In this case a sophisticated investor who purchased a limited partnership interest in an oil drilling venture seeks to rescind. The question raised is whether the sale was part of a private offering exempted by §4(2) of the Securities Act of 1933 from the registration requirements of that Act. We hold that in the absence of findings of fact that each offeree had been furnished information about the issuer that a registration statement would have disclosed or that each offeree had effective access to such information, the district court erred in concluding that the offering was a private placement. Accordingly, we reverse and remand.

I. Facts

Prior to July 1970, Petroleum Management Corporation (PMC) organized a California limited partnership for the purpose of drilling and operating four wells in Wyoming. […] During the late summer of 1970, plaintiff William H. Doran, Jr., received a telephone call from a California securities broker previously known to him. The broker, Phillip Kendrick, advised Doran of the opportunity to become a “special participant” in the partnership. PMC then sent Doran the drilling logs and technical maps of the proposed drilling area. PMC informed Doran that two of the proposed four wells had already been completed. Doran agreed to become a “special participant” in the Wyoming drilling program. In consideration for his partnership share, Doran agreed to contribute $125,000 toward the partnership. Doran agreed to discharge this obligation by paying PMC $25,000 down and in addition assuming responsibility for the payment of a $113,643 note owed by PMC to Mid-Continent Supply Co. Doran's share in the production payments from the wells was to be used to make the installment payments on the Mid-Continent note.

[…] During 1970 and 1971, PMC periodically sent Doran production information on the completed wells of the limited partnership. Throughout this period, however, the wells were deliberately overproduced in violation of the production allowances established by the Wyoming Oil and Gas Conservation Commission. As a consequence, on November 16, 1971, the Commission ordered the partnership's wells sealed for a period of 338 days. On May 1, 1972, the Commission notified PMC that production from the wells could resume on August 9, 1972. After August 9, the wells yielded a production income level below that obtained prior to the Commission's order.

Following the cessation of production payments between November 1971 and August 1972 and the decreased yields thereafter, the Mid-Continent note upon which Doran was primarily liable went into default. Mid-Continent subsequently obtained a state court judgment against Doran, PMC, and the two signatory officers of PMC for $50,815.50 plus interest and attorney's fees.

On October 16, 1972, Doran filed this suit in federal district court seeking damages for breach of contract, rescission of the contract based on violations of the Securities Acts of 1933 and 1934, and a judgment declaring the defendants liable for payment of the state judgment obtained by Mid-Continent. […]
II. The Private Offering Exemption

No registration statement was filed with any federal or state regulatory body in connection with the defendants' offering of securities. Along with two other factors that we may take as established that the defendants sold or offered to sell these securities, and that the defendants used interstate transportation or communication in connection with the sale or offer of sale the plaintiff thus states a prima facie case for a violation of the federal securities laws.

The defendants do not contest the existence of the elements of plaintiff's prima facie case but raise an affirmative defense that the relevant transactions came within the exemption from registration found in §4(2). Specifically, they contend that the offering of securities was not a public offering. The defendants, who of course bear the burden of proving this affirmative defense, must therefore show that the offering was private.

This court has in the past identified four factors relevant to whether an offering qualifies for the exemption. [...] The relevant factors include the number of offerees and their relationship to each other and the issuer, the number of units offered, the size of the offering, and the manner of the offering. Consideration of these factors need not exhaust the inquiry, nor is one factor's weighing heavily in favor of the private status of the offering sufficient to ensure the availability of the exemption. Rather, these factors serve as guideposts to the court in attempting to determine whether subjecting the offering to registration requirements would further the purposes of the 1933 Act.

The term, “private offering,” is not defined in the Securities Act of 1933. The scope of the §4(2) private offering exemption must therefore be determined by reference to the legislative purposes of the Act. In SEC v. Ralston Purina Co., the SEC had sought to enjoin a corporation's offer of unregistered stock to its employees, and the Court grappled with the corporation's defense that the offering came within the private placement exemption. [...] According to the Court, the purpose of the Act was “to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.” It therefore followed that “the exemption question turns on the knowledge of the offerees.” That formulation remains the touchstone of the inquiry into the scope of the private offering exemption. It is most nearly reflected in the first of the four factors: the number of offerees and their relationship to each other and to the issuer.

In the case at bar, the defendants may have demonstrated the presence of the latter three factors. A small number of units offered, relatively modest financial stakes, and an offering characterized by personal contact between the issuer and offerees free of public advertising or intermediaries such as investment bankers or securities exchanges these aspects of the instant transaction aid the defendants' search for a §4(2) exemption.6

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4 The district court correctly concluded that the limited partnership interest was a “security” as that term is defined by the Securities Act of 1933 and the Securities and Exchange Act of 1934.

6 Although Doran was initially contacted by a broker, he appears to have conducted much of the subsequent partnership business in which he was involved through direct dealings with PMC. There is evidence that PMC negotiated directly with the remaining offerees.
Nevertheless, with respect to the first, most critical, and conceptually most problematic factor, the record does not permit us to agree that the defendants have proved that they are entitled to the limited sanctuary afforded by §4(2). We must examine more closely the importance of demonstrating both the number of offerees and their relationship to the issuer in order to see why the defendants have not yet gained the §4(2) exemption.

A. The Number of Offerees

Establishing the number of persons involved in an offering is important both in order to ascertain the magnitude of the offering and in order to determine the characteristics and knowledge of the persons thus identified.

The number of offerees, not the number of purchasers, is the relevant figure in considering the number of persons involved in an offering. A private placement claimant's failure to adduce any evidence regarding the number of offerees will be fatal to the claim. The number of offerees is not itself a decisive factor in determining the availability of the private offering exemption. Just as an offering to few may be public, so an offering to many may be private. Nevertheless, “the more offerees, the more likelihood that the offering is public.” In the case at bar, the record indicates that eight investors were offered limited partnership shares in the drilling program, a total that would be entirely consistent with a finding that the offering was private.

[Court rejects argument that Doran was the only offeree.] In considering the number of offerees solely as indicative of the magnitude or scope of an offering, the difference between one and eight offerees is relatively unimportant. Rejecting the argument that Doran was the sole offeree is significant, however, because it means that in considering the need of the offerees for the protection that registration would have afforded we must look beyond Doran's interests to those of all his fellow offerees. Even the offeree-plaintiff's 20-20 vision with respect to the facts underlying the security would not save the exemption if any one of his fellow offerees was in a blind.

B. The Offerees' Relationship to the Issuer

Since SEC v. Ralston, courts have sought to determine the need of offerees for the protections afforded by registration by focusing on the relationship between offerees and issuer and more particularly on the information available to the offerees by virtue of that relationship. Once the offerees have been identified, it is possible to investigate their relationship to the issuer. […]

1. The role of investment sophistication

The lower court's finding that Doran was a sophisticated investor is amply supported by the record, as is the sophistication of the other offerees. Doran holds a petroleum engineering degree from Texas A&M University. His net worth is in excess of $1,000,000. His holdings of approximately twenty-six oil and gas properties are valued at $850,000.
Nevertheless, evidence of a high degree of business or legal sophistication on the part of all offerees does not suffice to bring the offering within the private placement exemption. [...] “[I]f the plaintiffs did not possess the information requisite for a registration statement, they could not bring their sophisticated knowledge of business affairs to bear in deciding whether or not to invest...” Sophistication is not a substitute for access to the information that registration would disclose. [...] 

2. The requirement of available information

[...] For purposes of this discussion, we shall adopt the following conventions: We shall refer to offerees who have not been furnished registration information directly, but who are in a position relative to the issuer to obtain the information registration would provide, as having “access” to such information. By a position of access we mean a relationship based on factors such as employment, family, or economic bargaining power that enables the offeree effectively to obtain such information. When offerees, regardless of whether they occupy a position of access, have been furnished with the information a registration statement would provide, we shall say merely that such information has been disclosed. When the offerees have access to or there has been disclosure of the information registration would provide, we shall say that such information was available.

The requirement that all offerees have available the information registration would provide has been firmly established by this court as a necessary condition of gaining the private offering exemption. Our decisions have been predicated upon Ralston Purina, where the Supreme Court held that in the absence of a showing that the “key employees” to whom a corporation offered its common stock had knowledge obviating the need for registration, the offering did not qualify for the private offering exemption. The Court said that an employee offering would come within the exemption if it were shown that the employees were “executive personnel who because of their position have access to the same kind of information that the act would make available in the form of a registration statement.”

[...] Because the district court failed to apply this test to the case at bar, but rather inferred from evidence of Doran's sophistication that his purchase of a partnership share was incident to a private offering, we must remand [...]. [W]e shall require on remand that the defendants demonstrate that all offerees, whatever their expertise, had available the information a registration statement would have afforded a prospective investor in a public offering. Such a showing is not independently sufficient to establish that the offering qualified for the private placement exemption, but it is necessary to gain the exemption and is to be weighed along with the sophistication and number of the offerees, the number of units offered, and the size and manner of the offering. Because in this case these latter factors weigh heavily in favor of the private offering exemption, satisfaction of the necessary condition regarding the availability of relevant information to the offerees would compel the conclusion that this offering fell within the exemption. [...]
C. On Remand: The Issuer-Offeree Relationship

In determining on remand the extent of the information available to the offerees, the district court must keep in mind that the “availability” of information means either disclosure of or effective access to the relevant information. The relationship between issuer and offeree is most critical when the issuer relies on the latter route.

To begin with, if the defendants could prove that all offerees were actually furnished the information a registration statement would have provided, whether the offeree occupied a position of access pre-existing such disclosure would not be dispositive of the status of the offering. […]

Alternatively it might be shown that the offeree had access to the files and record of the company that contained the relevant information. Such access might be afforded merely by the position of the offeree or by the issuer's promise to open appropriate files and records to the offeree as well as to answer inquiries regarding material information. In either case, the relationship between offeree and issuer now becomes critical, for it must be shown that the offeree could realistically have been expected to take advantage of his access to ascertain the relevant information. Similarly the investment sophistication of the offeree assumes added importance, for it is important that he could have been expected to ask the right questions and seek out the relevant information.

In sum, both the relationship between issuer and offeree and the latter's investment sophistication are critical when the issuer or another relies on the offeree's “access” rather than the issuer's “disclosure” to come within the exemption. […] When the issuer relies on “access” absent actual disclosure, he must show that the offerees occupied a privileged position relative to the issuer that afforded them an opportunity for effective access to the information registration would otherwise provide. When the issuer relies on actual disclosure to come within the exemption, he need not demonstrate that the offerees held such a privileged position. Although mere disclosure is not a sufficient condition for establishing the availability of the private offering exemption, and a court will weigh other factors such as the manner of the offering and the investment sophistication of the offerees, the “insider” status of the offerees is not a necessary condition of obtaining the exemption. […]

IV. Conclusion

An examination of the record and the district court's opinion in this case leaves unanswered the central question in all cases that turn on the availability of the §4(2) exemption: Did the offerees know or have a realistic opportunity to learn facts essential to an investment judgment? We re- mand so that the trial court can answer that question. […]

We have conditioned the private offering exemption on either actual disclosure of the information registration would provide or the offerees' effective access to such information. If the issuer has not disclosed but instead relies on the offerees' access, the privileged status of the offerees relative to the issuer must be shown. […]