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2003-25-329  
A-ECM-EC1

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May 30, 2003

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Ladies and Gentlemen:

We are acting as counsel to EnergyNet.com, Inc. ("EnergyNet"), a Texas corporation with principal offices in Amarillo, Texas. EnergyNet desires to operate an online web-based Internet auction dedicated to the buying and selling of oil, gas and other mineral interests. On behalf of EnergyNet we respectfully request that the Division of Securities concur with our view that EnergyNet, its officers, directors and employees may in the future operate the auction according to the factual representations hereinafter set forth, without registering or becoming licensed as a broker, dealer or salesman under COLO. REV. STAT. Title 11 Article 51 (the "Colorado Act"), on the grounds that either (1) the interests to be sold do not constitute "securities", under the Colorado Act, or (2) registration as a broker, dealer or salesman is not required for the type of transaction to be entered into. EnergyNet has provided us with and has authorized us to make on its behalf the factual representations set forth below.

1. **Background.** There are two basic theories under which oil, gas and other mineral interests may be considered securities: (1) under investment contract principles; and (2) through the fractionalization of oil, gas and mineral interests. We request the Division of Securities issue a no action letter pursuant to Colorado Act that the transactions in connection with EnergyNet's proposed auction plan as described below will not involve the offer or sale of a security within the meaning of COLO. REV. STAT. § 11-51-201, because they involve neither the elements of an investment contract nor the creation of interests through fractionalization. The proposed plan for EnergyNet's transactions and the basis for the request are outlined below.

2. **Statement of Facts.** The following conditions will generally apply to the auctions:

(a) EnergyNet proposes to conduct auctions of various oil, gas and other mineral interests in properties owned by third parties and situated throughout the United States. The properties offered in each auction will be owned by one seller, and will be offered and sold to the highest bidder. The offer of the property and the bids will be communicated through an online system and the sale will be complete when the auction closes at a predetermined date and time. The

sales price of a property may range from \$100 to \$1,000,000 or more. The gross proceeds of a single auction may be as large as several million dollars. Because the auctions are conducted online, properties and bidders may be located anywhere in the United States.

(b) EnergyNet will establish suitability requirements for its bidders. Before being allowed to view property details, a potential bidder will be required to acknowledge an "Agreement and Statement Concerning Property Review Listing." In addition to the "Agreement and Statement Concerning Property Review Listing," prior to bidding on a property, a bidder will be required to complete a buyer's agreement and credit certification process through EnergyNet. The suitability requirements established by EnergyNet will be equivalent to qualification of "accredited investors" under Regulation D promulgated under the Federal Securities Act of 1933 (the "1933 Act"), or, alternatively "qualification" relating to sophistication and/or experience in prior oil and gas investments, including satisfaction of applicable "industry participant" exemptions, under the Colorado Act. The purpose of EnergyNet's qualification process will be to assure the financial ability of a successful bidder to pay for the properties upon conclusion of the auction.

(c) Before bidding, all prospective purchasers will be required to complete and execute Bidder Registration forms which include (i) an Acknowledgment, (ii) Buyer's Agreement and (iii) an Investment Profile. The forms will be approved by EnergyNet before prospective purchasers may receive a bid allowance. During the bidder certification process, a bidder will be required to disclose banking information, and EnergyNet will verify with the disclosed institutions the bidder's funds available for investment.

(d) The oil and gas properties to be auctioned:

1. may include any or all of the following: mineral interests, working interests, royalty and overriding royalty interests, operations and operating interests, reversionary interests, and fee interests in oil and/or gas properties, and may be producing properties, nonproducing properties, properties with additional development potential, properties without additional development potential, shut-in properties and other interests. Said interests are hereinafter referred to as "properties."
2. will not be subject to any geographical restrictions and may be any size of interest;
3. may be offered without warranty as to production, title or condition, on an "as is" basis; and
4. will be sold subject to any existing operating agreements, production purchase agreements, farmout agreements or other contracts or existing encumbrances or title defects, if any.

(e) The following information generally will be provided (subject to the purchaser's verification through its own due diligence) by the seller with respect to each property:

1. location;
2. well name (if any);
3. size, type, and legal description of interest offered;
4. average oil and/or gas production per day (if a producing property);
5. name of the operator (if any); and
6. name of the seller, and seller's contact information.

Certain additional information provided by the seller concerning cash flow and production history with respect to producing properties will generally be available to prospective purchasers directly online; however, EnergyNet will not have independently verified such information, and potential bidders will be so informed.

In addition to the foregoing, in every direct mail brochure sent to prospective purchasers (see paragraph (k)(1), below), EnergyNet will provide the URL of the EnergyNet website. From the website, prospective purchasers will be able to obtain information with respect to liens, drilling records, plugging reports, production reports, decline curves, etc.

(f) A seller will be required to offer its entire ownership of the type of interest in the property that is being offered for sale, but may retain a royalty, overriding royalty, or horizontal severance of the subject property (where the seller retains all of its existing or rights in certain formations or depths under the whole property, or adjacent acreage), without additional fractionalization, and there may be only one purchaser for each individual property. Specifically but not by way of limitation, the seller will not be permitted to retain a portion of any working interest being offered, or an operating position regarding any working interest being offered. The seller must also represent in writing that there are no contractual provisions with respect to the property, except as are customary in the industry, which would limit the control of the buyer over the property. Future developmental potential of the properties will not be emphasized to prospective buyers; however, possible potential undrilled locations, zones located "behind pipe" and other similar information may be pointed out.

(g) The seller or EnergyNet will record and/or deliver to the purchaser for recording the conveyancing documents or notices in favor of the purchaser. The purchaser will be charged a recording fee by EnergyNet for each assignment to be recorded.

(h) All payments for properties will be placed with an unaffiliated bank serving as escrow agent.

(i) EnergyNet will receive a commission not to exceed 10%, based on the sales price of the properties sold, to be paid by the seller. [EnergyNet is a licensed auctioneer in Texas, and by reciprocity, in Colorado]

(j) Expenses of notification and promotion of an auction, which include a brochure listing the properties and the sale date, and website administration expenses, will be paid by EnergyNet.

(k) Notice and promotion of each auction generally will be by means of the following:

1. direct mail brochures to qualified persons and entities actively engaged in the oil and gas industry on EnergyNet's mailing list.
2. publication of notices in various trade journals, whose subscribers generally are members of the oil and gas industry, such as Oil and Gas Journal. There will be no advertising to the public in general circulation newspapers or other publications which are not industry trade journals relating to oil, gas or other minerals.

(l) EnergyNet will not perform activities traditionally associated with securities brokers, dealers and salesmen. Specifically, but not by way of limitation, EnergyNet will not recommend specific properties to customers or potential bidders; EnergyNet will not assist in developing content for any of the disclosure materials, all of which will be prepared exclusively by the seller; and EnergyNet will not explain, interpret or otherwise discuss sellers' disclosures with any potential bidder or the suitability of any proposed purchase. EnergyNet may advise customers or bidders registered with EnergyNet that certain properties are to be auctioned; and may assist sellers in formatting disclosure materials for display on EnergyNet's website.

**3. Legal Basis For The Request.** In our opinion, the offer and sale of oil and gas properties by EnergyNet (as internet auctioneer) as discussed above will not involve the offer or sale of a security. Oil, gas and other mineral interests are real estate interests, and have traditionally been considered "securities" only in certain narrow circumstances; specifically, (i) where the interests sold constitute an "investment contract" because of the overall nature and character of the investment; and (ii) where the oil, gas or other mineral interests owned have been fractionalized by the owner, for purpose of resale to multiple purchasers. The basis for our position that EnergyNet's proposed activities will not constitute the offer or sale of a security is therefore twofold: (i) since EnergyNet's transactions do not contain all the elements of an investment contract, they are not investment contracts under the 1933 Act, and should not be considered investment contracts under COLO. REV. STAT. § 11-51-201 of the Colorado Act; and (ii) EnergyNet's transactions do not involve a sale of (or the creation of) fractionalized interests, are not "fractional undivided interests in oil, gas or other mineral rights" within the meaning of Section 2(a)(1) of the 1933 Act, and should not be deemed to be "securities" as defined in COLO. REV. STAT. § 11-51-201 of the Colorado Act. In summary, EnergyNet's proposed transactions will involve the sale of real estate and should not be considered the offer or sale of a security because they neither contain the elements of an investment contract, nor do they involve fractionalization of oil, gas and mineral interests.

Our position is supported by federal cases interpreting securities statutes and is detailed as follows:

**EnergyNet's transactions will not contain the elements of an investment contract. Therefore, EnergyNet's transactions will not involve an investment contract constituting a security:**

The test of an investment contract is whether the transaction involves an investment of money in a common enterprise with profits to come solely from the efforts of others. *SEC v. W.J. Howey*, 328 U.S. 293 (1946). The transaction discussed above should not be deemed to be an investment contract for the following reasons: (i) there is not a common enterprise because there is only one purchaser of each property; (ii) there is no reliance on the efforts of others because the seller will not be associated with the properties after their sale in any supervisory or management capacity; and (iii) there is no emphasis on the efforts of others that will make the properties more valuable. *Ballard & Cordell Corp. v. Zoller & Danneberg*, 544 F.2d 1059 (10<sup>th</sup> Cir. 1976).

In *Ballard & Cordell v. Zoller & Danneberg*, the court held that the sale of undivided working interest in two producing wells was not the sale of an investment contract. The company that purchased the working interest had been previously engaged in the oil and gas business for approximately three years at the time of the sale. It operated wells, participated in drilling operations and acquired oil and gas properties, including producing acreage. The seller sold its entire working interest in the wells and an unrelated third-party served as operator of the wells. Because the seller would have no interest in the wells after the sale, the trial court found, and the Court of Appeals agreed, that there would be no common enterprise between the two. In addition, under the operating agreement, the purchaser had the right to limited participation in the operation of the wells and, in light of the purchaser's experience in oil and gas production and exploration, the purchaser had the ability to actually exercise its rights with respect to the operation of the wells. Each Seller in the EnergyNet auctions is required to sell 100% of its ownership interest in the property being sold (except for the possible retention of royalty, overriding royalty, or other non-participating, non-working, passive interest) and only one purchaser must buy all of the offered interest in that property on an "as is" basis. Further, no seller will have any contractual relationships with the purchaser (such as management, etc.) after the sale. Consequently, there should not be any "common enterprise" or "reliance on the efforts of others" which are required for an "investment contract".

In *Woodward v. Wright*, 266 F.2d 108 (10<sup>th</sup> Cir. 1959), the seller retained an interest in the lease and became the operator after the purchasers acquired their interest in the lease. However, the purchasers owned the controlling interest in the property and controlled its operation even to the point of terminating the seller as operator when they became dissatisfied with his efforts. The court held this relationship did not create an investment contract. This case supports the conclusion that the properties sold through EnergyNet are not investment contracts because when the properties are sold they are not subject to additional limitations, imposed by the seller, on the purchaser's right to exercise actual control over the properties.

In *SEC v. C.M. Joiner Leasing Corp.* 320 U.S. 344 (1943), the Supreme Court held that the sale of oil and gas leases accompanied by the representation that the seller would drill a well in the general area which would enhance the value of the lease involved the sale of an investment contract. The court stated that the drilling of the well was not an unconnected or uncontrolled phenomenon merely pointed out by the seller, instead it permeated the whole transaction. However, if the sellers had omitted the economic inducements of the promised exploration well, the court stated it would have been a quite different proposition. In that case the purchasers would have been left to their own efforts in order to profit from the leases. This is the case with respect to the EnergyNet auctions where properties are sold on an “as is” basis, without any additional economic inducement on the part of the seller. In the EnergyNet auctions the purchasers are clearly left to their own devices to realize a profit from the properties they purchase. This fact is disclosed to potential bidders in the Buyer’s Agreement.

In *Deutsch Energy Co. v. Masur*, 813 F.2d 1567 (9<sup>th</sup> Cir. 1987), the purchasers contracted to buy producing wells and undeveloped drill sites from the sellers, and the parties agreed to enter into an operating agreement designating a third party as operator, under which the purchasers would retain significant managerial powers, including the power to veto any decision by the sellers to replace the operator or to abandon wells as dry holes. The court found there was no investment contract.

Also, the proposed sales by EnergyNet will not involve a pooling of funds for the joint benefit of the owners of the property. Nor will the success of the transaction be dependent upon the development of the property. Additional favorable facts for avoiding “investment contract” characterization include: (i) full information or access to information concerning the property will be provided to the purchaser; and (ii) the purchaser will be free to actually participate in the development and operation of the property consistent with the nature of the interest in the property that is purchased.

**Since the oil and gas properties offered for sale by EnergyNet will not involve fractionalized interests, they should not be deemed securities within the meaning of the Colorado Act:**

A good deal of case law has evolved under the definitional provisions of the 1933 Act. The 1933 Act defines a security as a “fractional undivided interest in oil, gas or other mineral rights.” Section 2(4) of the 1933 Act limits the term “issuer” to only the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering. In construing fractionalized interests under the 1933 Act, it has been held that only that interest which is created by subdivision of a portion of the owner’s interest for the purpose of a public offering for sale is a security. *Lynn v. Caraway*, 252 F. Supp. 858 (W.D. La. 1966). Thus it is the creation of fractionalized interests for sale, not the owner’s ownership interest, that constitutes a “security.”

Also, if the seller transfers the whole of what he owns, there can be no creation of a fractional undivided interest in oil and gas, even though what he sold was a fractional or partial interest in the fee. *Woodward v. Wright*, 266 F.2d 108 (10<sup>th</sup> Cir. 1959). Even if the seller does not transfer the whole of what he owns, a security may not be created. For example, in *Graham v. Clark*, 332 F.2d 155 (6<sup>th</sup> Cir. 1964), the court held that the transfer of all the seller’s interest in an oil and gas lease

and the producing wells situated thereon was not a security, notwithstanding the reservation of an oil payment to be paid out of the working interest that was sold. In addition, in *Fearneyhough v. McElvain*, 598 F.Supp. 905 (C.D. Ill. 1984), a landowner's lease of all of its oil and gas rights was held not to be a security, notwithstanding the reservation of a standard 1/8 landowner royalty interest.

Therefore, although certain interests may be retained by the sellers, as noted in paragraph 4 of the Proposed Facts, the oil and gas properties to be offered for sale by EnergyNet should not be deemed to be fractionalized interests which would be securities within the meaning of COLO. REV. STAT. § 11-51-201.

4. **Conclusion.** We believe EnergyNet's business plan as described in this letter, under the authorities cited herein, will not involve an offer or sale of a security under the Colorado Act. Owners offering Properties for sale will not be permitted to fractionalize their interests for sale, will not retain any interest that would be a fractional undivided interest in the Properties offered for sale, and will not retain any control over the management or development of the Properties. The sale of Properties at auction under these circumstances will not involve "an investment of money in a common enterprise with profits to come solely from the efforts of others." *SEC v. W.J. Howey Co.*, *supra*, 328 U.S. 301, 66 S.Ct. 1104. Any promise of future development through the efforts of the owner of the Properties will not be permitted and would be contrary to the representations and warranties required of the owner. Further, there will be neither a "common enterprise" nor reliance on the efforts of others.


Permitting the owners to retain an interest in a separate horizontal zone which is distinguishable from any of the zones being conveyed, or sever and sell only the wellbore, would constitute a retained ownership, and as such would not be an undivided fractional interest. It is not a form of individual or concurrent ownership in the whole. Further, allowing owners to retain overriding royalties would not create either an investment contract or an undivided fractional interest. *Robertson v. Humphries*, [1979-1980 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 97,283 (10th Cir.1978).

In our opinion, EnergyNet's proposed transactions should not be considered the offer or sale of a security because they will neither contain the elements of an investment contract, nor will they involve fractionalization of interests. On the basis of the foregoing we respectfully request the staff, based on our opinion that the auction of Properties in the manner described herein does not involve an offer or sale of a security, advise us that the staff will not recommend any enforcement if Properties are sold in the manner described herein.

If it would be helpful to have any additional information or to clarify any of the comments made herein, please contact me. I will be happy to discuss these matters by telephone and will respond promptly to any requests for additional information.

Very truly yours,

**SANDERSBAKER PC**



Edward L. Morris

ELM/ms

# STATE OF COLORADO

## Division of Securities

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July 1, 2003

Edward L. Morris  
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**RE: EnergyNet.com, Inc.**  
**File Nos. A-004-001 and OP-2004-25-329**

Dear Mr. Morris:

The staff of the Division of Securities ("Staff") is in receipt of your letter dated May 30, 2003, regarding the above-referenced matter. As counsel for EnergyNet.com, Inc. ("EnergyNet"), you request the Staff confirm that EnergyNet, its officers, directors, and employees need not be licensed as a broker-dealer or sales representatives, as may be, in order to engage in the transactions described in your letter since these transactions do not constitute the offer or sale of a "security" as that term is defined under the Colorado Securities Act ("Act"), §11-51-201(17), C.R.S., or, alternatively, that such licensing is not required under the Act for the type of transactions described in your letter.

According to the representations in your letter, we understand that EnergyNet proposes to operate an online web-based Internet auction dedicated to the purchase and sale of oil, gas, and other mineral interests in properties owned by third parties and situated throughout the United States. The properties offered in each auction will be owned by one seller, and will be offered to the highest bidder through the online system.

The properties in question may include mineral interests, working interests, royalty and overriding royalty interests, operations and operating interests, fee interests in oil and/or gas properties, or any combination of such interests. These properties may further be producing or nonproducing properties, and properties with or without additional development potential. While the seller will be required to offer its entire ownership in the type of interest in the specific property, the seller may retain a royalty,

Edward L. Morris  
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overriding royalty, or horizontal severance of the subject property, without additional fractionalization. Further, there may be only one purchaser for each individual property.

EnergyNet proposes to establish suitability requirements for bidders/purchasers. These requirements will be equivalent to the qualification of "accredited investors" under Regulation D promulgated by the United States Securities and Exchange Commission ("SEC") under the Federal Securities Act of 1933, or, alternatively, "qualification" relating to sophistication and/or experience in prior oil and gas investments, including satisfaction of applicable "industry participant" exemptions under the Act. We understand the purpose of this qualification process by EnergyNet is to assure the financial ability of a successful bidder to pay for the properties upon conclusion of the auction.

Based on the representations and facts in your letter, the Staff cannot confirm that the online auction and transactions related thereto proposed by EnergyNet will not constitute the offer and sale of a "security" under the Act. Section 11-51-201(17), C.R.S. provides, in pertinent part, that a "security" means "...certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such title or lease..." The description of the properties and related interests to be auctioned as contained in your letter appears to fall within the statutory definition of "security" under the Act.

Since the proposed online auction would ostensibly involve the offer and sale of a security, EnergyNet would be required to comply with the registration, licensing, and anti-fraud provisions of the Act. In connection with oil and gas auctions, Division Rule 51-3.10, promulgated under the Act, provides a transactional exemption from the securities registration requirements of the Act relative to the offer and sale by auction of "interests in or under oil, gas, or mining leases, fees, titles, including real property from which the interests have not been severed, or contracts relating thereto." The Rule contains various requirements that must be met in order for the exemption to be available, including that all offers and sales by auctions of interests be conducted by a Colorado licensed broker-dealer registered with the SEC and a member of the National Association of Securities Dealers, Inc. While we understand EnergyNet is a licensed auctioneer in Texas, it would nonetheless be required to comply with the requirements under the Rule, or otherwise under the Act, in order to offer and sell the interests described in your letter at auction in Colorado. In the absence of compliance with the Act, the Staff would recommend to the Securities Commissioner that formal enforcement proceedings be initiated against EnergyNet, its officers, directors and employees for violation of the Act in connection with the offer and sale of oil, gas and other mineral interests as described in your letter.

It should be noted that by this letter, the Staff only expresses its opinion as to the recommendation of formal enforcement proceedings under the Act and does not purport to express any formal opinion or conclusion. Also, it should be noted that the position taken is done so based on the facts as presented, and any change in those facts or circumstances described might require a different response.

Edward L. Morris  
July 1, 2003  
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If there are any questions, please contact the undersigned.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard Djokic".

Richard Djokic  
Deputy Securities Commissioner