

Louisiana Office of Financial Institutions
Securities Division

Investor Alert

Oil and Gas Investments*

Investors are warned that oil and gas investment scams are alive and well. Although not quite as prevalent since the oil boom ended in the mid-1980s, recent fluctuations in oil prices have led some con artists back to these kinds of scams.

What Are Oil And Gas Investments?

Oil and gas investments take many forms, including limited partnership interests and ownership of fractional undivided interests in leases, which are securities under state law. In a drilling limited partnership, an oil or gas company sells partnership units to investors and uses the money it raises to lease property and drill wells. In return for managing the project, the sponsor company usually takes an upfront fee that averages about 15-16% of one's investment and also shares in a percentage of any revenue generated. The promoter offers the investor the prospect of a substantial first year tax write-off and quarterly cash distributions from the sale of any oil and gas the partnership finds until the wells run dry.

Drilling partnerships have always been a gamble, but recently, they have proven somewhat riskier than usual. This type of investment is very speculative, highly illiquid, and can have a long holding period.

Fraudulent Sales Techniques

Fraudulent oil and gas deals are frequently structured with the limited partnership (or other legal entity) in one state, the operation and physical presence of the field in a second state, and the offerings made to prospective investors in other states. Thus, there is less chance of an investor dropping by a nonexistent well site or company headquarters. Such a structure also makes it difficult for law enforcement officials and victims to identify and expose the fraud.

Boiler Rooms & Internet Pitches

In order to attract the interest of potential investors, fraudulent promoters frequently use the Internet and "boiler room" offices with banks of phones manned by salespeople with little or no background in energy exploration, but plenty of experience in high-pressure sales. Their techniques include repeated unsolicited phone calls hyping the profitability

of the deal. Some swindlers use professionally designed brochures. Beware of unsolicited oil and gas promotions on the internet and through e-mail.

You should be especially suspicious of the following claims in a typical high-pressure sales pitch:

- You will have an interest in a well that cannot miss
- The risks are minimal
- A geologist has given the salesperson a tip
- The salesperson has personally invested in the venture
- The promoter has “hit” on every well drilled so far
- There has been a tremendous “discovery” in an adjacent field
- A large, reputable oil company is operating or planning to operate in the area
- Only a few interests remain to be sold and you should immediately send money to assure the purchase of an interest
- This is a special private deal open only to a lucky chosen few investors

How To Avoid Being Swindled

You should not to be afraid to ask the hard questions when solicited for oil and gas investment opportunities. You can minimize the risk of being swindled if you resist pressures to make hurried, uninformed investment decisions. The following is a list of five key areas to examine before investing:

- 1. Registration Requirements.** Ask if the offering is registered with this office and the securities commission in the state in which the promoters are located. If the promoter claims that the offering is exempt from registration, find out the basis under which the exemption is claimed. If the promoter claims that the investment does not constitute a security, find out why. Contact this office to confirm whatever the promoter says.
- 2. The Salesperson.** If it is a legitimate deal, the salesperson will not be reluctant to answer questions or provide written explanations to questions. Ask the name of the person offering you the security, where he is calling from, and what his background is in the oil or gas industry. Ask what commission and/or other compensation the salesperson will receive. Contact this office to find out if the promoter or salesperson has been cited for previous violations of securities laws.
- 3. The Company.** Critical information about the company promoting the investment should be contained in a prospectus or “offering document” that the promoter must furnish to potential investors before they commit their funds. Review this document to

obtain information about the promoters, the financial condition of the company, and its history in drilling operations.

- 4. The Investment.** Make sure funds raised are kept in a separate escrow account until used and that they won't be commingled with other funds. Also, be certain the funds will not be used for purposes other than those specified. Ask how much money is to be raised and the cost per fractional interest. Ask how much of the money will pay for advertising, salaries, sales commissions and any estimated profit to the company. Ask if the well to be drilled is a wildcat (drilled in territory not known to be productive) or is the drilling to be done in an area of proven oil reserves?
- 5. The Lease.** Secure a legal description of the property on which the drilling is to take place. How and when was it acquired? Is the principal selling the lease to the venture at the acquisition cost, and if not, how much profit is being made? Ask for a description of surrounding property, including local well completions and a geologist's report on the area.

Where To Turn For Help

OFI cautions potential investors to thoroughly check out *every* investment opportunity. To inquire about a securities salesperson or report suspected fraud, call or write OFI at:

Call: 1-877-516-3653 (Free call)

OR (225) 925-4512

Office of Financial Institutions (OFI)
Securities Division

Fax: (225) 925-4511

8660 United Plaza Boulevard
Baton Rouge, Louisiana 70809

Website: www.ofi.la.gov/SecuritiesInvestorEd.htm

*Obtained from the North American Securities Regulators Association's *Investor Alert Bulletins* at www.nasaa.org.