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# Nebraska Blue Sky Law and Oil and Gas Interests

Duncan A. Bonjorni\*

## I. INTRODUCTION

While the "problems at which securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers,"<sup>1</sup> the application of regulatory laws to oil and gas interests has been comparatively recent. With the development of the oil and gas industry, these laws have gained increasing significance in their application to this area. The purpose of this paper will be to review the Nebraska Blue-Sky Law,<sup>2</sup> with emphasis on its application to oil and gas interests.

The derivation of the appellation "blue-sky law" indicates generally the type of activity which these laws have sought to curb. The genesis of the term is credited to a remark by one of the sponsors of the original Kansas securities act<sup>3</sup> that "some companies sought to 'capitalize the blue skies.'" In upholding blue sky legislation as a valid exercise of state police power, the Supreme Court of the United States stated that these laws were aimed at "speculative schemes that have no more basis than so many feet of 'blue sky.'"<sup>4</sup>

Loss, in his work on securities regulation, enumerates and discusses the problems that brought about securities regulation in general.<sup>5</sup> Many of these problems were of an interstate nature and

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<sup>1</sup> Loss, *Securities Regulation* 3 (1951).

<sup>2</sup> Neb. Rev. Stat. §§ 81-302-81-346 (Reissue 1950) inclusive, and §§ 81-347, 348 (Supp. 1955). "Blue-Sky Law" is the short title of the Nebraska Act.

<sup>3</sup> The Kansas act, enacted in 1911, was the first of the blue-sky laws in the United States. When the Federal Securities Act of 1933 was passed, all the states except Nevada had some form of blue sky law.

<sup>4</sup> *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917). In this case, and companion cases known as the "Blue Sky" cases, the Court held that state regulation of securities sold within the state was neither a direct burden on interstate commerce, nor violative of the equal protection clause of the 14th Amendment. Prior to this time, lower federal courts had declared several of these acts invalid. *Bracey v. Darst*, 218 Fed. 482 (N.D. W.Va. 1914); *William R. Compton Co. v. Allen*, 216 Fed. 537 (S.D. Iowa 1914); *Alabama & N. O. Transportation Co. v. Doyle*, 210 Fed. 173 (E.D. Mich. 1914).

<sup>5</sup> Loss, *Securities Regulation* 14-15 (1951).

involved national public interest; hence they were prone to federal regulation.<sup>6</sup> Some of the problems, however, were properly within the scope of state regulation.

The statutes in this area, state and federal, employ a complex of regulatory devices. Ordinary civil and criminal remedies for fraudulent securities dealing are made easier to enforce, the instrumentalities of securities distribution (exchanges, brokers, dealers, salesmen) are licensed and held to new legal standards, and perhaps most important, security issues themselves are subject to administrative inspection. This inspection is to test one of two things. Under *disclosure* laws, the issue must be accompanied by sufficient honestly-focused information to enable a person skilled in the investment field to appraise the attractiveness of the deal. But under an *approval* type statute, more stringent regulation is imposed, and the security issue must offer a "fair and equitable" transaction to the prospective purchaser. If a particular transaction is one whose only consequence would be to verify Barnum's dictum, a disclosure law would require that the sucker be given the financial data, but the sixth freedom—"to make a fool of oneself"—is unimpaired. Such an issue could not be sold, however, under an *approval* statute.

The several state and federal statutes employ these devices in varying combinations and with variations in detail and emphasis. Most of the state laws (Blue-Sky Laws) are approval statutes; the basic federal statute, the Securities Act of 1933,<sup>7</sup> (based on federal power over the mails and on the Commerce clause<sup>8</sup>) is a disclosure statute.<sup>9</sup>

<sup>6</sup> See § 2 of the Securities Exchange Act of 1934. 48 Stat. 881 (1934), 15 U.S.C. § 78b (1952).

<sup>7</sup> 48 Stat. 74 (1933), 15 U.S.C. §§ 77a-77aa (1952). The Securities and Exchange Commission (hereinafter referred to as SEC), created by the Securities Exchange Act of 1934, operates under a total of seven acts. Of these, the Securities Act of 1933 and the Securities Exchange Act of 1934 have the closest relationship to blue sky legislation.

<sup>8</sup> The enacting clause of the Securities Act of 1933 reads: "An act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce through the mails. . . ."

<sup>9</sup> See the enacting clause, *supra* note 8. The SEC looks only to the accuracy and completeness of the registration statement and may issue an order preventing a registration from becoming effective if the statement "is on its face incomplete or inaccurate in any material respect." 54 Stat. 857 (1940), as amended, 15 U.S.C. § 77h(b) (1952). The Commission may also issue a stop order suspending a registration statement if it includes an "untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 54 Stat. 857 (1940), as amended, 15 U.S.C. § 77h(d) (1952). But if the registration

State and federal governments have concurrent jurisdiction over securities regulation by virtue of a savings clause inserted in the federal acts, expressly preserving the jurisdiction of state regulatory agencies.<sup>10</sup> The Securities Act of 1933 further exempts from Federal jurisdiction sales of any security which is part of an issue offered or sold only to persons resident within a single state or territory (§3 (a) (11)), generally referred to as the "intrastate exemption."<sup>11</sup>

## II. THE NEBRASKA STATUTE

Our statute like most state blue-sky laws<sup>12</sup> covers the full range of legislative possibilities, with a pro-buyer change of civil and criminal law,<sup>13</sup> broker-dealer registration,<sup>14</sup> and administrative checks on security issues for *approval*.<sup>15</sup> By administrative action, as will be shown later, we also have *disclosure* rules.

### A. DEFINITIONS

It would not be advantageous to discuss the definitions used in the Nebraska act at length, but some aspects of them should be

statement meets the disclosure demands of the SEC, or when so amended as to meet these demands, it becomes effective without an affirmative act of approval by the SEC and without an examination and approval of the security involved.

A prospectus containing essentially the same information as the registration statement must accompany or precede any security carried in the mails or in interstate commerce for the purpose of sale or delivery after sale. 48 Stat. 906 (1934), as amended, 15 U.S.C. § 77e(b) (1952).

<sup>10</sup> Securities Act of 1933, 48 Stat. 85 (1933), 15 U.S.C. § 77r (1952); Securities Exchange Act of 1934, 48 Stat. 903 (1934), 15 U.S.C. § 78bb(a) (1952).

<sup>11</sup> 48 Stat. 75 (1933), 15 U.S.C. § 77c(a)(11) (1952). This exemption is not, however, a mere statement of lack of federal control over intrastate commerce, in that intrastate transactions may involve use of a means or instrument of interstate commerce or communication, or of the mails, which is the basis for federal regulation of securities.

<sup>12</sup> An examination of blue-sky laws in the Corporation Manual reveals that only one state (New Jersey) has a pure fraud statute; one (Wyoming) has securities registration only; four have a broker-dealer registration act; one (New York) combines broker-dealer registration with anti-fraud provisions; twenty-four combine broker-dealer registration with securities registration; and sixteen combine all three elements. None is listed for Delaware, which at one time had a very weak anti-fraud statute. United States Corporation Co., Corporation Manual, 58th Ed. (1957).

<sup>13</sup> Neb. Rev. Stat. §§ 81-339, 341 (Reissue 1950).

<sup>14</sup> Neb. Rev. Stat. § 81-305 (Reissue 1950).

<sup>15</sup> Neb. Rev. Stat. § 81-314 (Reissue 1950).

noted.<sup>16</sup> A securities sale covered by the Nebraska act includes a present transfer, a future transfer, or an agreement to transfer in the future, the property in a security, for a consideration. It also includes an offer or solicitation. Securities used as a bonus on account of a purchase of a security are declared to be part of the purchase, and to have been sold for a consideration.

While the Nebraska act may be characterized in part as a broker-dealer registration act, only the term *broker* is defined and used. The definition, however, is very similar to the definition of the term dealer as used in the Securities Act of 1933.<sup>17</sup> Terminology differs, but both acts, in effect, cover persons buying, selling, or otherwise dealing, either as a principal or as an agent, in securities issued by another person. The term dealers, as defined in the federal act, would appear to include salesmen, while the terms *broker* and *salesman* are separately defined in the Nebraska act.<sup>18</sup>

The definition of *securities* in the Nebraska act contains four elements: (a) dealing with evidences of interest in or right to the income, gain or profit of a business or venture from which the owners of these interests or rights receive, or might expect to receive income, gain or profits by reason of their interests or rights; (b) dealing with the sale of any real estate or leasehold, or interest therein, on the basis of a representation of oil or gas exploration or development on the premises or in the vicinity; (c) listing several commonly known classes of securities, including "a royalty interest or agreement, a certificate of interest in an oil, gas or mineral lease or property;" (d) a catchall provision. Part (b) and the portion of part (c) quoted above are the important considerations insofar as regulation of the sale of interests in oil or gas rights is concerned.

## B. EXEMPTIONS

That an item falls within the broad definition of a "security" subject to a Blue-Sky Law does not close inquiry as to coverage. Most acts contain first a specific section defining "exempt" securities, second, a section classifying securities as to whether they are

<sup>16</sup> Neb. Rev. Stat. § 81-304 (Reissue 1950).

<sup>17</sup> 48 Stat. 74 (1933), 15 U.S.C. § 77b(12) (1952).

<sup>18</sup> The distinction between a broker and dealer, if one is to be made, is that a dealer buys and sells in his own name as principal, whereas a broker performs these acts as agent for other parties. The definitions remove the distinction, and in practice many traders in securities perform both operations.

subject to full dress treatment under the law (with registration, prospectus, Commission approval, and the like) or merely a simple procedure, such as notifying the Commission of the nature of the proposed issue, and third, a classification of the transactions involving "securities" (issuance, sale by broker, sale by dealer, etc.) as to whether a particular transaction involving a security is exempt or not.

In our statute, most exemptions are handled as "exempt" securities under § 81-312, with relatively slight use of the other devices for limiting or softening coverage.<sup>19</sup> Most important of these exemptions for our purposes is that provided for "any leasehold, or other interest in oil, gas or other minerals in the State of Nebraska."<sup>20</sup> Thus, by the definition of securities in the Nebraska Blue-Sky Law, some out-of-state interests in oil or gas rights are specifically brought within the provisions of the statute, but by the exemption stated above, all interests in oil and gas within the state are specifically excluded from the provisions of the statute, subject to some exceptions therein provided.

### C. SECURITY REGISTRATION

Unless specifically exempt under § 81-312, securities may not be sold or offered for sale or exchange unless authorized by the Department of Banking.<sup>21</sup> In connection with the issuance of an authorization order to sell securities, the applicant must file a verified written application, stating "such facts as the department may require."<sup>22</sup> The Department of Banking is also empowered

<sup>19</sup> Securities enumerated in items (3), (11), (13), and (15) of § 81-312 are those which in many other blue-sky laws are open to registration by notification or description. Registration by notification or description takes place automatically upon the filing of the prescribed forms or information, or at a fixed time thereafter, subject to the subsequent action of the state securities regulatory agency. It does not require an affirmative approval of the security.

The Nebraska Blue-Sky Law has no "exempt transactions" category. Securities enumerated in items (8), (9), (10), (12), (14), (16), and (17) are those generally found in the "Exempted Transactions" section of blue sky laws. If a distinction may be made between exempted securities and exempted transactions, it is that the former is based on the nature of the security, and the security is exempt regardless of the nature of the transaction, whereas in the latter the exemption is based on the nature of the transaction and the transaction is exempt regardless of the securities involved.

<sup>20</sup> Neb. Rev. Stat. § 81-312(18) (Reissue 1950).

<sup>21</sup> Neb. Rev. Stat. § 81-314 (Reissue 1950).

<sup>22</sup> Neb. Rev. Stat. § 81-315 (Reissue 1950).

to make an investigation concerning the application, costs to be borne by the applicant; to investigate where and when it deems necessary; and to subpoena witnesses from any part of the state in connection with any such examination or investigation.<sup>23</sup> If, upon examination, the offering appears in all respects to be "fair and equitable", the Department then issues an order authorizing sale of the securities, with power to attach such conditions or limitations as it deems necessary.<sup>24</sup> It should be noted that control of advertising matter used in connection with an issue or offering is accomplished through these sections.

#### D. BROKER-DEALER REGISTRATIONS

Brokers, before engaging in the sale of securities, must secure a license from the Department of Banking.<sup>25</sup> This requirement must be met whether the broker is selling securities exempt under § 81-312, or securities authorized for sale by the Department of Banking. With his application the broker must file evidence of good moral character, and of financial soundness and responsibility. The Department is authorized to make such examination of the applicant as it deems necessary,<sup>26</sup> and is also empowered to revoke an issued license.<sup>27</sup>

Comparable provisions apply to salesmen<sup>28</sup> selling within the state. Such salesmen must be appointed by a broker, and must file a verified written statement of appointment executed by the broker by whom appointed. The license issued by the Department authorizes the salesman to deal in securities exempt from registration under § 81-312, or those authorized for sale by the Department of Banking, but only in his capacity as salesman for the broker by whom he was appointed. The license of the salesman expires upon the expiration or revocation of the license granted to the broker by whom he was appointed.<sup>29</sup> This license also may be suspended by the Department.<sup>30</sup>

A non-resident issuer or applicant must file an irrevocable power of attorney with the Department of Banking, appointing

<sup>23</sup> Neb. Rev. Stat. § 81-317 (Reissue 1950).

<sup>24</sup> Neb. Rev. Stat. § 81-318 (Reissue 1950).

<sup>25</sup> Neb. Rev. Stat. § 81-305 (Reissue 1950).

<sup>26</sup> Neb. Rev. Stat. § 81-308 (Reissue 1950).

<sup>27</sup> Neb. Rev. Stat. § 81-307 (Reissue 1950).

<sup>28</sup> Neb. Laws c. 373, p. 1311 (1957).

<sup>29</sup> *Ibid.*

<sup>30</sup> Neb. Rev. Stat. § 81-311 (Reissue 1950).

the Director of Banking attorney in fact for service of process in any action arising out of the sale of securities in the state.<sup>31</sup> The act provides for notice of service to the applicant or issuer by mailing a certified copy of such process to the address disclosed in the records of the Department.

#### E. SANCTIONS

Sanctions imposed by the Nebraska act include criminal prosecution;<sup>32</sup> civil remedies;<sup>33</sup> license suspension and revocation;<sup>34</sup> the broad investigatory power of the Department;<sup>35</sup> and the discretion granted the Department in requiring information,<sup>36</sup> granting licenses,<sup>37</sup> and imposing restrictions or conditions.<sup>38</sup> Criminal penalties are imposed upon sale of securities without authority from the Department of Banking;<sup>39</sup> fraudulent sales;<sup>40</sup> making false statements as to the value of securities, or as to the financial condition of an issuing corporation;<sup>41</sup> conversion of proceeds from the sale of securities;<sup>42</sup> sales by an insolvent issuer or broker;<sup>43</sup> unlawful pledging or otherwise disposing of a customer's securities by a

<sup>31</sup> Neb. Rev. Stat. § 81-324 (Reissue 1950). The Department of Banking has a prepared form for execution of the power of attorney, which sets out the extent and limitation of the power granted.

<sup>32</sup> Most of the criminal penalties are set out in the text of the paper. However, § 81-333 contains numerous minor penalties, and § 81-338 provides a catchall penalty provision.

<sup>33</sup> Neb. Rev. Stat. § 81-331 (Reissue 1950).

<sup>34</sup> Neb. Rev. Stat. § 81-307 (broker), § 81-311 (salesman), § 81-318 (securities). In addition § 81-316 confers a general power of revocation.

<sup>35</sup> Here, as so often occurs in the statute, the grant of the investigatory power is spread through many provisions of the act. General powers of investigation are a part of the licensing provisions of the act. The broadest grant of power is to be found in § 81-317, with an additional provision for investigation of violations found in § 81-320.

<sup>36</sup> In addition to the discretionary power vested in the Department with regards to application for licenses, additional power to compel disclosure is granted the Department by §§ 81-306 and 81-317.

<sup>37</sup> This discretion of the Department in granting licenses is readily apparent in § 81-318, dealing with securities. While not so explicitly set out in § 81-305 (brokers) and § 81-309 (salesmen), it is inherent in these provisions.

<sup>38</sup> Neb. Rev. Stat. § 81-318 (Reissue 1950).

<sup>39</sup> Neb. Rev. Stat. § 81-333 (Reissue 1950).

<sup>40</sup> Neb. Rev. Stat. § 81-339 (Reissue 1950).

<sup>41</sup> Neb. Rev. Stat. § 81-341 (Reissue 1950).

<sup>42</sup> Neb. Rev. Stat. § 81-334 (Reissue 1950).

<sup>43</sup> Neb. Rev. Stat. § 81-342 (Reissue 1950).



broker, issuer, or salesman;<sup>44</sup> and participation in a sale of securities by an unlicensed person.<sup>45</sup> In addition, the act contains a provision imposing both civil and criminal liability on a principal for the acts of his agent.<sup>46</sup>

#### F. CIVIL REMEDIES

Three provisions of the Nebraska act must be considered as affecting civil remedies: a section imposing civil liability for false advertising by use of written or printed materials, and extending the liability to the officers or directors where any person so liable is a company, corporation, partnership or association;<sup>47</sup> a section making dealing in securities in violation of the act *prima facie* evidence of fraud in any civil action involving said dealing;<sup>48</sup> and a section imposing civil liability on a principal for the material misrepresentations of his agent, made for the purpose of inducing or procuring the sale or exchange of a security, and relied upon by the purchaser.<sup>49</sup> By contrast, most blue sky laws merely make sales in violation of the statute voidable.

#### G. POWERS OF THE DEPARTMENT OF BANKING

Broad discretionary powers are vested in the Director of Banking, who is charged with the responsibility of administering the act.<sup>50</sup> He may employ an assistant, or assistants, and delegate "any and all powers, authority and duties" granted to the Director, within the limits of the common law and statutes of the State.

All of the registration provisions, in addition to requiring the filing of specific information in connection with an application for license, also require the filing of "such other information as the department may require." In addition, the Department may make such investigation of an applicant for broker's license as it deems necessary,<sup>51</sup> and conduct such examination in connection with an application for an authorization order to sell securities as it deems necessary,<sup>52</sup> in both instances at the expense of the applicant. The

<sup>44</sup> Neb. Rev. Stat. § 81-343 (Reissue 1950).

<sup>45</sup> Neb. Rev. Stat. § 81-340 (Reissue 1950).

<sup>46</sup> Neb. Rev. Stat. § 81-336 (Reissue 1950).

<sup>47</sup> Neb. Rev. Stat. § 81-331 (Reissue 1950).

<sup>48</sup> Neb. Rev. Stat. § 81-335 (Reissue 1950).

<sup>49</sup> Neb. Rev. Stat. § 81-336 (Reissue 1950).

<sup>50</sup> Neb. Rev. Stat. § 81-303 (Reissue 1950).

<sup>51</sup> Neb. Rev. Stat. § 81-308 (Reissue 1950).

<sup>52</sup> Neb. Rev. Stat. § 81-317 (Reissue 1950).

proviso to § 81-308 has been interpreted to mean the Department may go beyond state boundaries to examine records in conducting an investigation of an applicant for a broker's license.<sup>53</sup> While this would seem to be inherent in the powers of the Department, it is difficult to find any other meaning for the proviso. The Department may compel the filing of reports by brokers,<sup>54</sup> and may compel the attendance of witnesses and the production of books and records in connection with an investigation.<sup>55</sup> In an investigation of the purported violation of an order of the Department, made on a written complaint and at the written request of a complaining party, it may require the posting of a deposit by the complainant to defray costs of the investigation.<sup>56</sup>

The real effectiveness of the Department is derived from its authority to revoke licenses granted;<sup>57</sup> to prescribe forms of application, documents, and records kept in connection with the administration of the statute; and to establish rules and regulations of procedure and practice for applicants appearing before the Department.<sup>58</sup> In addition, the department may impose such conditions or limitations on an authorization order as it deems necessary for proper control; to cancel, alter, or amend such conditions or limitations; and to require an applicant or issuer to specifically consent in writing to the conditions or limitations imposed, as a condition precedent to the issuance of an authorization order.<sup>59</sup> In the exercise of the power to impose conditions or limitations the Department requires the use of a prospectus with an issue or offering.<sup>60</sup> This aids in the accomplishment of two major effects: (1) Department examination and control of advertising and literature used in connection with an offering; and, (2) the dissemination of information to prospective purchasers and investors that will assist

<sup>53</sup> This was the meaning applied to it by Mr. Johnson, Department of Banking, in response to a question concerning this proviso. (March 12, 1957.)

<sup>54</sup> Neb. Rev. Stat. § 81-306 (Reissue 1950).

<sup>55</sup> Neb. Rev. Stat. § 81-317 (Reissue 1950).

<sup>56</sup> Neb. Rev. Stat. § 81-320 (Reissue 1950).

<sup>57</sup> Neb. Rev. Stat. § 81-307 (broker), § 81-311 (salesman), § 81-318 (securities). In addition § 81-316 confers a general power of revocation.

<sup>58</sup> Neb. Rev. Stat. § 81-316 (Reissue 1950).

<sup>59</sup> Neb. Rev. Stat. § 81-318 (Reissue 1950).

<sup>60</sup> So reported by Mr. Johnson, Department of Banking. (Conversation, March 12, 1957).

them in evaluating the offering. Thus, the advantages of the disclosure type act may be had in this approval statute.

It is interesting to note that the Department is not expressly given the power to seek an injunction, which is one of the dominant features of the Federal Securities Act of 1933,<sup>61</sup> and which is found in some form in 33 of the state acts.<sup>62</sup> This is presumably covered in the grant of power to "prosecute *all* civil actions, both legal and equitable."<sup>63</sup> Thus the Department has in the past obtained a temporary restraining order.<sup>64</sup>

#### H. EVIDENCE

Five provisions dealing with evidence and burden of proof are found in the act. Foremost is the provision that any person claiming the exemptions of § 81-312 as a defense in a civil or criminal action has the burden of proof to establish such exemption.<sup>65</sup>

In the section of the act imposing civil liability for false advertising, lack of "reasonable diligence" to ascertain the fact of publication or falsity of any statement in such publication is deemed knowledge of the publication, and of the falsity of the statement.<sup>66</sup> A similar rule is applied in criminal prosecutions.<sup>67</sup>

Similar provisions make dealing in securities in violation of the Nebraska Blue-Sky Law *prima facie* evidence of fraud in a civil action involving such said dealing,<sup>68</sup> and the section of the act making it perjury for a person to testify with regard to, or to sign any application, knowing any testimony or representation given therein to be false or untrue, where such application must be verified or sworn to, <sup>69</sup> makes the giving of such testimony or depositing of such application *prima facie* evidence of the knowledge and wilfulness thereof.

<sup>61</sup> 48 Stat. 86 (1933), 15 U. S. C. § 77t (1952).

<sup>62</sup> Kans. Laws c. 145, § 15, p. 335 (1957).

<sup>63</sup> Neb. Rev. Stat. § 81-323 (Reissue 1950).

<sup>64</sup> This remedy was recently used in a case involving sale of oil and gas interests in Nebraska. (Temporary restraining order against Wyoming Oil Co. and agents, February 18, 1957).

<sup>65</sup> Neb. Rev. Stat. § 81-313 (Reissue 1950).

<sup>66</sup> Neb. Rev. Stat. § 81-331 (Reissue 1950).

<sup>67</sup> Neb. Rev. Stat. § 81-345 (Reissue 1950).

<sup>68</sup> Neb. Rev. Stat. § 81-335 (Reissue 1950).

<sup>69</sup> Neb. Rev. Stat. § 81-330 (Reissue 1950).

### III. APPLICATION OF NEBRASKA STATUTE TO OIL AND GAS TRANSACTIONS

#### A. BACKGROUND

Securities regulation would be a good deal simpler if all promoters sought to exploit their ventures by incorporating and by selling stock shares through regular dealer channels. But they don't. In the oil business, for example, sale of speculative opportunities under an oil and gas lease will often take the form of partial transfers (by conveyance or assignment) of legal interests in the lease, sometimes the lessor's "royalty," sometimes the lessee's "working interest."

Although sometimes a partial transfer of an oil and gas interest represents a sale of speculative or investment opportunities, and accordingly ought to be covered by the securities law, at other times a partial transfer is a device used as part of regular commercial deals involving oil and gas production and marketing and these ought to be excluded. Another differentiation is desirable. Granted that an oil interest is being sold for investment, and the individual investor may need some government protection; but if Standard of New Jersey decides to buy in on a wildcatter's dream, it may be that Standard can make out all right without the help of the Nebraska Banking Department. Transactions involving seasoned investors accordingly get differentiation in securities laws. Finally, it is not every sale of a speculation or investment item which is sought to be covered by blue-sky legislation. A real estate transfer, a sale of a painting; these may be purchased "on spec" but they are not worth blue-sky treatment. This is because the deals are relatively small, or because typically in these transactions the buyer is apt to be close to the relevant information, and not insulated from the seller by distance, ignorance, or a dealer, as is the case in major stock distributions.

The various security-regulation statutes use a number of different techniques for making the necessary differentiations as to oil interest transfers; some by restricting the definition of security, others by exemptions. Thus the Kansas blue-sky law covers all oil and gas royalty or working interest sales, but goes on to exclude transactions in which (a) the quantity sold is more than a 1/25th interest in a tract larger than 80 acres; or (b) where the interest is given in exchange for labor, material or machinery for use in drilling.<sup>70</sup> The Federal Securities Act contains a number of provisions which exclude some oil transactions. For one thing, the only oil interest transfers subject to the act are the sale of frac-

<sup>70</sup> Kans. Laws c. 145, § 11, p. 332 (1957).

tional undivided royalty or mineral interests.<sup>71</sup> (The bulk of non-stock oil speculations take this form.) Further a private offering is by § 77d excluded from Security Act coverage—it is only the transactions which involve a kind of general merchandising of securities that are covered. Another differentiation: regulation B of the S.E.C. sets up a simplified procedure for oil transactions involving less than \$100,000 (and adds a further simplification for sales of less than \$100,000 to regular oil explorers or producers).<sup>72</sup>

Other examples could be given; draftsmen have given serious thought to the problem of differentiating among oil and gas interest transfers so as to restrict blue-sky coverage to situations where the investor needs protection.

#### B. IN-STATE EXEMPTION

How does Nebraska solve this problem? As to transfers of interest in Nebraska's own oil and gas, the legislature has not attempted to draw the delicate line. As previously stated, "Any leasehold or other interests in oil, gas, or other minerals in the State of Nebraska" are expressly exempted from our blue-sky law.<sup>73</sup> The purpose of this exemption, placed in the act, was seemingly to encourage oil and gas development in Nebraska.<sup>74</sup> At that time the oil and gas industry in Nebraska was in its infancy, and

<sup>71</sup> Although it is not my purpose to analyze the Federal Securities Act in detail, it seems worthwhile to explain some of the terminological difficulties in this area. An entire interest in minerals in a particular tract is a mineral fee. If the mineral fee owner (say a farmer) is unable to exploit the petroleum, he leases to an oil company. The effect of the lease (subject to some drafting and conveyancing technicalities) is to divide the interests in the minerals between fee owner and lessee. Further subdivisions may take place: a fee owner, a lessor, or a lessee, each may sell undivided portions of his total interest, his total interest in a specific geographic portion of the tract, or various parts of the several expectations which make up his undivided interest.

"Fractional undivided interest in oil, gas or other mineral rights" under the Securities Act is obviously designed to cover some but not all of these transfers. There has been litigation over various speculative transactions which in form are not "fractional undivided." The leading case of *S. E. C. v. C. M. Joiner Corp.*, 320 U. S. 344 (1943) discloses a judicial willingness to look to substance. See also, *Fisher v. Schildes*, 131 F. 2d 522 (10th Cir. 1942). Generally on this subject see Bloomenthal, *SEC Aspects of Oil and Gas Financing*, 7 Wyo. L. J. 49 (1952).

<sup>72</sup> 17 C.F.R. §§ 230.300-356 (1949).

<sup>73</sup> Neb. Rev. Stat. § 81-312(18) (Reissue 1950).

<sup>74</sup> The exemption provided by § 81-312(18) was added to the act on the floor in the 1937 session of the legislature.

if in fact development was encouraged, the exemption served a valuable purpose.

LB 465, introduced before the legislature in 1957, would have removed this exemption from the Nebraska Blue-Sky Law.<sup>75</sup> Statements were made at the hearings on LB 465, before the committee on Banking, Commerce and Insurance, to the effect that unscrupulous promoters, taking advantage of the exemption, were selling worthless interests in oil and gas rights. No testimony or evidence was introduced to support these statements. However, Mr. Johnson, in the Department of Banking, stated to the author that promotion schemes involving oil and gas interests in Nebraska had come to his attention which would not meet with Department approval if subject to regulation under the Blue-Sky Law.<sup>76</sup>

Whether or not abuses are in fact taking place, it remains that oil and gas interests in Nebraska are not subject to our statute, and abuses are possible. To the degree it permits unregulated sales and the possibility of offerings not "fair and equitable," the act is weakened.

### C. THE INTERESTS COVERED

In its application to out-of-state interests, it is difficult to determine what interests in oil and gas are within the provisions of the Nebraska Blue-Sky Law, and to what extent they are covered. The definition of security, as earlier set out, includes a royalty interest or agreement and a certificate of interest in an oil, gas or mineral lease, or property. The two phrases are apparently inconsistent, depending on the meaning applied to "certificate of interests." As applied to oil and gas, an instrument evidencing a fractional or percentage interest in oil and gas production is a certificate of interest.<sup>77</sup> Whether this definition is intended to include entire royalty, leasehold, or other interest, which are usually expressed as fractions or percentages of the whole mineral interest, or oil and gas production, is not clear. If it does include entire interests in oil or gas production, the two phrases are consistent as both would apply to entire interests. The result would be regulation of every mineral or royalty conveyance or assignment.

If, however, the definition is intended to apply only to fractional or percentage interests in mineral rights less than the full

<sup>75</sup> The bill was voted out of committee but was killed before reaching the floor.

<sup>76</sup> Conversation, Feb. 22, 1957.

<sup>77</sup> *People v. Sidwell*, 27 Cal. 2d 121, 162 P. 2d 913 (1945).

mineral interest (e.g., royalty interests, and leasehold or working interest), then the provision relating to "certificate of interest in oil, gas or mineral lease or property" would be inconsistent with the provision relating to "royalty interest or agreement." It is difficult to construe "royalty interest or agreement" to include fractional interests in the royalty rights in view of the use of "certificate of interest" to designate a fractional interest in a mineral right of the same class as "royalty interests."

Of the five interests defined in Regulation B, under the Federal Securities Act of 1933, only "landowners' royalty interest," "overriding royalty interest" and "working interest" appear to be within the meaning of the two interests referred to in the state act. Thus, "participating interests" and "oil or gas payments," as used in the federal act, would be covered only by the catchall provision of the state act.

Should the Nebraska Blue-Sky Law be extended to cover entire interests in oil and gas rights, considerable unnecessary restriction would be placed on oil and gas development while adding little by way of protection for the average investor. By imposing regulation on transactions that do not ordinarily affect the average investor (such as lease assignments, farmout agreements, and pooling agreements that effect a cross-conveyance of pooled interest), such an extension places a burden on dealings between people regularly engaged in oil and gas exploration and development. Such regulation could reach the near-ridiculous extreme of subjecting the sale of a farm subject to an oil and gas lease, by one farmer to another, to compliance with the Blue-Sky Law.<sup>78</sup>

Much of the confusion in this area could be avoided by adopting language which has assumed a more precisely defined meaning through judicial and administrative interpretation.<sup>79</sup> If the Nebraska Blue-Sky Law is intended to apply only to fractional interests in oil and gas rights, the use of "fractional undivided interests in oil or gas rights" in the definition of securities in the Nebraska act, giving it the same meaning it has in the federal act,<sup>80</sup> would be a solution to the problem. In addition to clearing up the problems in connection with interests covered and the extent of cover-

<sup>78</sup> The sale of the property, including the mineral rights, subject to an oil and gas lease, operates as an assignment of the lease. The assignment would be subject to blue-sky regulation.

<sup>79</sup> The Nebraska Blue-Sky Law was passed the same year Regulation B was issued and before some of the important cases in this area were decided; hence it did not have the benefit of this background.

<sup>80</sup> As defined 17 C. F. R. § 230.300 (1949).

age,<sup>81</sup> it would be a step toward uniformity between state acts, and coordination between state and federal legislation.

The effect of part (b) of the definition of securities in the Nebraska act, relating to the sale of any real estate or leasehold, or interest therein, on the basis of a representation of oil or gas exploration or development on the premises, or in the vicinity, is to bring within blue-sky regulation sales of oil and gas interests made in the guise of real estate transactions in order to avoid regulation. Such interests are covered by the term "investment contract" in the definition of securities in the federal securities act.<sup>82</sup> The inclusion of the term "investment contract" in the definition of securities in the Nebraska act, in conjunction with the term "fractional undivided interests in oil or gas rights," would provide a safeguard to include sales of less than entire interest in oil or gas rights which were not fractional, undivided interests.<sup>83</sup>

#### IV. GENERAL OPERATION OF THE ACT

In its role as *parens patriae* to the investor, the Department of Banking must tread a narrow trail between an overly protective position, with the resultant burden upon issuers and traders in securities, and an opposite position that opens the gates for trading in securities, with a resultant loss of the protection intended by the statute. There are no judicial guideposts<sup>84</sup> to mark the way, and while the statute establishes standards<sup>85</sup> for the Department to follow in determining the advisability of issuing an authorization

<sup>81</sup> SEC v. C. M. Joiner Leasing Corp., 320 U. S. 344, 352 (1943).

<sup>82</sup> 48 Stat. 74 (1933), 15 U. S. C. § 77b(1) (1952). SEC v. C. M. Joiner Leasing Corp., 320 U. S. 344 (1943); Mansfield v. United States, 155 F. 2d 241 (5th Cir. 1946), *cert. denied*, *sub nom*, Browne v. United States, 329 U. S. 792 (1946).

<sup>83</sup> It should be noted that an "investment contract" not being an interest in oil and gas does not get the relaxed treatment of SEC Regulation B. But it does qualify under another general relaxer, Regulation A, which generally grants any security in an issue of less than \$300,000 an exemption from the onerous registration and prospectus requirements of the Securities Act. 17 C. F. R. § 230.215 (1955 Supp.).

<sup>84</sup> No cases are reported where the Nebraska Supreme Court ruled upon the denial of an authorization order or grounds for such denial. While time did not permit a search of district court records, the author was informed by Mr. Johnson, Department of Banking, that since the Department has been charged with administration of the act, no one has taken an appeal to the district court based on the denial of an authorization order. (Conversation, March 21, 1957.)

<sup>85</sup> Neb. Rev. Stat. § 81-318 (Reissue 1950).



order, these standards are not as specific as they might be and leave a broad range of discretion in the Department.

Granting that the determination must be made by some agency, and that any such determination necessarily involves the discretion and judgment of the agency to which the power is delegated, it would appear that the statute could, and should, establish standards for the Department to use which provide a more tangible basis for evaluation of the security. The "fair and equitable" determination under the Nebraska act is made on the basis of legal concepts involving consideration of terms such as "fraudulent" and "misleading," without reference to specific factors determinable on the basis of business practices and principles.<sup>86</sup> In making the determination, the Department of Banking is not required to make specific findings and reduce them to writing, but is required only to issue a written order authorizing the issuance or sale of the security, or denying the application, on the basis of its determination.<sup>87</sup>

In making the evaluation of the security being offered, the Department must also determine the sufficiency of the information disclosed by the applicant, which forms the basis for the evaluation. Here again the statute provides a standard for the Department,<sup>88</sup> and again it leaves the real burden of determination to the Department. The standard, as set out, includes seventeen items the Department may require the applicant to include with his application; the statute does not make any of the items mandatory.<sup>89</sup> The language of § 81-315 is phrased so that the items of information there enumerated might be construed as the maximum disclosure the Department could require, with the discretionary power to require less. Should the statute be construed as not imposing the maximum limitations on the information to be filed with an application, the minimum requirements are still at the discretion of the Department of Banking. In effect, it is a delegation by the legislature of the power to determine minimum requirements of disclosure, a function the legislature should properly exercise. Minimum disclosure provisions should be made mandatory by the statute with power in the Department to require such further information as it deems necessary and proper.

<sup>86</sup> Kans. Laws c. 145, § 9(a), p. 328 (1957).

<sup>87</sup> Neb. Rev. Stat. § 81-318 (Reissue 1950).

<sup>88</sup> Neb. Rev. Stat. § 81-315 (Reissue 1950).

<sup>89</sup> The word "may" as used in § 81-315 is construed as permissive.

<sup>90</sup> See text *infra* at footnotes 70, 71, and 72.

In determining whether an offering is "fair and equitable," and whether the information filed with the application is sufficient, the Department also faces the problem of what standard of knowledge, reasoning, and understanding it should apply. To presume that a person with money to invest has the business acumen to recognize the material and relevant information in connection with an offering, and to utilize it in making an evaluation of the security, would be to defeat the purpose of the statute. Its paternalism is inherently inconsistent with such a presumption. The philosophy of the disclosure acts is more consistent with this concept of a "reasonable and prudent" investor. The disclosure type statute is concerned primarily with providing the investor with sufficient information for him to make an informed judgment. Beyond this it permits the investor to exercise his own discretion and suffer the fate of his own folly if he acts unwisely.

Certainly a seasoned investor does not need the paternalistic shielding a first-time or occasional investor does. Recognition of the seasoned investor in financing operations is given in some blue-sky laws and in federal Regulation B, as noted above.<sup>90</sup> In addition to the seasoned investor, there are many people who, although only occasional investors, are prudent in their operations. But there remains a group of investors who either cannot, or will not, protect themselves,<sup>91</sup> and it has been the experience of the Department of Banking that, in relation to interests in oil and gas rights, investors tend to lose their perspective.<sup>92</sup> The Department must operate with these people, and these conditions, in mind.

The Department has engrafted onto the basic "approval" scheme a "disclosure" feature. It requires that a security issue be accompanied by a prospectus, and, in deciding whether to approve an issue, evaluates the applicant's prospectus for adequacy of disclosure. A problem arises in connection with this policy of the Department. This requirement is imposed as a condition to the

<sup>91</sup> Mr. Johnson, Department of Banking, stated that, in their experience with blue-sky violations, the Department encountered many "repeaters"—people who were involved in unlawful sales more than once and who seemed to be unable or unwilling to recognize unsound investments. (Conversation, February 22, 1957.)

<sup>92</sup> Mr. Johnson, Department of Banking, stated that people were "crazy about oil" and "eager to buy" interests in oil and gas. In many instances the promoters or salesmen of fractional undivided interests in oil or gas rights can stay within the fraud provisions of the Nebraska act, because many people are so eager to buy anything connected with oil and gas that the offeror need not make any material representations about the interest offered. (Conversation, February 22, 1957).

issuance of an authorization order under § 81-318.<sup>93</sup> Under the "Rules of Administrative Agencies"<sup>94</sup> every agency is required to file a certified copy of rules adopted by it with the Secretary of State,<sup>95</sup> and a rule not so filed is not valid against any person until so filed.<sup>96</sup> The requirement of the use of a prospectus fits within the statutory definition of a rule.<sup>97</sup> The bulletin prepared by the Department of Banking for use in the preparation of a prospectus contains a written statement of the requirement. The Department has issued no "rules" as it is authorized and directed to do in § 81-316, preferring to handle each application on an individual basis with primary attention to compliance with the statute.<sup>98</sup> A check with the office of the Secretary of State reveals that no rules have been filed with that office by the Department of Banking.<sup>99</sup> If this is in fact a rule, the failure to file it with the Secretary of State, as required, renders it invalid. The question might be raised by a person selling securities not authorized for sale, after a denial of his application on the basis of his failure to file a prospectus, as a defense to a criminal prosecution; or by a person appealing the revocation of an authorization order for failure to use a prospectus, after one has been properly filed.

## V. JURISDICTION AND ENFORCEMENT

Enforcement of state blue-sky laws presents complex jurisdictional problems. The Nebraska act provides for the appointment by a non-resident applicant or issuer of the Director of Banking as agent for service of process and provides for notice by forwarding such process to the applicant or issuer by registered mail.<sup>100</sup> The validity of such provisions and of such service is no longer in doubt.<sup>101</sup> Nor is service of process on an agent within the state

<sup>93</sup> So stated by Mr. Johnson, Department of Banking (Conversation, February 22, 1957).

<sup>94</sup> Neb. Rev. Stat. §§ 84-901 - 908 (Supp. 1955).

<sup>95</sup> Neb. Rev. Stat. § 84-902 (Reissue 1950).

<sup>96</sup> Neb. Rev. Stat. § 84-906 (Reissue 1950).

<sup>97</sup> Neb. Rev. Stat. § 84-901(2) (Supp. 1955).

<sup>98</sup> So stated by Mr. Johnson, Department of Banking. (Conversation March 12, 1957).

<sup>99</sup> May 14, 1957.

<sup>100</sup> Neb. Rev. Stat. § 81-324 (Reissue 1950).

<sup>101</sup> *Hess v. Pawloski*, 274 U. S. 352 (1927).

where the agent has not registered and is not authorized to receive service of process of doubtful validity.<sup>102</sup>

Where, however, a seller of securities operates entirely from without the state, or where a hit-and-run operation is conducted, problems are increased. With regards the out-of-state seller, the problem is two-fold, involving state regulation of the mails, and raising a problem on service of process for an *in personam* action. The trend of decisions indicates, however, that the courts will uphold state regulation of an out-of-state dealer in securities, with regard to transactions within the state, as a proper exercise of the police power.<sup>103</sup> The standards established by *International Shoe Co. v. State of Washington*,<sup>104</sup> and followed in *Travelers Health Association v. Commonwealth*,<sup>105</sup> uphold substituted service where the person served is not within the state and has no agent within the state.

The policy of the Department of Banking has been to obtain a cease and desist order against out-of-state violators and use this as a means of publicity to inform the public.<sup>106</sup> Notice of such action may be sent to regulatory agencies in the state where the violator is resident and to the SEC. Some of these violators may be in violation of other state laws and federal acts.<sup>107</sup> Most of them

<sup>102</sup> *International Shoe Co. v. State of Washington*, 326 U.S. 310 (1945); *Henry L. Doherty Co. v. Goodman*, 294 U.S. 623 (1935).

<sup>103</sup> *Travelers Health Association v. Commonwealth of Virginia*, 339 U.S. 643 (1950); *Merrick v. Halsey*, 242 U.S. 568 (1917).

<sup>104</sup> 326 U.S. 310 (1945). The court here applied the test of "continuous and systematic activity," but indicated it considered the "quality and nature of the activity in relation to the fair and orderly administration of the law" as a proper test. [at 319.] The court further stated that for a state to support an action *in personam* where the defendant was not present within the state, he must have "certain minimum contacts with it [the state] such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice'." [at 316.]

<sup>105</sup> 339 U.S. 643 (1950). Upholding service of process by registered mail on a defendant who was not present and did not have an agent within the state, the Supreme Court was satisfied that it was "reasonably calculated to appraise" defendant of the action. At 647, the court stated: "But where business activities reach out beyond one state and create continuing relationships and obligations with citizens of another state, courts need not resort to a fictional 'consent' in order to sustain the jurisdiction of regulatory agencies in the latter state."

<sup>106</sup> Interview with Mr. Johnson, Department of Banking, April 3, 1957.

<sup>107</sup> In addition to the Securities Act of 1933 and the Securities Exchange Act of 1934, these operators are also subject to, and may be in violation of, the mail fraud statute. 18 U.S.C. § 1341 (1952).

do not wish to be put in an unfavorable position with the securities commission of either the offended state, or the state in which they are resident, and will comply to avoid unfavorable publicity.

The last recourse is extradition and criminal prosecution. When necessary, this remedy has been used by the State of Nebraska.<sup>108</sup> It is the only practical remedy available to be used against the criminal or fringe operator with no reputation to protect and against the hit-and-run operator.

In the case of resident violators, without the problems of jurisdiction involved with non-resident violators, enforcement would appear to be relatively simple. Practical problems of enforcement appear, however, which render this task much more difficult than it appears on the surface, and increase the problems where non-resident violators are concerned.

The primary problem is that of discovery of violations. The Department is not staffed so as to permit them to search for violations. Usually they are alerted by complaints from affected parties or through information directed to them by cooperating agencies. If they are fortunate, they become aware of a violation during the period of solicitation and sale; more often their attention is called to a violation long after the transaction is completed, usually when someone discovers he has made an unwise investment. The reluctance of investors to admit they have been "stung" is the major cause for this delay. And once they come forward to complain, their primary concern is the return of their money, not the punishment of the violator.

If the Department becomes aware of the violation during the period of solicitation and sale, its effectiveness is greatly increased; first, in that the Department may act immediately against the violator,<sup>109</sup> and, secondly, the securing of evidence for purposes of criminal prosecution is greatly facilitated. Where, however, the transaction constituting the violation has been completed for some time, the Department faces a two-fold problem: gathering sufficient evidence on which to base a prosecution, and finding the violator and instituting charges against him before the statute of limitations has run.<sup>110</sup>

<sup>108</sup> Interview with Mr. Johnson, Department of Banking, April 3, 1957.

<sup>109</sup> As in the case of Wyoming Oil Co. and its agents, where a temporary restraining order was issued in Lancaster District Court, February 18, 1957. Where the Department may so act, it can prevent the sale of fraudulent or unsound securities, or sales in violation of the act.

<sup>110</sup> Neb. Laws c. 374, p. 1314 (1957) increased the "Blue-Sky" criminal limitations to five years.

Often the best evidence available against a violator is the testimony of investors who participated in the transactions constituting the violation. Many of the investors are hard to find and even more reluctant to testify. Some are willing to testify until the violator, in order to avoid the criminal penalties, offers to refund their money or give them a "new bargain." At this point they lose interest in the prosecution.<sup>111</sup> Man's reluctance to admit his own gullibility, and his desire to recoup his losses and forget the whole matter, increase the burdens on the Department considerably.

## VI. EVALUATION OF THE ACT

### A. IMPACT ON INVESTORS

The Nebraska Blue-Sky Law, as administered by the Department of Banking, provides some protection for the investor in Nebraska. Department examination and approval of an issue or offering before it may be sold in the state, and the powers vested in the Department in connection with the exercise of this function, provide a measure of prior protection against unsound securities, and permit the investor to make an informed judgment of the security offered, on the basis of the information disclosed in the prospectus used in connection with the offer. It has been the experience of the Department, however, that many investors are unable to understand and utilize a prospectus, and do not seek the advice of competent and experienced counsel capable of interpreting it.<sup>112</sup> In addition, the regulatory provisions for brokers and salesmen protect the investor against fly-by-night promoters, and

<sup>111</sup> Discussing these problems with the author, Mr. Johnson, Department of Banking, related, without identifying, a case in which the Department took action against a violator. An affected investor, the chief witness in the case, was not only willing to testify against the violator but was insistent that "no so-and-so was going to swindle him and get away with it." The violator had previously been convicted in other states for the same type activities.

Immediately prior to the trial the witness reaffirmed the statement he had given the Department and stated he would so testify at the trial. Instead he changed his position and did not testify as he had indicated he would. As a result, the case was lost. When asked why he had changed his position, he related that the violator had talked to him the night before and had promised him a "new deal—a big Texas oil well." "And," he stated, "that's what I want—a big Texas oil well." While this is an extreme example, Mr. Johnson stated it was not an isolated instance of this type of occurrence.

<sup>112</sup> So reported by Mr. Johnson, Department of Banking. (Conversation, February 22, 1957).

against "fringe operators"—financially or morally unsound brokers or salesmen.

The civil liability section,<sup>113</sup> the provision making sales in violation of the act *prima facie* evidence of fraud,<sup>114</sup> and the provisions extending liability to a principal for the acts of his agent,<sup>115</sup> provide a measure of redress for an affected investor. While providing an investor remedies beyond his common law remedies, these provisions would appear to be inadequate in view of the paternalism of the act. Many of the state acts contain provisions making sales in violation of the act voidable, permitting the affected investor to recover costs and attorney's fees. Such a provision would encourage compliance with the act by persons issuing or offering a security for sale in Nebraska.<sup>116</sup>

The penal provisions, in addition to being a deterrent to violation of the act, sometimes act as a corrective force in that they encourage return of an investor's money in an attempt to forestall prosecution. This incidental benefit to the investor is balanced by a resultant detriment to the Department's enforcement activities, weakening the deterrent force of the act.<sup>117</sup>

Despite the paternalistic nature of the act and the attitude of the Department of Banking, the investor still may, and often does, "make a fool of himself." If he persists in buying unauthorized securities, or in buying securities from an unlicensed broker or salesman, he nullifies the benefits of the act, and of Department action, and opens the door for the unethical operator. And if he remains silent once he has been "hooked," he aids the violator in escaping the consequences of his unlawful act, and in continuing his nefarious activities.

Nor do these investors, once bitten, become wary. Many of them are "repeaters" who have been involved in an unlawful sale of an unsound interest or security and have been rescued by the Department. They should be aware of the pitfalls and should be cautious before investing again. But often these same people are

<sup>113</sup> Neb. Rev. Stat. § 81-331 (Reissue 1950).

<sup>114</sup> Neb. Rev. Stat. § 81-335 (Reissue 1950).

<sup>115</sup> Neb. Rev. Stat. § 81-336 (Reissue 1950).

<sup>116</sup> This provision has been criticized as giving the investor a "free shot." If the investment is good, he keeps it. If it is bad, he gets his money back.

<sup>117</sup> Mr. Johnson, Department of Banking, stated that many affected investors were interested only in getting their money back and once this was done, had no desire to testify against the violator. (Conversation, February 22, 1957).

found investing in "visionary" oil wells and looking to the Department to bail them out again.<sup>118</sup>

#### B. IMPACT ON ISSUERS

Under the provisions of § 81-312, oil and gas interests in the State of Nebraska are exempt from the provisions of the Blue-Sky Law, and, with some specific exceptions, issuers of oil and gas interests in the State of Nebraska receive the benefit of this exemption. An issuer of a security, exempt under this provision, would appear to be within the meaning of § 81-336, imposing liability on a principal for the material misrepresentations of his agent, but could avoid civil liability for false advertising<sup>119</sup> or liability under the provision of § 81-335, making sales in violation of the act prima facie evidence of fraud.<sup>120</sup> The same situation exists with regard to criminal penalties. By language of the statute, an issuer of exempt securities is exempt from many of the criminal penalties.<sup>121</sup> In addition, the exemption removes the prior protection of Department examination and approval of local interest in oil and gas offered for sale. Coupled with the limited offerings exemption of § 4(1), or the intrastate exemption of § 3(a) (11) of the federal securities act, it permits the sale of oil and gas interests in Nebraska to residents of Nebraska without any regulation whatsoever. To the degree it opens the door to unethical promoters, it permits them to compete with the legitimate operator for capital and may tend to destroy public confidence in oil and gas financing operations generally.

What the effect of the necessity for compliance with the Blue-Sky Law is on the issuer must be measured in terms of the incon-

<sup>118</sup> Another case history related by Mr. Johnson involved a "repeater." He had invested \$10,000 in a worthless promotion involving a trout farm. The sale was made in violation of the Nebraska Blue-Sky Law, and, through the action of the Department against the promoter, the investor was able to regain his investment. At the time of the author's interview with Mr. Johnson, this same investor was clamoring for the Department to get back \$5,000 he had invested in an oil promotion scheme. Again the sale was made in violation of the Nebraska Blue-Sky Law. (Conversation, February 22, 1957).

<sup>119</sup> The civil liability for false advertising provision related only to written or printed matter. Neb. Rev. Stat. § 81-331 (Reissue 1950).

<sup>120</sup> This provision applies only to transactions in violation of the act. The only provisions an issuer of exempted interests might violate require essentially the same evidence for proof as 81-335 provides.

<sup>121</sup> An issuer of an exempted interest would appear to be within § 81-339, relating to fraudulent sales, and § 81-341, relating to false statements as to value.



venience and delay occasioned by the filing and the period necessary for Department investigation and determination. As the statute now stands, without the benefit of rules and regulations promulgated by the Department or of published reports of Department decisions, an applicant faces a difficult task in preparing an application which he can be reasonably sure will satisfy the Department. Necessity for amendment may cause further delay and inconvenience. The Department bulletin relating to the content, form, and manner of presentation of a prospectus would provide assistance in this area. Unfortunately, the information therein is general, and would provide little, if any, assistance with problems unique to applications relating to oil and gas. In view of the nature of oil and gas transactions, which may change character in a very short time, delay could be costly.

The "fair and equitable" basis would not appear to impose an undue hardship on an issuer. Neither the law nor the Department requires an issuer to guarantee the success of any operation in connection with an offering. But it will not permit an issuer to insure a profit for himself at the expense of the investor while giving the investor less than a fair business bargain. The issuer receives the benefits of the deterrent to fly-by-night operators and the favorable atmosphere for selling created by Department approval.

#### C. IMPACT ON BROKERS AND SALESMEN

Brokers and salesmen are in a position analogous to that of the issuer. They are subjected to licensing provisions and to regulation in certain respects. The qualification requirements imposed do not appear to be unreasonable, nor do the limitations and conditions placed upon them appear to be unduly restrictive. They, too, receive the benefits of the deterrent effect of state regulation upon fringe operators and of any confidence the investing public may have in licensed brokers or salesmen because of state regulation.

#### D. ADMINISTRATION

While the making of broad, general rules by the Department of Banking is restricted by the diversity of applications received by it under the Blue-Sky Law, it would appear rules could be made in particular areas such as oil and gas interests. Published rules and regulations of the Department and published decisions of Department rulings would be invaluable guides to future applicants. The bulletin prepared by the Department relating to the form and content of a prospectus is a step in this direction. From the standpoint of applicants, it would also appear to be desirable for specific findings to be made and reduced to writing in connection with the

denial of any application or in any other case where an issuer or offeror is adversely affected.

As it stands now, the statute presents a legislative maze. It is verbose without being definitive,<sup>122</sup> contains multiple provisions relating to a single feature of the act,<sup>123</sup> and does not appear to have a central basis of organization. Related provisions are not always contiguous,<sup>124</sup> and some sections of the act are totally out of context with adjacent provisions.<sup>125</sup> In some instances one section of the act may contain two or more independent provisions;<sup>126</sup> in other instances one provision may be divided between two or more sections.<sup>127</sup> The resultant difficulty encountered in attempting to trace a single feature of the act and determine its exact content adds to the problems in connection with an application made under the act.

## VII. CONCLUSION

A revision and reorganization of the present act, without changing its content, would provide only a partial remedy. The author would suggest that: (1) minimum requirements for disclosure in connection with an application should be established by the legislature; (2) the standard for evaluating an issue or offering should be in more specific language, with factors determinable on the basis of business principles and practices included therein; (3) the definition of securities should clearly indicate what interests in oil

<sup>122</sup> See for example the definition of security already discussed. Neb. Rev. Stat. § 81-304 (Reissue 1950).

<sup>123</sup> There are five sections (81-303, 81-316, 81-317, 81-320, 81-323) dealing primarily with the powers of the Director of Banking and the Department of Banking. In addition, other sections of the act confer powers on the Department, incidental to their other provisions. There appears to be a duplication in these sections. (Compare the proviso of § 81-317 with § 81-320).

<sup>124</sup> See, for example, § 81-316 (general powers of the Director of Banking), and § 81-317 (proviso relating to general investigatory power) inserted between § 81-315 and § 81-318 relating to authorizing the sale of securities.

<sup>125</sup> Interspersed between the penalty provisions are provisions relating to license fees, liability of principal, matters of evidence, and other unrelated provisions.

<sup>126</sup> § 81-333 contains seven penalty provisions (5 misdemeanor, 2 felony) that are in no way separated. Lost in the middle of this section is perhaps the single most important felony provision, relating to the selling of securities without an authorization order.

<sup>127</sup> § 81-330 makes certain acts perjury but imposes no penalty. § 81-333, in one of its seven penalty provisions, imposes a penalty for perjury as defined in § 81-330.

and gas are covered and to what extent; (4) the statute should require findings to be made and reduced to writing in connection with an order of the Department, and rules to be promulgated and published for the assistance of applicants; (5) the statute should include a section making sales in violation of the act voidable, providing a measure for recovery; (6) the exemption of oil and gas interests in Nebraska be removed from the act; (7) the penalty provisions of the act be revised and reorganized; and, (8) the whole act be revised and reorganized with a systematic classification of provisions adopted.

In such a revision project, the adoption of terminology that has acquired a well-defined meaning through definition in federal legislation, other state legislation, and through judicial construction would help avoid ambiguity and uncertainty. It would also be a step toward uniformity between state acts and co-ordination with federal legislation. The adoption of the Uniform Securities Act<sup>128</sup> might solve most of these problems. Certainly its use as a guide to amendment and revision of the existing Nebraska Blue-Sky Law would bring the benefits of invaluable research and experience to the task.

<sup>128</sup> The Uniform Securities Act, basically the work of Louis Loss, Professor of Law, Harvard Law School, was published in final draft form in August of 1956, with commentaries by the draftsmen, and was subsequently approved by the National Conference of Commissioners on Uniform State Laws and by the National Association of Securities Administrators. There is no report available at this time regarding action on the act by the several state legislatures. The act, including comments of the draftsmen, will be printed as an appendage to a study of state blue sky laws to be published in 1957 by Little, Brown & Co. as Loss and Cowett on Blue Sky Laws. Current Status of the Uniform Securities Act, 12 Bus. Law 26 (November, 1956).