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BLUE SKY AND BLACK GOLD: ARE MINERAL INSTRUMENTS WITHIN THE FLORIDA SECURITIES ACT?

HOLDEN E. SANDERS*

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I

INTRODUCTION

Fifteen eventful years have sped by since Powell and Petteway announced their concern over the lack of competent administrative machinery to grind up the schemes of fraud and sharp practice in mineral transactions.¹ At that time the Sunniland well had just been brought in and dreams of a petroleum future for Florida were rampant. Today, the dreamed-of era is over-due but Powell and Petteway had pointed to a problem which is quite independent of a local petroleum or mineral development; inter-jurisdictional commerce in mineral transactions. Mineral development requires capital in great quantities and it was this feverish

*Editor-in-Chief, University of Miami Law Review. Grateful acknowledgment is made for the criticism and supervision of Professor Hugh L. Sowards, dean of the Florida Securities Act commentators.

1. Powell & Petteway, *Speculation in Oil and Gas Leases and Royalty Contracts in Florida*, 17 FLA. L. J. 286 (1943).

search for capital and its attendant abuses with which they became concerned.

Questions of the applicability of Blue Sky laws first appeared in California² and Texas³—almost unnoticeably—in the Thirties. As the industry grew and the search for capital was intensified, the questions arose more frequently and in other jurisdictions. The answers were often bitterly and expensively discovered. Florida's almost negligible experience occurred in the late Thirties and early Forties.⁴ Within the past two decades a definite field of litigation has clearly evolved at the crossroads of Blue Sky legislation and mineral commerce. By summarizing these developments and interpreting them with a view toward the Florida Securities Act, it is hoped the profession will be afforded an ounce or two of prevention.

Scope is necessarily limited to what mineral transactions involve securities without seriously considering the problems of exemption, issuance, and registration which are adequately treated elsewhere.⁵ Questions involving the federal securities laws are likewise purposely avoided. This empirical treatment is followed by a critique and speculative analysis with regard to the Florida Securities Act, especially as it affects securities and real estate dealers.

II

LEGISLATIVE, JUDICIAL, AND EXECUTIVE TREATMENT OF THE MINERALS CLAUSE IN THE FLORIDA SECURITIES ACT

The genesis of mineral transactional problems of any securities act is the definitions section and, specifically, the statutory expression of what constitutes "securities." The Florida section is Chapter 517.02 (1) which declares a security to be, among a host of other things, any "certificate of interest in an oil, gas, petroleum, mineral or mining title or lease, or the right to participate therein . . ." Even if this unequivocal statement were absent, such interests are still subject to the act by a subsequent clause which states that "interests in or under a profit sharing or participation agreement or scheme . . ." are securities.⁶

The minerals clause has not remained untouched by the three governmental branches since the original enactment of the Uniform Sale of

2. *E.g.*, *Domestic and Foreign Petroleum Corp. v. Long*, 4 Cal. 2d 547, 51 P.2d 73 (1935).

3. *E.g.*, *Muse v. State*, 137 Tex. Cr. R. 622, 132 S.W.2d 596 (Tex. Crim. App. 1939).

4. *Ryan v. State*, 128 Fla. 1, 174 So. 438 (1937); *Ryan v. State*, 131 Fla. 486, 180 So. 10 (1938); *Boyer v. Black*, 154 Fla. 723, 18 So.2d 886 (1944).

5. Robinton & Sowards, *The Florida Securities Act: A Re-Examination*, 12 U. MIAMI L. REV. 1 (1957); Robinton & Sowards, *Florida's Blue Sky Law: The Lawyer's Approach*, 6 MIAMI L. Q. 525 (1952).

6. *Ryan v. State*, *supra* note 4.

Securities Act in 1931.⁷ At that time the clause read: "... certificate of interest in an oil, gas or mining lease" By an amendment in 1935⁸ words were added to make the clause read as it does today. Immediately after the act was passed, Attorney General George Couper Gibbs had occasion to interpret the clause.⁹ The question had been presented to him as to whether a contract and deed, used by the All Florida Land Company required registration. The deed was a conveyance to the purchaser of an undivided interest in an undivided ½ interest in property, "together with a like undivided interest in all bonuses, royalties and rentals received as provided for in present or future contracts in oil and gas lease" covering the lands. The query had been made in reference to Chapter 14899, the original act, but the Attorney General answered in the light of the then recently passed amendment.

The instruments were securities, he advised, in that they definitely were rights to participate in, or certificates of interest in, an oil, gas, petroleum, or mining title or lease and by reason of the fact that it was a *profit sharing agreement or scheme*. This latter basis for the opinion was judicially approved two years later in *Ryan v. State*.¹⁰ Considering developments in other jurisdictions at the time,¹¹ subsequent Florida legislation,¹² and judicial treatment,¹³ the Attorney General's statements appear remarkably advanced.

*Ryan v. State*¹⁴ was Florida's first judicial attempt to bring minerals transactions within the purview of the Sale of Securities Act. The Securities Commission sought an injunction (by virtue of section 517.19) against Frank J. Ryan and the Ryan Florida Corporation in their sales of "Partnership Profit-Sharing Agreements" and "Guaranteed Re-Sale Lease Agreements" without complying with the registration provisions of the Act. These instruments were of a hybrid character in that designated acreage under an oil and gas lease was sold to the vendee with a provision that

7. Fla. Laws 1931, ch. 14899 § 1. This first form of the Uniform Sale of Securities Act was withdrawn in 1943 after Florida, Hawaii, Louisiana, Oregon and South Carolina, Michigan, and Alabama adopted it with various modifications. See Nat'l Conf. of Comm'rs on Uniform State Laws, Handbook and Proceedings, 356 (1942). The new Uniform Securities Act (9C U.L.A. 84) was adopted in toto by Kansas in 1957, Kans. Laws 1957, ch. 145. Besides the other broad definitions of securities, in the new Act, the minerals clause of section 401 (L) reads as follows: "certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease"

8. Fla. Laws 1935, ch. 17253 § 1.

9. Op. ATT'Y GEN. (July 23, 1935. References to such opinions in this article refer to those of the Attorney General of Florida unless otherwise noted.

10. *Ryan v. State*, 128 Fla. 1, 174 So. 438 (1937); *Ryan v. State*, 131 Fla. 486, 180 So. 10 (1938).

11. E.g., *Kadane v. Clark*, 135 Tex. 496, 143 S.W.2d 197 (1947); *El Claro Oil Co. v. Daugherty*, 11 Cal. App.2d 274, 53 P.2d 1028, 55 P.2d 488 (1936). See note, 10 CAL. L. REV. 483 (1937).

12. Fla. Laws 1943, ch. 21709 § 1.

13. *Boyer v. Black*, 154 Fla. 723, 18 So.2d 886 (1944).

14. 128 Fla. 1, 174 So. 438 (1937).

Frank J. Ryan (individually and as president of the Ryan Florida Corp. and as fiscal agent for Southern Petroleum Corp. and Malone and Pope, Inc.) guaranteed to net the vendee the amount of the original consideration.^{14a} The agreements referred to a subsequent re-sale, through the agency of Ryan, "as soon as mutually agreed after the bringing in of Well No. 1 as a producer by the Southern Petroleum Company" and that the parties would share the proceeds equally of everything above the original consideration. Both types of contracts involved substantially the same provisions.

The chancellor found the transactions to be within the Act and granted the injunction. On appeal, the Florida Supreme Court also held the contracts subject to the Act but without discussion. This seems rather strange, considering the novelty and far-reaching effects of such a decision. However, the judgment was reversed on another ground which, it is believed, like the *Children of Strangers*,¹⁵ was conceived in an atmosphere of chance.¹⁶ When the case appeared before the Supreme Court the second time, the chancellor was affirmed.^{16a}

Attorney General Gibbs' understanding of minerals conveyancing is further illustrated by an opinion which he issued in March, 1937.¹⁷ The question was asked whether "securities" were involved in a submitted prospectus that offered for sale 1/600 of the whole royalty interest under a lease. He answered in the affirmative, emphasizing 'title' and noting that a royalty was usually an interest reserved under an oil lease in a portion of the total production of oil and gas from the tract.

In 1943, the existing lucid statement of the minerals clause was amended¹⁸ in such a way as to arouse no end of curiosity in the modern examiner. It should be noted that the clause before amendment had no geographical jurisdictional limitation; that is, the "securities" were subject

14a. One of the vendees was an 83 year old man and the consideration was a \$1,000 government Bond.

15. SAXON, *CHILDREN OF STRANGERS*, (1937).

16. From the Complaint, paragraph Five:

"That the undersigned State's Attorney has been requested by D. Kirk Gunby as Examiner for the Florida Securities Commission to bring this suit; that the said D. Kirby Gunby was ordered and directed by the Commission to cause this suit to be filed as appears from a copy of said order attached thereto as Exhibit "A" and hereby made a part of the Bill of Complaint."

From the Answer:

"These defendants are without knowledge of the allegations of paragraph five of the Bill."

The court held this was a denial and it failed to show there was sufficient evidence that The Securities Commission had authorized the institution of the suit. When the cause appeared the second time before the Supreme Court, the chancellor's decree was affirmed. *Ryan v. State*, 131 Fla. 486, 180 So.10 (1938).

16a. *Ryan v. State*, 131 Fla. 486, 180 So.10 (1938).

17. *OP. ATT'Y GEN.* (March 19, 1937).

18. Fla. Laws 1943, ch. 21709 § 1.

to the commission's regulation regardless of the location of the lands to which they were related. As a matter of fact, why *should* it matter? It is true that *lex situs* applies to land but the *securities transaction* was what was sought to be regulated and there should have been no reasonable challenge to Florida's jurisdiction in that respect. There was certainly an abundance of authority at the time to support such a contention.¹⁹

However, the legislature in its collective wisdom thought differently. Apparently, it was thought that the Act did not bring within the commission's administrative grasp transactions made within the state affecting lands situated outside the state. By the amendment, "in or on lands situated outside the state, offered for sale to the public by a dealer or salesman in this state . . ." was added. As it turned out, the legislature had unwittingly muddled the waters for a decade or more in its zeal to regulate such commerce.

Within a year, the supreme court struck the amending act down with a heavy but dull judicial axe.²⁰

Boyer was arrested for violation of the securities Act. He was charged with unlawfully engaging in the business of dealing in securities issued by another without having registered them and with failing to register as a dealer. The transaction, effected in June, 1943, was an assignment for value by Boyer of an oil and gas lease on 40 acres of Texas land to a purchaser in Florida. In habeas corpus proceedings Boyer was remanded to trial on the above counts.

On his appeal to the Florida Supreme Court in 1944, he attacked the very constitutionality of the 1943 amendatory Act. He argued that the *title* of the act was insufficient in view of the mandate of section 16 of article III of the Florida Constitution.²¹ Boyer further contended that such a lease, in *Texas* being a conveyance of an interest in land²² with none of the characteristics of a security as the word is commonly understood, was not properly includible in the Florida Securities Act. This devious strategy; that is, wedding a clear and traditional doctrine (the constitutional mandate) with a not so valid inferential line of reasoning (the 'interest in land') won Boyer his reversal. The court adopted his arguments and the 1943 Act was declared invalid.

19. E.g., *People v. Jackson*, 24 Cal. App.2d 182, 74 P.2d 1085 (1937). See also, LOSS & COWETT, *BLUE SKY LAW*, 180-228 (1958); Note, *Conflict of Laws Liability for Interstate Sales of Securities Under State Blue Sky Laws*, 31 CALIF. L. REV. 95 (1942). *State v. Pullen*, 58 R.I. 294, 192 Atl. 473 (1937).

20. *Boyer v. Black*, 154 Fla. 723, So.2d 886 (1944); See Annot. 153 A.L.R. 874 (1944).

21. "Each law enacted in the Legislature shall embrace but one subject and matter properly connected therewith, which subject shall be briefly expressed in the title; and no law shall be amended or revised by reference to its title only; but in such case the act, as revised, or section, as amended, shall be re-enacted and published at length."

22. But see *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943).

The *Boyer* decision is subject to criticism on several grounds. To borrow a phrase from Justice Holmes, "This case is decided on an economic theory which a large part of the country does not entertain."²³ Justice Sebring, speaking for the majority, said:

From the citation of authorities presented in briefs it appears that in the State of Texas, at least, the sale and assignment of a gas and oil lease such as we have here is equivalent to the sale and assignment of a leasehold interest in land in the specific tract described.²⁴

He then repeated the citations. Curiously enough, at the head of the list was the leading case that such transactions were 'securities' under the federal securities act.²⁵ Perhaps the court was without benefit of adequate research because there were several extant opinions²⁶ from the appellate level in Texas, California and others to the effect that such instruments were securities under Acts with definitions sections substantially the same as the Uniform Act.²⁷ Not the least criticizable was the court's concern for Texas law. If the court was sincere in its articulation of the 'insufficient title' objection, why was it so concerned with the meaning given to "securities" by a foreign jurisdiction, at the same time prescribing the criterion of sufficiency of the title to the act to be the understanding given to the language by a "reader of normal intelligence"? The concern should have been for the legislature's intent with respect to *Florida transactions*; not how Texas regards a Texas mineral lease.²⁸ Retrospectively it seems clear that the court was led into a misapplication (in its dicta) of a conflicts rule by Boyer's argument. Justice Chapman dissented without discussion; one could wonder if he were thinking of the *Ryan* case²⁹ and his minerals experience in *Miller v. Carr*.³⁰

The most serious objection is that the *Boyer* decision, technically limited to the constitutionality of the 1943 Act, cast doubts on the validity of the whole minerals clause by the unfortunate dicta within the opinion. Securities Commissioner Larson presented the obvious question to Attorney General Watson (who had argued for the state on appeal) within weeks after *Boyer*. Did the *Boyer* decision involve the validity of the whole minerals clause and did it restore the original (1935) language? The

23. *Lochner v. New York*, 198 U.S. 45, 74 (1904).

24. *Boyer v. Black*, 154 Fla. 723, 727, 18 So.2d 886, 887 (1944).

25. *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). See note 17 So. CAL. L. REV. 324 (1944). See also Annot. 163 A.L.R. 1065 n. 1 (1946).

26. Cases cited, notes 2, 3 *supra*.

27. Meer believes the Texas Act is not substantially different from the Uniform Act. Meer, *The Texas Securities Act—1957 Model: Facelift or Forward Look?* 36 TEXAS L. REV. 429, 437 (1958).

28. Cf: "The mere fact that this deed and this transfer order are treated in Texas as instruments conveying an interest in land does not preclude their being considered in this state also as securities, evidencing an interest in an oil development project." *State v. Pullen*, 58 R.I. 294, 192 Atl. 473, 478 (1937).

29. *Ryan v. State*, *supra* note 9.

30. 137 Fla. 114, 188 So. 103 (1939).

Attorney General gave the obvious answer:³¹ Boyer declared unconstitutional and affected only the 1943 amendment, citing *In re Wade*.³²

The damage was already done. Had the court confined the discussion to its articulated objection and dispensed with the Texas law dicta, the legislative propriety of subjecting mineral transactions to Florida administrative control would have remained unimpaired, regardless of the locus of lands affected. A little over a year later, Commissioner Larson again queried the Attorney General. "Is it necessary," he asked, "for fractional certificates of interest in oil and gas titles on land in Florida to be registered . . .?" The Boyer dicta had evidently convinced the executive department also. The Attorney General answered:

So long as the Law of Florida defining a security includes the words [the minerals clause as amended] and such words are given their plain and patently intended meaning, the conclusion seems to be inescapable that it is not necessary to register with the commission fractional certificates of interest in oil and gas titles in lands *situated in Florida* before such certificates can be sold legally in Florida. (Emphasis added.)³³

In 1947, the legislature finally did something about the muddled state of affairs by removing the troublesome appendage to the 1935 minerals clause. The clause now stands as it was amended in 1947:³⁴ "certificate of interest in an oil, gas, petroleum, mineral or mining title or lease, or the right to participate therein"

Comptroller Gay (also an officer of the Securities Commission) was the next to so question the Attorney General. He wanted to know whether the new clause brought *royalties* within the purview of the Securities Act. He also wanted to know if the Securities Commission had jurisdiction over the sale of six leases whether in or out of the state. The Attorney General replied that the term royalty "is too broad; each must be determined by the interest such as overrides³⁵ and the like." As to the leases, he answered in the negative, cryptically remarking, "I think discussion of this question is unnecessary as the same should be and is answered in the negative."³⁶ One can almost hear him despairingly whisper that he was *just tired of the whole thing*.

31. OP. ATT'Y GEN. 044-233 (Aug. 16, 1944).

32. Fla. 440, 7 So.2d 797 (1942).

33. OP. ATT'Y GEN. 045-538 N(ov. 15, 1945).

34. Fla. Laws 1947, ch. 24066 § 1.

35. "An overriding royalty is a certain percentage of the working interest which, as between the lessee and the assignee, is not charged with the cost of development or production. That is, it is an assignment of a part of the lessee's seven-eighths interest under the conventional oil and gas lease and neither impairs nor diminishes the landowner's one-eighth royalty. It may be created by an outright grant by the lessee or by a reservation in the assignment of the operating rights of the lessee. SULLIVAN, *HANDBOOK OF OIL AND GAS LAW*, 239 (1955). See also, Seaman, *Financing Aspects of Oil and Gas Transactions*, 9 U.C.L.A. L. Rev. 550, 559 (1956).

36. OP. ATT'Y GEN. 047-217 (July 25, 1947).

Some fundamental conceptions were involved in the *Boyer* case, most of which had not at the time ever been considered by the court. It is true that in *Miller v. Carr*³⁷ the court held that generally the terms rents and royalties as used in oil and gas leases are synonymous and that oil severed from the land is personalty, but for the most part, terminology used by the court in *Boyer* and by the executive department in opinions was borrowed from petroleum jurisdictions. For one thing, the court has never been called upon to draw the distinction between an assignment and a sub-lease of an oil and gas lease although it characterized the *Boyer* instrument as an "assignment." The courts have held that where the lessee (*Boyer*) retains a reversionary interest,³⁸ rights to rental,³⁹ an overriding royalty,⁴⁰ or where the interest conveyed terminates a month before the expiration of the end of the original term,⁴¹ it is a sublease.⁴² Where he transfers his entire interest for the entire term, it is an assignment.⁴³ In *Boyer* the court noted that the "assignment" involved no profit sharing or participation agreement and it was not "an obligation for the payment of money."⁴⁴ It appears from that language that were the court to be confronted with a question as to whether a given instrument were a security, the criterion *might* be whether the lessee had made any reservations or whether a share in the management had been retained.

The importance of the distinction can be easily recognized. The court in *Boyer* said:

There would seem to be little question but that, *subject to certain limitations*, the legal instruments by which gas and oil rights are transferred from one person to another may be lawfully brought into the sphere of operation of the Uniform Sale of Securities Law and regulated as securities. Perhaps they ought to be. (Emphasis added.)⁴⁵

That the court would apply the constitutional test of reasonableness to a transaction to establish its qualification as a security seems clear. Stated

37. 137 Fla. 114, 188 So. 103 (1939). For other oil and gas language see, *Ball v. Yates*, 158 Fla. 521, 29 So.2d 729 (1947) ("Joint venture"); *Neel v. Rodman*, 160 Fla. 36, 33 So.2d 234 (1948) (nature of instruments transferring minerals in place and those transferring royalties); *Watson v. Holland*, 155 Fla. 342, 20 So.2d 388 (1944) ("negotiating" in leases).

38. *Schreck v. Coates*, 59 Ariz. 269, 126 P.2d (1942) (a gold mining lease); *McNamer Realty Co. v. Sunburst Oil and Gas Co.*, 76 Mont. 332, 247 Pac. 166 (1926).

39. *Palmer v. Bender*, 49 F.2d 316 (D.C. La. 1931); *rev'd on other grounds*, 287 U.S. 551 (1932).

40. *Cockburn v. O'Meara*, 155 F.2d 340 (5th Cir. 1946).

41. *Jackson v. Sims*, 201 F.2d 259 (10th Cir. 1953).

42. See Brown, *Assignments of Interests in Oil and Gas Leases, Farm-Out Agreements, Bottom Hole Letters, Reservations of Overrides and Oil Payments*, *Fifth Annual Institute on Oil and Gas Law and Taxation* 25 (1954); Note, 23 Miss. L. J. 299 (1952); *Moses, Assignment and Subleases of Oil and Gas Mineral Leases in Louisiana*, 23 Tul. L. Rev. 231 (1948).

43. *Roberson v. Pioneer Gas Co.*, 173 La. 313, 137 So. 46 (1931); Annot. 82 A.L.R. 1264 (1933).

44. *Boyer v. Black*, 154 Fla. 723, 727, 18 So.2d 886, 887 (1944).

45. *Id.* at 727, 18 So.2d at 888.

another way, would it be *reasonable* to treat this or that minerals transaction as one involving a security? Infiltration of economic philosophy by way of the judiciary is by no standard a novelty. Clashes between judicial bias and legislative intent sometimes take the appearance of East and West, leaving the litigant with a prayer for a meeting of the twain. It would not be atypical of the Florida Supreme Court to compare the characteristics of a given minerals instrument with those of the traditional corporate security.

Some characteristics of the corporate security are separation of management from ownership, fluctuating value, minute division of ownership interests, and the speculative nature of the interest.

Similar features may appear in a lease situation. Where there was ever a hope of minerals present, the large companies usually become the original lessees of the usually small tract owner. Many times a company does not wish to take the risk of exploration (especially in wildcat areas) and "farms out"⁴⁶ (subleases) part or all of the leaseholds to a smaller, independent producing company. Very often the independent is unincorporated. The lessee company naturally reserves a royalty interest — an "overriding royalty"⁴⁷ — the amount of which depends upon negotiations. Assuming the sublessee-producing company to be a partnership and, not infrequently, in need of operating capital,⁴⁸ it may sell fractions of its own fractional interest. Just such a situation was brought to the attention of Attorney General Ervin by the Securities Commission in 1951.⁴⁹

46. "A farm-out agreement is a contract between an oil and gas lessee and a third person to assign, or an outright assignment of, the leasehold interest in a described tract, conditional, however, upon the drilling of a test well and the performance of specified obligations incident thereto. The purpose of such an agreement is to secure the drilling of a well prior to the expiration of the primary term of the lease." SULLIVAN, *op. cit. supra*, note 35 at 526-7.

47. "Although the term 'overriding royalty' is not conclusive of the nature of the interest created, it does have a usage in the industry as denoting a share in the gross production which is carved out of the lessee's interest." *Id.* at 240, citing *Dashko v. Friedman*, 59 S.W.2d 203 (Tex. Civ. App. 1933) and noting that the term means freedom from costs of production and that it is not an interest in land. See also, *Hollis, Depletable Interest in Oil?*, 11 *MIAMI L. Q.* 244, 253 (1957): "The interest of the lessee operator is called the working interest and bears all the expense of exploitation. The lessee may transfer this working interest, reserving a fraction of the oil produced (called an overriding royalty) . . ."

48. "There are a number of miscellaneous methods of financing wildcat drilling which should be given attention. In some instances the leaseholder sells overriding royalties or participating units for cash to various individuals in order to finance part or all of the drilling costs for a test well, or, perhaps, some of these costs are financed by assigning overriding royalties to drilling contractors for free or low cost drilling." Seaman, *Financing Aspects of Oil Transactions*, 3 *U. C. L. A. L. REV.* 550, 559, (1956).

49. The present owner of an undivided 1/32 interest in an undivided 3/4 interest in an undivided 7/8 interest in an oil and gas lease on an 80 acre tract in Oklahoma had sold it in Florida in 1950. The 7/8 interest was that interest transferred to the lessee by the landowner, having by the lease reserved a 1/8 royalty interest, the usual amount. This 7/8 lessee interest had evidently been farmed out, the lessee having retained a 7/32 override. The 1/32 was one of the fractional interests transferred by the sublessee to raise capital or possibly to 'let a friend in.' The Attorney General advised that the question of whether such an interest was covered by the Securities Act was not free from doubt and that until the courts settled the matter, the commission should treat it and others like it as a security. *OP. ATT'Y GEN.* 051-393 (Nov. 2, 1951).

Fractional interests are in this manner created so that they must be expressed in decimals and the minute division of ownership interests is analogized in minerals transactions.⁵⁰ Moreover, and admittedly ignoring other important lease provisions, the major management and control has been shifted from the major ownership (lessee and landowner) to the sublessee. The analogy is not difficult to continue. It may very well be that in *Florida's* future, the distinction between the nature of the interests in the minerals will be determinative of what is a security.⁵¹

Judicial activity in mineral securities has been negligible in Florida, both in form and substance; yet, only the most naive would be willing to assert that mineral commerce is nil in the state.⁵² The opinions of the Attorney General continue to flow,⁵³ but for some reason or another, there *has not been one single instance of a criminal prosecution for violations of the act with reference to petroleum transactions since 1944*. This seems rather strange in view of the fact that registrations of such securities, as late as November 17, 1958, were termed as "very nominal" by Dannitte H. Mays, Acting Director of the Securities Commission.⁵⁴

The answer is not to be found in negligible minerals activity — hardly an acre now exists south of Orange County that is not covered by a current lease. It is almost as certain that every courthouse in the same area could attest that *one shipbuilding corporation* has at one time or another been the grantee or grantor of mineral rights to literally tens of thousands of acres of land. It might even be an interesting pursuit to

50. The writer knows of one lease in which the interests as to the gas and distillate proceeds in a dual producer were as follows:

Twenty working interests ranging from .006798 to .085539.

Eight overriding royalty interests from .002504 to .157227, the latter being held by the lessee oil company.

Twenty-seven landowner's royalty interests ranging from .000091 to .022841.

52. The following advertisement appeared in the October 17, 1958, edition of the Miami Herald in prominent block form:

**A \$300 SPECULATION
FOR BIG STAKES**

OIL & GAS LEASE issued by the State of New Mexico on State owned lands. 40 Acre leases recorded by the STATE in YOUR name. New Mexico's 1957 production 94,317,000 barrels of oil from 10,358 wells. 1,719 new producing wells drilled in 1957. We offer leases in areas where new wells are now drilling. Practically every major oil company has operations in the State. Write for full particulars TODAY!

PETROLEUM LEASE CORPORATION
1346 Connecticut Avenue, N.W.
Washington 6, D.C.

This offer to sell did not have the benefit of registration. (Personal correspondence from Dannitte H. Mays, Acting Director of the Florida Securities Commission, November 17, 1958.)

53. In the most recent one, Attorney General Richard Ervin advised that the sale of a 100% mineral interest, conveyed by deed to a specific area of land was a security within the purview of section 517. *OP. ATT'Y GEN.* 058-160 (May 15, 1958). This appears unquestionably correct under the plain terms of the definitions section.

54. Personal correspondence, November 17, 1958.

determine just how many readers of this article can recall one or more mineral transactions without the benefit of registration.

III

EMBROILED IN OIL — AND SECURITIES, CALIFORNIA STYLE

A. General.

More than a generation ago, the California Supreme Court passed squarely on the question of whether fractional interests in mineral leases were securities under the California Corporate Securities Act.⁵⁵ The applicable clause of that law declared a "certificate of interest in an oil, gas, or mining lease" to be a security and required the sale of it to be preceded by registration. In *Domestic & Foreign Petroleum Corp. v. Long*,⁵⁶ fractional interests in such leases were for the first time held to be securities. The California court *had* dealt with the question slightly two years before in *People v. Craven*⁵⁷ where minerals instruments were involved, but the attack was on the constitutionality of the Corporate Securities Act. Therefore, it can be said that the *Domestic* case settled the matter.⁵⁸

In the latter case, the original lessees assigned fractional interests in their interest in the oil and gas lease to three others in an ordinary business transaction. No offering to the public or intent to evade the Act was found. Consideration for the assignments was cash and legal services. Later, the lessees made other assignments for cash. Finally, the lessees assigned all their remaining rights under the lease to the plaintiff, subject to the rights of the prior assignees. This last assignee, after oil was discovered, brought suit to have the assignments to the first three assignees declared void on the ground that the Securities Act had not been complied with.⁵⁹ The trial court and court of appeals denied relief, ruling *that such transactions were without the act*.

The Supreme Court of California properly held that the instruments were securities but refused to declare them void. It is interesting to compare the suggestion made earlier that Florida courts should look to a transaction to see if it resembles the traditional notion of a security, with the language and reasoning of the court in the *Domestic* case.

55. Cal. Stat. 1929, ch. 707 p. 125; CAL. CORP. CODE § 25008.

56. 4 Cal.2d 547, 51 P.2d 73 (1935).

57. 219 Ca. 522, 27 P.2d 906 (1933).

58. *Buttrick v. Seines*, 209 Cal. 567, 289 Pac. 616 (1930) was an earlier case yet but arose under a former, much less elaborate law. See also *Smith v. George F. Getty, Inc.*, 120 Cal. App. 274, 7 P.2d 733 (1933).

59. "Every security of its own issue sold or issued by a company without a permit of the Commissioner then in effect authorizing the issuance or sale of the security is void. Every security of its own issue sold or issued by a company with the authorization of the Commissioner but which has been sold or issued in nonconformity with any provision in the permit authorizing the issuance or sale is void." CAL. CORP. CODE § 26100.

In decisions in this state and in other jurisdictions where it has been contended that a transaction under attack did not come with the Corporate Securities Act because it constituted only a sale of specific real or personal property or an interest therein, the courts have looked through form to substance and found that in fact the transaction contemplated the conduct of a business enterprise by others than the purchasers, in the profits or proceeds of which the purchasers were to share . . . such interests are generally declared to be investment contracts.⁶⁰

It is also interesting to compare the language with the Florida court's discussion in the *Boyer* case of whether a lease is an interest in land. What *could* be more reasonable than to disregard the form and look to substance to see if traditional notions of investment contracts are involved?

Two important points were involved in the *Domestic* case that require attention: Whether there was an "issue" of a security and the effect on the rights of the parties by the fact that the instrument was executed contrary to law. The first three assignees argued that their transferors, the lessees, did not "issue" because there was no offering to the public. Therefore, they reasoned, the transferors were only individual owners and on authority of *Pace v. Pace*,⁶² such an owner needed no permit to sell his interest. The supreme court held such a requirement could not be read into the Act, relied on *Cecil B. De Mille Productions v. Woolery*,⁶³ and held the lessee's transfer was an issue. The court also reached a reasonable conclusion as to the effect on the interest conveyed by the violation of the Securities Act. The intent of the Act was to protect the public; had the court followed the general rule that illegal agreements confer rights on no one, that intent would have been frustrated. The proper form of discouragement of such activity is by collateral penal prosecution with the state as a party. The court refused to entirely void the transaction and held the three assignees entitled to share in the oil in accordance with the agreement.

B. The Criminal Cases.

The *Craven* and *Domestic* cases heralded a rash of litigation in the nature of a dichotomy⁶⁴ continuing until the present time. There are the cases led by *Craven* where the state as a party has consistently and successfully prosecuted corruption in minerals transactions on the basis of non-securities criminal laws, violations of the Corporate Securities Act, or

60. 4 Cal.2d 547, 555, 51 P.2d 73, (1935).

61. For "public offering" considerations under the Florida Securities Act, see Robinton & Sowards, *The Florida Securities Act: A Re-Examination*, 12 U. MIAMI L. REV. 2, (1957).

62. 73 Cal. App. 548, 238 Pac 1089 (1925).

63. 61 F.2d 45 (9th Cir. 1932).

64. "Every fancy article you read now uses the word 'dichotomy.'" GOLDEN, ONLY IN AMERICA—(1958).

both.⁶⁵ On the other hand, there are the strictly civil cases led by the *Domestic* case, where one party in a controversy over a minerals transaction invokes the violation of the Act as a defense or as a ground for recovery of money or securities under the contract.⁶⁶

In the leading criminal case, the defendant Craven was indicted for violating the Corporate Securities Act. He had sold interests in oil and gas leases without a permit from the Corporations Commissioner. The sales took place in 1929 and 1930; therefore, some of them were governed by the Corporate Securities Act as amended in 1925.⁶⁷ The applicable clause was "any instrument offered to the public by an 'individual' evidencing or representing any right to participate or share in oil, gas or other hydrocarbon substances or other minerals of any sort, as yet undeveloped, or in the proceeds of the sale thereof." Those sales in 1930 were affected by the Act as amended in 1929⁶⁸ where the language was "certificate of interest or participation, certificate of interest in a profit sharing agreement, certificate of interest in an oil, gas or mining lease or beneficial interest in title to property, profits or earnings."

Craven attacked the constitutionality contending that he was denied property due process, but the court finally characterized his objection as a policy one and proper concern of another department of the government. He had cited *Buttrick v. Seines*⁶⁹ where the individual issuer was not required to obtain a permit. The court reminded Craven of what he had neglected to see — that the *Buttrick* case was decided under the 1917 Act⁷⁰ which did not require the individual issuer to have a permit. It was not until the 1923 Act⁷¹ that this requirement was inserted.

65. *People v. Sidwell*, 27 Cal.2d 121, 162 P.2d 913 (1945); *People v. Craven*, 219 Cal. 522, 27 P.2d 906 (1933); *People v. Shalhoob*, 147 Cal. App.2d 455, 305 P.2d 264 (1957); *People v. Chiat*, 69 Cal. App.2d 503, 159 P.2d 445 (1945); *People v. Dutton*, 41 Cal. App.2d 866, 107 P.2d 937 (1941); *People v. Yant*, 26 Cal. App.2d 725, 80 P.2d 506 (1938); *People v. Daniels*, 25 Cal. App.2d 64, 76 P.2d 556 (1938); *People v. Jackson*, 24 Cal. App.2d 182, 74 P.2d 1085 (1937); *People v. Rubens*, 11 Cal. App.2d 576, 54 P.2d 98 (1936).

66. *Morello v. Metzenbaum*, 25 Cal.2e 494, 154 P.2d 670 (1944); *Austin v. Hallmark Oil Co.*, 21 Cal.2d 718, 134 P.2d 777 (1943); *Domestic and Foreign Petroleum Co. v. Long*, 4 Cal.2d 547, 51 P.2d 73 (1935); *Goldberg v. Paramount Oil Co.*, 143 Cal. App.2d 215, 300 P.2d 329 (1956); *Ogier v. Pacific Oil & Gas Dev. Corp.*, 135 Cal. App.2d 776, 288 P.2d 101 (1955); *Ogier v. Pacific Oil & Gas Dev. Corp.*, 132 Cal. App.2d 496, 282 P.2d 574 (1955); *M.G.N. Oil Co. v. Guiberson*, 126 Cal. App.2d 87, 271 P.2d 525 (1954); *Paine v. Smith*, 114 Cal. App.2d 767, 251 P.2d 18 (1952); *Blackburn v. Union Oil Co.*, 90 Cal. App.2d 775, 204 P.2d 69 (1949); *Moore v. Stella*, 52 Cal. App.2d 766, 127 P.2d 300, *on rehearing after* 51 Cal. App.2d 42, 124 P.2d 167 (1942); *McFaul v. Deck*, 30 Cal. App.2d 424, 86 P.2d 890 (1939); *Julian v. Schwartz*, 16 Cal. App.2d 310, 60 P.2d 887 (1936); *White v. Cascade Oil Co.*, 14 Cal. App.2d 695, 58 P.2d 994 (1936); *El Claro Oil Co. v. Daugherty*, 11 Cal. App.2d 274, 55 P.2d 488 (1936).

67. Cal. Stats. 1925, p.964.

68. Cal. Stats. 1929, p.1251.

69. 209 Cal. 567, 289 Pac. 616 (1930).

70. Cal. Stats. 1917, ch. 532 § 1.

71. Cal. Stats. 1923, ch. § 9.

In subsequent criminal cases, mineral deeds⁷² as well as interests in leases have been held within the Act to subject the violator to prosecution.⁷³ It should be pointed out that in the case of *People v. Jackson*, the transaction was in California, the lands affected were in Texas and Oklahoma, and the forum was in California. This was eight years before *Boyer v. Black in Florida*. The argument that the transaction involved interests in real property has likewise availed the defendant nothing.⁷⁴ In another case,⁷⁵ this last contention was argued more adroitly by referring to a real estate broker's right to convey interests in real property, where the transaction involved grant deeds purporting to convey interests in real property. But the results were the same; the broker was not a securities broker and therefore a violator. The "grant deeds" purported to convey an undivided 1-100 of $\frac{1}{4}$ of an acre per unit. It was promptly noted by the court that such a small amount of land hardly indicated that the parties intended land but rather, the minerals.

It has also been established in these cases that it is also the act of selling, whether by solicitation, offering, or subscription, which is prohibited by the Act where there is no compliance.⁷⁶

In the fairly recent case of *People v. Shalhoob*,⁷⁷ the defendant obliquely attempted to introduce the joint venture exemption⁷⁸ of the Act. One assignment of error set up the trial court's limitation of the defendant's cross examination and although he did not unequivocally inform the court, it was aware that his purpose to extend cross examination was to establish a joint adventure.

In retrospect, one thing seems eminently clear: California has had a remarkably successful experience in enforcing the intent of the legislature to protect the public, supported by a firm and enlightened approval by the courts.

72. "[A] mineral deed is an instrument which transfers the minerals as they exist in place, or the right to obtain them. In form, it is similar to a general warranty deed, and was adapted from the forms of conveyance used to transfer ownership of solid minerals." Sullivan, *op. cit.* supra at 207,208.

73. *People v. Jackson*, 24 Cal. App.2d 182, 74 P.2d 1085 (1937).

74. *People v. Rubens*, 11 Cal. App.2d 576, 54 P.2d 98 (1936).

75. *People v. Daniels*, 25 Cal. App.2d 64, 76 P.2d 556 (1938).

76. *People v. Sidwell*, 27 Cal. App.2d 121, 162 P.2d 913 (1945).

77. 147 Cal. App.2d 455, 305 P.2d 264 (1957). See also Discussion Note, 6 OIL & GAS REP. 602 (1957).

78. CAL. CORP. CODE § 25100 (1953). The elements of a joint venture under this section are delineated in *Beck v. Cagle*, 46 Cal. App.2d 152, 115 P.2d 613 (1941):

"(a) a community of interest in the object of the under taking; (b) an equal right to direct and govern the conduct of each other with respect thereto; (c) share in the losses if any; (d) close and even fiduciary relationship between the parties."

Sharing of the profits is not enough; it also involves the element of control participation. *Speir v. Lang*, 4 Cal.2d 711, 53 P.2d 138 (1935). For a discussion of joint venture as applied to Florida mineral considerations see *Ball v. Yates*, 158 Fla. 521, 531; 29 So.2d 729, 734 (1947).

C. The Civil Cases.

From the strictly civil cases there have evolved various interesting aspects of the Blue Sky-mineral transaction litigation aside from the now elementary rule that such transactions do involve securities. In *White v. Cascade Oil Co.*,⁷⁹ the defendant set up his own violation — an assignment of a percentage of the lease — as a defense to a suit by the assignee asserting rights under the assignment. Although the transaction was to be declared void under the Act,⁸⁰ the court invoked the traditional notion that no one can take advantage of his own wrong. Good faith was held not to be an element in the statute by the *El Claro*⁸¹ case, where the intricacies of the whole transaction would tax the analytical capacity of a Univac. In *Julian v. Schwartz*,⁸² by way of dicta, the court declared that creditors or their representatives may assert the invalidity of mineral royalties issued in violation of the Act and that one purpose of it was to protect merchants and tradesmen.

*Austin v. Hallmark Oil Co.*⁸³ seems to have announced the rule that a purchaser of a security is not in *pari delicto* with the issuer, even though he has knowledge of the fact that no permit was issued. This — in the face of a statutory declaration that such violative sales are void. The court also stressed the all-important distinction between the investor's status and that of a participant:

Where, however, as in the present case, the assignee is to *share in the conduct of an enterprise*, the instrument representing an assignment of a fractional interest in the production of oil is not a security within the act (Emphasis added.)⁸⁴

The devices by which drafters attempt to evade regulation are sometimes ingenious but usually futile. However, it is not believed that minerals development is orientated *solely towards securities regulation*. The greatest incentive for the ingenuity lies elsewhere. As Meer says, "The fact that a substantial amount of oil exploration is carried out by independent operators with limited financial resources has led to the development of many novel types of arrangements designed to *obtain capital without losing control of the venture*."⁸⁵ (Emphasis added.) This provokes the familiar picture of "operators" in a different sense with very little more

79. 14 Cal. App.2d 695, 58 P.2d 994 (1936).

80. "Every security of its own issue sold or issued by a company without a permit of the Commissioner then in effect authorizing the issuance or sale of the security is void. Every security of its own issue sold or issued by a company with authorization of the Commissioner but which has been sold or issued in nonconformity with any provisions in the permit authorizing the issuance or sale is void. CAL. CORP. CODE § 26100 (1953).

81. *El Claro Oil Co. v. Daugherty*, 11 Cal. App.2d 274, 58 P.2d 994 (1936).

82. 16 Cal. App.2d 310, 60 P.2d 887 (1936).

83. 21 Cal.2d 718, 134 P.2d 777 (1943).

84. *Id.* at 727, 134 P.2d at 783.

85. Meer, *Oil Finance and the Securities Laws*, 29 TEXAS L. REV. 885 (1951).

than an idea. Too often the idea turned out to be a quilting party of pieces of "blue sky" — sub-surface and sub-rosa — which undoubtedly inspired the drafters of the Uniform Act to insert the minerals clause.

In *McFaul v. Deck*,⁸⁶ despite an expression of an intent of the parties to create a joint tenancy in an oil venture, the court glared through a fog of formality and beheld the substance of a security.⁸⁷

*Morello v. Metzenbaum*⁸⁸ was an action on a promissory note due one day after date of December 15, 1941. The mineral interest was the landowner's 1/8 royalty. The defendant had purchased it from the landowner of a tract under an existing lease, the purchase authorized by a permit from the Commissioner of Corporations.⁸⁹ In order to buy the interest, the defendant borrowed the money from the plaintiff giving him a note. The note was not paid when due and subsequently the defendant executed an instrument in the form of a deed and assignment conveying to the plaintiff the 12½% royalty as security for the note with the understanding that 1% was to go to the plaintiff outright and the rest as security. The rest of the agreement provided for an escrow of the interest upon default of the note, the mortgagee (Morello) being entitled to receive the security, notify the mortgagor and sell the security without advertising. Such a default did occur and the plaintiff bid in the royalty interest at \$2,000, giving that much credit on the note. This action was brought to recover a deficiency and then in an amended complaint, for the full amount of the loan. The plaintiff had done this alleging that the interest he had acquired by the agreement was a nullity, being transferred without a permit required by the Act. The defendant admitted all of the transactions but pleaded as a bar, section 580 (d)⁹⁰ of the Code of Civil Procedure which barred deficiency actions after a mortgagee's sale. The question therefore was whether the transaction involved the sale of an exempted security and specifically whether section 2 (c) of the Act applied which provided:

The provisions of this act shall not apply to the sale of any security in any of the following transactions:

2. By or for the account of a pledgee or mortgagee selling or offering for sale or delivery in the ordinary course of business, to liquidate bona fide debt, a security pledged in good faith as security for such debt.

After a judgment for the defendant and on appeal to the Supreme Court of California, it was held that the transfer to the plaintiff did come

86. 30 Cal. App.2d 424, 86 P.2d 890 (1939).

87. The very early case of *Cecil B. De Mille Productions v. Woolery*, 61 F.2d 45 (9th Cir. 1932), involved *promissory notes* which had a feature by which they were the instruments of transfer of overriding royalties. The court held them void but noted that that they were so only because of the attempted transfer.

88. 25 Cal.2d 494, 154 P.2d 670 (1944).

89. See note 193 *infra*.

90. This section bars deficiency actions by the mortgagee or pledgee after he has

within the exemption and consequently the action was really a deficiency judgment. The lower court was affirmed.

Some of these decisions seem to over-stretch the minerals clause. The previously noted case⁹¹ involving grant deeds to napkin sized plots of land and the recent *Ogier* cases⁹² are in point. In the latter cases, the action was for the recovery of money paid on the basis of fraud. The offending transaction involved grant deeds to land merely *represented* as oil land and that the buyer would, at some future time, be able to lease the purchased lands to the defendants. This was the sole connection between minerals and the transaction involved. The feeling develops from cases like these that the line, if indeed there be any, between securities transactions and real estate transactions is discernible only after the court has spoken.

Another disturbing result of the application of the California act besides the *Ogier* cases came from a Ninth Circuit Federal case.⁹³ The non-resident purchaser resold his fractional interest under a lease, back to the seller. The original transaction was registered and a permit was issued; however, the permit was limited in that future transfers without commission approval were prohibited. The defendant argued that the transaction in resale was void because the transaction was contradictory to the terms of the permit. The Ninth Circuit held that such resales were without the act and the Commission's limitation on the permit without authority. Naturally the court had to concern itself with the *Erie* doctrine and it required seven paragraphs to avoid it.

One writer believes that the lease should be without the Corporate Securities Act although the question has apparently never been litigated.

It should not be within the Act . . . for at least two reasons. First, since a security is defined by Section 25008 as a certificate of interest in an oil lease, it seems logical that the lease itself was not intended to be included within the statute. Second, the lessor rarely has a voice in the management of the drilling operation of which the lessee is really the proprietor.⁹⁴

California, without serious doubt, has led the way for minerals securities regulation.⁹⁵ That this efficient administration of a law, founded upon the strongest considerations of public policy, has not unduly restricted or impeded mineral development can hardly be contradicted. Nor can the probability of such pioneer efforts being spread over most of the nation be avoided. In California at least, it has not only become a result "devoutly to be wished" but one eminently consummated.

sold the property under a power of sale.

91. *People v. Daniels*, 25 Cal. App.2d 64, 76 P.2d 556 (1938).

92. *Ogier v. Pacific Oil & Gas Dev. Corp.*, 135 Cal. App.2d 776, 288 P.2d 101 (1955); *Ogier v. Pacific Oil & Gas Dev. Corp.*, 132 Cal. App.2d 574 (1955).

93. *Rice v. May*, 231 F.2d 389 (9th Cir. 1956).

94. 3 U.C.L.A. L. Rev. 580, § 82 (1956).

IV

UNDER TEXAS BLUE SKIES

A. *The Criminal Cases.*

The history relating to the sale of securities in this State is well known. The development of the oil industry emphasized the necessity of regulating sales of securities issued on oil leases and other instruments relating to the oil business. An enormous number of worthless securities were sold to the public, and nothing was realized on many of these investments by the buyers. There was no restraint upon such sales nor upon those who made them. The public was notoriously imposed upon and oftentimes people were defrauded out of their life's savings. There was public demand for protection against such sales. The legislature sought to cope with the situation by enacting the Securities Act.⁹⁵

This cogent statement by Justice Sharp of the Supreme Court of Texas in *Kadane v. Clark*⁹⁷ summarizes the intent, purpose, and judicial appraisal of the Texas Act as applied to mineral transactions. That Act was adopted in 1935⁹⁸ and repealed the existing one. Professor F. Lanier Cox said of it, "The most important changes effected by this act were the inclusion of 'any instrument representing any interest in or under an oil, gas or mining lease, fee or title' in the definition of a security and the requirement for registration of dealers and salesmen."⁹⁹

This latter requirement of registration was the vehicle by which the problem of mineral transactions involving securities rode to the Court of Criminal Appeals in Texas and established the precedent in that jurisdiction,¹⁰⁰ three years after adoption of the Act.

Atwood was convicted of selling oil and gas leases without having registered as a dealer. In other transactions as well as the one on which his conviction rested, he had approached lease owners with an offer to dispose of the leases at an agreed price but only if he were able to find a buyer. If he could find one, he would transfer it to the vendee and pay over to the owner the previously agreed amount. Should no buyer be found, he merely returned the lease without compensation to either party. On appeal, he contended that he was an individual owner and the application of the Act in that case was a deprivation of a property right guaranteed to him by

95. For an excellent analysis of the California Corporate Code as applied to oil and gas transactions and procedures for obtaining permits see, Harshbarger, *California Corporate Securities Law Applied to Oil Transactions*, 3 U.C.L.A. L. REV. 540 (1956).

96. *Kadane v. Clark*, 135 Tex. 496, 498, 143 S.W.2d 197, 199 (1940).

97. *Id.*

98. Texas Acts 1935, ch. 100, p.255. Art. 600 (a) of the Revised Civil Statutes (so long the Texas Securities Act) is now Art. 581 by virtue of the 1957 "overhaul" of the Securities Act. See notes 123, 135 *infra*.

99. Cox, *The Securities Act. Special Commentary on the History and Development of the Securities Law of Texas*, 2 TEX. REV. CIV. STAT. ANN. p. XIV (Vernon's 1953).

100. *Atwood v. State*, 135 Cr. R. 543, 121 S.W.2d 353 (1938).

the federal constitution. The court repulsed this attack by noting that *even if he were the owner*, his total activities constituted a course of dealing clearly within the meaning of a "dealer" under the statute in which case, the constitutionality was clear. The primary question before the court was whether mineral leases in their transfer were securities. The authority for the court so regarding them was not found from the California cases but from, of all places, Rhode Island. That state, in *Pullen v. State*,¹⁰¹ had ignored the futile "interest in realty, not securities" argument and sustained a lower court's view that mineral transactions were within the similar Rhode Island Act.

Atwood also claimed discrimination. One of the provisions of the Texas Act, a quite common one, exempted from registration transactions for personal investments of an ordinary nature where the investor is not otherwise engaged in selling securities. This rather weak argument was quickly disposed of by the court, citing the United States Supreme Court case of *Hall v. Geiger-Jones Co.*¹⁰²

The Atwood case is one of only two criminal cases ever to reach the appellate level in the criminal aspect of mineral transactions under the Texas Act. It was followed a year later by *Muse v. State*.¹⁰³ J. W. Muse was sentenced to one year of imprisonment for selling an assignment of an oil and gas lease to another without first having registered and obtained a permit. The Court of Criminal Appeals relied upon the Atwood case, affirmed the conviction and brushed aside a technical error asserted by Muse for a reversal. The indictment had not declared to whom the assignment had been made although the assignment was repeated in the indictment. This was perhaps only a minor technical error, but it is interesting to compare the result of it with the "accidental" reversal previously referred to in the Florida case of *Ryan v. State*.¹⁰⁴ Muse also tried the exemption of personal investments argument but his course of conduct too, definitely established him as a dealer.

It is difficult to assess and evaluate the success of the penal provisions of the Texas Act. These two cases are unequivocal in supporting the legislative intent but one *could* wonder if there really have been no violations since *Muse* which was decided a generation ago. As usual with such regulatory laws administered by the "headless fourth branch," the problem appears not to be in the adequacy of the law but in the enforcement of it.¹⁰⁵

101. *Pullen v. State*, 58 R.I. 294, 192 Atl. 473 (1937).

102. *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1916).

103. *Muse v. State*, 137 Cr. R. 622, 132 S.W.2d 596 (1939).

104. 128 Fla. 1, 174 So. 438 (1937); The first oversight was finally corrected and judgment affirmed a year later. *Ryan v. State*, 131 Fla. 486, 180 So. 10 (1938).

105. "Yet the author has been informed as recently as [1950] that only two or three registrations of oil and gas interests have ever been effected under the Texas Act." Meer, *Oil Finance and the Securities Laws*, 29 TEXAS L. REV. 885, 887 (1951).

B. *The civil cases: suits for commissions.*

All but one¹⁰⁶ of the civil cases¹⁰⁷ in which the Texas Securities Act has been invoked with reference to mineral transactions have developed from alleged dealer and principal relationships. These cases involve suits for commissions earned in obtaining buyers for a lease, the plaintiff acting on behalf of the seller,¹⁰⁸ for commissions in procuring a *seller* of a lease, the defendant being the *buyer*,¹⁰⁹ for damages for conspiracy to defraud the procurer of compensation for his services in disposing of estate property,¹¹⁰ for commissions for obtaining a "shooting permit" for the defendant,¹¹¹ and for damages, not for simple breach of contract, but for breach of contract with a third person resulting in a loss of compensation to the plaintiff who was the alleged procuring cause of a drilling contract between the defendant landowner and another.¹¹²

A thread of similar facts runs through all these cases. The plaintiff generally is a dealer or one alleged to be acting in that capacity and the defendant, after breaching his contract with the plaintiff, sets up the defense that the transaction involved a security and that the plaintiff was unlicensed to deal in such securities in contravention of the Act.

In the leading case of *Kadane v. Clark*,¹¹³ the plaintiff sought to recover his commissions for procuring a purchaser of the defendant's leasehold interest. The defendant contended the now familiar argument that Clark was an unlicensed dealer and the res was a security. Clark had been active in selling such leases for others, and the defendants — six members of the Kadane family and the Big Six Oil Company — had been active in the oil business. Clark alleged that he was a geologist, that he was also in the oil business, that he contacted the Kadanes for the purpose of

106. *Lewis v. Davis*, 145 Tex. 468, 199 S.W.2d 146 (1947). This was a suit for an accounting of partnership profits in an oil and gas venture. The plaintiff had failed to allege in his petition that he was licensed as a Securities Dealer and the lower courts had denied him relief. On appeal to the Commission of Appeals, Commissioner Smedley reversed, holding that there was no burden on the plaintiff to allege compliance.

107. *Great Western Drilling Co. v. Simmons*, _____, Tex. _____, 302 S.W.2d 400 (1957); *Mecom v. Hamblen*, 155 Tex. 406, 289 S.W.2d 553 (1956); *Breeding v. Anderson*, 152 Tex. 92, 254 S.W.2d 377 (1952); *Lewis v. Davis*, 145 Tex. 468, 199 S.W.2d 146 (1947); *Herren v. Hollingsworth*, 140 Tex. 263, 167 S.W.2d 735 (1943); *Fowler v. Hults*, 138 Tex. 636, 161 S.W.2d 478 (1942); *Kadane v. Clark*, 135 Tex. 496, 143 S.W.2d 197 (1940); *Flournoy v. Gallagher*, 189 S.W.2d 108 (Tex. Civ. App. 1045); *Cosner v. Hancock*, 149 S.W.2d 239 (Tex. Civ. App. 141); *Culver v. Cockburn*, 127 S.W.2d 328 (Tex. Civ. App. 1939). There are two federal cases collaterally involving the Texas Securities Act in mineral transactions: *Lack v. Borsum*, 44 F. Supp. 47 (D.C. La. 1942) and *Auers v. Phillips Petroleum Co.*, 25 F. Supp. 458 (N.D. Tex. 1938).

108. *Kadane v. Clark*, 135 Tex. 496, 143 S.W.2d 197 (1940); *Culver v. Cockburn*, 127 S.W.2d 328 (Tex. Civ. App. 1939); *Lack v. Borsum*, 44 F. Supp. 47 (D.C. La. 1942).

109. *Fowler v. Hults*, 138 Tex. 636, 161 S.W.2d 478 (1942).

110. *Breeding v. Anderson*, 152 Tex. 92, 254 S.W.2d 377 (1952).

111. *Auers v. Phillips Petroleum Corp.*, 25 F. Supp. 458 (N.D. Tex. 1938).

112. *Herren v. Hollingsworth*, 140 Tex. 263, 167 S.W.2d 735 (1943).

113. 135 Tex. 496, 143 S.W.2d 197 (1940).

getting them to list a specific lease with him, and that eventually he became the procuring cause of the sale of it to the Sunray Oil Company.

The supreme court reversed, saying:

The statute is strictly penal in nature, and was enacted solely to protect the interests of the public. While the law does not specifically provide that a contract made in violations of this Act shall be void, yet, when the Act as a whole is read, and the purposes for which it was passed are considered, we think the very letter and spirit of the law is to absolutely prohibit sales of securities not made under the terms of this law The conclusion is inescapable that a contract made in violations of its terms is not enforceable. Any other construction would nullify the very purposes for which it was enacted.¹¹⁴

Since the Texas Court of Criminal Appeals had already declared such a transaction as one involving a security in *Atwood* and *Muse*,¹¹⁵ as a matter of "comity," the supreme court reversed the court of civil appeals and held that Clark was not entitled to his commissions for acts done in violation of a criminal law.

The *Kadane* case was not the first reported civil case in Texas involving securities and minerals after *Atwood* and *Muse*. *Culver v. Cockburn*¹¹⁶ was the first such case and it was decided by the court of civil appeals about a year and a half before *Kadane*, yet there was no mention of the *Culver* case in the *Kadane* opinion.¹¹⁷ It was decided after *Atwood* and *Muse*, yet Chief Justice Monteith said, "We have been cited no Texas cases involving an interpretation of the provisions of the Securities Act."¹¹⁸ In the *Culver* case, the plaintiff was an employee of the Cockburn Oil Corporation and he entered into an agreement with George Cockburn whereby Culver procured a purchaser of a lease and for which he was to receive a commission. In defense of the suit, Cockburn set up the "dealer-security-no license" argument to avoid payment. At no time was the lease in Culver's possession, he was not present at the transfer and the jury found that he was the procuring cause of the sale. The court of appeals held that he was neither a dealer nor was the lease a security. The court cited the personal investment exemption of the Act and said:

There is nothing in the subject matter of the Act, however, which would justify the presumption that the Legislature intended to thereby regulate the type of a contract which might be made by the owner of real property with an agent for the payment of compensation for procuring a purchaser therefor.¹¹⁹

114. *Id.* at ____ , 143 S.W.2d at 200.

115. *Atwood v. State*, 135 Cr. R. 543, 121 S.W.2d 353 (1938); *Muse v. State*, 137 Cr. R. 622, 132 S.W.2d 596 (1939).

116. 127 S.W.2d 328 (Tex. Civ. App. 1939).

117. *Culver* emerged from the intermediate court but it does seem the supreme court should have at least noted it.

118. *Culver v. Cockburn*, 127 S.W.2d 328, 330 (Tex. Civ. App. 1939).

119. *Id.* at 330.

The court then cited the California cases of *Lesser*¹²⁰ and *Buttrick v. Seines*¹²¹ and the Pennsylvania case of *Commonwealth v. Johnson*,¹²² completely ignoring a fair majority of cases to the opposite. The fact that subsequent courts in Texas have likewise ignored the *Culver* case may be some indication of its stature in the applicable case law. Another criticism that can be made of it is that a security that is exempt is nonetheless a security. Moreover, the exemption applies to the transaction; not to the agents that may have effected it.¹²³

In the case of *Cosner v. Hancock*,¹²⁴ which followed hot on the heels of the *Kadane*¹²⁵ case, oil payments¹²⁶ were held to be a security within the Act and recovery of commissions for their sale was precluded because of the plaintiff's failure to become a licensed dealer. The defendant Cosner owned an oil payment reserved out of a one-sixth of the seven-eighths working interest in a 160 acre lease and entered into a written agreement with the plaintiff authorizing the latter to act as the exclusive agent to sell. The court of civil appeals reversed a judgment for the plaintiff because of his lack of license to "deal in securities." The court relied heavily on *Kadane v. Clark* and brushed aside the only real distinction between the two cases. Hancock had argued that *just one sale* should not preclude recovery. The court answered:

We fail to see any substantial distinction between a person, for a consideration, *effecting the sale of a security for another and effecting sales generally*. It is true, that one is a transaction for a single purpose, the other a series of transactions. In the single transaction the same action is involved as in the series. There can

120. *People v. Lesser*, 123 Cal. App. 489, 11 P.2d 668 (1937).

121. 209 Cal. 567, 289 Pac. 616 (1930).

122. 89 Pa. Super. 439 (1926) (not a mineral case).

123. See text at *infra*. This case was later distinguished by the court in *Cosner v. Hancock*, 149 S.W.2d 239 244 (Tex. Civ. App. 1941) from *Kadane v. Clark*, *supra* note 96 and the *Cosner* case:

Culver v. Cockburn . . . we think, is distinguished from *Kadane v.*

Clark . . . and the case at bar, in that there the owner contracted to pay the agent for obtaining one to lease land on terms satisfactory to him.

This seems to be semantic horseplay. It is the same thing as saying "I shall hire you, not to sell something for me, but to get someone to buy from me." It is very reminiscent of Albert's classic statement, "But Pogo, you gotta admit it's a devious writer that can say nothing in two directions at the same time." For further discussion of the *Culver* and *Cosner* cases, see Meer, *The Texas Securities Act—1957 Model: Facelift or Forward Look?*, 36 TEXAS L. REV. 429, 437 (1958).

124. 149 S.W.2d 239 (Texas Civ. App. 1941).

125. *Kadane v. Clark*, 135 Tex. 496, 143 S.W.2d 197 (1940).

126. ". . . a promise by the owner of the working interest under an oil and gas lease to deliver a fractional interest of the production of any or all of the minerals covered by the lease to the payee, or to pay him the monetary value thereof, until the payee has realized a certain sum from such deliveries or payments." Walker, *Oil payments*, 20 TEXAS L. REV. 259, 262 (1942), quoted in BROWN, *THE LAW OF OIL AND GAS LEASES* (1958) at 358, 359. Brown also notes "The oil payment has been extensively used in the financing of oil development, not only in the raising of cash but in payments made to drilling contractors and supply houses. *Ibid.* See also, Hollis, *Depletable Interest in Oil?* 11 MIAMI L.Q. 244, 256 (1957): "The right to take the oil payment may be acquired by reserving it when assigning a lease, by purchase or by drilling oil wells."

be little difference between one casually selling securities for others or for another, and in making that his business. Such a distinction would cause the law to apply unequally and unfairly. In our opinion the holding of the Supreme Court in *Kadane v. Clark* . . . applies here.¹²⁷

In another interesting case, *Fowler v. Hults*,¹²⁸ decided in 1942, the unlicensed dealer seeking his commissions was allowed to recover by the Supreme Court of Texas because he was acting for the *purchaser* and not the *seller*, the rationale being that the Act prohibits certain sales; not purchases.

In summary, Fowler's testimony tended to prove he was an agent of the buyer; Hults' that Fowler was an agent of the sellers. Further terms of the agreement were that the leases were to be deposited in escrow and that Hults was to pay Fowler the 10% upon paying for the leases to the escrow agent. Hults failed to take the leases and Fowler sued for the commissions. Hults interposed the "securities-no license defense," one special issue submitted to the jury as to whether Fowler was a dealer under the Act was answered in the negative and there was a judgment for the plaintiff.

Commissioner of Appeals Smedley regarded the jury's finding on the special issue as determinative of the fact that Fowler was Hults' agent and not the landowners'. He also distinguished *Kadane v. Clark*¹²⁹ in that in the instant case, the leases had not been executed at the time of Fowler's employment, whereas in the *Kadane* case, the plaintiff was dealing in existing leases. Commissioner Smedley further emphasized the turning point of the *Fowler* case by saying: "Sellers and sales are regulated and purchasers are protected against sellers. The Act does not undertake to regulate purchasers of to protect sellers against purchasers."¹³⁰

The 1945 the supreme court case of *Herren v. Hollingsworth*¹³¹ followed the rule established by *Fowler v. Hults*,¹³² an agent or dealer acting for the purchaser does not have to be licensed as a securities dealer under the Act. It also illustrates the problem of the modern real estate dealer finding himself on the twin horns of a dilemma. When he acts as an agent in a mineral lease transaction, is he required to be licensed as a real estate dealer, a securities dealer or both? In *Herren*, as in the *Fowler* case, he was not required to be licensed as either simply because he acted for the purchaser. Instead of a suit for commissions, Herren brought an action for damages as a result of his principal's breach of contract with another in a drilling agreement which Herron procured. He failed to allege that he was a licensed dealer in his petition and the trial court

127. *Cosner v. Hancock*, 149 S.W.2d 239, 244 (Tex. Civ. App. 1941).

128. 138 Tex. 636, 161 S.W.2d 478 (1942).

129. 135 Tex. 496, 143 S.W.2d 197 (1940).

130. 138 Tex. 636, 638, 161 S.W.2d 478, 480 (1942).

131. 140 Tex. 263, 167 S.W. 2d 735 (1943).

132. 138 Tex. 636, 161 S.W.2d 478 (1942).

dismissed. On authority of the *Fowler* case, the supreme court reversed both lower courts, emphasizing the fact that an agent for the purchaser need not be licensed.

The case of *Breeding v. Anderson*¹³³ definitely deserves noting. In that case, decided two years before the 1955 "overhaul"¹³⁴ of the Act, one Anderson brought suit against Breeding who had been acting for the Lacy estate and several other defendants, including the Texas Company which had purchased the Lacy oil property through the plaintiff. Anderson alleged that Breeding advised him that the Lacy properties were for sale and that Breeding had such authority to sell. He further alleged that he and Breeding agreed to a commission if Anderson sold the properties to the Texas Company. Anderson had been buying leases, mineral interests and land for that company exclusively for years. In his petition, Anderson did not allege that he was licensed as a securities dealer or as a real estate dealer but he entered a stipulation that he was not so licensed. After joinder of issue, the defendants moved for a summary judgment on the ground that the plaintiff was unlicensed and in which case he could not legally recover his commission.

In Anderson's answer to the motion, he contended that he came within the exemption of sections 3 (a) and (c)¹³⁵ of the Securities Act. These sections provided that the Act should not apply to transactions at a judicial, executor's, administrator's, guardian's or conservator's sale nor to sales by receivers. They also exempted sales by a seller in the course of ordinary personal investment if he is not otherwise engaged in the business as a dealer. Anderson further contended that since the Securities Act governed his transactions, the Real Estate License Act¹³⁶ did not apply. These arguments were turned aside by the supreme court on writ of certiorari after the summary judgment was granted and the court of civil appeals reversed. The supreme court entertained no doubt that the cause of action was governed by both licensing laws. That court also adopted part of the opinion of the court of appeals in *Sibley v. Coffield*,¹³⁷ in which the court had said:

Several court decisions have construed either Sec. 3(c) or Sec. 33 b, or both of them together, and hold in substance that even if, in fact, an owner or seller of stock or security were exempt from obtaining a dealer's license and from registering such stock or security, and even if in fact the sale or offer to sell by such

133. 152 Tex. 92, 254 S.W.2d 377 (1952).

134. For a relatively detailed history of the development and enactment of the 1955 Act and analyses of its controversial features, see Tinsley, *Texas Securities Act*, 18 TEX. B. J. 273 (1955).

135. Section 3 (c) has since been repealed but the same provisions are incorporated in the 1957 Securities Act, 2 TEX. REV. CIV. STAT. ANN. art. 581-5 A and C (1) (Vernon, Supp. 1958).

136. 19 TEX. REV. CIV. STAT. ANN. art. 6573 (Vernon, 1958 Supp.).

137. 193 S.W.2d 239 (Tex. Civ. App. 1946).

owner or seller is made in the ordinary course of a bona fide sale, *such facts to do not exempt or relieve a person employed to aid the owner or seller in making or offering the stock or security for sale from registering and obtaining a license as a 'dealer' or 'broker', as required by Sec. 2(c) of the Act, before he can collect a commission or compensation for such services; or sue therefor in the courts.* (Emphasis added.)¹³⁸

Although the transaction might be exempt, the 'dealer' could not be by virtue of the nature of the transaction. This is the point that the court failed to see in *Culver v. Cockburn*.¹³⁹ The court in the instant case went even farther and announced the obvious — that the facts evidenced no such exempt sale and even if they had, Anderson was not an administrator, executor, etc. Furthermore, he was not the owner of the securities and therefore section 3(c) was inapplicable.

The most important aspect of the *Breeding* case is the double licensing contention and the respective licensing statutes. Anderson had argued that his actions were governed by the Securities Act, to which the court agreed. But, further argued Anderson, that being true, section 3(c) of the Real Estate License Law applied which provides:

The provisions of this Act shall not apply to, and the terms 'Real Estate Dealer' and 'Real Estate Salesman', . . . shall not include . . .

(c) Any person, partnership, or corporation *who has secured a license under the Texas Securities Act.* (Emphasis added.)

There was only one thing wrong with Anderson's argument and the court spelled it out — the exemption in the real estate law applies only to licensed dealers, and Anderson had no license. Therefore, the court reversed the court of civil appeals and affirmed the summary judgment for the defendant in the trial court.¹⁴⁰

138. *Id.* at 241.

139. 127 S.W.2d 328 (Tex. Civ. App. 1939).

140. Compare *Howard v. Simons*, 285 S.W.2d 478 (Tex. Civ. App. 1955) where the plaintiff, licensed as a securities dealer but not as a real estate dealer, sought commissions for the sale of a lease on downtown business property and asserted he needed no real estate license. The cause arose before the exemption in section 3 (c) was repealed. *Held*, summary judgment for the defendant affirmed. Said the court:

In Texas, "The Securities Act" is unique, in that it includes oil and gas interests as securities . . . Yet oil and gas interests, prior to severance of oil or gas from the soil, are also classified as real estate. *Eliff v. Texon Drilling Co.*, 146 Tex. 575, 210 S.W.2d 558, 4 A.L.R.2d 191. Thus there might have been serious confusion and possible conflict when a licensed securities dealer, engaged in selling oil and gas interests *as securities*, was confronted with the provisions of "The Real Estate Dealer's Act" . . . [Section 3 (a)] would give the securities dealer protection from this overlapping of oil and gas interests as securities and as real estate, as long as the securities dealer was *operating as a securities dealer* selling oil and gas interests. In the instant case it was stipulated that no oil and gas interests were involved in the leasehold estate in question so section 3 (c) was not applicable. (Emphasis added.) *Id.* at 480.

The *Breeding* case should be carefully studied by all persons dealing in such transactions not only in Texas but in Florida¹⁴¹ and in any other jurisdiction having comparable dual licensing statutes. Such regulation, despite occasional judicial assault, is definitely appearing in more and more areas. Anderson is not the only dealer that has discovered the folly of non-compliance too late.

Two other sales commissions cases should be mentioned in passing. In the federal district court case of *Auers v. Phillips Petroleum Corp.*,¹⁴² decided in 1938, the plaintiff sought to recover his commissions for securing a "shooting permit" (permit from a land owner to conduct blasting operations in seismographic oil exploration) for the defendant. The defendant posed the Securities Act as a defense and disclaimed liability because the plaintiff was not a licensed dealer. The court felt that a shooting permit was too far afield to read into the Act without further authority from the statute or case law. *Lack v. Borsum*¹⁴³ involved mineral lands in Louisiana but the contract to broker the mineral lease was made in Texas. The federal district court, applying the *lex loci celebrationis*, looked to the Texas Securities Act and relied upon *Kadane v. Clark*¹⁴⁴ to deny recovery to the unlicensed broker for not having complied with the Act. Although the *Lack v. Borsum* case is cited principally for the minerals securities authority, some nice questions of conflict law were presented.

The 1945 case of *Flournoy v. Gallagher*¹⁴⁵ cannot be discussed independently of the more recent case of *Brown v. Cole*¹⁴⁶ which has caused such a furore in Texas. The former case was a suit for an accounting of the profits from the sale of oil and gas leases. The plaintiff had entered into an agreement and operations with Gallagher (who died during the pendency of the suit) whereby they were to work together in acquiring leases, the plaintiff laying out expenses, time and know-how, and upon assembly of a set of leases and sale of it, net profits were to be shared equally. The deceased sold some of the leases and Flournoy tried to get an accounting from the executrix. He had been a dealer in such properties but unlicensed and the defendant asserted this in bar of recovery. The court chose to ignore the equality of participation and characterized the suit as one for commissions:

Appellant contends in his brief that he does not come under the Securities Act, for the reason that the agreement with the deceased Joe Gallagher was made prior to the time the leases were acquired; that this is not a commission suit; that the plaintiff

141. Concern has already been expressed in reference to the problems of this type by Florida realtors. See Schuman, *Securities vs. Real Estate*, 6 FLORIDA REALTY NEWS 4 (1958).

142. 25 F. Supp. 458 (N.D. Tex. 1938).

143. 44 F. Supp. 47, (D.C. La. 1942).

144. 135 Tex. 496, 143 S.W.2d 197 (1940).

145. 189 S.W.2d 108 (Tex. Civ. App. 1945).

146. 291 S.W.2d 704 (Tex. 1956).

was not a broker and did not seek a commission, but that it was a suit to enforce an expressed trust. If from this we are to conclude that the appellant by his petition alleged that he was a joint owner of the oil and gas leases . . . we still believe that the plaintiff came under the Securities Act and could not maintain the suit.¹⁴⁷

Brown v. Cole,¹⁴⁸ decided by the Texas Supreme Court was not an oil and gas case but it provided a basis for what Meer believes¹⁴⁹ is "an implied exemption" in the Texas Act: that the creation of a joint venture does not involve the sale of a security. The court in the *Brown* case said:

Joint adventurers and partners are not to be denied the right to receive their interest merely because of a failure to comply with the Securities Act and we think it is equally true that a dissatisfied joint adventurer may not recover from other joint adventurers merely because of the failure of the latter to comply with the Act.¹⁵⁰

Of course, the implied exemption is not expressed in the Texas Act as it is in the California Corporate Code.¹⁵¹ Meer speaks of it with muffled approval and this writer concurs. The result reached in the *Flournoy*¹⁵² case definitely appears to have an unhealthy starboard list and one could validly speculate that the case would have had a more even keel had it succeeded the *Brown* decision.

The remaining two cases, *Great Western Drilling Co. v. Simmons*¹⁵³ and *Mecom v. Hamblen*¹⁵⁴ are fairly recent and seem to close the door on any speculation that the trend attempted to be emphasized in this article is going to be thwarted—at least in Texas. Both cases involved "new" phases of mineral securities transactions. In the *Great Western* case, the unlicensed plaintiff (as a securities dealer and as a real estate dealer) was denied commissions in the trial court for his services in securing "farm-out" agreements for the defendant. The latter had asserted that Simmons was not licensed, *inter alia*, as a defense.

The intermediate court reversed, sidestepped the Securities Act and rested its decision on the Real Estate Dealer's Act.¹⁵⁵ That law, in Article 3995 (a) requires suits for commissions for the sale or *purchase* of oil and gas interests to be in writing and in the instant case the agreement was oral. The Supreme Court of Texas reversed the intermediate court and

147. 189 S.W.2d 108, 110.

148. 291 S.W.2d 704 (1956). For an extremely well written analysis of the case, its implication and comments on the new Texas Securities Act [2 TEX. REV. CIV. STATS. ART 581 (Vernon, 1958 Supp.)] see Hill, *Pitfalls in the Texas Securities Act*, 10 S.W.L.J. 265 (1956).

149. Meer, *The Securities Laws and Oil and Gas Financing*, 20 TEXAS B. J. 211, 242 (1957).

150. 291 S.W.2d 704, 109 (1956).

151. CAL. CORP. CODE § 25100 (m) (1953).

152. *Flournoy v. Gallagher*, 189 S.W.2d 108 (Tex. Civ. App. 1945).

153. *Great Western Drilling Co. v. Simmons*, 302 S.W.2d 400 (1957).

154. 155 Tex. 406, 289 S.W.2d 553 (1956).

155. 19 TEX. REV. CIV. STAT. ANN. art 6573a (Vernon, 1958 Supp.)

also relied on the Real Estate Dealer's Act. However, in discussing the inapplicability of the Securities Act, the court dealt with *Fowler v. Hults*¹⁵⁶ at some length which seems to indicate that even if the real estate law had not been involved, the plaintiff's effecting the farm-out agreements would not be considered a commerce in securities. Said the court, "The decision [Fowler v. Hults] may also be authority for the proposition that, if the plaintiff could be considered as 'selling' something to the driller, all he could have sold would have been the mere possibility that the defendant would make a lease to the driller, such a possibility not being a security."¹⁵⁷ Undoubtedly the court was trying to stress the fact that in neither case did the procurer actually participate in an actual and present agreement between the principal and the driller or farm-out contractee. This seems to be at first glance a rational and invulnerable view but the question could be asked if the plaintiff was not the cause of a contract being made. The only answer is an affirmative one, even though the contract in prospect did not come into being until long after the plaintiff performed his services. The decision admittedly only incidentally involved the securities Act, but it can be cited for dicta reflecting on the application of the Act to farm-out agreement commission suits.

The *Mecom*¹⁵⁸ case involved an unusual and highly complex form of election lease in an involved series of transactions. The case is authority for the rule that retention of rights in an assignment where the rights actually represent the value of services for obtaining the lease, there is a security and if the holder was unlicensed under the Securities Act, he cannot recover for such disguised commissions. This important holding, as was indicated by the editor in the Oil and Gas Reporter,¹⁵⁹ may very well be applied in the future to overrides and production payments.

V.

OTHER STATES OF MIND

Illinois.

One of the most bitterly contested cases, and in the writer's opinion the most interesting, ever to arise from a mineral security transaction is the 1956 case of *Hammer v. Sanders*¹⁶⁰ in Illinois. It was carried to the Supreme Court of the United States where certiorari was ultimately denied.¹⁶¹ Space does not permit a detailed analysis of the facts and arguments made in the case in its sojourn through the courts but briefly, the following occurred.

156. 138 Tex. 636, 161 S.W.2d 478 (1942).

157. _____ Tex. _____, 302 S.W.2d 400, 404 (1951).

158. *Mecom v. Hamblen*, 155 Tex. 406, 289 S.W.2d 553 (1956).

159. 5 OIL & GAS REP. 789 (1956).

160. 8 Ill.2d 414, 134 N.E.2d 509 (1956).

161. 352 U.S. 878 (1956).

The plaintiffs, Hammer and others, sought rescission of letter agreements and recovery of sums paid under them to the defendant Sanders-Fye Drilling Company. Working interests were to be transferred to the plaintiffs for advancements of monies for development and upon completion of wells in the leaseholds held by the drilling company, assignments of interests were to be made to the plaintiffs. The property provided no minerals (although several of the previous ones did) and the plaintiffs contended that the transaction was one for the sale of a security and, being made in violation of the Blue Sky law, voidable. The Illinois Blue Sky law¹⁶² defines a security to be, *inter alios*, "any oil, gas or mining lease, royalty or deed, and interest, units or shares in any such lease, royalty or deed" It also requires the usual registration of the security and provides that any transaction in violation of its terms gave the right to the purchaser to void it and recover the consideration upon tender of the security.

The Illinois Supreme Court exerted an admirable effort to examine the whole transaction and establish its nature. It appears that the decision finally turned on the manner in which the plaintiffs themselves regarded the transaction:

Significantly, the plaintiffs treated all sums advanced by them as 'intangible drilling and development costs' on their Federal income tax returns, not as payments for a leasehold interest, a security, or other capital asset.¹⁶³

Therefore even the plaintiffs regarded themselves as *participants in the development* rather than purchasers of an investment contract. This is the other "implied exemption" of which Meer speaks.¹⁶⁴ The court reversed in part and held the plaintiffs not entitled to recover; that securities were not involved but a joint endeavor.

Iowa.

*State v. Walters*¹⁶⁵ was a criminal case in which the defendant was charged with and found guilty of selling a 1/32 "pipeline interest" (royalty) in a lessee's 7/8 interest in a 160 acre mineral lease without having registered it and others as a security in compliance with the Iowa Securities Law.¹⁶⁶ That law contained the usual requirements for registration of securities and securities salesmen and also the usual broad definition of a security, including "certificate of interest in an oil, gas, or mining lease"

162. ILL. REV. STAT. ch. 121½, p. 132 (Smith-Hurd 1953). For a fine commentary on the Illinois Act see, Young, *The Illinois Securities Law of 1953*, 42 ILL. B.J. 94 (1953).

163. 8 Ill. App. 414, —, 134 N.E.2d 509,513 (1956).

164. Meer, *The Securities Laws and Oil and Gas Financing*, 20 TEXAS B.J. 211, 242 (1957).

165. 244 Iowa 1253, 58 N.W.2d 4 (1953).

166. IOWA CODE, ch. 502 (1950).

The case is authority in that state for the ever-spreading rule that the transfer of a royalty interest for consideration involves the sale of a security.

Michigan.

In *People v. Blankenship*,¹⁶⁷ the sole Michigan case on point, the precise issue of whether mineral deeds can be securities under that state's existing Blue Sky Law,¹⁶⁸ arose in a criminal case in 1943. The defendant was charged with selling fractions of his landowner's $\frac{1}{8}$ royalty interest in lands in Texas and transferring the interest by mineral deed without filing the "securities" with the Michigan corporation and securities commission. The transaction took place in Michigan.

The trial court found the deeds as transferred, securities, and held the defendant guilty of violating the Act. The supreme court regarded its duty as one to "look through such rather ingenious devices of conveyance and, in the light of the circumstances surrounding . . . the execution and sale, ascertain the substance of the transaction and the real intent and purpose of the parties."¹⁶⁹ One of the interests transferred was an undivided $\frac{6}{200}$ of the $\frac{1}{8}$ royalty interest. Considering the tone of the opinion, it was not too difficult for the court to regard the fractions involved, discern the investment contract nature of the deed and rely on *State v. Pullen*¹⁷⁰ to affirm the lower court.

New Mexico.

Farrar v. Hood,¹⁷¹ a 1952 New Mexico case, was an action to quiet title to mineral lands. As stated by the court, the questions on appeal were,

(a) whether the sale of speculative securities in contravention of Chapter 44, Laws of 1921, 50-1071, 1941 Comp. [the Blue Sky law] is void or voidable; and if voidable; (b) whether the purchaser of such securities is barred by laches from maintaining an action for rescission.¹⁷²

The Act prohibited sales or offers to sell of speculative securities by public offering unless a permit were obtained from the Bank Commissioner. The mineral interests involved were transferred to a royalty owners pooling company for aliquot unit interest certificates. The transfer was effected by mineral deed and the trial court concluded as a matter of law that the *unit interest certificates* received by the mineral grantors were securities within the New Mexico Blue Sky Law.¹⁷³ On appeal, the supreme court

167. 305 Mich. 79, 8 N.W.2d 919 (1943).

168. MICH. STAT. ANN. § 19.741 (1935).

169. 305 Mich. 79, 86, 8 N.W.2d 919, 921 (1943).

170. 58 R.L. 294, 192 A.H. 473 (1937).

171. 56 N.M. 724, 249 P.2d 759 (1952).

172. *Id.* at 726, 249 P.2d at 760.

173. 7 NEW MEX. STAT. ANN. § 48-18. (1953).

affirmed on the securities issue, relying on *Marney v. Home Royalty Ass'n of Okla.*¹⁷⁴ As to the issue of voidability, since the statute was silent, the court was unable to determine a legislative intent of inherent voidness and held that the transaction in violation of the law was voidable only and subject to the defense of laches.

North Carolina.

*State v. Allen*¹⁷⁵ was a case that turned on the question of whether mineral transactions involve securities and was a prosecution for violation of that state's securities law. It was decided about a year after *Ryan v. State* in Florida.¹⁷⁶ In the *Allen* case, the North Carolina Capital Issues Law¹⁷⁷ prohibited persons from dealing in securities without being so licensed. It defined a security to be a "certificate of interest in an oil, gas or mining lease . . ." The defendants were charged and convicted of selling leases by assignment in North Carolina on lands in New Mexico. The prosecuting witnesses were the purchasers of the leaseholds. On appeal, the Attorney General relied upon and cited the *Atwood*,¹⁷⁸ *Pullen*¹⁷⁹ and *Muse*¹⁸⁰ cases for affirmance. Despite the array of authority, and the clear language of the statute, the North Carolina Supreme Court reversed, holding that the "facts of the case" did not come within the Act. One wonders how explicit statutory language has to be for some courts to follow the will of the legislature.

Minnesota.

The writer believes the first reported case of a mineral interest being held as a security was *State v. Ogden*,¹⁸¹ decided in 1923 by the Supreme Court of Minnesota. The defendant was an owner of an 80 acre leasehold of oil lands in Wyoming. He sub-divided it into 4,800 equal and undivided units and offered $\frac{5}{8}$ of them for sale at \$120,000, terming them each a "statement and purchase." The intent was to later form an Arizona corporation and the purchasers were to share in the profits proportionally.

174. 34 N.M. 632, 286 Pac. (1930).

175. 216 N.C. 621, 5 S.S.2d 844 (1939).

176. 128 Fla. 1, 174 So. 438 (1937).

177. Pub. Laws 1927, ch. 149 § 2. By the present law the clause reads "certificate of interest in a profit sharing agreement, any instrument representing any interest or right in or under any oil, gas or mining lease, . . . certificate of interest in an oil, gas or mining lease . . ."

178. *Atwood v. State*, 135 Cr. R. 543, 121 S.W.2d 353 (Tex. Crim. App. 1938).

179. *State v. Pullen*, 58 R.I. 294, 192 Atl. 473 (1937).

180. *Muse v. State*, 137 Cr. R. 622, 132 S.W.2d 596 (Tex. Crim. App. 1939).

181. 154 Minn. 425, 191 N.W. 916 (1923). A later case from the same jurisdiction involved similar facts. *Busch v. Noerenburg*, 279 N.W. 34 (Minn. 1938). There the purchaser sought to rescind her contract for the purchase of a fractional interest in a tract of land, the latter being in contemplation of a corporation being formed, and claimed it was a sale of a security. Held, not a security but an interest in land. See Note, 6 DUKE B.A.J. 92 (1938) where the court was criticised for not revealing all the facts and finding a security.

Ogden sold some of these units and under the existing Blue Sky Law,¹⁸² he was convicted of selling investment contracts without a license. On appeal, the supreme court affirmed without too much discussion but it did note that the defendant was without the isolated sale exemption.

Rhode Island.

The early Rhode Island case of *State v. Pullen*,¹⁸³ relied upon by courts all over the nation, put the landowner's royalty squarely within the Rhode Island Blue Sky law.¹⁸⁴ Pullen, the lessor of oil lands in Texas, sold fractions of his landowner's one-eighth royalty in Rhode Island. In order to make assignments effective by the terms of the lease, he issued them in written certificate deed form accompanied by a transfer order to the lessee. Rhode Island, through its Banking and Insurance Division, sought a restraining order against Pullen for not having registered as a broker or salesman of securities. Pullen argued the "interest in realty, not securities" theory. He cited the Texas case of *Waggoner Estate v. Wachita County*,¹⁸⁵ a tax suit in which it was held that the personal tax could not be applied to a lease because it was an interest in realty. The Rhode Island court correctly ignored the Texas pronouncement as having no bearing on a Rhode Island transaction. Pullen also cited a lower court Pennsylvania case¹⁸⁶ which had relied on the *Waggoner* case and the realty theory to declare an oil and gas royalty not a security. The Rhode Island court also ignored this attack and upheld the restraining order on the basis of the statutory policy.

These documents, upon close examination, clearly present a situation which demands that the realities prevail over the merely technical effect of the legalistic form of the documents themselves. Really and actually behind the form of a conveyance of an interest in land set out in these documents is an investment contract, and it is peculiarly the kind of an investment contract which lends itself readily to the perpetration of evil which the Securities Act is designed to eradicate.¹⁸⁷

Pennsylvania.

In the *Pullen* case the court was concerned as to whether the *Hose*¹⁸⁸ case from a lower court in Pennsylvania really expressed that state's policy with regard to mineral securities under the Pennsylvania Securities Act. The question was answered by the supreme court in the cases of *Commonwealth*

182. Minn. Laws 1917, ch. 429 § 2, as amended by Minn. Laws 1919, ch. 105 § 3.

183. 58 R.I. 294, 192 Atl. 473 (1937).

184. Gen. Laws 1923, ch. 273 § 16.

185. 273 U.S. 113 (1927).

186. *Hose v. Pennsylvania Securities Comm'n*, 38 Dauphine Co. R. 146 (1933).

187. 58 R.I. 294, 303, 192 Atl. 473, 477 (1937).

188. *Hose v. Pennsylvania Securities Comm'n*, 38 Dauphine Co. R. 146 (1933).

*v. Ferneau*¹⁸⁹ and *Commonwealth v. Mason*.¹⁹⁰ In these two cases, the defendants were convicted of violating section 22 (b) which prohibited any dealer or salesman from engaging in the business of "inducing holders of securities to effect the sale thereof through a person registered [under the Act or otherwise] directly or indirectly, in order to produce funds to pay for other investments sold by such dealer or by such salesman for a dealer" unless registered. This is a very unusual provision and at least one writer believes that it closes a loophole still open in other Acts. The defendants had made several transfers to one Martin in Pennsylvania of leases and fractional interests in oil wells in New Mexico. From him they received corporate stock and cash and neither was registered as required by the Act.

On appeal, the defendants contended the transaction was exempt in that the leases involved were within the government securities clause, but the court pointed out:

Even if we were to assume that the oil leases were 'securities' of the State of New Mexico within the meaning of Section 2 (f) (1), the defendants would be in no better position. Our understanding of the evidence is that *only the oil leases* were instrumentalities of the State of New Mexico. The *transactions* involving oil interests would not be affected [by the section].¹⁹¹ (Emphasis added.)

Moreover, it was the combination of section 22 (b) and the selling that made up the offense. This activity appears clearly within the Act and the court appeared to have little difficulty in affirming the convictions.

VI

FLORIDA CRITIQUE

A. General considerations.

The foregoing empirical treatment of mineral securities has been presented in order to provide a broad picture of what has happened in the field, with the hope that a better understanding of similar problems in Florida would result.

Several conclusions can justifiably be drawn. First, securities regulation, and that specific type related to minerals, has experienced a steady expansion — qualitatively and quantitatively. More and more states have extended regulation to mineral securities. On the whole, the vast majority indicate a desire to encompass all mineral transactions with only a few exemptions. This is but legislative intent.

The second conclusion, an inescapable one, is that today, the great need is not for adequate legislation, but rather, vigorous and informed

189. 175, Pa. Super. 570, 106 A.2d 624 (1954).

190. 175, Pa. Super. 576, 106, A.2d 877 (1954).

191. 175, Pa. 570, 593, 106 A.2d 624, 676 (1954).

enforcement. Despite the ultimate reasons of political philosophy, the immediate fact of grossly inadequate appropriations for the Florida Securities Commission (and others like it) is the bottleneck in needed enforcement. It is nothing short of shocking that for the 1957-1959 biennium, the Florida Securities Commission had appropriated to it only \$192,000 — *about \$26,000 less than the appropriation for the Ringling Museum.*¹⁹²

Another observation that can be made is that the nature of mineral interests is relatively foreign to the legal profession as well as the layman. This is very true in Florida as well as other states. The proposal that a mineral instrument can be a security is doubly incredible — even to some of the courts.

The commission cases in Texas and California point to a crying need for legislative action to limit and delimit the application of the real estate and securities licensing laws in regard to mineral transactions. A dealer or agent in the field has a right to know in advance whether his contemplated action is prohibited or restricted by the law, and to require him to seek the advice of an attorney who can only tell him to "try it and see what happens" is not complimentary of the modern legislature. Neither is it the proper atmosphere for commerce. The question might be posed as to whether this could not more properly be done by the administrative ruling function of the Securities Commission. This writer does not so believe — and does not so recommend — at least not until dissemination of administrative policy reaches a higher degree of efficacy than at present. Administrative rule-making is too often lacking but more often, and more importantly, fails to be disseminated in a desired manner.¹⁹³

Seldom a day goes by in Florida but that newspapers all over the State exhibit potential violations of the securities act in their advertising sec-

192. FLA. STAT. § 282, Items 52, 54 (1957). Florida is not the only state with budget problems in the regulation of securities. See Reavely & Barns, *Operation of the Texas Securities Act*, 10 S.W.L.J. 249, 250 (1956) in which it is pointed out that the Securities Division of the Secretary of State's office, was given \$45,000 in 1937 through 1940, and \$42,196 in 1950; yet, from 1951 through 1954 the legislature tried to reduce this amount to \$25,000! They go on to say:

In 1955 and 1956 the appropriation was increased to \$65,228 and the Securities Division has been able to switch from more or less a filing agency to an enforcement agency that has, to some degree, taken the offensive in this difficult field of regulation. Obviously, its budget is still pitifully small and wholly unrealistic *when the vast and complicated field of securities in a growing state* are considered, but it is a step in the right direction. (Emphasis added.)

Although the Florida appropriations do not seem to provide a sufficient basis for needed field personnel, the commission is reported to be on a self-sustaining basis through fees, etc. at its present level of operations.

193. An exception to this blanket generalization is California. As an example of the high degree of administrative development in that state see CALIF. ADM. CODE, of which section 421 is illustrative:

"Application for Permission to Transfer Royalty Interest in Escrow.
An application for permission to transfer royalty or mineral interests in escrow shall contain the following:

(a) A statement signed by the proposed transferor describing the

tions.¹⁹⁴ Commission monitoring of advertising media, so desperately needed, could be both relatively inexpensive and conducive of facilitating the purpose of the Securities Act. Promotional activity takes many forms but advertising is its major outlet and the one by which the public is most often abused. It is complimentary of human nature that most of these offerings are legitimate and violations are often unintentional. However, fraud is not the only evil which the Act was designed to eradicate; simple irresponsibility and ignorance in commerce with the public is another which, together with fraud, bilks investors of millions of dollars annually. In a romance industry such as minerals development, this is most rampant. Surely, if Florida can spend a quarter of a million dollars in two years to satisfy carnival curiosity in one museum, it can well afford to spend twice that amount to protect the curiosity seeker in his investment pursuits.

B. A specific problem area and a suggested solution.

By chapter 475.01 (2) of the Florida statutes, "Every person who shall, in this state, for another [and for a consideration, sell, etc.] . . . any

interest to be sold, the consideration to be paid therefor, and the name of the transferee.

(b) A statement signed by the proposed transferee that the transferor disclosed to the transferee:

- (1) The date the proposed transferor acquired the interest.
- (2) The source from which the proposed transferor acquired the interest.
- (3) The valuation of the interest and the basis upon which such valuation was determined.
- (4) That none of the proceeds of the transfer, will be applied directly or indirectly to the promotion, development or operation of the wells or properties on which the interest is based.
- (5) That the assignment or transfer of the interest will be recorded by the proposed transferor on behalf of the proposed transferee in the county in which the property on which the interest is based is located; or, that the proposed transferee has been instructed by the proposed transferor to record said assignment.

(c) A written commitment by the producing company, or the holder of the leasehold if there is no producing company, or the original issuer of the interest, or an authorized disbursing agent to whom the proceeds from the interest are to be paid, that it will recognize the proposed transferee as owner of such interest, and will pay all royalties to which such interest is entitled to the transferee." See also, Harshbarger, *California Corporate Securities Law Applied to Oil and Gas Transactions*, 3 U.C.L.A. L. Rev. 540, 543 (1956).

194. As an example, the following advertisement appeared in a prominent metropolitan newspaper recently:

800 PATENTED MINING CLAIMS FOR SALE
GOLD, SILVER, LEAD, ZINC AND COPPER
7500 ACRES — SILVERTON, COLORADO
One of the Richest precious metal districts in the world
Will sell (Retaining a 3% Royalty)
for less than cost of Patent and Taxes Paid. Terms.
U. S. Mining Engineer's Maps; Reports, Blueprints, etc.
write.....

real property, or any interest in or concerning the same, *including mineral rights or leases* . . . shall be deemed to be a 'real estate broker' or 'real estate salesman' " and must be so licensed and registered by other provisions. By an enactment in 1955,¹⁹⁵ the term "real estate" or "real property" includes leaseholds, assignments of leaseholds, subleaseholds and "any and every interest or estate in land."

When these provisions are considered *vis a vis* the oil and gas provision of the Securities Act, Mr. Shuman's caveat¹⁹⁶ appears more than timely. Where one effects the transfer or sale of an interest in minerals in place for another person in Florida, regardless of where the land is situated, must he have both licenses or only one? If only one, which one? The *Ryan*¹⁹⁷ case brought such transactions within the Securities Act and the *Boyer*¹⁹⁸ case affected only the 1943 amendment. Obviously, and excluding all else, the agent must be licensed under the securities law. But then chapter 475 et seq. apparently requires him to be licensed as a real estate agent. These twin horns of a regulatory dilemma can be and should be clipped in the near future to prevent personal jeopardy as well as maintain desired regulation.¹⁹⁹

The Texas and California cases provide very little help except to accentuate the fact that a problem exists. This writer believes that the answer lies in a combination of legislative direction, judicial awareness and administrative supplemental rule making. It is believed that the origin of the problem, aside from lobbying activity, lies in the long standing (and now useless) concept of mineral interests as being "interests in realty." It was this hobgoblin with which the supreme court tangled in *Boyer v. Black*.²⁰⁰ It has already been shown how closely mineral instruments resemble investment contracts and such contracts are personalty. Also, it is well settled, even in Florida, that once minerals are severed from the ground, they are considered personalty. Prior to that time rights in them might as well be considered as intangible personalty due to the sub-surface nature of minerals.

195. Fla. Laws 1955, ch. 29983 § 1.

196. "It, therefore, becomes important to the real estate broker to recognize when a transaction involves a security as defined in Chapter 517, Florida Statutes. Otherwise both the broker and his client may be subjected to severe criminal penalties.

The first obvious real estate transaction which could involve a security is a transaction involving an oil lease." Shuman, 6 FLORIDA REALTY NEWS 4 (1958).

197. 128 Fla. 1, 174 So. 438 (1937).

198. *Boyer v. Black*, 154 Fla. 723, 18 So.2d 886 (1944).

199. A collateral aspect of the problem—Who is an issuer?—is apparently rectified in the new Uniform Securities Act by section 401 (g):

'Issuer' means any person who issues or proposes to issue any security, except that . . . (2) with respect to certificates of interest or participation in oil, gas or mining titles or leases or in payments out of production under such titles or leases, there is not considered to be any 'issuer.'

200. 154 Fla. 723, 18 So.2d 886 (1944). For an excellent discussion with reference to the realty concept, see comment, *Oil and Gas Interests as Securities*, 26 Calif. L. Rev. 359 (1938).

There is no longer any justifiable reason why they should be regarded as realty. With this in mind, the suggestion is made that the whole problem could be solved by specific words in the Real Estate License Law²⁰¹ that such interests are not within its provisions. Specific reference to mineral interests — leases, assignments of leases, royalties, etc. — is necessary to avoid affecting the leasehold interests in buildings and land which obviously should remain within the law. The courts, following such legislative direction would no longer have any compulsion to wander into the “realty” concept and administrative officials, could issue rules with assurance.²⁰²

201. FLA. STAT. § 475 (1957).

202. The American courts are by no means uniform about the nature of the interest acquired by a mineral lease. A majority appears to favor the incorporeal heritament theory; a lesser number of states, including Texas, regard the property as realty; and a few others are not precise. See BROWN, *THE LAW OF OIL AND GAS LEASES*, 25 (1958).