# APPENDIX A

Opinion of the Court of Appeals

# IN THE UNITED STATES COURT OF APPEALS
# FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit

**FILED**

December 4, 2018

Lyle W. Cayce
Clerk

No. 17-41022

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff - Appellee

v.

SAMEER P. SETHI,

Defendant - Appellant

Appeal from the United States District Court
for the Eastern District of Texas

Before STEWART, Chief Judge, and KING and OWEN, Circuit Judges.

CARL E. STEWART, Chief Judge:

Sameer P. Sethi sold interests in an oil and gas joint venture. He promised investors partnerships with world-famous oil companies and large returns. The SEC wasn't buying it—not only did Sethi fail to register his interests as securities, he materially misrepresented his relationships with large oil companies. The SEC filed claims against Sethi under Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a). Then the SEC filed a motion for summary judgment. The district court granted the motion, holding that Sethi offered securities and committed securities fraud. Sethi appeals. We affirm.

I.

Sethi sold interests in an oil and gas drilling joint venture. He sold these interests through his company, Sethi Petroleum, which he founded in 2003 and manages alone. Sethi sought out investors using a broad cold-calling campaign. With the help of twenty salespersons, he purchased lead lists and offered positions in his joint venture to potential investors. When a potential investor expressed interest, Sethi would determine whether the investor was "accredited." If so, he would further promote the venture using two main documents: a private placement memorandum ("PPM") and a copy of the joint venture agreement ("JVA").

The PPM told investors that Sethi intended to raise $10 million by selling fifty units at $200,000 apiece. Sethi would then use the investor funds to purchase mineral interests in an oil and gas development in the Williston Basin in North Dakota, South Dakota, and Montana. The PPM further specified that Sethi would use the funds to purchase a 62.5% net working interest in at least twenty wells, all of which would be operated "by publicly traded and/or major oil and gas companies," such as ExxonMobil, Hess Corporation, and ConocoPhillips. The PPM also made clear that Sethi would not commingle venture funds with funds from "Sethi Petroleum or any Affiliate."

The JVA laid out the rights, duties, and obligations for the investors and the managing venturer—Sethi Petroleum. While the JVA purported to give the investors control over the venture's affairs, it delegated power over the day-to-day operations to Sethi Petroleum. The JVA also gave Sethi Petroleum the sole power to distribute profits, execute oil and gas agreements, hire professionals, and take and hold property. The JVA required a majority vote of the investors for larger actions, such as acquiring oil and gas interests.

As a result of his sales efforts, Sethi ended up raising over $4 million from ninety investors, which he used to purchase a fractional working interest in eight wells from Irish Oil & Gas, with the interests ranging from 0.15% to 2.5%. Three different operators worked on the wells—Crescent Point Energy U.S. Corp., Oxy USA Inc., and Slawson Exploration Co. Six of the wells produced oil, and the operators voluntarily cancelled two other wells.

Over the course of the investments, no evidence shows that a vote or investor meeting ever occurred.

II.

We review a district court's grant of summary judgment de novo, using the same legal standard as the district court. *Turner v. Baylor Richardson Med. Ctr.*, 476 F.3d 337, 343 (5th Cir. 2007). Summary judgment is appropriate where there is no genuine issue of material fact and the parties are entitled to judgment as a matter of law. *Id.* All reasonable inferences must be drawn in favor of the nonmovant, but "a party cannot defeat summary judgment with conclusory allegations, unsubstantiated assertions, or only a scintilla of evidence." *Id.* (internal quotation marks omitted).

III.

On appeal, Sethi challenges two of the district court's decisions. First, he argues that the district court erred when it held that interests in his drilling projects qualified as securities. Second, he argues that the district court erred in granting summary judgment on the SEC's securities fraud claims.

A.

Under Section 5 of the Securities Act, it is "unlawful for any person, directly or indirectly" to use interstate commerce to offer to sell "any security" unless the person has filed a "registration statement" for the security. 15 U.S.C. § 77e(c). The Securities Act broadly defines the term security to include a long list of financial instruments, including "investment contracts," the type of security at issue here. *See* 15 U.S.C. § 77b. While Congress defined the term "security," it left it to the courts to define the term "investment contract." In *Howey*, the Supreme Court developed a "flexible" test for determining whether an arrangement qualifies as an investment contract:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.

*SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). Distilled to its elements, an investment contract qualifies as a security if it meets three requirements: "(1) an investment of money; (2) in a common enterprise; and (3) on an expectation of profits to be derived solely from the efforts of individuals other than the investor." *Williamson v. Tucker*, 645 F.2d 404, 417-18 (5th Cir. 1981) (citing *SEC v. Koskot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974)). Here, the parties dispute the third factor.

When determining whether investors expect to rely "solely on the efforts of others," courts construe the term "solely" "in a flexible manner, not in a literal sense." *Youmans v. Simon*, 791 F.2d 341, 345 (5th Cir. 1986). Courts read this requirement flexibly "to ensure that the securities laws are not easily circumvented by agreements requiring a 'modicum of effort' on the part of investors." *Long v. Shultz Cattle Co.*, 881 F.2d 129, 133 (5th Cir. 1989). The critical inquiry is whether "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *Williamson*, 645 F.2d at 418 (internal citation omitted). Even though an investor might retain "substantial theoretical control," courts look beyond formalities and examine whether investors, in fact, can and do utilize their powers. *Affco Invs. 2001, LLC v. Proskauer Rose, LLP*, 625 F.3d 185, 190 (5th Cir. 2010).

Here, the court must apply these general principles to a partnership.[1] While we employ a "strong presumption" that "a general partnership . . . is not a security," *Nunez v. Robin*, 415 F. App'x 586, 589 (5th Cir. 2011) (per curiam) (unpublished) (quoting *Youmans*, 791 F.2d at 344), this court in *Williamson* articulated three factors that, if proven, overcome this presumption. These factors flesh out situations where investors depend on a third-party manager for their investment's success, and each factor is sufficient to satisfy the third *Howey* factor. Under the *Williamson* factors, a partner is dependent solely on the efforts of a third-party manager when:

> (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

*Williamson*, 645 F.2d at 422.[2] Courts, however, are not limited to these three factors—other factors could "also give rise to such a dependence on the promoter or manager that the exercise of partnership powers would be

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[1] This court applies the same analysis to partnerships and joint ventures. *Youmans*, 791 F.2d at 346 n.2 ("Our discussion of partnerships applies with equal force to joint ventures since this kind of business investment device is the same for purposes of the federal securities laws.").

[2] A number of other circuits have adopted the *Williamson* factors as a way to analyze the third *Howey* factor. *See, e.g.*, *SEC v. Shields*, 744 F.3d 633, 644 (10th Cir. 2014) (adopting the *Williamson* factors); *United States v. Leonard*, 529 F.3d 83, 90-91 (2d Cir. 2008) (same); *SEC v. Merch. Capital, LLC*, 483 F.3d 747, 755-66 (11th Cir. 2007) (same); *Stone v. Kirk*, 8 F.3d 1079, 1086 (6th Cir. 1993) (same); *Koch v. Hankins*, 928 F.2d 1471, 1477-81 (9th Cir. 1991) (same); *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 241 (4th Cir. 1988) (same).

effectively precluded." *Id.* But regardless of which factor is at issue, a party can only prove one of the *Williamson* factors by looking to the unique facts of the arrangement at issue. Differently put, a party faces a "factual burden" when proving one of the *Williamson* factors. *Id.* at 425.

The first *Williamson* factor is whether the drilling projects left the investors so little power "that the arrangement in fact distribute[d] power as would a limited partnership." *Id.* at 422. In determining whether an arrangement deprives investors of power, courts look to two sources of evidence. First, courts look to the legal documents setting up the arrangement to see if investors were given formal powers. *See, e.g., id.* at 424 (looking to the "partnership agreement" to see if partners were given power). Second, courts examine how the arrangement functioned in practice. How the arrangement functioned is typically the most important indication of whether investors had power.[3] *See, e.g., Nunez*, 415 F. App'x at 590 (looking to the fact that an investor exercised power over the partnership's finances); *Long*, 881 F.2d at 134 (crediting the jury's conclusion that investors, in practice, followed the manager's recommendations).

Here, the governing venture documents gave investors some theoretical power to control the drilling projects. Importantly, they had the power to remove Sethi as manager. *See Youmans*, 791 F.2d at 347 (holding that the

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[3] Post-investment conduct is relevant for determining the expectations of the parties at the time they entered the drilling investment contracts, as other circuits have held. *Shields*, 744 F.3d at 646; *see also Merch. Capital, LLC*, 483 F.3d at 760; *Koch*, 928 F.2d at 1478 (looking to the "practical possibility of the investors exercising the powers they possessed pursuant to the partnership agreements."). Although the Fifth Circuit has not explicitly held that courts may look to post-investment activity, nearly every case has in fact analyzed such activity. *See, e.g., Nunez*, 415 F. App'x at 590 (looking to the fact that the investor exercised power over the partnership's finances); *Long*, 881 F.2d at 134 (crediting the jury's conclusion that investors followed the manager's recommendations); *Youmans*, 791 F.2d at 347 (directing the trial court on remand to further develop the "practical application" of the relevant contract provisions).

removal power is "an essential attribute of a general partner's . . . authority.").
They also could call meetings and propose amendments with a 20% vote, develop rules for meetings with a 50% vote, and veto Sethi's decisions.

These powers, however, were illusory in practice. Sethi blocked investors from using their powers on numerous occasions. First, and most tellingly, Sethi was responsible for calling meetings and soliciting votes. He never did. The investors never held a meeting and did not vote on any matter. A receiver appointed by the district court also found no evidence that Sethi ever "organized a vote or solicited input of any kind from investors." While Sethi contends that the project was in its early stages, the SEC provided evidence that Sethi took several actions without informing investors. When he purchased well interests for the venture, he did not inform the investors or solicit any investor approval, even though this approval was required by the JVA. He did not notify investors when he sued to rescind this interest. Nor did Sethi ask for any investor input when he drilled eight of twenty wells promised in the PPM.

Second, Sethi gave the investors little to no information. The investors did not have access to the project's books. One investor, Michael Martin, declared that Sethi's employees stymied his efforts to gather information on numerous occasions, denying him promised "up-to-date" reports and repeatedly failing to return his calls and emails. Other investors corroborated Martin's story, declaring that Sethi "never consulted" them on "business matters" and failed to provide "promised quarterly updates." The district court's receiver further supported this evidence, concluding that Sethi "actively sought to minimize transparency with investors and limit the information to be made available to, and the involvement of, the investors." Without "sufficient information," investors could not "make meaningful decisions" about their investments. *Merch. Capital*, 483 F.3d at 759.

Sethi does not provide any evidence to the contrary. He correctly states the law in arguing that a voluntarily passive investor cannot transform an investment into a security. *See Rivanna Trawlers Unlimited*, 840 F.2d at 240-41. Sethi did not, however, support this argument with any evidence. Meanwhile, the SEC provided summary judgment evidence that investors did seek to use their powers but could not. Sethi also argues—again without evidence—that investors might have been actively monitoring their investments. But overcoming a motion for summary judgment requires Sethi to do more than provide "unsubstantiated assertions." *Turner*, 476 F.3d at 343.

In sum, the SEC provided unrebutted evidence showing that the investors could not use their legal powers. As a result, the district court correctly concluded that Sethi's drilling projects distributed power as if they were limited partnerships. Because we agree that the first *Williamson* factor was met, we do not address the second and third factors.

B.

Sethi also argues that the district court erred when it granted the SEC's motion for summary judgment on its securities fraud claims under Section 10(b) of the Exchange Act, Rule 10b-5, and Section 17(a) of the Securities Act.

Section 10(b) of the Exchange Act makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Under the power granted by this statute, the SEC created Rule 10b-5, which makes it unlawful for any person, directly or indirectly:

> (a) To employ any device, scheme, or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements

> made, in the light of the circumstances under which they were made, not misleading, or
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> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person

17 C.F.R. § 240.10b-5.

To prove a violation of Rule 10b-5[4] for material representations or misleading omissions, the SEC must prove three elements: "(1) material misrepresentations or materially misleading omissions, (2) in connection with the purchase or sale of securities, (3) made with scienter." *SEC v. Seghers*, 298 F. App'x 319, 327 (5th Cir. 2008) (unpublished) (per curiam) (citing *Aaron v. SEC*, 446 U.S. 680, 695 (1980)). To show that a defendant has violated § 17(a)(2) or (a)(3), the SEC must show the same elements as for Rule 10b-5, except that it need only prove "the defendant acted with negligence." *Id.*

Here, the parties dispute the first and third elements of this test, material misrepresentation and scienter. Under Rule 10b-5, a defendant makes a misrepresentation when "the information disclosed, understood as a whole, would mislead a reasonable potential investor." *Laird v. Integrated Recs., Inc.*, 897 F.2d 826, 832 (5th Cir. 1990). The scope of this standard is determined by the relative status and sophistication of the parties. *Id.* The defendant's misrepresentation is material "if there is a substantial likelihood that a reasonable investor would consider the information important in making a decision to invest." *ABC Arbitrage Plaintiffs Grp. v. Tchuruk*, 291 F.3d 336, 359 (5th Cir. 2002). To prove scienter, the SEC need only prove that the defendant acted with severe recklessness. *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961 (5th Cir. 1981) (en banc). Severe recklessness is defined as "those highly unreasonable omissions or misrepresentations that involve not

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[4] The scope of liability under Section 10(b) and Rule 10b–5 is the same. *See SEC v. Zandford*, 535 U.S. 813, 816 n.1 (2002).

merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Id.* at 961-62.

Sethi primarily argues that he did not make any misrepresentations at all. He also suggests that he did not act with scienter. We are not persuaded. Sethi's brief cites no summary judgment evidence to support his conclusory arguments. Meanwhile, the district court, relying on unrebutted evidence, held that Sethi misstated his relationships with major oil companies when offering interests in his drilling venture and, as a result, misled investors. The record supports the district court's findings.

In communications with prospective investors, Sethi and his employees made several statements concerning his relationships with major oil companies. His cold-call script emphasized the venture's current relationship with "HUGE, PUBLICLY traded companies, like Conoco Phillips, Continental, GMXR just to name a few." The script also claimed that the venture was "working DIRECTLY with these major companies." Affidavits confirm this evidence. One investor declared that Sethi told him that "Sethi Petroleum was partnering with Exxon Mobil and other major oil companies to drill and operate." A former cold-caller also declared that Sethi instructed him to emphasize Sethi Petroleum's relationships with "major oil and gas companies."

Sethi did not stop these representations after the initial call—the offering documents also portrayed Sethi Petroleum as having current partnerships with several major oil and gas companies. The Executive Summary represented that "all" of the venture's wells would be drilled by "Exxon Mobil (XOM), Conoco Phillips (COP), Continental Resources (CLR), Hess Corp. (HES), and several others, all of whom have extensive drilling experience in the Williston Basin." The PPM told investors that "publicly traded and/or major oil and gas companies" would drill the venture's wells. The PPM also specifically mentioned the four companies listed above as examples of the type of company that would drill the venture's wells.

Taken together, Sethi's statements suggest that Sethi Petroleum had preexisting relationships with some of the largest oil companies in the world—relationships that Sethi would leverage in the venture's favor. In reality, these relationships did not exist. No evidence in the record indicates that Sethi Petroleum had any preexisting relationship with any of the listed companies or ones that are similar. Nor does the record show that the venture ever partnered with Exxon Mobil, Conoco Phillips, or a similar company. In fact, Sethi acquired the venture's only well interests from Irish Oil & Gas, Inc.—a small, private oil company. Three other companies—Crescent Point Energy U.S. Corp., Slawson Exploration Co., and Oxy USA Inc.—operated the wells. Sethi does not point us to any contrary evidence. Sethi also offers no evidence that either Crescent Point Energy or Slawson Exploration are of the same scale and notoriety as the major oil companies touted in the offering documents. And while Oxy USA is a subsidiary of Occidental Petroleum, a major oil company, Sethi offers no evidence about whether and to what extent Occidental Petroleum was involved in the well operation. Nor does he present any evidence of a preexisting relationship with Oxy USA or Occidental Petroleum. The district court correctly concluded that these facts constitute a misstatement.

These facts also establish scienter. Sethi knew that he did not have relationships with the listed companies, and Sethi does not dispute that the venture never partnered with a major oil company.[5] Nevertheless, he

[5] Sethi contends that he relied on consultants when he made these statements and, therefore, did not act with scienter. Again, however, he provides no evidence to support his argument. Nowhere in the record do we find any sign that Sethi relied on statements by his

repeatedly represented that he had relationships with several major oil companies, and he used these representations as a tool to entice investors. By touting his relationships with major oil companies, Sethi created a "danger of misleading buyers" into believing that his venture would be well-managed and their investments would be in the hands of the most successful drillers in the world. *Broad*, 642 F.2d at 961.

In sum, the district court correctly found that Sethi made material misstatements to investors when he knowingly misrepresented his relationships with major oil companies.

IV.

For the foregoing reasons, the judgment of the district court is AFFIRMED.

consultants, or that consultants ever made statements about Sethi Petroleum's relationships with major oil companies.

# APPENDIX B

# Memorandum Opinion of the District Court

# United States District Court
**EASTERN DISTRICT OF TEXAS**
**SHERMAN DIVISION**

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| SECURITIES AND EXCHANGE COMMISSION | § | |
| | § | |
| v. | § | Civil Action No. 4:15-CV-00338 |
| | § | Judge Mazzant |
| SETHI PETROLEUM, LLC and SAMEER P. SETHI | § | |
| | § | |
| | § | |

## AMENDED MEMORANDUM OPINION AND ORDER

Pending before the Court is Plaintiff's Motion for Summary Judgment as to Sameer Sethi (Dkt. #195). After reviewing the relevant pleadings and motion, the Court finds that the motion should be granted.

## BACKGROUND

As early as January 2014, Defendant Sameer Sethi and his company, Sethi Petroleum, LLC ("Sethi Petroleum"), began offering investors positions in the Sethi-North Dakota Drilling Fund-LVIII Joint Venture ("NDDF"). This purported "joint venture" offered investors returns from two sources: oil-and-gas revenues and tax benefits from oil-and-gas exploration and production activities. The NDDF was promoted primarily through two documents: a Confidential Private Placement Memorandum ("PPM") and an Executive Summary (collectively, the "Offering Documents").

Sethi Petroleum marketed NDDF interests through a twenty-person sales staff using cold calls, pitch scripts, and purchased lead lists. Defendant regularly visited Sethi Petroleum's boiler room to provide sales tips and directions on statements to make to potential investors. Once salespeople determined that an investor was interested in NDDF and was "accredited," Sethi Petroleum would send Offering Documents to the potential investor through the United States mails. An "accredited" investor is a person with a net worth over $1,000,000 independently or combined with a spouse or with individual income over $200,000 or joint income over $300,000.

In the PPM, Sethi Petroleum stated its intention to raise $10 million to exploit its exclusive rights to purchase mineral interests and to participate in oil and gas development on 200,000 acres in the Williston Basin of North Dakota, South Dakota, and Montana. Each of the fifty units was offered at $200,000. Sethi Petroleum estimated that 70% of investor funds would be used for the acquisition, drilling, and completion of the wells and that the remaining 30% would be spent on legal, engineering, syndication, and management expenses.

The PPM further stated that the investors' funds would be used to purchase approximately 62.5% net working interest in at least twenty wells. The Offering Documents further state that NDDF's wells would be "operated by publicly traded and/or major oil and gas companies" such as Continental Resources, ExxonMobil, Hess Corporation, and ConocoPhillips (APP205).[1] In August 2014, NDDF acquired a fractional working interest from Irish Oil & Gas ranging from 0.15% to 2.5% in eight or nine wells. The operators of the acquired wells were Crescent Point Energy U.S. Corp., Oxy USA Inc., and Slawson Exploration Co. Of those wells, only six produced oil or gas. Two wells were voluntarily cancelled by their operators in December 2014 and January 2015. The remaining wells produced a combined total of 9,147 barrels of oil in January 2015; 13,995 barrels of oil in February 2015; and 12,357 barrels of oil in March 2015. Since the appointment of a receiver for all of Sethi Petroleum in May 2015, all of the wells associated with Sethi Petroleum have produced total proceeds of $2,489.85.

[1] The SEC incorporates the Appendix filed in support of the SEC's Motion for Temporary Restraining Order (Dkt. #4, Exhibit 2) as evidence for this motion. In addition, the SEC has attached additional materials to this motion beginning with APP722, supplementing the TRO's 721-page Appendix. The Court will refer to all of these materials in reference to their Appendix citation.

The PPM alerted investors to various risk factors associated with the NDDF venture including: "The venture is newly formed and has limited financial resources"; "There is no minimum capitalization required before subscriptions will be utilized for venture operations"; "Our prior performance is not an indication of how the venture will perform"; "The prospect wells may not be productive"; "You may not recover your investment in the venture"; "We may profit from the venture's operations even if the venture is not profitable" (APP28–34).

The Executive Summary contained projections for the NDDF venture including a projection for annual returns ranging from 32% to 254% on first year investments. These projections were based on a $90/barrel price of oil. In March 2015, the price per barrel ranged from $43.36 to $51.53.[2]

Attached to PPM was a Joint Venture Agreement ("JVA"). The JVA provided by Sethi Petroleum established the NDDF venture and appointed Sethi Petroleum as Managing Venturer. The JVA gave investors control of NDDF's affairs and operations, but empowered Sethi Petroleum to manage the venture's day-to-day operations. Among the powers granted to Sethi Petroleum were "sole and absolute discretion" to distribute NDDF profits to investors; authority to execute oil and gas operating agreements; power to take and hold title to NDDF's property; and authority to hire all professionals on NDDF's behalf, including engineers, geologists, and appraisers. Certain significant actions—such as acquiring oil and gas interests or removing the Managing Venturer—required the majority vote of investors. No evidence shows that a vote was ever conducted or that a list of investors was ever provided to NDDF investors.

The PPM stated that "there will be no commingling of funds between the Venture and Sethi Petroleum or any Affiliate thereof other than may temporarily occur during the payment of

[2] Based on U.S. Energy Information Institute reports for daily spot prices of crude oil, Cushing, OK. U.S. Energy Info. Admin. *Petroleum & Other Liquids* (Nov. 9, 2016), http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pet&s=rwtc&f=d.

bills and/or distributions by Sethi Petroleum on behalf of the Venture." From January 28, 2014, through March 9, 2015, Sethi Petroleum raised over $4 million from ninety investors in twenty-eight states across the country. From February 6, 2014 through March 21, 2015, Defendant and Praveen Sethi moved $3.15 million of investor funds to the Sethi Petroleum general account in more than eighty account transfers.[3]

On May 14, 2015, the Court granted the SEC's emergency *ex parte* request and issued a temporary restraining order, asset freeze, and other injunctive relief (the "TRO") against Sethi Petroleum and Defendant (Dkt. #11). The Court also appointed a receiver over Sethi Petroleum (Dkt. #12). On May 26, 2015, the Court issued an Agreed Order Granting Preliminary Injunction, Asset Freeze, and Other Relief (the "Preliminary Injunction") (Dkt. #23).

On December 4, 2015, Defendant was noticed, and appeared, for a sworn deposition in this case. Throughout the deposition, Defendant invoked his Fifth Amendment rights to nearly every question (Dkt. #195, Exhibit 2-A). On April 7, 2016, Defendant executed a declaration stating that he would assert his Fifth Amendment privilege to decline to testify, including without limitation, testimony regarding his personal information, assets, conduct related to Sethi Petroleum, receipt of funds in any way related to Sethi Petroleum, expenditures of funds, relationships related to himself or Sethi Petroleum, any efforts to raise money from investors, and communications with Sethi Petroleum (Dkt. #195, Exhibit 2-A).

On September 14, 2016, the SEC filed this Motion for Summary Judgment as to Sameer Sethi (Dkt. #195). On October 11, 2016, Defendant filed a response (Dkt. #211). On October 18, 2016, the SEC filed a reply (Dkt. #218). On November 1, 2016, Defendant filed a sur-reply (Dkt. #220).

[3] It is disputed whether these transfers were legitimately used for expenses and distributions as stated in the PPM, or whether they were fraudulent. The Court needs not decide because the fact that they occurred is not in dispute.

## LEGAL STANDARD

The purpose of summary judgment is to isolate and dispose of factually unsupported claims or defenses. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323–24 (1986). Summary judgment is proper under Rule 56(a) of the Federal Rules of Civil Procedure "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a). A dispute about a material fact is genuine when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby Inc.*, 477 U.S. 242, 248 (1986). Substantive law identifies which facts are material. *Id.* The trial court "must resolve all reasonable doubts in favor of the party opposing the motion for summary judgment." *Casey Enters., Inc. v. Am. Hardware Mut. Ins. Co.*, 655 F.2d 598, 602 (5th Cir. 1981).

The party seeking summary judgment bears the initial burden of informing the court of its motion and identifying "depositions, documents, electronically stored information, affidavits or declarations, stipulations (including those made for purposes of the motion only), admissions, interrogatory answers, or other materials" that demonstrate the absence of a genuine issue of material fact. FED. R. CIV. P. 56(c)(1)(A); *Celotex*, 477 U.S. at 323. If the movant bears the burden of proof on a claim or defense for which it is moving for summary judgment, it must come forward with evidence that establishes "beyond peradventure *all* of the essential elements of the claim or defense." *Fontenot v. Upjohn Co.*, 780 F.2d 1190, 1194 (5th Cir. 1986). Where the nonmovant bears the burden of proof, the movant may discharge the burden by showing that there is an absence of evidence to support the nonmovant's case. *Celotex*, 477 U.S. at 325; *Byers v. Dall. Morning News, Inc.*, 209 F.3d 419, 424 (5th Cir. 2000). Once the movant has carried its burden, the nonmovant must "respond to the motion for summary judgment by setting forth particular facts indicating there is a genuine issue for trial." *Byers*, 209 F.3d at 424 (citing

*Anderson*, 477 U.S. at 248–49). A nonmovant must present affirmative evidence to defeat a properly supported motion for summary judgment. *Anderson*, 477 U.S. at 257. Mere denials of material facts, unsworn allegations, or arguments and assertions in briefs or legal memoranda will not suffice to carry this burden. Rather, the Court requires '"significant probative evidence"' from the nonmovant to dismiss a request for summary judgment. *In re Mun. Bond Reporting Antitrust Litig.*, 672 F.2d 436, 440 (5th Cir. 1982) (quoting *Ferguson v. Nat'l Broad. Co.*, 584 F.2d 111, 114 (5th Cir. 1978)). The Court must consider all of the evidence but must "refrain from making any credibility determinations or weighing the evidence." *Turner v. Baylor Richardson Med. Ctr.*, 476 F.3d 337, 343 (5th Cir. 2007).

**ANALYSIS**

**Evidentiary Objections**

Defendant moves to strike portions of Plaintiff's Appendix that do not comport with the requirements of Federal Rule of Civil Procedure 56. First, Defendant moves to strike statements by Marcus Helt that are conclusory or without foundation. Statements setting forth conclusory facts or conclusions of law are insufficient evidence on a motion for summary judgment. *See Clark v. America's Favorite Chicken Co.*, 110 F.3d 295, 297 (5th Cir. 1997). An affidavit in support of a motion must be made on "personal knowledge, set out facts that would be admissible in evidence, and show that the affiant or declarant is competent to testify on the matters stated." FED. R. CIV. P. 56(c)(4).

The Court finds that several statements in Marcus Helt's affidavit are conclusions of law. Thus, the Court sustains Defendant's objection and excludes Helt's statements that, "the entire Sethi Enterprise was a sham"; "the Sethi Enterprise was insolvent; "The Sethi Enterprise received approximately $13 million of cash under false representations"; and "the enterprise never had a possibility, let alone probability, of being a viable business."

Next, Defendant seeks to strike hearsay portions of the declarations of Michael Martin and Joseph Barbaria. The Court overrules this objection. Martin's and Barbaria's statements are supported by the record before the Court. Additionally, Defendant has not specified which statements he perceives to constitute hearsay. The Court finds that the statements by Sethi Petroleum employees are not hearsay because they are not offered for the truth of the matter asserted, but rather to prove their falsity. *See* FED. R. EVID. 801(c)(2). Further, Barbaria's statements regarding what Defendant told him would be admissible as statements by a party opponent. FED. R. EVID. 801(2). Therefore, the Court overrules this objection.

**Negative Inference**

The SEC argues that the Court should draw an adverse inference from Defendant's refusal to testify to establish that (1) Defendant did in fact control Sethi Petroleum and all of its employees and related entities and (2) that he conducted the fraudulent offer, issuance, and sale of Sethi Petroleum venture shares (Dkt. #195 at pp. 21–22). Defendant responds that a negative inference is inappropriate at the summary judgment stage because the Court is required to make all reasonable inferences in favor of the nonmovant (Dkt. #211 at p. 32).

In the Fifth Circuit, courts may draw an adverse inference from a defendant's refusal to testify in a civil case. *See Hinojosa v. Butler*, 547 F.3d 285, 295 (5th Cir. 2008). This inference is available to the court on summary judgment. *See State Farm Life Ins. Co. v. Gutterman*, 896 F.2d 116, 119 (5th Cir. 1990). However, a court cannot decide an issue on summary judgment against a party solely on the basis of the party's invocation of the Fifth Amendment. *Id.* at 119, n.2 (citing *United States v. White*, 589 F.2d 1283, 1287 (5th Cir. 1979)). A court may only decide an issue if there is any independent evidence in addition to the invocation. *Gulf Coast Bank & Trust Co. v. Stinson*, No. 2:11-CV-88-KS-MTP, 2013 WL 30136, at *4, n.2 (S.D.

Miss. Jan 2, 2013). Therefore, while the Court declines to base its decisions solely on Defendant's assertion of Fifth Amendment rights, it may consider such silence as a failure to dispute other evidence.

**Joint Venture Units Were Investment Contract Securities**

The SEC argues that the joint venture units are securities as investment contracts because they meet each of the three factors from *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981) (Dkt. #195 at p. 15). Defendant argues that the SEC's arguments for each factor are insufficient to meet their heavy burden to prove an investment contract on summary judgment (Dkt. #211 at p. 17). Specifically, Defendant argues that no factor is met because the JVA gives investors actual power over the NDDF venture and each venturer represented that he or she possessed the requisite knowledge and experience to exercise those powers (Dkt. #211 at pp. 19–22).

A security is broadly defined under the Securities Act and the Exchange Act. 15 U.S.C. §§ 77b(a)(1) & 78c(a)(10). An investment contract exists where: (1) individuals are led to invest money; (2) in a common enterprise; (3) with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946). The first two elements are clearly established and are not seriously disputed. Therefore, the issue for the Court is whether the investors had an expectation that they would earn a profit solely through the efforts of someone other than themselves.

The leading Fifth Circuit case interpreting *Howey's* third element is *Williamson v. Tucker*. In *Williamson*, the Fifth Circuit held that the term "solely" is interpreted in a flexible manner, not in a literal sense. *Id.* at 418. In evaluating whether an interest is a security, "form should be disregarded for substance," and courts should analyze the "economic reality underlying a transaction, and not [focus] on the name appended thereto." *United Hous. Found.,* *Inc. v. Forman*, 421 U.S. 837, 848–49 (1975). Therefore, to determine whether profits are expected to come "solely" from the efforts of others, the Fifth Circuit adopted the Ninth Circuit's test, which defined the critical question as "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 (5th Cir. 1974) (citing *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973)).

In *Williamson*, the Fifth Circuit concluded that a general partnership or joint venture interest may satisfy the third *Howey* element if the investor can establish any one of the following factors: (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers. 645 F.2d at 424. These factors are not exhaustive. *Id.* at 424, n.15. Although "[t]he test stated in *Williamson* . . . refers to the investor's experience in "business affairs," without referring to specialized knowledge, the Fifth Circuit has "made clear that the knowledge inquiry must be tied to the nature of the underlying venture." *Long v. Shultz Cattle Co.*, 881 F.2d 129, 134 n.3 (5th Cir. 1989) (noting that "any holding to the contrary would be inconsistent with *Howey* itself").

Furthermore, the Fifth Circuit has stated that "a strong presumption remains that a general partnership or joint venture interest is not a security." *Youmans v. Simon*, 791 F.2d 341, 346 (5th Cir. 1986). The *Youmans* court made it clear that "[a] party seeking to prove the contrary must bear a heavy burden of proof." *Id.* (citing *Williamson*, 645 F.2d at 424). Therefore, the Court will examine each of the *Williamson* factors to determine if the SEC has met its heavy burden in establishing that the type of interest that Defendant sold was actually a security.

<u>The First *Williamson* Factor: Venturers' Actual Power</u>

The first *Williamson* factor the Court considers is whether the agreement between the parties gives the venturer little to no power, such as a limited partner would have. 645 F.2d at 424. A general partnership or joint venture interest usually does not fall within the broad definition of "investment contract." *Williamson*, 645 F.2d at 419–421. However, agreements that are more akin to limited partnerships may be considered a security under the statutory definition. *Youmans*, 791 F.2d at 346. Limited partners have limited liability, are typically unable to dissolve the partnership or bind other partners, and have virtually no power to take an active role in the management of the partnership. *Id.*

The SEC argues that investors did not have any real power over their investment because Sethi Petroleum had "sole and absolute discretion" to distribute NDDF profits to investors; authority to execute oil and gas operating agreements; power to take and hold title to NDDF's property; authority to hire all professionals on NDDF's behalf; and to choose operators for drilling on NDDF's wells (Dkt. #195 at pp. 16–17). The SEC supports its arguments with unrebutted declarations from an accountant, an investor, a salesman, and the Receiver.

Defendant points to several of the venturer's alleged powers in support of his argument that the venturers had real power, making the NDDF shares not a security. According to Defendant, Venturers could remove the managing venturer, could propose and pass amendments to the [JVA], calling meetings, develop rules and procedures for holding meetings, and vote on "any matter that may be submitted for decision by the Venturers in accordance with the express terms of [the JVA] or under the provisions of the TBOC" (Dkt. #211 at p. 20). Defendant then argues that it is reasonable to infer that a venturer with these types of rights would actually check up on the performance of the NDDF venture (Dkt. #211 at p. 20). Defendant further argues that it requires an unfavorable inference to assume that just because one investor had no power then all investors did not have power (Dkt. #211 at p. 21).

This case is similar to *Arcturus*, where the joint venturers also had the ability to call meetings and the voting power to remove the managing venturer. *SEC v. Arcturus*, 171 F. Supp. 3d 512, 525 (N.D. Tex. 2016). The *Arturus* court pointed out that "[i]f the venturers did not have any contact information for the other venturers . . . how could the venturers ever satisfy the minimum percentage interest to exercise these powers[?]" *Id.* The court went on to state that "[a]ny right to vote or call a meeting that required a percentage of the venture interest was absolutely hindered by the inability of the venturers to contact each other." *Id.*

Here, Sethi Petroleum solicited investors from across the country with no prior relationships to Sethi Petroleum or to each other. Further, Sethi Petroleum did not provide access to its books or records. Therefore, the summary judgment evidence establishes that the investors could not exercise any powers they had because they did not know the names or addresses of other investors. *Arcturus*, 171 F. Supp. at 525; *see also SEC v. Merchant Capital, LLC*, 483 F.3d 747, 758 (11th Cir. 2007) (finding barriers to exercise of powers were compounded because the investors "were geographically dispersed, with no pre-existing relationships").

Furthermore, even if the investors could contact each other or otherwise force a vote, Sethi Petroleum's misrepresentations frustrated any meaningful management powers of the investors. Michael Martin ("Martin"), an NDDF investor, asked multiple people for a status update of his investment and was repeatedly stymied. First, Martin was given a letter by Sethi

Petroleum's Vice President, Michael Davis ("Davis") who told Martin that Sethi Petroleum had engaged independent contractors to provide such updates. Further, Davis told Martin that he would provide an up-to-date report on the status of Martin's investment. Martin has never received either the name of the independent contractor or the report. Davis further directed Martin to call Diane Cimoperlik ("Cimoperlik") if he had any further questions. When Martin reached Cimoperlik, she told him that only eight of the twenty promised NDDF wells had been drilled. However, when Martin asked for additional detail during that call and in a follow up email, he did not receive any response.

One of Sethi Petroleum's salesmen, Joseph Barbaria ("Barbaria"), stated in his declaration that the "closers" for Sethi Petroleum were instructed to reassure investors that they would eventually receive revenue checks, and that Sethi Petroleum had interests in more wells than it actually did. Barbaria was personally contacted by one investor who had concerns about receiving status updates on his investments. On December 23, 2014, Davis sent an email to the closers stating that NDDF only had interest in five wells, not twelve. However, William Shavers, Sethi Petroleum's Sales Director, immediately told the closers that the email was sent in error and they should continue telling prospective investors that NDDF had interest in twelve wells.

Defendant argues that it is reasonable to infer that at least some investors took steps privately to track the performance of the NDDF venture to not be reliant on the managing venture (Dkt. #211 at p. 20). However, as the foregoing facts demonstrate, investors did take steps to learn of the NDDF venture, but were stymied at every step along the way and when they were given information, it was inconsistent at best. The Fifth Circuit has stated that "access to information does not necessarily protect an investor from complete dependence on a third party where, as here, that same third party is the sole source of information and advice regarding the underlying venture and the investor does not have the expertise necessary to make the essential management decisions himself." *Long*, 881 F.2d at 135–36; *see also Arcturus*, 171 F. Supp. 3d at 530–31; *Merch. Capital*, 483 F.3d at 761. The Eleventh Circuit has determined that powers are illusory when the promotor controls how much information is given to investors, and he does "not submit sufficient information for the partners to be able to make meaningful decisions." *Merch. Capital*, 483 F.3d at 758. Even though Martin eventually obtained information about the NDDF venture, his convoluted path to that discovery demonstrates that he was reliant upon Sethi Petroleum to provide that information.

Therefore, the summary judgment record establishes that the majority of the venturers' powers were delegated to Sethi Petroleum, and any power the venturers still possessed could not be exercised because the necessary information was controlled by Sethi Petroleum. Because the first *Williamson* factor proves the venturers' dependence on the efforts of Sethi Petroleum, the Court finds the third *Howey* element is established. *See Williamson*, 645 F.2d at 424. Accordingly, Sethi Petroleum's joint venture is an investment contract and, therefore, a security. *See Arcturus*, 171 F. Supp. 3d at 527.

The Second *Williamson* Factor: Venturers' Experience and Knowledge

Even if the first *Williamson* factor had not been satisfied, the Court could look to the second *Williamson* factor to establish complete dependence. *Id.* Under this factor, the Court considers whether the venturers were inexperienced and lacked expertise in the oil and gas well business. The Court finds the SEC presented sufficient evidence to establish this second factor.

Courts look to the investor's experience and knowledge in the particular business of the venture at issue, not the investor's general business experience. *Long*, 881 F.2d at 135 n.3 (noting that *Williamson* "made clear that the knowledge inquiry must be tied to the nature of the underlying ventures."); *see Howey*, 328 U.S. at 296. The critical inquiry is whether the investors are inexperienced and unknowledgeable in this particular business, making it more likely they would "be relying solely on the efforts of the promoters to obtain their profits." *Merch. Capital*, 483 F.3d at 762; *see also Long*, 881 F.2d at 134 ("[A] plaintiff may establish reliance on others within the meaning of *Howey* if he can demonstrate not simply that he did not exercise the powers he possessed, but that he was incapable of doing so.").

Courts have consistently held that when offerings are made by hundreds of cold calls per day, via a nationwide network of investors with little, if any, experience in the oil and gas industry, then one can conclude that the investors were so inexperienced or unknowledgeable in business that they were not capable of "intelligently exercising their partnership powers." *See, e.g., Arcturus*, 171 F. Supp. 3d at 528.

Defendant argues that the SEC has not produced enough evidence to meet its burden on summary judgment and even if it has, the statements in the JVA that each venturer has "the requisite business knowledge and experience" is sufficient to satisfy the requisite knowledge requirement (Dkt. #211 at p. 22). The SEC has provided unrebutted declarations from its investigating accountant, a former NDDF employee, and an investor, to prove that NDDF sought out and obtained investors who had no experience in the oil and gas industry. The Court finds that these uncontroverted statements from multiple sources are sufficient to establish that no genuine issue of material fact exists as to the venturers' experience and knowledge.

The sheer breadth of indiscriminate solicitation of investors shows that the second *Williamson* factor is present. There are approximately ninety investors from at least twenty-five different states. Sethi Petroleum employed between ten and twenty "fronters" who initiated calls through automatic dialing and purchased leads list. Once a "fronter" determined that the caller was accredited and interested in purchasing a joint venture interest, the call would be sent to a "closer" to make the sale. Fronters and closers were told that they could sell to investors that had no prior experience making oil and gas investments as long as they were "accredited investors." An "accredited investor" was simply a rating on how much money a person had. Sethi Petroleum employed eight closers. All employees in the call center, with the exception of two successful closers, worked from 8 a.m. to 5 p.m.. The fronters and closers were told to continually make calls to potential investors.

Further, the testimony of an NDDF investor, Martin, shows that he was solicited despite lacking relevant knowledge or experience. When Martin was first contacted by a Sethi Petroleum Vice President, Jerry Impini ("Impini"), Martin said that he had no experience in oil and gas. Nevertheless, Sethi Petroleum continued to ensure that Martin was an "accredited investor" and followed through with the sale. Whether or not an individual is an accredited investor is unrelated to whether or not they are knowledgeable about oil and gas. Further, Defendant has failed to produce any evidence supporting his argument that a majority, if not all, of the investors possessed the requisite knowledge. Considering the circumstances under which Sethi Petroleum solicited potential investors, and the investors' lack of knowledge at the time of the investment, it is clear that investors did not have the necessary experience in oil and gas to manage their own investment.

The Court finds that the second *Williamson* factor has been established. Because the second *Williamson* factor proves the venturers' dependence of the efforts of Sethi Petroleum, the Court finds the third *Howey* element is established. *See Williamson*, 645 F.2d at 424. Accordingly, NDDF's venture is an investment contract and, therefore a security.

The Third *Williamson* Factor: Venturers' Dependence on the Unique Capabilities of Sethi Petroleum

Even if the first and second factors had not been satisfied, the third *Williamson* factor establishes that the venturers were completely dependent on Sethi Petroleum's efforts. Under this third factor a dependent relationship exists when the investors rely "on the managing partner's unusual experience and ability in running that particular business." *Williamson*, 645 F.2d at 423. As noted in *Williamson*, even a partner knowledgeable in the particular investment "may be left with no meaningful option when there is no reasonable replacement for the investment's manager." *Id.* In such a situation, "a legal right of control would have little value if partners were forced to rely on the manager's unique abilities." *Id.*; *see also Merch. Capital*, 483 F.3d at 763 ("[E]ven if the arrangement gives the partners some practical control, the instrument is an investment contract if the investors have no realistic alternative to the manager."). In assessing the third *Williamson* factor, a court may consider "the representations and promises made by promotors or others to induce reliance upon their entrepreneurial abilities." *Gordon v. Terry*, 684 F.2d 736, 742 (11th Cir. 1982); *see also Koch*, 928 F.2d at 1478.

The SEC argues that "Sameer and his company structured and operated the NDDF investment leaving investors completely dependent on the company's supposed entrepreneurial and managerial abilities, without any reasonable alternative management option" (Dkt. #195 at p. 21).

The summary judgment evidence establishes that Sethi Petroleum's cold call regime was built around touting the company's established relationships in the oil and gas industry and promising that the wells would produce one million barrels of oil per month from a major oil and gas company, that new investors would immediately begin receiving revenue checks, and that investments would return 30%–60% per year. Martin explicitly stated that he did not have experience in the oil and gas industry except for a one-well project that never produced oil. After Martin spoke on the phone with Impini, he received an NDDF PPM and other documents. In the PPM, Sethi Petroleum touts its experience and ability to produce profit in the oil and gas industry, specifically in the Bakken Shale. The Executive Summary further states that the Bakken Shale area has been monopolized such that only major oil companies can participate in drilling. Due to Sethi Petroleum's purported experience and access to an exclusive market, the Court agrees that investors were "without any reasonable alternative management option."

Additionally, the SEC argues that "if NDDF investors somehow wrestled power away from Sethi Petroleum, they would have found . . . funds hopelessly commingled with [Sethi Petroleum's] own funds and those of other joint ventures" (Dkt. #195 at p. 21). Defendant argues in response that "a majority-in-interest of the investors could have voted down all actions taken by Sethi Petroleum and could have replaced Sethi Petroleum without cause" (Dkt. #211 at p. 23).

Other courts have held that investors were granted only illusory control over an investment where the enterprise was run by pooling investors' interests so that an individual investor had no control over the operation as a whole, even if he had some control over a subsidiary portion. *See, e.g.*, *Koch*, 928 F.2d at 1478, 1480; *Bailey v. J.W.K. Props., Inc.*, 904 F.2d 918, 924–25 (4th Cir. 1990). In *Merchant Capital*, the Eleventh Circuit concluded that the partners had no realistic alternative to the current manager, as well as no actual power to remove him, because the manager "effectively had permanent control over each partnership's assets." 483 F.3d at 763; *see also Arcturus*, 171 F. Supp. 3d at 530 (Stating that "[t]he venturers had no access to their funds because the money was held in an account controlled exclusively by [the manager], not the Joint Venture.").

This is similar to the case at hand. The summary judgment evidence establishes that Sethi Petroleum took the investments, placed them in an account Sethi Petroleum exclusively controlled, and used the funds to pay for the costs associated with running Sethi Petroleum's office. Although the entire Sethi Enterprise was represented to include several different joint ventures, it was in reality a single enterprise with significant commingling of funds. Until January 2015, only Defendant had signatory power over the NDDF account. Defendant did not observe corporate formalities or otherwise keep the NDDF account separate from other Sethi Enterprise accounts. Furthermore, while the entire Sethi Enterprise raised approximately thirteen million dollars, less than $100,000 remained on the date of the receiver's appointment. Despite the receiver's efforts to sell the mineral interests actually owned by the Sethi Enterprise, no one has offered to buy the interest for cash. Additionally, when Martin asked for a refund of his investment, Cimoperlik refused to provide one, clearly indicating that NDDF venturers had no access to their funds.

These facts clearly indicate that even if Sethi Petroleum was replaced, the assets would not be accessible to the NDDF venturers. The SEC has submitted evidence that, just as in *Arcturus*, the venturers in the current case lacked any control over their money, which created a complete dependency on Sethi Petroleum.

The Court finds the third *Williamson* factor has been established. Because the third *Williamson* factor proves the venturers' dependence on the efforts of Sethi Petroleum, the Court finds the third *Howey* element is established. *See Williamson*, 645 F.2d at 424. Accordingly, the NDDF joint venture is an investment contract and, therefore, a security.

## Securities Fraud

The SEC claims that Defendant made material misrepresentations including: (1) falsely describing Defendant's criminal history; (2) falsely describing Defendant's and Sethi Petroleum's regulatory history; (3) falsely claiming partnerships with major oil companies; (4) misrepresenting the scope of the NDDF venture; (5) misrepresenting expected returns; and (6) stating that investors funds would be used in accordance with the Operating Documents when, in reality, those funds were diverted for purposes not disclosed to investors. The Court finds that summary judgment should be granted only as to the misrepresentations of partnerships with major oil companies. Summary judgment is therefore denied for all other alleged misrepresentations.

To establish a prima facie case under Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, the SEC must prove by a preponderance of the evidence: (1) a misstatement or omission (2) of material fact (3) in connection with the purchase of a sale or security (4) made with scienter. *SEC v. Gann*, 565 F.3d 932, 936 (5th Cir. 2009). Information is material if there is a substantial likelihood that disclosure of the misstated or omitted fact would have significantly altered the "total mix" of information to be considered by a reasonable investor. *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). The scope of this standard is determined by the relative status and sophistication of the parties. *Laird v. Integrated Res., Inc.*, 897 F.2d 826, 832 (5th Cir. 1990). Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Gann*, 565 F.3d at 936. Section 17(a)(2) and (3) require essentially the same elements, but do not require scienter. *See SEC v. Evolution Capital*, 866 F. Supp. 2d 661, 667 (S.D. Tex.

2011). Since the SEC must essentially prove the same elements for each violation, the Court will consider these allegations together. *See Arcturus*, 171 F. Supp. 3d at 535.

The SEC argues Defendant intentionally made a material misstatement when he told investors that Sethi Petroleum had partnerships with major oil companies (Dkt. #195 at pp. 25–28). Defendant argues that any misstatements were not material because the "total mix of information" included cautionary language, the statements were predictive, insufficient time had elapsed, and unfavorable market conditions intervened (Dkt. #211 at pp. 12, 24). Based on these facts, Defendant argues that a reasonable inference in his favor would lead to the conclusion that these were not actionable misrepresentations. The Court finds that despite hedging and cautionary statements in parts of the offering documents, the "total mix" of information based on the relative sophistication between Sethi Petroleum and its investors was that these relationships were currently existing, and that larger relationships may develop as the investors pour in.

Defendant, individually and through Sethi Petroleum, unequivocally advertised to the world that Sethi Petroleum presently "works with companies such as ExxonMobil and Hess in big oil and gas plays in the Bakken [Shale]" (APP476). The very first interaction that investors have with Sethi Petroleum is through a cold call. The Sethi Petroleum script for its salespeople states: "We're partnered directly with a couple of HUGE, PUBLICLY traded companies like Conoco Phillips, Continental, GMXR just to name a few" (APP480). Salespeople pursue investors solely on the basis of the investor being "accredited," which has nothing to do with actual experience in the oil and gas industry or even investing in general. Once an investor expresses interest, the salesperson sends offering documents including the PPM and Executive Summary. The Executive Summary states:

> [T]his area has become monopolized, allowing only major oil companies to participate in the Bakken Shale developments . . . Sethi Petroleum is working

> directly with major oil companies, operators, landmen, service crews, landowners, mineral rights owners, and royalty owners thus gaining ground floor access to developmental opportunities in both the Bakken Shale and the Three Forks formations.

(APP204). The Executive Summary goes on to describe the extent of Sethi Petroleum's operations as "rights and options to drill in more than 200,000 available net acres of land in North Dakota" (APP204). Later, it ambiguously states "all of our wells will be drilled by publicly traded and/or major oil and gas companies" (APP204). Given the unequivocal preceding statements, it would not be reasonable to infer that the final statement about major oil and gas companies is simply a predictive statement of "hoped-for major operators" (Dkt. #211 at p. 12). Rather, Sethi Petroleum, by using the word "directly" in the present tense, led NDDF investors to believe that it was currently working with major companies to establish a direct link to profit.

Further removing doubt as to the misstatement regarding major oil and gas relationships are the unofficial statements made in the press and on social media about Sethi Petroleum's business. A "D Magazine" article about Defendant stated that "the company works with companies such as ExxonMobil" (APP476). A Craigslist listing seeking investors states among the documents that it will send a list of "Partnerships with the major Oil and Gas companies" (APP482). Finally, Defendant's own LinkedIn page describes his company as having "ground-floor investment opportunities managed and operated by major oil or publically traded energy companies" (APP486). Each of these statements would lead a reasonable investor to believe that Sethi Petroleum had present relationships with major oil and gas companies at the time that the statements were made. In fact, Sethi Petroleum only had interests with Irish Oil & Gas, Inc., a small, private oil company. The unrebutted evidence regarding Sethi Petroleum's mischaracterization of its relationships with major oil and gas companies proves that there is a substantial likelihood that disclosure would have significantly altered the "total mix" of information to be considered by a reasonable investor. Thus, the first and second elements of a violation of the anti-fraud provisions are established.

To establish the third element, the SEC must prove that the misstatement was made in connection with the sale or purchase of a security. This element is met if the misstatement 'somehow touches upon' or has 'some nexus' with 'any securities transaction.' *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993) (quoting *SEC v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990)). The purpose of Sethi Petroleum misstating its relationship with major oil and gas was to sell its securities. This is sufficient to satisfy the "in connection with" requirement. *See Clark*, 915 F.2d at 449. Therefore, the SEC has established the third element of securities fraud.

To establish the fourth element, the SEC must prove that Defendant acted with scienter. In the Fifth Circuit, scienter may be established by showing that the defendant acted intentionally or with severe recklessness. *See Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961–62 (5th Cir. 1981) (en banc). Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it. *Id.* The Executive Summary stated that the Bakken Shale area "has become monopolized, allowing only major oil companies to participate" (APP204). The following statement that "Sethi Petroleum is working directly with major oil companies" would obviously create a danger of misleading investors into thinking that the NDDF venture is a viable investment. Defendant has not produced any argument or evidence disputing this point or that such relationships in fact existed. Therefore, the SEC has proved that Defendant acted with at least severe recklessness. Having found that Defendant acted with scienter with regard to the statements about relationships with oil companies, Defendant has violated Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5.

To establish a violation of Section 17(a)(2) or 17(a)(3), the SEC need only make a showing of negligence in connection with Defendant's sale of securities. *Meadows v. SEC*, 119 F.3d 1219, 1226 n.15 (5th Cir. 1997). The Court has already determined the evidence conclusively establishes Defendant acted with scienter. Therefore, the Court finds the summary judgment evidence supports a finding that Defendant violated Sections 17(a)(2) and 17(a)(3).

To establish joint and several liability, the SEC must prove that Defendant is a control person or acted through or by means of another person. To establish that Defendant is a control person under Section 20(a) of the Exchange Act, the SEC must show an underlying violation and that person's control of the violating entity. 15 U.S.C. § 78t(a). The SEC argues that Defendant is a control person of Sethi Petroleum because Defendant was Sethi Petroleum's President and sole Managing Member (Dkt. #195 at p. 28). Defendant created, owned, managed, and controlled the company's operations from at least November 7, 2011, until May 2015. This unrebutted evidence is sufficient to show that Defendant had control of Sethi Petroleum when the misstatements were made. Therefore, Defendant is jointly and severally liable with and to the same extent as Sethi Petroleum for the fraudulent sale of securities.

Further, Defendant is jointly and severally liable for violating the antifraud provisions through or by means of another person. 15 U.S.C. § 78t(b). Defendant directed his salespeople to tell potential investors that Sethi Petroleum is "partnered directly" with major oil companies such as Conoco Phillips and Continental. Further, he directed the author of the Executive Summary to state similar misstatements about direct relationships with major oil and gas companies.

Defendant is therefore jointly and severally liable for directing others to make misstatements in violation of the federal securities laws.

## CONCLUSION

It is therefore **ORDERED** that Plaintiff Securities and Exchange Commission's Motion for Summary Judgment as to Sameer Sethi (Dkt. #195) is hereby **GRANTED**.

The Court finds that Sameer Sethi is liable for violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Court further finds that Sameer Sethi is jointly and severally liable with and to the same extent as Sethi Petroleum under Section 20(a) of the Exchange Act for Sethi Petroleum's Exchange Act violation. The Court further finds that Sameer Sethi is liable for violations of Section 17(a) of the Securities Act.

The Court hereby withdraws its previous Memorandum Opinion and Order (Dkt. #232) and enters this order in its place.

**SIGNED this 17th day of January, 2017.**

AMOS L. MAZZANT
UNITED STATES DISTRICT JUDGE

Additional material from this filing is available in the Clerk's Office.