 228-5740
www.rrc.state.tx.us

Additional Information

For our [Investor Alert](#) detailing common red flags in oil and gas scams, visit www.sec.gov/investor/pubs/oilgasscams.htm.

For a FINRA [investor alert](#) regarding energy stock scams, visit www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/p037236.

For a NASAA [investor alert](#) regarding oil and gas investment fraud, visit www.nasaa.org/6782/oil-gas-investment-fraud/.

For FINRA's [BrokerCheck](#) resource, visit www.finra.org/Investors/ToolsCalculators/BrokerCheck/.

For our [Investment Adviser Public Disclosure \(IAPD\)](#) website, visit www.adviserinfo.sec.gov.

For our [Investor Bulletin](#) on tips on picking an investment professional, visit www.sec.gov/investor/alerts/ib_top_tips.pdf.

For the SEC release regarding *SEC v. Hartmut Theodor Rose*, visit www.sec.gov/litigation/litreleases/2009/lr21031.htm.

For the SEC release regarding *SEC v. Wellco Energy, LLC*, visit www.sec.gov/litigation/litreleases/2009/lr21040.htm.

For the SEC release regarding *SEC v. Petroleum Unlimited, LLC*, visit www.sec.gov/litigation/litreleases/2011/lr21808.htm.

For the SEC release regarding *SEC v. Provident Royalties, LLC*, visit www.sec.gov/litigation/litreleases/2009/lr21118.htm.

For FINRA's news releases regarding the sanctioning of brokers in connection with the Provident Royalties offerings, visit www.finra.org/Newsroom/NewsReleases/2011/P123441 and www.finra.org/Newsroom/NewsReleases/2011/P125193.

For the SEC release regarding *SEC v. Hilton*, visit www.sec.gov/news/press/2012/2012-205.htm.

For the SEC release regarding *SEC v. Sunray Oil Co.*, visit www.sec.gov/litigation/litreleases/2006/lr19737.htm.

For additional investor educational information, see the SEC's website for individual investors, www.investor.gov.

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.