

PROPOSED APPENDIX F TO
ARTICLE III, SECTION 35
OF THE RULES OF FAIR PRACTICE

Section 1 - Filing Requirements

All members and persons associated therewith making a distribution of securities to the public which is subject to the provisions of this Rule are required to file with the Association for review the appropriate documents and filing fee referred to under the subsection "Filing Requirements" as contained in the "Interpretation of the Board of Governors With Respect to Review of Corporate Financing" of Article III, Section 1 of the Rules of Fair Practice.

Section 2 - Conflicts with Requirements of Appendix F

The requirements of this Appendix shall apply except where there is an irreconcilable conflict between Sections 4, 6, 10 or 11 and the regulations or guidelines established by state securities administrators' associations to the extent adopted by the state or states with jurisdiction. An irreconcilable conflict shall be limited to instances where compliance with both these sections and state regulations is impossible.

All public offerings of direct participation programs must conform to the standards set forth in this Appendix. However, arrangements which do not conform explicitly thereto, but which are not inconsistent with the spirit thereof, may to the extent appropriate be permitted if they can be justified to the Association taking into consideration standards of fairness and reasonableness to participants.

Section 3 - Definitions

The following words shall have the stated meanings whenever used in this Appendix:

- (a) ACQUISITION FEE - the total of all fees and commissions paid by any party in connection with the selection or purchase of property by a program. Included in the computation of such fees or commissions shall be any real estate commission, acquisition fee, development fee, selection fee, construction fee, guaranteed payment, nonrecurring management fee, or any fee of a similar nature. Excluded from the computation of such fees and commissions shall be such items as legal expenses, independent appraisals, settlement costs, title insurance

and a development fee paid to a person not affiliated with a sponsor, in connection with the actual development of a project after acquisition of the land by the program.

- (b) ADJACENT ACREAGE - producing or nonproducing leases located within four spacing units of any well site or located within the boundaries of the same prospect, whichever is larger.
- (c) AFFILIATE - when used with respect to a member or sponsor, shall mean any person which controls, is controlled by, or is under common control with, such member or sponsor, and includes:
 - (1) any partner, officer or director (or person performing similar functions) of (a) such member or sponsor or (b) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor.
 - (2) any person which beneficially owns or has the right to acquire 10% or more of the equity interest in or has the power to vote 10% or more of the voting interest in (a) such member or sponsor or (b) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor.
 - (3) any person with respect to which such member or sponsor, the persons specified in paragraphs (1) or (2), and the immediate families of partners, officers or directors (or persons performing similar functions) specified in paragraph (1) or other persons specified in paragraph (2), in the aggregate beneficially own or have the right to acquire, 10% or more of the equity interest or have the power to vote 10% or more of the voting interest.
 - (4) any person an officer of which is also a person specified in paragraphs (1) or (2) and any person a majority of the board of directors of which is comprised of persons specified in paragraphs (1) or (2); or
 - (5) any person controlled by a person or persons specified in paragraphs (1), (2), (3) or (4).
- (d) APPRAISAL - a written opinion of the value of property

prepared by a qualified independent appraiser of the type of property which is the subject of the appraisal.

- (e) ASSESSMENTS - additional amounts of capital which a participant may be called upon to furnish beyond his subscription amount. Assessments may be mandatory or optional.
- (f) AUDITED FINANCIAL STATEMENTS - financial statements of a program including the balance sheet, the profit and loss statement, and cash flow and source and application of revenues statement which have been audited by an independent certified public accountant.
- (g) CAPITAL CONTRIBUTION - the gross amount of investment in a program by a participant, or all participants, not to include any units purchased by the sponsors.
- (h) CAPITAL EXPENDITURES - costs of lease acquisitions and drilling and completing wells which are generally accepted as capital expenditures pursuant to the provisions of the Internal Revenue Code.
- (i) CASH LIQUIDATION VALUE - the amount, based upon an evaluation made by a qualified independent appraiser and computed in accordance with a formula or in accordance with terms contained in the prospectus, which will be paid for an interest in a program upon exercise by the participant of his right to receive such value.
- (j) CASH AVAILABLE FOR DISTRIBUTION - cash flow less that amount set aside for restoration or creation of reserves.
- (k) CASH FLOW - program cash funds provided from operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.
- (l) DEVELOPMENT FEE - a fee for the packaging of a program's property, including negotiating and approving plans, and undertaking to assist in obtaining zoning and necessary variances and financing for the specific property, either initially or at a later date.
- (m) DIRECT PARTICIPATION PROGRAM (PROGRAM) - a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited

to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. A program may be composed of one or more legal entities or programs but when used throughout this Appendix the term shall mean each of the separate entities or programs making up the overall program and/or the overall program itself. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code and individual retirement plans under Section 408 of the Internal Revenue Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company, including separate accounts, registered pursuant to the Investment Company Act of 1940.

- (n) EQUITY INTEREST - when used with respect to a corporation, means common stock and any security convertible into, exchangeable or exercisable for common stock, and, when used with respect to a partnership, means an interest in the capital or profits or losses of the partnership.
- (o) FAIR MARKET NET WORTH - the difference between total fair market value of assets and total liabilities including, in the case of an oil and gas program sponsor, the present value of proven reserves of oil, gas and other minerals as determined by an appraisal by a qualified independent appraiser.
- (p) GENERAL AND ADMINISTRATIVE EXPENSE - all costs and expenses incurred by the sponsor in connection with administering a program, including salaries paid by the sponsor, which costs and expenses are not directly allocable to the operations of the program.
- (q) GUARANTEED LEASE - an arrangement whereby the leasee of a property makes an agreement or has the right to lease the property from the buyer pursuant to terms and conditions which are non-renegotiable for a reasonable length of time.
- (r) IMMEDIATE FAMILY - parent, mother-in-law or father-in-law, husband or wife, children, or any relative to whose support the sponsor, the member, or person associated with the member contributes directly or indirectly.
- (s) MANAGEMENT FEE - a fee paid to a sponsor of a program for management and administration of the program.

- (t) MINIMUM SUBSCRIPTION AMOUNT - the minimum amount to which a person must initially subscribe in order to be a participant in a program.
- (u) NET PROCEEDS - the total gross proceeds received from an offering less organization and offering expenses incident thereto.
- (v) NET PROFITS INTEREST - that interest measured by net profits from a property or program, without any liability for losses, which becomes payable after receipt by the participants in a program of net profits equal to certain specified expenditures as detailed in the prospectus for the program.
- (w) NET OPERATING PROFITS INTEREST - a special class of net profits interest which means an interest in net profits from the commencement of production without regard for expenditures for leasehold, exploration or development.
- (x) NON-CAPITAL EXPENDITURES - any expenditures incurred by an oil and gas program in drilling and completing wells which are generally accepted as current expense items pursuant to the appropriate provisions of the Internal Revenue Code.
- (y) OIL AND GAS PROGRAM - a direct participation program which has for its primary purpose oil and gas exploration, development, or purchase of production.
- (z) OPERATING EXPENSES - production and/or leasehold expenses of an oil and gas program incurred in the operation of a producing lease, including district expenses, direct out-of-pocket expenses for labor, materials and supplies, and that share of taxes and transportation changes not borne by overriding royalty interests.
- (aa) OPERATOR - a person designated to supervise and manage the exploration, drilling, production and leasehold operations of an oil and gas program or a portion thereof.
- (bb) ORGANIZATION AND OFFERING EXPENSES - those expenses which are incurred in preparing a direct participation program for registration and subsequently offering and distributing it to the public, including sales commissions paid to broker-dealers in connection with the distribution of the program.
- (cc) ORIGINAL COST - the sum of the price paid by the seller for property plus all costs and expenses, if any,

reasonably and properly allocable to the property in accordance with generally accepted accounting principles, except, in the case of oil and gas programs, the costs of drilling wells which are not commercial producers.

- (dd) OVERRIDING ROYALTY INTEREST - an interest in oil and gas produced or in the proceeds from the sale of oil and gas, free of operating expenses but subject in some cases to production and ad valorem taxes and transportation charges.
- (ee) PARTICIPANT - the purchaser of an interest in a direct participation program.
- (ff) PAYOUT - that point at which the gross revenues from production attributable to a program equal the sum of all costs. As used herein, costs shall include expenditures for leasehold, exploration, development, operation and overhead but do not include depletion, depreciation or income taxes.
- (gg) PERSON - any natural person, partnership, corporation, association or other legal entity.
- (hh) PERSON ASSOCIATED WITH A SPONSOR - any person or member of the immediate family of any person who is employed in any capacity by a sponsor, who is contractually obligated to the sponsor or to whom the sponsor is contractually obligated, or who is, directly or indirectly, controlling or controlled by such sponsor; provided, however, that independent contractors such as attorneys and accountants shall not be deemed to be persons associated with a sponsor.
- (ii) PRINCIPAL OR PRIME TENANT - a person, or group of related persons, who is the largest single occupant of a piece of real property and who occupies more than 25 percent of the aggregate square footage thereof.
- (jj) PROPERTY MANAGEMENT FEE - the fee paid to a sponsor or others for day-to-day professional property management services in connection with a real estate program's real property project.
- (kk) PROSPECT - an area geographically defined by the sponsor of an oil and gas program in which the program owns or intends to own an interest in one or more oil and gas leases and which is reasonably anticipated by the sponsor to have possibilities for the production of oil and gas.
- (ll) PROSPECTUS - shall have the meaning given to that term by Section 2(10) of the Securities Act of 1933, including

a preliminary prospectus; provided, however, that such term as used herein shall also include an offering circular as described in Rule 256 of the General Rules and Regulations under the Securities Act of 1933 or, in the case of an intrastate offering, any document by whatever name known, utilized for the purpose of announcing the offering and selling securities to the public.

(mm) QUALIFIED INDEPENDENT APPRAISER - a person, including a qualified independent petroleum engineer and a qualified independent real estate appraiser, who holds himself out as an appraiser of a particular type of property and who:

- (1) is licensed or registered to practice his profession with the appropriate professional and/or regulatory body, if any, within the state of his business activity, if such is required, and can demonstrate himself to be qualified to appraise the type of property in respect to which he holds himself out; and,
- (2) is totally independent in that:
 - a. he is informed of the purpose for which the appraisal is to be used and that it is to be relied upon for the public program;
 - b. he has relied upon sufficient competent evidence of value and has based the appraisal upon his own experience and judgment;
 - c. he has no present interest or contemplated future interest, either legal or beneficial, in the property appraised;
 - d. he has no interest in any proposed transaction involving the property or in the parties to such transaction;
 - e. his employment and compensation are not contingent upon any value found by him or upon anything other than the delivery of his report for a predetermined fee; and,
 - f. he is not an affiliate of a sponsor.

(nn) QUALIFIED INDEPENDENT PETROLEUM ENGINEER - a person who holds himself out as an evaluator of producing petroleum properties and who:

- (1) is licensed to practice petroleum engineering in the state of his professional activity, if such is required, and can demonstrate himself to be qualified to appraise oil and gas properties and petroleum reserves; and
 - (2) is totally independent in that:
 - a. he is informed of the purpose for which the appraisal is to be used and that it is to be relied upon for the public program;
 - b. he has relied upon sufficient competent evidence of value and has based the appraisal upon his own experience and judgment;
 - c. he has no present interest or contemplated future interest, either legal or beneficial, in the property appraised;
 - d. he has no interest in any proposed transaction involving the property or in the parties to such transaction;
 - e. his employment and compensation are not contingent upon any value found by him or upon anything other than the delivery of his report for a predetermined fee; and,
 - f. he is not an affiliate of a sponsor.
- (oo) QUALIFIED INDEPENDENT REAL ESTATE APPRAISER - a person who holds himself out as an appraiser of real property and who:
- (1) is registered with a recognized national real estate appraisal organization within the state of his professional activity, if such is required, and can demonstrate himself to be qualified to appraise the type of real property at issue; and
 - (2) is totally independent in that:
 - a. he is informed of the purpose for which the appraisal is to be used and that it is to be relied upon for the public program;
 - b. he has relied upon sufficient competent evidence of value and has based the appraisal upon his own experience and judgment;

- c. he has no present interest or contemplated future interest, either legal or beneficial, in the property appraised;
- d. he has no interest in the proposed transaction for acquisition of the property by the program or in the parties to such transaction;
- e. his employment and compensation are not contingent upon any value found by him or upon anything other than the delivery of his report for a predetermined fee; and,
- f. he is not an affiliate of a sponsor.

(pp) REAL ESTATE PROGRAM - a direct participation program which has for its purpose the expenditure of a determinable sum of money for the investment in and/or the operation of or gain from an investment in real property.

(qq) REGISTRATION STATEMENT - shall have the meaning given to that term by Section 2(8) of the Securities Act of 1933; provided, however, that such term as used herein shall also include a notification on Form 1-A filed with the Securities and Exchange Commission pursuant to the provisions of Rule 255 of the General Rules and Regulations under the Securities Act of 1933 and, in the case of an intrastate offering, any document, by whatever name known, initiating the registration or similar process by whatever name known for an issue of securities which is required to be filed by the laws or regulations of any state.

(rr) REVERSIONARY INTEREST - an interest in a program the benefits of which accrue in the future upon the occurrence of some event.

(ss) SALES LITERATURE - any communication (including radio, television and slide presentations, photographs, recordings and illustrations) used to supplement a prospectus; provided, however, such shall not mean:

- (1) letters of transmittal which do no more than refer to the enclosed prospectus and sales literature; and,
- (2) periodic reports required by Section 11 hereof supplied by issuers to members and current participants in the program, provided that said reports are used in no way as sales literature and do not contain an expressed or implied offer to sell a security.

- (tt) SALES MEMORANDA - any communication used as a supplement to the prospectus or selling agreement and intended solely for use by broker-dealers distributing the program.
- (uu) SHARING ARRANGEMENT - an interest in a program granted to the sponsor for his services at a lower cost than that charged participants.
- (vv) SPACING UNIT - that area or distance between wells specified in an order of a regulatory body, or in the absence of such an order, the customary spacing pattern followed in the area which establishes the number and location of wells over an oil and gas reservoir as a conservation measure.
- (ww) SPONSOR - a person who directly or indirectly provides promotional or management services for a direct participation program whether as general partner, pursuant to contract or otherwise.
- (xx) SUBORDINATED INTEREST - one which is junior to the rights of participants until such time as they have received cumulative distributed cash or net revenues in an amount at least equal to their capital contribution.
- (yy) SUBSCRIPTION AMOUNT - the total dollar amount for which a participant in a direct participation program has subscribed for his participation in the program.
- (zz) TAXABLE INCOME - shall have the meaning given that term in Section 63 of the Internal Revenue Code of 1951, as amended, without taking into consideration investment in the program.
- (aaa) TAX BRACKET - the maximum rate at which a portion of a person's taxable income would be taxed.
- (bbb) UNSPECIFIED PROPERTY PROGRAM - a program which, at the time the registration statement becomes effective, does not have 75 percent or more of the net proceeds of the total dollar amount of the offering allocable to specific purposes or, in the case of a real estate program, allocable to the purchase or construction of specific properties. Cash reserves shall be included in the unspecified 25 percent.
- (ccc) WORKING INTEREST - an operating interest entitling the holder to a share of production under an oil and gas lease which carries with it the obligation to bear a corresponding share of all costs associated with the production of income.

Section 4 - General Requirements and Requirements Concerning
Subscriptions, Assessments, Reinvestment of Revenue
and Liquidations

A member or person associated with a member shall not underwrite or participate in the distribution to the public of a direct participation program of which a member or an affiliate of a member is the sponsor unless:

General

- (a) such sponsor and affiliates of the sponsor have expertise appropriate to the program and in services to be rendered of not less than three (3) years or such expertise is directly or readily available to it within its corporate complex, under contract or otherwise and there is full and complete disclosure of the details of that expertise in the prospectus;
- (b) the sponsor or sponsors of the program have a combined fair market net worth at least equal to the greater of (1) \$50,000, or (2) the lesser of \$1,000,000 or 5 percent of the total capital contributions made by the holders of program participations issued by all programs of which such persons are a sponsor organized during the twelve (12) month period immediately preceding the offering date of the program plus 5 percent of the gross amount of the current offering; provided, however, that for purposes of this subsection the term "sponsor" shall not include members of the immediate family of or persons associated with a sponsor except to the extent that such persons are guarantors of obligations entered into by the sponsor in its capacity as sponsor of the program in question;
- (c) until the minimum subscription is raised all monies received are transmitted in accordance with the provisions of Rule 15c2-4(b) of the Securities Exchange Act of 1934, as amended;
- (d) the minimum amount or conditions are not met, the total capital contributions of all participants, including sales commissions, shall be returned to them promptly following termination of the offering period which period shall not be unreasonably extended;
- (e) in the case of an oil and gas program, the program requires, as a prerequisite to the activation thereof, minimum public sales in the amount of no less than \$500,000 per program (except specified oil and gas operations registered pursuant to or validly exempt

from registration under the Securities Act of 1933, including Regulation B exemptions, or under applicable state laws);

- (f) the program, other than an oil and gas program, contains a provision preventing the activation of the program if a stated minimum amount of money is not raised which shall be sufficient, after funding all of the organization and offering expenses and giving due consideration to the fixed obligations of the program, to effect the objectives thereof without changing the nature of the investment called for by the general terms of the program;
- (g)
 - (1) the program meets the requirements of the Internal Revenue Code which enable participants to obtain tax benefits as described in the prospectus and such can be demonstrated by a tax ruling or an opinion with respect to such requirements by independent tax counsel; or,
 - (2) in the case where such a tax ruling or opinion has not been received:
 - a. the program provides for a right of withdrawal and the return of the capital contribution including commissions to all participants from the program in the event a tax ruling or opinion is subsequently received which states in substance that the program will not enable participants to obtain the tax benefits as described in the prospectus; and,
 - b. the program requires that all funds received will be placed in an escrow account and not used until a tax ruling or opinion has been received which states in substance that the program will enable participants to obtain the tax benefits described in the prospectus.

Subscriptions

- (h) in the case of an oil and gas program:
 - (1) the drilling program's terms require that the minimum subscription in a unit of investment, whether as a result of a direct purchase or an

assignment, except by gift or operation of law, shall not be less than \$5,000, or such higher amount as required by state or local law.

- (2) the income or production purchase program's terms require that the minimum subscription be limited so that assignees or assignors may not hold less than the program's prescribed minimum except by gifts or operation of law.
- (i) the program's terms require that all subscriptions be fully paid for within a twelve (12) month period following the date of the commencement of the program or as otherwise required to conform with applicable federal credit regulations; however, a period of deferred payment in excess of the twelve months may be granted in certain types of offerings, i.e., farming, real estate development, among others, where the nature of the investment and development of the product demand a longer period provided, however, the period of payment shall coincide with the anticipated cash needs of the program;
- (j) in the case of an unspecified property program, it prohibits deferred payment plans;
- (k) the program prohibits interest or other similar charges assessed against a participant purchasing units on an installment basis where those installment or benchmark payments are scheduled so as to meet future capital requirements; in cases where installment payments are utilized as a convenience to contributors but the underlying capital is immediately required for program operations, interest payments on the installment proceeds may be considered appropriate;

Assessments

- (l) in any assessment, the sponsor includes with the call for the assessment a statement of the purpose and intended use of the proceeds from such assessment, a statement of the penalty to be imposed for failure of the participant to meet the assessment, and to the extent practicable, a summary of pertinent data on the properties to which the assessment relates;
- (m) the program prohibits payment of sales commissions for assessments on units;
- (n) the possibility of assessments is fully disclosed in the prospectus with a statement as to the maximum

- amount which the units may be assessed and whether the assessments are mandatory;
- (c) in a real estate program, it prohibits the levying of assessments other than to the extent necessary to meet any deficiencies in partnership obligations, including default;
 - (p) in the case of unspecified property programs, it prohibits the levying of assessments;
 - (q) all voluntary assessments do not exceed 100% of the participant's initial capital contribution;
 - (r) mandatory assessments of the program are not in excess of 25 percent of the participant's initial capital contribution in the offering of the securities and provided further, the total of all assessments are not to be in excess of 100% of the participant's initial capital contribution;
 - (s) when penalties are to be imposed upon participants for failure to meet assessments, the penalty:
 - (1) is fair and reasonable;
 - (2) is disclosed in the prospectus;
 - (3) accrues to the benefit of the program rather than the sponsor;
 - (4) for voluntary assessments is,
 - a. a proportionate reduction of the participant's percentage interest in revenues derived from future development based on the ratio of his unpaid assessment to all capital contributions and assessments used for such future development, or
 - b. a subordination of the defaulting participant's right to receive revenues from future development until those nondefaulting participants who have paid the defaulting participant's assessment have received an amount of revenues from revenues of the program from future development equal to 300% of the proportionate amount of the defaulted assessment which they paid.

(5) for mandatory assessments is,

- a. a proportionate reduction of the participant's percentage interest in program revenues based on the ratio of his unpaid assessment to all capital contributions and assessments, or
- b. a subordination of the defaulting participant's right to receive revenues from the program until those non-defaulting participants who have paid the defaulting participant's assessment have received an amount of revenues from all revenues of the program equal to 300% of the proportionate amount of the defaulted assessment which they paid, or

In the case of a mandatory assessment, the sponsor may enforce such personal liability through a lien on the participant's program interest, which permits the sponsor to withhold and apply all revenues attributable to the participant to the payment of any delinquent assessment.

For purposes of this subsection, voluntary assessments which a participant has committed to pay will be considered mandatory assessments.

- (t) if a failure on the part of a participant to meet an assessment in the case of an oil and gas program is to result in a forfeiture by him of a right to participate in future optional development wells, this fact is disclosed in the prospectus;

Reinvestment of Distributable Cash Flow

- (u) when the reinvestment of a program's distributable cash flow into a subsequent program is provided for, such reinvestment is optional to the investor who shall be given the opportunity to elect whether he desires to have his interest therein so invested, and who shall, pursuant to the terms of the program being offered, prior to his election, be provided with complete information on the amount of money to which he is entitled and a copy of a prospectus relating to the subsequent program in which reinvestment is contemplated;

Liquidation of Program Interests

- (v) the program prohibits the sponsor or an affiliate of the

sponsor from transferring or selling his program interest therein except as may be required for mortgage purposes without requiring that an offer comparable in all respects simultaneously be made to all participants and a reasonable period of time be given to them to transfer or sell their interests;

(w) the program prohibits:

(1) the purchase by it of the program interests of any other program with the same sponsor; however, nothing herein shall preclude entering into partnerships or ventures to acquire and operate a particular property; or

(2) the repurchase by the program of its participants' interests in a manner or in an amount which is not in the best interests of the program; provided, however, this shall not be construed so as to prevent the sponsor of a program from purchasing and reselling such interests on a non-exclusive basis;

(x) when the liquidation of participants' interests in a program are provided for other than as a result of the resale of properties in a program, cash liquidation values are required to be computed on the basis of an appraisal of the program's properties made within the preceding twelve (12) months by a qualified independent appraiser pursuant to a formula or in accordance with terms clearly spelled out in the prospectus; provided, however, if there has been a material change in value subsequent to the last appraisal a new appraisal must be made prior to any liquidation;

Business Transacted

(y) when the program contemplates transacting business with any person in an amount aggregating at least 20 percent of the total dollar value of the participants' interests therein, that fact is disclosed in the prospectus; and,

(z) the details with respect to subsections (a) through (v) hereof are fully disclosed in the prospectus.

Section 5 - Rights of Participants

Unless such conflicts with federal law or rules and regulations or interpretative positions of the Internal Revenue Service or the law of the state within which the program has

been organized, a member or person associated with a member shall not underwrite or participate in the distribution to the public of a direct participation program of which a member or an affiliate of a member is a sponsor which:

- (a) does not permit its participants the right by a majority of the then outstanding units to remove the sponsor as general partner or manager;
- (b) does not require the approval of its participants by a vote of at least a majority of the outstanding units:
 - (1) to amend the partnership or other agreement organizing the program entity;
 - (2) to dissolve the partnership or other entity formed to carry out the purposes of the program; and/or,
 - (3) to approve or disapprove the sale of all or substantially all of the assets of the program in a single sale, or in multiple sales in the same twelve (12) month period, except in the orderly liquidation and winding up of the business of the program upon its termination and dissolution;
- (c) does not:
 - (1) provide for the termination of all contracts between the program and the sponsor or affiliate of the sponsor, and the sponsor and the underwriter of the program without penalty on 60 days notice in writing; and/or,
 - (2) require the sponsor upon the written request of 10 percent of the outstanding program units to cause a vote to be taken on any of the matters referred to in subsections (a) and (b) hereof;
- (d) imposes any restrictions on the assignment of a participant's program interests; provided, however, such shall not be construed to prohibit a requirement for approval by a sponsor of the transfer of a participant's interests nor shall such prohibit a restriction on transfer imposed by any regulatory body having jurisdiction over the program.
- (e) does not grant the right to every participant in the program to obtain a complete list of names and addresses of, and interests held by, all participants in the program, upon written request to the sponsor and payment of the cost of reproduction thereof, for exercise of rights under the program; and,

- (f) does not prevent the amendment of the partnership or other agreement establishing the program entity in any material respect affecting the rights or interests of the participants unless notice is previously given to all participants and, if 10 percent or more of the then outstanding unit interests object, by the affirmative vote of not less than a majority of the outstanding number of program interests.

Section 6 - Conflicts or Potential Conflicts of Interest

Permissible Conflicts of Interest

- (a) A member or person associated with a member shall not underwrite or participate in the distribution to the public of units of a direct participation program of which a member or an affiliate of a member is a sponsor which does not fully disclose all potential conflicts of interest in the prospectus and does not by its terms, in addition, conform to the following standards concerning conflicts of interest. Thus, if the program permits:
- (1) the acquisition by the program of property owned by the sponsor or an affiliate of a sponsor, except as otherwise provided herein, such acquisition by the program shall be at the lesser of original cost to the sponsor or its affiliate or fair market value as determined by an appraisal made by a qualified independent appraiser; provided, however, such an acquisition may be at a price greater than cost if all details in respect thereto, including the profit to the sponsor or its affiliate, are fully disclosed to program participants and to subsequent program subscribers; the acquisition is at no more than fair market value as determined by an appraisal made by a qualified independent appraiser and:
 - a. the property has been owned for at least a period of two years prior to the acquisition by the program; or,
 - b. a material change in the value of the property has occurred since the acquisition thereof by the sponsor or its affiliate in which case the change and the basis for the change are disclosed;
 - (2) the acquisition by an oil and gas program of non-producing acreage owned by the sponsor or an affiliate of the sponsor, such acquisition shall be at cost unless there is reason to believe that the cost is either materially in excess of, or materially lower

than, fair market value. Where property is acquired at a price other than cost the price shall be based on the opinion of a qualified independent appraiser and all details shall be disclosed with respect to the acquisition, including the profit to the sponsor or its affiliates, to program participants and to subsequent program subscribers;

- (3) the purchase of property owned by an oil and gas program by the sponsor or affiliates of the sponsor, such purchase shall be made at fair market value as determined by a qualified independent appraiser unless the sponsor has reasonable grounds to believe the cost is materially higher than fair market value, in which case the purchase shall be made for a price not less than cost;
- (4) the sale of services, other than those provided for hereafter in Section 10, or the sale or lease of supplies, equipment, furnishings or other property of any kind except as otherwise provided herein to the program by its sponsor or an affiliate of the sponsor, the program must require that the fees and prices to be charged for such services, supplies, equipment, furnishings or other property shall not exceed those customarily charged for such in the same or in a comparable geographical location by persons dealing at arms'-length and having no affiliation with the recipient; provided, however, that if there exists no basis for comparing such fees and prices or if the sponsor or its affiliate is not independently and as an ongoing business activity actively engaged in the business of rendering such services or selling such supplies, equipment, furnishings or other property, they shall not exceed cost;
- (5) the sponsor or an affiliate of the sponsor of an oil and gas program to sell or transfer property to the program, the program must also provide that the sponsor shall not retain therein any interest or rights of any kind whatsoever except those rights created by virtue of the sponsor's status as sponsor of the program and that those rights are fully disclosed in the prospectus, unless the sponsor or its affiliate is required by the program to participate with the program in the development of the property on a cost basis proportionate to its retained interest in the property;
or,
- (6) the sponsor or an affiliate of the sponsor of a real estate program to provide development or

construction of a property for the program in accordance with the terms of the program, the program shall require that:

- a. the specified terms of the development and construction of identifiable properties are ascertainable and are fully disclosed in the prospectus;
- b. such be done only on a firm contract basis at a price not to exceed the appraised value of the property when completed, including the total cost of the property as determined by a qualified independent real estate appraiser at the time of the commitment for such services; and,
- c. if the development or construction contracting is to be supplied by the sponsor or its affiliates after formation of the program, such shall be done in accordance with those provisions set forth under paragraph (4) of this section.

Impermissible Conflicts of Interest

- (b) The following situations are considered impermissible conflicts of interest; thus, a member or person associated with a member shall not underwrite or participate in the distribution of a direct participation program of which a member or an affiliate of a member is a sponsor which permits:
 - (1) in the case of a real estate program, a sponsor or an affiliate of a sponsor to be the principal or prime tenant on property owned by the program. Such shall not apply to fully guaranteed leaseback arrangements where the terms of such are considered to be fair and reasonable and no more favorable to the sponsor or its affiliate than those offered other persons;
 - (2) the rendering by the sponsor or an affiliate of the sponsor of professional services, such as the certifying of financial statements or legal opinions in connection with the organization and registration of the program, or the payment of fees for such services to the sponsor or its affiliates, except for services which may be offered in connection with the day-to-day management of the program such as legal, accounting and recordkeeping services, leasing agreements and settlement arrangements, among others;

- (3) sales or exchanges of properties or any interest therein between programs with the same sponsor, provided, however, that such sales or exchanges may be made in the case of oil and gas programs where the sales or exchanges are of nonproducing acreage, are at cost or, if there is reason to believe there has been a material change in value, at fair market value as determined by a qualified independent appraiser, are in the best interests of the program, and are between programs whose compensation arrangements with the sponsor are substantially comparable; provided, further, that this paragraph shall not apply to transactions among oil programs by which property is transferred from one to another in exchange for the transferee's obligation to conduct drilling activities on the property transferred or to joint ventures among such oil programs, provided that the compensation arrangement of the manager and each affiliated person in each such oil program is the same, or such transfer is reasonably calculated to be in the best interests of the program.
- (4) the sponsor or an affiliate of the sponsor of a program, except as otherwise provided herein, to retain any interest or rights of any kind whatsoever in property sold or transferred to the program, or, in the case of other programs, in the general area of such property, except such shall not be considered impermissible in the case of a real estate program if such is fully disclosed in the prospectus including the disclosure of any potential benefits to the sponsor and its affiliates of any conflicts of interest which could result from any type of service or supplies rendered to such properties by the sponsor or its affiliates;
- (5) the sale to the program by the sponsor or an affiliate of the sponsor of an unspecified property program of any services including development and construction contracting on any property owned by it unless any such property is specifically designated and detailed information concerning any such service and each specified property is disclosed in the prospectus;
- (6) the sale to the sponsor or an affiliate of the sponsor by the program of any property except as provided in Section 6(a)(3) hereof;
- (7) directly or indirectly, a commission or fee to a

sponsor or an affiliate of the sponsor in connection with the reinvestment of the proceeds of the resale, exchange, or refinancing of program property, except if total acquisition fees including reinvestment fees with regard to the property remain within the limitations of Section 10(h)(1);

- (8) a sponsor or an affiliate of a sponsor to have an exclusive right to sell or exclusive employment to sell property for the program; or,
- (9) loans to be made by the program to the sponsor or an affiliate of the sponsor or the commingling of program funds with the funds of the sponsor or its affiliates.

Other Conflicts of Interest

- (c) All conflicts of interest not conforming to the provisions of this Section 6 shall be considered impermissible conflicts of interest and members or persons associated with members shall not underwrite or participate in the distribution of units in a program of which a member or an affiliate of a member is a sponsor which contains such unless justification therefor, taking into consideration standards of fairness and reasonableness to participants, can be demonstrated to the Association and it accepts such provisions as being consistent therewith.

Section 7 - Suitability

- (a) A member or person associated with a member shall not underwrite or participate in the distribution to the public of units of a direct participation program unless standards of suitability have been established by the program for participants therein and such standards are fully disclosed in the prospectus and are not inconsistent with the provisions of subsection (b) of this section.
- (b) In any sale, solicitation or recommendation of the purchase of a direct participation program to a customer, a member or persons associated with a member shall:
 - (1) inform the customer of all pertinent facts relating to the liquidity and marketability of the program during the term of the investment and the tax consequences upon dissolution of the program;
 - (2) be assured on the basis of information obtained that the customer, after giving effect to all of

his direct participation investments, is reasonably anticipated to be in a tax bracket appropriate to enable him to obtain the tax benefit described in the prospectus; provided, however, that in the case of an oil and gas program, other than a program formed to acquire producing properties, the customer shall be reasonably anticipated to be in at least a 50 percent tax bracket prior to giving effect to all of his direct participation investments;

- (3) be assured that the customer has a fair market net worth sufficient to sustain the risk inherent in the program, including loss of investment and loss of liquidity of investment and that his subscription to all direct participation programs bears a reasonable relationship to his fair market net worth;
 - (4) have reasonable grounds for believing that the purchase of the program is suitable for the customer on the basis of information furnished by him concerning his investment objectives, financial situation and needs and any other information known by such member or person associated therewith; and,
 - (5) maintain in the files of the member the basis for and reasons upon which the determination of suitability was reached as to that customer.
- (c) In any instance in which a determination of suitability is made without the provisions of subsection (a) or (b) hereof being entirely satisfied:
- (1) the burden of proving justification for the determination shall be upon the member or person associated therewith making it; and,
 - (2) the member or person associated therewith who makes such a determination shall document in writing the basis therefor with particular references to its departure from the standards specified in subsections (a) and (b) hereof and retain such documentation in the files of the member.
- (d) In any solicitation or recommendation of the resale, transfer or other disposition of a direct participation program to a customer, a member or persons associated with a member shall advise the seller of all details of program interest evaluations by the sponsor and the likely tax consequences of the proposed transactions.

- (e) Notwithstanding the provisions of subsections (a) through (d) hereof, a member shall in no event execute a transaction involving a unit of a direct participation program without first receiving specific authority from the customer to do so.

Section 8 - Disclosure

In participating in the distribution of securities to the public of a direct participation program, members or persons associated therewith, shall have reasonable grounds for believing that the information made available to them by the sponsor through a prospectus or other materials is adequately and accurately disclosed so as to provide a basis for evaluating the economic merits with regard to these highly technical securities.

Members shall therefore give consideration, depending on the nature of the offering, to the items of compensation; the physical properties; the tax aspects; the financial stability and experience of the sponsor; the program's conflicts and risk factors; appraisals and other pertinent reports; and any other items of material fact.

Section 9 - Organization and Offering Expenses

- (a) A member or person associated with a member shall not underwrite or participate in the distribution to the public of units of a direct participation program if:
- (1) organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors;
 - (2) organization and offering expenses which are paid by the program of which a member or an affiliate of a member is a sponsor exceed 15 percent of the dollar amount of the cash receipts of the offering;
 - (3) sales commissions, wholesaling fees, finder's fees, consultant's fees, underwriter's counsel fees, costs of due diligence, or any other items of distributive compensation of any kind from whatever source are paid in advance of the breaking of escrow unless otherwise deemed appropriate under this section, or are not fair and reasonable in relationship to the cash receipts of the offering;
 - (4) commissions or other compensation are to be paid or awarded either directly or indirectly to any person engaged by a potential investor for investment advice as an inducement to such advisor to

advise the purchaser of interests in a particular program, unless such person is a registered broker-dealer or is considered a properly licensed person for selling program interests; and,

- (5) the program provides for compensation to be paid to members or persons associated with members for sales of program units, or for services of any kind rendered in connection with or related to the distribution thereof, in a form other than cash if of an indeterminate nature, such as, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an overriding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, or other similar incentive items.
- (b) Miscellaneous items of compensation to underwriters or dealers, or their affiliates, such as, but not necessarily limited to, underwriter's expenses, underwriter's counsel's fees, rights of first refusal, consulting fees, brokerage commissions, investor relations fees and all other items of compensation for services of any kind or description, deemed to be in connection with or related to the distribution of the offering, paid by the program directly or indirectly shall be taken into consideration in computing the amount of sales commissions to determine compliance with the provisions of subsection (a)(3) hereof.
- (c) The acquiring of warrants, options, stock or partnership interests in a sponsor or an affiliate of a sponsor in connection with an offering shall be prohibited. The determination of what is in connection with or related to an offering as referred to in subsections (a)(5), (b), and (c) shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member in the organization, management and direction of the enterprise in which the sponsor is involved. For purposes of determining the factors to be utilized in computing compensation derived from securities received prior to the filing of an offering with the Association, the guidelines set forth in the Interpretation of the Board of Governors With Respect to Review of Corporate Financing shall govern to the extent applicable.

- (d) The allowance of any sales incentive items by the sponsor, an affiliate of the sponsor or the program to any member or associated person in the form of travel bonuses, prizes or awards shall be disclosed in detail and any incentive items in excess of \$25 per person per program shall be prohibited. Any sales incentive item of \$25 or less shall be taken into consideration in computing the amount of sales commissions to determine compliance with the provisions of Subsections (a)(2) and (a)(3) of this section.

Section 10 - Sponsor's Compensation

General

- (a) A member or a person associated with a member shall not underwrite or participate in the distribution to the public of units of a direct participation program of which a member or an affiliate of a member is a sponsor;
- (1) which provides for compensation to the sponsor or an affiliate of the sponsor which is unfair or unreasonable taking into consideration all relevant factors;
 - (2) which does not have in its prospectus a summary of all compensation, direct or indirect, to be paid to the sponsor or affiliates of the sponsor in one section so entitled with a clear reference to other locations in the prospectus where more detail with respect to the various items of compensation may be found;
 - (3) unless it prohibits the payment of a fee upon the dissolution of the program in any manner inconsistent with the sponsor's sharing arrangement;
 - (4) unless it requires that any interest and fees earned on funds held for the sole account of the program shall be payable only to it; and,
 - (5) unless it prohibits receipt or disbursement of rebates or give-ups, and the participation in reciprocal business arrangements by the sponsor which are deemed inconsistent with Section 6(a)(4) above.

Oil and Gas Programs

- (b) In addition to the provisions of subsection (a) hereof,

a member or person associated with a member shall not underwrite or participate in the distribution to the public of units of an oil and gas program of which a member or an affiliate of a member is a sponsor:

Drilling Programs - Functional Allocation

- (1) a. if, in a functional allocation drilling program where the sponsor agrees to pay all capital expenditures of the program but in any case at least 10% of the total program's capital contributions, excluding any contribution made by the sponsor or its affiliates, his share of revenue is not determined by the following formula:
 - (i) if the agreement is to pay all capital expenditures but in any case a sum of not less than 10% of the capital contribution of the program, the sponsor is entitled to receive 35% of the program revenues; and
 - (ii) the sponsor's revenue sharing may be increased in additional increments of 5% for each additional 5% increase in the percentage of capital contribution agreed to be paid by him up to a maximum of 50% of revenues subject to sponsor's agreement to pay in any case all capital expenditures;
- b. unless, as an alternative to subsection (b)(1)a., the sponsor elects to receive 15% of revenues and an additional percentage of revenues determined by computing the sponsor's capital expenditures as compared to total costs associated with obtaining production, on a prospect basis, until such time as the sponsor shall have received from such additional percentage of revenues an amount equal to his capital expenditures; after which, revenues shall be distributed as follows: 15% of revenues to the sponsor and 85% of revenues to the participants until the participants shall have received on a program basis a return of their capital contributions and then, 15% plus the additional percentage of revenues shall be paid to the sponsor and the remainder to the participants;
or

- c. Unless in connection with any other possible alternatives to subsection (b) (1)a.:
- i) a promotional interest in excess of 25% on a program basis is prohibited; and
 - ii) there is a minimum commitment by the sponsor to pay at least 10% of the total program's contributions.
- (2) unless any arrangement to pay capital expenditures refers to and includes all capital expenditures for the drilling and completing of wells during the life of the program, which need not include capital expenditures for facilities downstream of a wellhead. If the sponsor should enter into farm-out or other arrangements through which only he is relieved of his obligations to pay for such capital expenditures, then the sponsor's share of revenue shall be proportionately reduced, the amount to be determined on an individual basis.
 - (3) unless, when electing a sharing arrangement as provided in subsections (1) and (2) above, the sponsor has a net worth of \$300,000 or 10% of the total contributions to the program by the participants, whichever is greater, and is under a contractual obligation to pay his pro rata share of expenses as such expenses are paid by the program and to complete his minimum financial commitment to the program by the payment of cash by the end of the third fiscal year succeeding the fiscal year in which the program commenced operations;
 - (4) unless a sponsor who does not actively participate in obtaining a significant portion of a program's wells satisfactorily demonstrates to the Association that his compensation together with the costs of procuring such services for the program from third parties does not exceed the permissible compensation to the sponsor set forth in subsections (1) and (2) above;
 - (5) unless, in the case of sharing arrangements in which the sponsor pays all development costs, exploratory wells are drilled on prospects which are reasonably expected to require developmental drilling if the exploratory drilling is successful; or
 - (6) in any program involving sharing arrangements where the sponsor does not pay his share or category of costs on a current basis.

Drilling Programs - Subordinated or Reversionary Working Interest

- (7) a. unless, as an alternative to sharing revenues on a basis related to costs paid as provided in subsections (b)(1) through (6) hereof, a sponsor of a drilling program receives a promotional interest in the form of a subordinated percentage of the working interest. The holder of a subordinated percentage of the working interest shall be entitled to receive his share of revenues only after the participants have had allocated to their respective accounts an amount determined in accordance with either one of the following alternative formulas:
- (i) an amount which reflects that the participants' share of revenues from production and other items credited to a prospect equal the sum of the costs of acquisition, drilling and development, all costs of operating the leases underlying the prospect, and an appropriately allocated portion of all other program expenses, including organizational and offering expenses; or
 - (ii) an amount which reflects that the revenues of the program equal all the expenses of the program.
- b. in the event the sponsor elects to utilize the provisions of subsection (7)a.(i), his subordinated working interest shall entitle him to receive up to 25% of program revenues. If he selects the second formula, he shall be entitled to revenues equal to 33-1/3% of program revenues. At such time as the sponsor is entitled to receive his promotional interest, he shall also bear program costs in the same ratio as he participates in program revenues.

Income or Production Purchase Programs

- (8) unless in income or production purchase programs, where a major portion of the sponsor's management and operating responsibilities are performed by third parties, the cost of which is paid by the program, the sponsor takes no more than a 3% working interest convertible to no more than a 5% working interest after the return from production to the investors of 100% of their capital contribution, computed on a total program basis.

- (9) unless, where the sponsor maintains the operating capabilities and technical staff so as to be in a position to, and in fact does, provide the program with a major part of the management and operating responsibilities of the program, the sponsor takes no more than a 15% working interest.
- (10) unless, where the individual characteristics of specific programs warrant modification from the provisions of either paragraph (9) or (10) regarding production purchase programs, such modifications are consistent with the aforesaid compensation arrangements.
- (11) unless the sponsor's interest in a program or in properties owned by a program bears a pro rata share of all costs, expenses and obligations of the program including, but not limited to, costs of operations, debt service and any other items of expense chargeable to the operation of the program. Program expenses shall be considered to include all actual and necessary expenses incurred by the program and may be paid by the sponsor out of capital contributions or out of program revenues. A sponsor may be reimbursed out of capital contributions and program revenues for all actual and necessary direct expenses paid or incurred by it in connection with its operation of a program, and for an allocable portion of its general and administrative overhead, computed on a cost basis. All overhead costs shall be determined in accordance with generally accepted accounting principles, subject to annual independent audit. Administrative and similar charges for services must be fully supportable as to the necessity thereof and the reasonableness of the amount charged. The prospectus shall disclose in tabular form an estimate of such expenses to be charged to the program showing direct expenses and general and administrative overhead shall be broken down into the various types of services and costs, with a separate breakdown for salaries to officers, directors and other principals of the sponsor and any affiliate of the sponsor: a summary of the manner in which such expenses are allocated shall be included. In addition, the prospectus shall disclose in tabular form for each program organized in the last three

years the dollar amount of the expenses so charged and allocated, and the percentage of subscriptions raised reflected thereby.

Real Estate Programs

(c) In addition to the provisions of Subsection (a) hereof, a member or person associated with a member shall not participate in the distribution to the public of units of a real estate program of which a member or an affiliate of a member is a sponsor unless:

(1) it prohibits the payment of a real estate acquisition fee in an amount exceeding the lesser of:

- a. the real estate commission customarily charges in arms'-length transactions by others rendering similar services as an ongoing business activity in the same geographical location and for comparable property; or,
- b. an amount equal to 18 percent of the gross proceeds of the offering;

provided, however, that the total cost of the property, including all prepaid items and acquisition fees whether paid by the seller or the program, shall not exceed fair market value;

(2) when the program provides for payment of a real estate brokerage commission or similar fee to be paid to the sponsor or an affiliate of the sponsor on the resale of the property by the program the commission or fee to the sponsor or the affiliate is not in excess of 50 percent of the real estate commission and is subordinated to a return of 100 percent of the capital contribution of the investor plus an amount equal to 6 percent of the capital contribution per annum on a cumulative basis, less the sum of prior distributions to the investor. To the extent that the sponsor or an affiliate of the sponsor participates with an independent broker on resale, the limitations and subordination only apply to commissions paid to that sponsor and its affiliates.

(3) it prohibits the payment of more than one real estate fee or other commission for the acquisition or sale of program properties in any transaction in which the sponsor or an affiliate of the sponsor is a participating broker;

- (4) it prohibits the payment of real estate acquisition fees, brokerage fees, or other commissions or fees of a similar nature to the sponsor or an affiliate of the sponsor except for services actually rendered by a sponsor or an affiliate licensed as a real estate broker or agent and engaged in the ongoing business of offering similar services to others;
- (5) it prohibits leasing fees or similar types of compensation from being paid by the program to the sponsor or an affiliate of the sponsor on properties leased to the sponsor or its affiliates;
- (6) it requires that mortgage placement fees to be paid to the sponsor or an affiliate of the sponsor for the arranging and financing of a property for the program be limited to no more than one fee for the financing of the same property during the property's life in the program provided, however, that fees received separately for the services of securing both a construction loan and a permanent mortgage on a property shall be deemed one fee;
- (7) it requires that property management fees to be paid to the sponsor or an affiliate of the sponsor be for services actually rendered at a rate based on a percentage of the cash receipts during the period of operation and at a price no higher than those customarily charged for similar services in the same geographical location on a similar property by a nonaffiliated person who engaged in the business of property management as an ongoing business activity;
- (8) it limits program management fees to be paid to a sponsor or an affiliate of the sponsor:
 - a. on a program owning unimproved land to annual compensation not exceeding 1/4 of 1% of the cost of such unimproved land for operating the program until such time as the land is sold or improvement of the land commences by the limited partnership. In no event shall this fee exceed a cumulative total of 2% of the original cost of the land regardless of the number of years held.
 - b. on a program holding property in government subsidized projects to annual compensation not exceeding 1/2 of 1% of the cost of

such property for operating the program until such time as the property is sold.

- c. program management fees other than as set forth in a. and b. above be prohibited.
- (9) it limits the amount of any sharing arrangement, promotional interest or similar type of compensation to be paid to the sponsor or an affiliate of the sponsor for promotional services to no more than the following:
- a. an amount equal to 25 percent of the undistributed amount remaining after payment to the investors of an amount at least equal to 100% of their original capital contributions; or,
 - b. an interest equal to:
 - 1. 10 percent of the cash available for distribution; and,
 - 2. 15 percent of distributions to investors from the proceeds of the sale or refinancing of properties remaining after payment to investors of an amount at least equal to 100 percent of their original capital contributions, plus an amount equal to 6 percent of the capital contribution per annum on a cumulative basis, less the sum of prior distributions to the investor.
- (d) The burden of demonstrating justification for levels and methods of compensation for programs in which a member or an affiliate of a member is a sponsor other than those listed in subsections (a) through (c) hereof shall be upon the person proposing such. In any event, such other levels or methods shall be comparable or equitably equivalent to those listed in subsections (a) through (c) and shall not be unfair or unreasonable taking into account all relevant factors and shall not include levels or methods of compensation prohibited by those subsections.
- (e) Income to a sponsor or an affiliate of the sponsor from any interest held as a participant in a program shall not be included in computing sponsor's compensation for purposes of this section.

Section 11 - Periodic Reports

A member or a person associated with a member shall not underwrite or participate in the distribution to the public of units in a direct participation program of which a member or an affiliate of a member is a sponsor unless:

- (a) quarterly operations reports are required by the terms of the program to be sent to all participants:
 - (1) in the case of an oil and gas program during the drilling phase of operations disclosing in reasonable detail the progress of drilling operations, the amount of production, if any, the receipt and disbursement of revenue and any other relevant information; and,
 - (2) in the case of all other programs commencing with the first full quarterly period after the activation of the program disclosing in detail the progress of the program, the receipt and disbursement of revenues and any other relevant information;
- (b) the sponsor is required by the terms of the program to send to each participant within 75 days after the close of each fiscal year audited financial statements and tax information to the extent required for the proper preparation of his income tax return;
- (c) in the case of an oil and gas program, the sponsor is required by the terms of the program to send to each participant within 90 days after the end of the second year of the program a report of the remaining proven reserve (as determined by an appraisal made by a qualified independent petroleum engineer), their present worth and a projection of the net cash distribution for the next fiscal year of the program; and,
- (d) when a sponsor or an affiliate of the sponsor is permitted by the terms of the program to sell services, supplies, equipment, furnishings or other property to the program, or if a program contemplates transacting business with any person in a material amount, the terms of the program require the audited financial statements referred to in Subsection (b) above to detail the terms of such arrangements and state the gross expenditures by the program to each such person in connection with such activity, and the gross receipts by such persons from all prior programs are disclosed in the prospectus of the current program.

Section 12 - Sales Literature

General Requirements

- (a) No member or person associated with a member shall use any sales literature or sales memoranda in connection with the offer or sale of a direct participation program which does not conform to the standards contained in this section.
- (b) No member or person associated with a member shall use any sales literature or sales memoranda in connection with the offer or sale of a direct participation program which is misleading, which contains an untrue statement of a material fact or which omits to state a material fact necessary in order to make a statement made, in light of the circumstances of its use, not misleading.
- (c) No member or person associated with a member shall make any oral statement or presentation which, if made in writing, would not conform to the standards outlined herein.

Required Content

- (d) If a sales kit or other integrated grouping of sales material is used collectively, such data may be contained in one or more pieces of sales literature except that the statement required by paragraph (7) shall be included in each separate piece of sales literature. Sales literature will be considered materially misleading if it fails to contain the data specified hereafter in paragraphs (1) through (8):
 - (1) a clear, concise statement outlining the general nature of the program being offered including a clear and accurate statement describing the program's proposed activities, including estimates of the percentages of proceeds to be applied to each of the proposed activities;
 - (2) a statement of the relevant factors of suitability for purchase of a direct participation program as contained in Section 7 above;
 - (3) a clear and accurate statement fully disclosing the amount, method, form and percentage of sales charge to the investor, based on a percentage of the gross proceeds of the offering, the management fee and any revenue sharing arrangement contained in the program, or in the alternative, a

clear reference to the location of such information in the prospectus;

- (4) a statement fully describing the assessments, if any, required of participants in the program; the purpose of the assessment, if such is an optional assessment, and the penalty, if any, which the participant would incur if he did not meet the call, or in the alternative, a clear reference to the location of such information in the prospectus;
- (5) a clear and accurate statement describing the liquidity and marketability of the program or the lack thereof;
- (6) a clear and accurate statement of the tax aspects during the term of the investment and the tax consequences at dissolution or liquidation of the program or upon the sale of a material percentage of the assets of the program, or upon the sale of an interest in the program, or in the alternative, a clear reference to the location of such information in the prospectus;
- (7) a statement that sales literature cannot be distributed to the public unless preceded or accompanied by a current prospectus; and,
- (8) a clear and accurate statement describing the three or more years of expertise possessed by or available to the sponsor as required by Section 4(a), hereof, or in the alternative, a clear reference to the location of such information in the prospectus.

Prohibited Content

- (e) Sales literature shall be considered materially misleading if such literature:
 - (1) contains hypothetical projections of income or other benefits to be received from a program except as provided hereafter or represents or implies an assurance that the investor will receive a specific, stable, continuous, dependable, or liberal return, or rate of return, unless such is guaranteed and there is reasonable assurance that the guarantor will be able to meet the obligation of such guarantee;
 - (2) represents or implies an assurance that an investor's capital will increase or will be preserved or protected against loss in value, unless

such is guaranteed by the terms of the program and there is reasonable assurance that the guarantor will be able to meet the obligation of such guarantee;

- (3) discusses or portrays in any way the appreciation or profit potential of the investment without explaining the potential risks of such investment;
- (4) makes extravagant claims regarding management ability, experience or competency;
- (5) makes any reference to registration or regulation of the securities being offered, or of the issuer, underwriter or sponsor thereof, under federal or state securities laws which could, or in any way does, constitute or imply endorsement or approval by a regulatory body;
- (6) makes any reference to the National Association of Securities Dealers, Inc. which could, or in any way does, constitute or imply endorsement or approval of the securities, the issuer, the underwriter, or the sponsor by the Association;
- (7) contains any statistical statement, table, graph, chart, or illustration without disclosing the source of the information;
- (8) contains any statement or claim of tax benefits resulting from an investment in the program without a clear statement as to the basis for such;
- (9) contains any comparison or reference to the similarities of an investment in the program with an investment in another non-affiliated program, whether similar in nature or not, or a comparison of the performance of the program with performance of any industry or property (e.g., real estate in general or the oil and gas industry), or a comparison with an investment in other securities, including investment company shares;
- (10) contains or refers to any statement of financial condition of an affiliate of a management or sponsoring organization unless such affiliate has direct financial responsibility for, or is the sponsor of, the program being offered.
- (11) contains any reference to or illustration of the possible effects of an exchange of program interests for the securities of any corporation whether

based on a hypothetical projection or an assumed exchange utilizing past market performance of the security. The provisions of this paragraph shall not be construed to prohibit the presentation of factual data regarding prior exchanges if such data is presented as part of an analysis of the results of prior programs in a manner consistent with the provisions of Subsection (f) (2) hereof regarding Oil and Gas Programs and Subsection (h) regarding Real Estate Programs, even if the program currently being offered has no exchange provisions.

Oil and Gas Programs

(f) In addition to the provisions of Subsections (a) through (e) hereof, sales literature designed to promote the sale of oil and gas programs shall be considered materially misleading unless it conforms to the provisions of this subsection.

(1) If a hypothetical illustration of the tax benefits of an oil and gas program is used, it shall conform to the following standards:

a. Illustration of Effects of Intangible Drilling Costs Deduction - An illustration of the effects of the non-capital expenditures deduction on an investment in an oil and gas program must:

1. be based on an assumed investment of \$10,000; provided, however, illustrations based upon the total value of the program or the minimum subscription commitment may also but shall not be required to be shown. The illustrations may give effect to future assessments but they must, in any event, be structured so that the total investment illustrated is \$10,000, or such other amount as is used in the additional illustrations. Programs with minimum investments higher than \$10,000 must clearly state in the illustration based on \$10,000 that that figure has been used for clarity of illustration only and that an investment below the program's minimum is not possible. Programs with minimum investments lower than \$10,000 may, if any illustration based upon

the lower amount is not also used, refer to their actual minimums but an illustration based upon \$10,000 must still be used;

2. reflect in both percentage and dollar figures, the "estimated deductible expenses" (non-capital expenditures costs of abandoned acreage and general and administrative expenses);
3. reflect the "tax savings" to the participant based on an assumed participant's federal income tax bracket of 50 percent which must be clearly stated in the illustration;
4. reflect the "net cost" to the investor (total investment minus "tax savings");
5. reflect the investor's "adjusted federal tax basis" (total investment less estimated deductible expenses);
6. illustrate the items listed in items 1. through 5. above in the same order, and using the same terminology, as they appear above;
7. contain an explanatory statement which:
 - (i) states that the illustration is hypothetical;
 - (ii) includes a description of the estimated deductible expenses;
 - (iii) states the period over which the deduction would occur;
 - (iv) states the source from which the estimated percentage deduction was obtained, that the percentage may vary and is not guaranteed; and,
 - (v) refers to the location in the prospectus where more complete information regarding the estimated deductible expenses may be found;

(Schedule I hereto is provided as a

guide to members in preparing an illustration which conforms to the above requirements.)

b. Illustration of Effects of Depletion Allowance - An illustration of the effects of the depletion allowance and/or depreciation on the taxability of income distributed to a participant from an oil and gas program must:

1. be based on one dollar (\$1) of "gross income;"
2. reflect a reasonable level of "operating expenses;"
3. reflect the "net income;"
4. reflect any "depreciation" which would be passed on to participants;
5. reflect the "tax depletion allowance" in both percentage and dollar figures;
6. reflect the "taxable income" to the investor;
7. illustrate the items listed in items 1. through 6. above in the same order, and using the same terminology, as they appear above; and,
8. contain an explanatory statement which:
 - (i) states that the illustration is hypothetical;
 - (ii) includes descriptions of depreciation and depletion allowance (specifically stating that the depletion allowance deduction is limited to 50 percent of net income);
 - (iii) includes a brief explanation of the calculation of the depletion allowance in the example; and
 - (iv) refers to the location in the prospectus where more complete information regarding depreciation allowance may be found;

- (v) depletion allowance may or may not be available to a particular investor depending upon the availability to him of the independent producers and royalty owner exemption created by the Tax Reduction Act of 1975;

(Schedule II hereto is provided as a guide to members in preparing an illustration which conforms to the above requirements.)

- c. If an illustration of either the non-capital expenditures deduction or the depletion allowance is made, an illustration of both must be made.
- (2) If an analysis of the results of previously offered programs is used, it shall conform to the following standards:
- a. General - All such analyses must:
 - 1. include the results of all programs offered within the previous five-year period from registration date if the results of any program are included. The results of programs offered more than five years prior to the date of the analysis may be included if the results of all such earlier programs are also included;
 - 2. present the results in terms of cash liquidation value and distributable cash flow and include an analysis of the results on the basis of both cash liquidation value and distributable cash flow if an analysis on the basis of either is included, unless the program has no liquidation provision; provided that the computation of such results must take into consideration the value of any exchange of stock for program interests;
 - 3. include only estimates of cash liquidation values and distributable cash flow which are based upon at least annual appraisals of oil and gas reserves made by a qualified independent petroleum engineer, whose identity is disclosed in the illustration;

4. include distributable cash flow estimates which must be based on proven reserves, whether producing or nonproducing, and actual cash liquidation values, as of the date of the illustration, calculated in accordance with a formula or terms contained in the prospectus;
5. be based on an assumed total investment of \$10,000 which must give effect to and illustrate actual assessments made for each program, provided, however, illustrations based upon the total value of the program or the minimum subscription commitment may also but shall not be required to be shown. Programs with minimum investments higher than \$10,000 must clearly state in the illustration based on \$10,000 that that figure has been used for clarity of illustration only and that an investment below the program's minimum is not possible. Programs with minimum investments lower than \$10,000 may, if any illustration based upon the lower amount is not also used, refer to their actual minimums but an illustration based upon \$10,000 must still be used;
6. be updated at least annually based on the appraisals referred to in item 3. above. More frequent revisions are permitted if based upon interim evaluations by a qualified petroleum engineer whose identity is disclosed in the illustration;
7. contain a prominent legend stating that the analysis is related solely to the results of previously offered programs and that it should not be construed as a representation that similar results will be achieved by any future program;
8. include the following items presented in the same order and utilizing the same terminology as appears below:
 - (i) "Initial Investment"
 - (ii) "Assessments"

- (iii) "Total Investment"
 - (iv) "Cumulative Deductible Expenses"
 - (v) "Adjusted Federal Tax Basis"
 - (vi) "Tax Savings"
 - (vii) "Net Cost"
- b. Analysis of Previously Offered Programs Based on Cash Liquidation Value - An analysis of the results of previously offered programs based on cash liquidation value must also include the following items presented in the same order and utilizing the same terminology as appears below:
- 1. "Cash Liquidation Value"
 - 2. "Adjusted Federal Tax Basis"
 - 3. "Taxable Gain"
 - 4. "Capital Gains Tax"
 - 5. "Net Proceeds After Tax"
 - 6. "Net Cost" (Total Investment less Tax Savings)
 - 7. "After Tax Cash Gain (Loss)"
- c. Analysis of Previously Offered Programs Based on Distributable Cash Flow - An analysis of the results of previously offered programs based on distributable cash flow must also include the following items presented in the same order and utilizing the same terminology as appears below:
- 1. "Total Net Income Paid to Participant"
 - 2. "Depreciation"
 - 3. "Depletion Allowance"
 - 4. "Taxable Net Income Received"
 - 5. "Federal Income Tax"
 - 6. "Net Income After Taxes"

7. "After Tax Cash Flow"
8. "Latest Three Months' Net Income Paid to Participant"
9. "Estimated Net Future Income to be Paid to Participant Over Next Five Years (or Remaining Life of the Program, Which-ever is Less)" so long as such presentation is not inconsistent with the provisions of federal and state securities law and is based on reports of qualified independent petroleum engineers
10. "Estimated Net Future Income to be Paid to Participant Over Remaining Life of the Program" so long as such presentation is not inconsistent with the provisions of federal and state securities law and is based on reports of qualified independent petroleum engineers

(Schedule III hereto is provided as a guide to members in preparing an analysis which conforms to the above requirements.)

Real Estate Programs

(g) In addition to the provisions of Subsections (a) through (e) hereof, sales literature designed to promote the sale of real estate programs which makes or includes a presentation on predicted future results (projections) of operations shall be considered materially misleading unless it conforms to the provisions of this subsection.

(1) General Requirements for Projections

- a. Projections shall be realistic and shall clearly identify the assumptions made with respect to all material features of the presentation.
- b. Projections shall be prepared by qualified persons or firms. Those persons or firms who participate in the preparation of the projections should be identified, together with their respective roles in such preparation.
- c. No projections shall be permitted in any sales literature or in any oral or other presentation whether formal or informal which

do not appear in the prospectus or offering circular. If any projections are included in the sales literature or oral or other presentations, all of the projections included in the prospectus or offering circular must be presented in total.

- d. Projections shall be for a period equivalent to the anticipated holding period for the property or properties in the program.
 - e. Projections shall prominently display a statement to the effect that they represent a prediction of future events which may or may not occur; that they are based on assumptions which may or may not occur; and may not be relied upon to indicate the actual results which might be attained.
 - f. The assumptions underlying tabular and numerical presentations should be fully explained and disclosed and, where appropriate, cross-referenced to relevant sections of the prospectus.
- (2) Non-Specified Property Programs. The use of projections in non-specified programs, whether contained in the offering circular, prospectus or any other advertising media, is prohibited.
- (3) Material Information for Specified Property Programs. Projections for programs where any property is specified shall include as to each property specified, at least the following information:

a. Initial Application of Funds

Gross amount of capital raised	
by the program;	xxxx
Organizational expenses;	(xxxx)
Offering expenses;	(xxxx)
Net proceeds available for	
acquisitions and operations	<u>xxxx</u>

b. Acquisition and Operations

Prepaid financial items;	xxxx
Prepaid operating expenses;	xxxx
Other fees and expenses;	xxxx
Initial principal payments;	<u>xxxx</u>

Net proceeds applied to acquisitions;	xxxx
Working capital and operating reserves;	<u>xxxx</u>
Net proceeds applied to acquisitions and operations.	<u>xxxx</u>

c. Other Financial Information

1. Mortgages and other financing separately stating as to each mortgage the material terms thereof (e.g., interest rate, maturity date, annual constant, balloon payments, lock-in period, prepayment penalties, acceleration provisions, assignability, subordination and participation);
2. Where the program develops a property, the predicted construction or development costs, including disclosures regarding contracts relating to such developments;
3. Allocation of the purchase price to the improvements, person property and loan including information on the depreciation methods, useful lives and salvage values as appropriate.

d. Operations

A proposed operating statement shall be shown for each year in the following format (unless shown to be inappropriate):

1. Scheduled gross revenues;	xxxx
Vacancy and collection loss;	<u>xxxx</u>
Effective gross revenues;	xxxx
Operating expenses;	<u>xxxx</u>
Cash flow from operations;	xxxx
Partnership administration;	xxxx
Sponsor's participation;	<u>xxxx</u>
Cash flow before debt	
service and reserves;	xxxx
Debt service;	xxxx
Reserves;	<u>xxxx</u>
Cash flow before income	
taxes	<u>xxxx</u>

2. Analysis of Cash Flow:

Cash flow before debt service and reserves;	xxxx
Interest;	xxxx
Depreciation (attach schedule);	<u>xxxx</u>
Taxable income (loss)	<u>xxxx</u>
Tax savings (cost) at various tax brackets;	xxxx
Cash flow before income taxes;	<u>xxxx</u>
Total	<u>xxxx</u>

For purposes of the foregoing, the minimum tax bracket used shall correspond to the minimum suitability standards based on combined federal and state income tax brackets. In addition the sponsor shall include projections at the combined federal and state 50 percent tax bracket and may show such additional brackets as are appropriate to the offering.

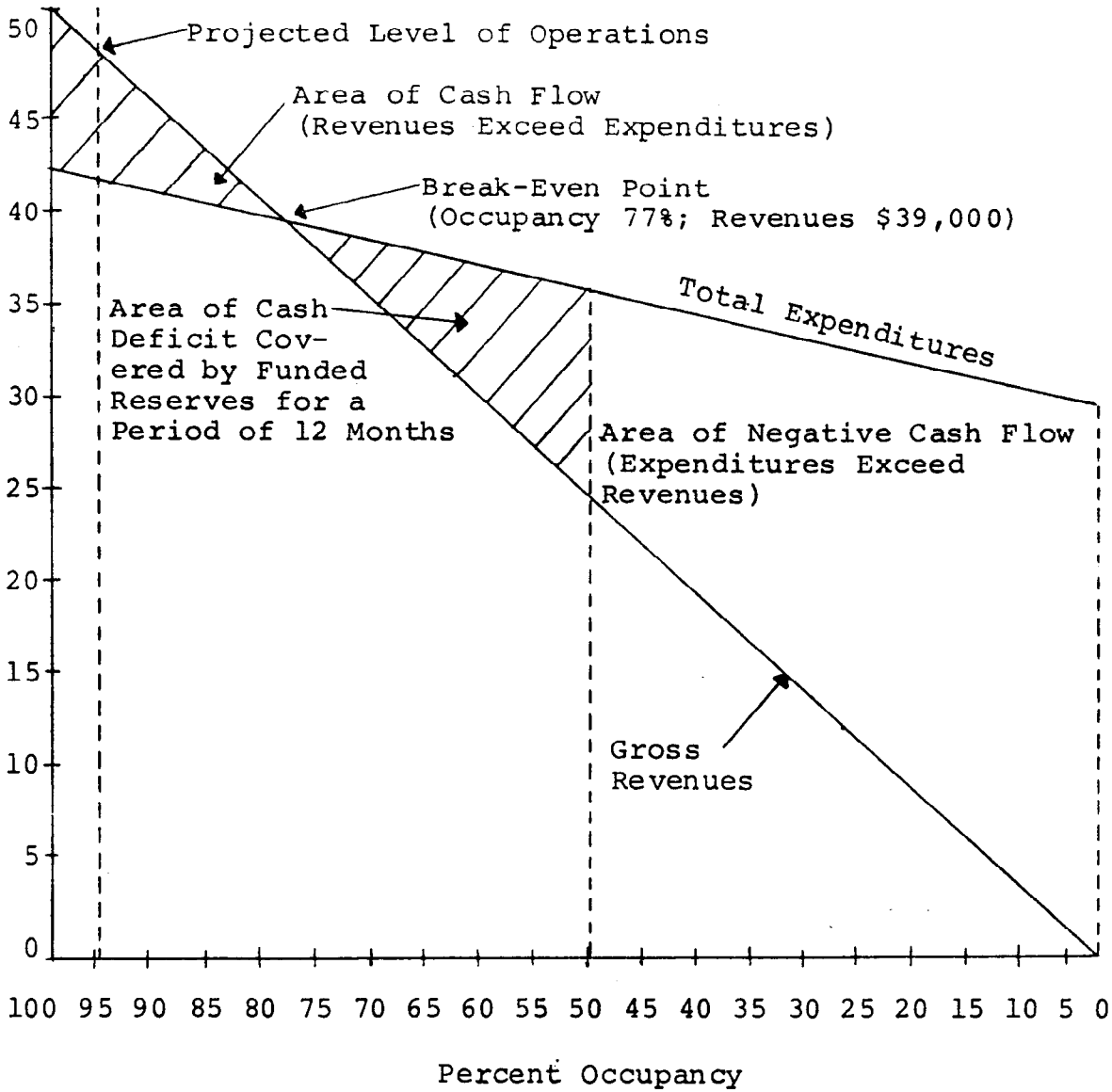
3. As part of the projections the sponsor shall include a graphic presentation for each specified property based on the proposed operating statement entitled "Projected Revenues in Relation to Occupancy Levels and Expenditures," or otherwise appropriately headed, which presentation shall include:

- Annual stabilized revenues expressed in appropriate dollar amounts at various occupancy levels in 5 percent increments from 0 percent to 100 percent;
- The level of expenditures at all occupancy levels;
- The projected revenue level;
- The break-even point.

The graphic presentation shall be in the following form:

PROJECTED REVENUES IN RELATION TO
OCCUPANCY LEVELS AND EXPENDITURES

Annual
Revenues
(000's)



e. Refinancing

Sponsor shall be required to project the effects of any anticipated refinancing. Such refinancing must be reasonable and supported by appropriate analysis.

f. Sale

1. The projections shall include a projection of the consequences of a sale of the property. The projected resale price must be reasonable. The total consideration paid for the properties shall be deemed a reasonable resale price except in special circumstances, e.g., some leasebacks, or subsidized housing. In such special circumstances, the sponsor must justify the proposed resale price by appropriate analysis of the projected financial characteristics of the property in the assumed year of sale. The presentation of the projected sale consequences shall be in the following form:

PROJECTED SALE CONSEQUENCES

	<u>Tax Bracket #1</u>	<u>Tax Bracket #2</u>	<u>Etc.</u>
Sale price;	xxxx	xxxx	
Costs of sale;	xxxx	xxxx	
Net selling price;	xxxx	xxxx	
Taxable gain (loss) on sale with ordinary income and capital gain on each sale separately stated;	<u>xxxx</u>	<u>xxxx</u>	
	<u>Tax Bracket #1</u>	<u>Tax Bracket #2</u>	<u>Etc.</u>
Net sales proceeds;	xxxx	xxxx	
Less sponsor's participation in net sales proceeds;	<u>xxxx</u>	<u>xxxx</u>	
Net sales proceeds distri- butable to investors;	xxxx	xxxx	
Income tax liability;	<u>xxxx</u>	<u>xxxx</u>	

Net after tax proceeds to investors;	<u>xxxx</u>	<u>xxxx</u>
Discounted rate of return (internal rate of return) or other comparable measure of performance	xxxx	xxxx

For purposes of the foregoing, the assumed tax brackets shall be the same as those tax brackets assumed for projection of operations. The discounted rate of return or other comparable measure of performance shall be disclosed for each assumed tax bracket. The discounted rate of return (internal rate of return) is defined as that interest rate which equates the present value of the after tax cash inflows to the present value of the investment.

2. The projections shall include a sensitivity table showing discounted rate of return or other comparable measure of performance under various operating and sale assumptions for the various combined federal and state income tax brackets which have previously been used in the projections. The table shall be in the following form:

SENSITIVITY TABLE

Discounted Rates of Return or Other Comparable Measure of Performance for the Performance Levels and Tax Brackets Shown

Performance Level	_____ %	_____ %	_____ %	_____ %
		<u>Tax Brackets</u>		

-
1. As Projected
 2. Disposition without equity
 - a. No cash flow - sale at mortgage balance in the projected year of sale
 - b. No cash flow - sale at mortgage balance half way through the originally projected holding period

- 3. 50 percent of projected cash flow with the sale price determined by a capitalization rate¹ based on that level of operating income - sale in projected year of sale
- 4. 150 percent of projected cash flow - sales price determined by a capitalization rate¹ based on that level of operating income - sale in projected year of sale

------(End of Sensitivity Table)-----

3. Where the net sales proceeds resulting from any of the sales assumed on the foregoing chart are less than the tax liability resulting from such sales, that fact shall be so stated as to each such sale as a specific dollar figure per thousand dollar investment.

(4) Material Information for Unimproved Land. Projections for unimproved land programs shall include all of the following information:

a. Initial Application of Funds

Gross amount of capital raised by program;	xxxx
Organizational expenses;	(xxxx)
Offering expenses;	(xxxx)
Net proceeds available for acquisitions and operations.	<u>xxxx</u>

b. Acquisition Expenditures

Prepaid financial items;	xxxx
Prepaid operating expenses;	xxxx
Other fees and expenses;	xxxx
Initial principal payments;	<u>xxxx</u>
Net proceeds applied to acquisitions;	xxxx

¹ The capitalization rate to be used is the rate computed by reference to the original total consideration (rather than contract price) for the property unless a lower capitalization rate can be justified.

Working capital and operating reserves;	<u>XXXX</u>
Net proceeds applied to acquisitions and working capital and reserves.	<u>XXXX</u>

c. Other Financial Information

Mortgages and other financing separately stating as to each mortgage, the material terms thereof (e.g., interest rate, maturity date, annual constant, balloon payments, lock-in period, prepayment penalties, acceleration provisions, assignability, subordination and participation).

d. Holding Costs

1. Operations:

Gross revenues;	XXXX
Taxes;	XXXX
Insurance;	XXXX
Maintenance and repairs;	XXXX
Debt service;	<u>XXXX</u>
Cash requirements (cash investment)	<u>XXXX</u>

2. Analysis of Cash Flow:

Cash investment;	XXXX
Add: equity build up;	XXXX
Less: depreciation (attach schedule);	<u>XXXX</u>
Taxable income (loss)	<u>XXXX</u>

Tax Savings (detriment):

Tax Savings (liability) for various tax brackets;	XXXX
---	------

Cash investment before taxes;	<u>XXXX</u>
Net cash investment	<u>XXXX</u>

3. Sale

The projections shall include a projection of the consequences of a sale of the property. The minimum sales price shall be the total consideration paid for the property, plus the necessary increase to cover all holding costs and thereby

achieve a sale of the property at a break-even price. All projections of sales shall be based on a minimum holding rate of at least 5 years. The projections shall include information as to the timing of the sale as well as the sale price.

4. Rate of Return

The projections shall include a schedule of anticipated discounted rate of return or other comparable measure of performance over the life of the program.

- (h) If an analysis of the results of previously offered programs is used, it shall include the results of all programs within the past five (5) years from the registration date, be disclosed in both the prospectus or offering circular and the sales literature, be summarized in tabular form, be consistent with the requirements established by the Securities and Exchange Commission and/or the regulations of the state(s) under which the program has been qualified, and shall in addition conform with the provisions of subsection (b) of Section 12.

SCHEDULE I

Hypothetical Illustration of Tax Treatment of a
\$10,000 Investment in an Oil and Gas Program

Initial Investment	\$ 7,000	
Assessments	<u>3,000</u>	
Total Investment	\$10,000	
Estimated Deductible Expenses (70%)		(\$7,000)
Tax Savings (based on participant's federal income tax bracket of 50%)	<u>(\$ 3,500)</u>	<u> </u>
Net Cost	\$ 6,500	
Adjusted Federal Tax Basis		\$3,000

This illustration is hypothetical and should not be construed as a guarantee of the amount or percentage of expenses which will be deductible. The estimated deductible expenses illustrated represent costs associated with drilling which are deductible under federal income tax law, such as non-capital expenditures, acquisition expenses of abandoned acreage and overhead expenses. The above illustration reflects an investor's net cost in "after-tax" dollars, assuming a 70 percent expense write-off in the first year of the program; however, actual deductible expenses may be more or less than 70 percent depending on drilling results. It is estimated by tax counsel that deductible expenses in the year 19__ will approximate 70 percent to 80 percent of the initial investment. The illustration does not give effect to possible taxable income to the participant which would reduce the tax benefits illustrated. Please refer to page __ of the prospectus for further information.

NOTE: Schedules I, II, and III are presently being modified to reflect the necessary tax changes as a result of the Tax Reform Act of 1976.

SCHEDULE III

Analysis of XYZ Exploration Co., Inc., Programs Return
to Participants in 50 Percent Federal Tax Bracket as of

This is an analysis of the results of previously offered programs and should not be construed as a representation that these or similar results will be achieved by any future program.

<u>Analysis of a \$10,000 Investment in Each Program Assuming a 50% Federal Income Tax Bracket:</u>	<u>1969</u> <u>Program</u>	<u>1970</u> <u>Program</u>	<u>1971</u> <u>Program</u>	<u>1972</u> <u>Program</u>	<u>1973</u> <u>Program</u>	<u>1974</u> <u>Program</u>	<u>1975</u> <u>Program</u>	<u>1976</u> <u>Program</u>	<u>Total All</u> <u>Programs</u>
Initial Investment	\$ 7,000								
Assessments	3,000								
TOTAL INVESTMENT	\$10,000								
Cumulative Deductible Expenses (a)	(7,000)								(a) Total of actual deductible expenses incurred since inception of program. (Actual deductible expenses for the first year of each program may also be reflected as a part of this footnote.
Adjusted Federal Tax Basis	3,000								
Tax Savings	3,500								
NET COST (total investment less tax savings)	\$ 6,500								
<u>Cash Liquidating Value</u>									
Cash Liquidation Value (b)	\$ 7,000*								(b) Based on appraisals of oil and gas reserves made by a qualified independent petroleum engineer.
Adjusted Federal Tax Basis	(3,000)*								
Taxable Gain	<u>\$ 4,000</u>								
Capital Gains Tax (based on an assumed liquidation by a taxpayer paying a capital gains rate of 25%)	(1,000)*								
NET PROCEEDS AFTER TAX	\$ 6,000*								
NET COST	\$ 6,500*								
AFTER TAX CASH GAIN (LOSS)	<u>\$ (500) *</u>								
<u>Cash Flow</u>									
TOTAL NET INCOME PAID TO PARTICIPANT	\$ 8,000								* Where program interests have been exchanged for stock, these lines would be blank, footnoted to an explanation of the terms of the exchange; where some program interests have been exchanged and others remain outstanding, two columns would be required showing the alternative results. Any data on an exchange of stock must conform to the requirements of Section 9(f)(2)a.2.
Depreciation	(2,240)								
Depletion Allowance**	(2,347)								
TAXABLE NET INCOME RECEIVED	<u>\$ 3,413</u>								
Federal Income Tax (50% federal income tax bracket)	<u>\$ 1,706</u>								
NET INCOME AFTER TAXES (exclusive of tax-free income)	<u>\$ 1,707</u>								
AFTER TAX CASH FLOW (depreciation and depletion allowance plus net income after taxes)	<u>\$ 6,000</u>								
Latest Three Months' Net Income Paid to Participant	<u>\$ 500*</u>								** Assuming gross income of \$10,667 and operating expenses of 25 percent, depletion allowance would be as shown.
Estimated Net Future Income to be Paid to Participant Over Next 10 Years (or remaining life of program, whichever is less) (b)	<u>\$10,000*</u>								
Estimated Net Future Income to be Paid to Participant Over Remaining Life of Program (b)	<u>\$15,000*</u>								

NOTE: Schedules I, II and III are presently being modified to reflect the necessary tax changes as a result of the Tax Reform Act of 1976.

SCHEDULE II

Hypothetical Illustration of Tax Treatment of Cash Flow
in an Oil and Gas Program on a Per \$1.00 Basis

Gross Income		\$1.00
Operating Expenses		<u>(.25)</u>
Net Income		.75
Depreciation	.10	
Tax Depletion Allowance (22% of gross income)	<u>.22</u>	<u>(.32)</u>
Taxable Income		\$.43

In this example, of \$.75 net income, \$.32 is tax free due to the depletion allowance and depreciation, leaving \$.43 taxable income, which, combined with the \$.32 tax free amount, results in a total net to the participant of \$.535 per \$1.00 gross income to the program.

This illustration is hypothetical and should not be construed as a guarantee that there will be income from the program or that there will be any specific level of income or expenses. The illustration is designed to show the advantages of the tax shelter provided by the depletion allowance and depreciation on the income earned by the program, if any. Since oil and gas are "depletable assets," i.e., eventually the supply will be completely exhausted by production, the federal income tax law permits, as an allowance for depletion, 22 percent of gross income (but not more than 50 percent of net income) to be earned tax free. This allowance commences when commercial production of a well begins and continues for the life of the well. Please refer to page ___ of the prospectus for further information.

NOTE: Schedules I, II, and III are presently being modified to reflect the necessary tax changes as a result of the Tax Reform Act of 1976.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

March 21, 1978

TO: All NASD Members

RE: San Francisco Investment Corporation
576 Sacramento Street
San Francisco, California 94111

ATTN: Operations Officer, Cashier, Fail-Control Department

On Thursday, March 16, 1978, a SIPC trustee was appointed for the above-captioned firm. Members may use the "immediate close-out" procedures as provided in Section 59(i) of the NASD's Uniform Practice Code to close-out open OTC contracts. Also, MSRB Rule G-12(h)(iv) provides that members may use the above procedure to close-out transactions in municipal securities.

Questions regarding the firm should be directed to:

SIPC Trustee
Patrick A. Murphy, Esquire
Cowans & Murphy
2600 Bank of America Center
San Francisco, California 94104
Telephone (415) 398-4700

Bradford M. Patterson
Financial Specialist