

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—E.D. Tex.: Oil and gas venture failed to gush money, \(Dec. 19, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Rodney F. Tonkovic, J.D.](#)

A district court found that positions in an oil and gas joint venture that fell far short of its promises were securities. According to the court, the investors had no meaningful powers and were completely dependent on the efforts of the company. Having found that the units were securities, the court went on to conclude that the company's CEO made intentional misrepresentations in the venture's offering documents that misled investors as to the viability of the investment (*SEC v. Sethi Petroleum, LLC*, December 16, 2016, Mazzant, A.).

Joint venture. In January 2014, Sethi Petroleum, LLC began offering positions in a purported joint venture offering returns from oil-and-gas revenues and tax benefits from oil-and-gas exploration and production activities. In its offering documents, Sethi Petroleum said that investor funds would be used to purchase a majority interest in at least twenty wells that would be operated by major oil and gas companies. In reality, the joint venture acquired a fractional interest from one small company in nine wells, only six of which were productive.

The offering documents for the joint venture also projected annual returns ranging from 32 percent to 254 percent. These projections were based on oil priced at \$90 per barrel, but during the relevant period, the price was around half that. Finally, the documents stated that there would be no commingling of funds between the joint venture and Sethi Petroleum, but by March 2015, approximately 75 percent of the investor funds received had been moved to a Sethi Petroleum general account.

In May 2015, the court granted the SEC's request for a temporary restraining order, asset freeze and other injunctive relief. Soon after, the court [found](#) that a second joint venture formed the day after the injunction was granted was established to thwart the injunction for the explicit purpose of holding the company for Sethi Petroleum's CEO, Sameer Sethi, and his family.

Venture units were securities. This action concerns the SEC's motion for summary judgment as to Sameer Sethi. At issue initially was whether the joint venture units were investment contracts and therefore securities. The first two elements under the Fifth Circuit's interpretation of *Howey*, (1) "investment" and (2) "in a common enterprise," were not disputed, so the issue was whether the investors had an expectation that they would earn a profit solely through the efforts of others. Sethi argued that no factor was met because the joint venture agreement gave investors actual power over the venture and each one represented that they possessed the requisite knowledge and experience to exercise those powers.

The court found that the venture units were securities. First, the record established that the majority of the investors' powers were delegated to Sethi Petroleum and that the rest could not be exercised because the company controlled all of the necessary information. Next, the evidence showed that the investors lacked experience and knowledge in the oil and gas industry and that the venture actually sought out investors with no experience. Finally, the structure of the venture made the investors completely dependent on Sethi Petroleum's efforts.

Securities fraud. The court then found that the Commission adequately pleaded that Sethi made material misrepresentations in the offering documents. Despite hedging and cautionary statements in the offering documents, the court said, Sethi intentionally made a material misstatement when he told investors that the venture had partnerships with major oil companies, and this created an obvious danger of misleading investors into thinking that the venture was a viable investment.

The case is [No. 4:15-CV-338](#).

Attorneys: Matthew Gulde for the SEC. Adam James Holcomb (Holcomb Law Office) for Sameer P. Sethi and John R. Weber.

Companies: Sethi Petroleum, LLC

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