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ARIZONA CORPORATION COMMISSION

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VICTOR RODARTE
ACTING DIRECTOR

SECURITIES DIVISION
1300 West Washington, Third Floor
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May 14, 1997

David M. Smart, President
EBCO Resources, Inc.
P.O. Box 32697
Oklahoma City, Oklahoma 73123

RE: EBCO Resources, Inc./EBCO U.S.A., Incorporated
A.R.S. § 1801(22)

Dear Mr. Smart:

On the basis of the facts set forth in your letter of April 23, 1997, and in reliance upon the opinion of counsel dated April 23, 1997, the Securities Division will not recommend enforcement action for violation of the Securities Act of Arizona (the "Act") should the transaction take place as set forth in your letter.

As this position is premised upon the facts set forth in your letter, it should not be relied on for any other set of facts or by any other person.

As the proposed transactions do not constitute "securities" for purposes of the registration requirements of the Act, the anti-fraud provisions of the Act are not applicable. To the extent that the transactions do not take place as describe in your letters, or a material change in circumstances cause the proposed transactions to be deemed "securities" for purposes of the Act, then the anti-fraud provisions would be applicable ab initio.

We have attached a photocopy of your letter. By doing this we are able to avoid having to recite or summarize the facts set forth therein.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Victor Rodarte".

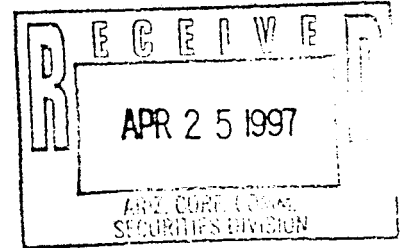
VICTOR RODARTE
Acting Director of Securities



April 23, 1997

FEDERAL EXPRESS

Ms. Leslie Block
Associate General Counsel
Corporation Commission
Securities Division
1300 W. Washington St., Third Floor
Phoenix, Arizona 85007



RE: No Action Request
Section 44-1801 (22)
Arizona Revised Statutes

Dear Ms. Block:

Pursuant to our telephone conversation, this request is being made by EBCO Resources, Inc. ("EBCO"), a member of the NASD, and its sister company, EBCO U.S.A., Incorporated ("EBCO U.S.A."). EBCO and EBCO U.S.A. are Oklahoma corporations with their principal offices at 6613 N. Meridian, Oklahoma City, Oklahoma 73116. EBCO U.S.A.'s predecessor company was established in 1979. EBCO and EBCO U.S.A. currently employ approximately 28 people and have a net worth in excess of \$500,000. EBCO was incorporated in November of 1990.

EBCO assists members of the oil and gas industry in buying and selling oil, gas and other mineral interests through an INVITATIONAL® oral bid auction sale ("auction"). EBCO is generally regarded as the leading company in its field, with sales of approximately \$50 million during the 1996 fiscal year. EBCO and EBCO U.S.A. have conducted over 125 auctions since 1987. The most active sellers include ARCO, American Exploration, Oryx, Pennzoil and Phillips which have collectively sold over \$100 million in property. Other clients have included such companies as Chevron, Exxon, Kerr-McGee, Texaco and Unocal Corporation. The volume of business conducted by EBCO demonstrates that its services are valuable to persons in the oil, gas and mineral industry.

Entities in the oil and gas business residing in Arizona have requested to receive notices and participate in these auctions. EBCO desires to include such entities in the auctions. We request that the Division issue a no action letter pursuant to ¶9614(B) of the Regulations of the Arizona Securities Act ("Arizona Act") that the transactions in EBCO's INVITATIONAL® sales as

described below do not involve the offer or sale of a security within the meaning of Sec. 44-1801 (22) of the Arizona Act. The facts involved in EBCO's transactions and the basis for this request are outlined below.

The following conditions generally apply to the auctions:

- (1) Typically, EBCO conducts an auction once or twice a month of hundreds of various oil, gas and other mineral interests in properties situated throughout the United States. The properties may be owned by one seller or by numerous, unrelated sellers. The properties may be "lotted" individually or in groups. The auction will include 200 to 400 or more lots. Each lot is offered and sold to the highest bidder. The offer of the property and the bids are communicated through open outcry and the sale is complete when the auctioneer so announces by exclaiming "sold!" The sales price of a property may range from \$100 to \$100,000 or more. The gross proceeds of a single auction may be as large as several million dollars, paid by fifty or more different purchasers. The auctions may be conducted anywhere in the United States, but historically most of the auctions have been held in Dallas, Denver, Houston and Oklahoma City.

In addition to auctions, sometimes sealed bids are requested by EBCO for a property, which eliminates the necessity for prospective purchasers to personally attend an auction. A sealed bid is a bid on a bid form provided by EBCO which can be submitted in person, by mail or by delivery, and must contain a bank letter guaranteeing funds equal to the amount of the bid tendered.

- (2) The oil and gas properties to be auctioned:
 - (i) may include any or all of the following: mineral interests, working interests, royalty interests, operations, reversionary interests, oil and/or gas properties, 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."
 - (ii) are not subject to any geographical restrictions and may be any size of interest;
 - (iii) are offered without warranty as to production, title or condition, on an "as is" basis; and
 - (iv) are sold subject to any existing operating agreement, production purchase agreement, farmout agreement or other contract and existing encumbrances and title defects, if any.

- (3) The following information generally is provided (subject to the purchaser's verification through its own due diligence) by the seller with respect to each property:
- (i) location;
 - (ii) well name;
 - (iii) size and type of interest offered;
 - (iv) average oil and/or gas production per day;
 - (v) name of the operator; and
 - (vi) name of the seller.

Certain additional information provided by the seller concerning cash flow and production history with respect to most of the properties is generally available to prospective purchasers at EBCO's offices and will be mailed to prospective purchasers upon request for a nominal fee and postage, however, EBCO will not have independently verified such information.

In addition to the foregoing, in every direct mail brochure sent to prospective purchasers, EBCO sets forth the name and telephone number of additional sources of information concerning the properties which are available. The additional sources of information include state agencies with jurisdiction over oil and gas properties and private companies which can provide information with respect to liens, drilling records, plugging reports, production reports, decline curves, etc.

- (4) A seller is 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, horizontal severance of the subject property (where the seller retains all of its existing or rights in certain formations of depths under the whole property, or adjacent acreage), and there must be only one purchaser. The seller must 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 development potential of the properties is not emphasized to prospective buyers, however, possible potential undrilled locations, zones located "behind pipe" and other similar information may be pointed out.

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- (5) The seller or EBCO will record or deliver to the purchaser the conveyancing documents or notices in favor of the purchaser. The purchaser is charged a recording fee by EBCO for each assignment to be recorded.
- (6) All payments for properties are made payable to an unrelated bank serving as escrow agent.
- (7) EBCO receives a commission not to exceed 12.5%, based on the sales price of the properties sold.
- (8) Expenses of notification and promotion of an auction, which include a brochure listing the properties and the sale date, room rental and refreshments, are paid by EBCO and are approximately \$40,000 per auction (Such expenses were previously shared by all the sellers in an auction).
- (9) Notice and promotion of each auction generally will be by means of the following:
 - (i) direct mail brochures to qualified persons on EBCO's mailing list (approximately 16,000), and
 - (ii) 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 is 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.
- (10) EBCO has established strict suitability requirements for its bidders. Before being allowed to purchase property, the bidder must satisfy EBCO that it is engaged in the business of exploration or production of oil, gas or other minerals as an ongoing business. EBCO generally will conclude that a person or entity meeting at least one of the tests set forth below is in the oil, gas or mineral business.
 - (i) any business entity currently active in exploring for or producing oil and gas and operates 25 or more oil or gas wells.
 - (ii) any business entity that currently derives at least \$500,000 of annual gross revenues from exploration for or production of oil and gas; or
 - (iii) any business entity that derives at least 75% of its gross annual income from exploration for or production of oil and gas;

- (iv) any business entity that is, and has been for at least 5 years, actively engaged in and derives at least 51% of its annual gross income from exploration for or production of oil and gas or other valuable minerals;

In addition, EBCO may conclude under the particular facts and circumstances of the case that a prospective buyer is in the oil and gas business even though it fails to satisfy any of the tests set forth above. For example a prospective purchaser may be a petroleum engineer, petroleum landman, geologist or other industry professional with experience in acquiring, owning or managing oil, gas or mineral properties.

- (11) Before bidding, all prospective purchasers must complete and execute Bidder Registration forms which include (i) an Acknowledgment, (ii) Buyer's Terms and Conditions of Sale and (iii) an Investment Profile. The forms must be approved by EBCO before prospective purchasers may become a Qualified Registered Bidder ("Bidder"). The Acknowledgment contains the four qualification tests stated above. Also, the bidder must acknowledge, among other things, that the properties are "being acquired for its own account for investment and not for the benefit of any other person or with a view toward resale or redistribution." In the Investment Profile, a bidder must disclose its annual income, net worth, dollar amount of oil and gas properties owned and funds available for investment.

The conditions surrounding EBCO's property transactions have been outlined for the securities administrators of the majority of the oil and gas producing states. EBCO has been granted favorable opinions or rulings from sixteen (16) states exempting the transactions from securities and advertising registration. Dealer registration is also not required by some states. These states are listed below, with the resulting action taken by the administrator in parenthesis:

- | | |
|---|--|
| 1. Arkansas (Auction Exemption) | 9. New Mexico (Interpretative Opinion) |
| 2. Colorado (Auction Exemption) | 10. North Dakota (No Action Letter) |
| 3. Kansas (Auction Exemption) | 11. Oklahoma (No Action Letter) |
| 4. Louisiana (Auction Exemption) | 12. Oregon (No Action Letter) |
| 5. Michigan (Interpretative Opinion) | 13. South Dakota (No Action Letter) |
| 6. Mississippi (Interpretative Opinion) | 14. Texas (Auction Exemption) |
| 7. Montana (Order of Exemption) | 15. Utah (No Action Letter) |
| 8. Nevada (Interpretative Opinion) | 16. Wyoming (No Action Letter) |

The Texas Oil and Gas Auction Exemption, effective August 23, 1991, was the first such rule enacted by a state securities administrator. Correspondence from seven states is included for reference.

The following exhibits to this letter were previously provided to the Division as exhibits to EBCO's draft letter dated April 4, 1997, with the exception of Exhibit "N" which is attached hereto:

Exhibits:

- A - Colorado: (i) Order dated October 16, 1991 - auction of oil & gas properties;
 (ii) Reg. Section 3.10. Exemption for Oil and Gas Auctions;

- B - New Mexico: (i) No Action letter dated February 5, 1992
 (ii) Reg. Sec. 58-13B-27(S) [exempt transactions - oil & gas leases];

- C - Nevada: (i) No Action letter dated October 2, 1996
 (ii) Section 90.318 [policy on opinions and requests]

- D - Oklahoma (i) No Action letter dated October 15, 1991
 (ii) Section 2 (r)18 of the Oklahoma Securities Act [security definition]

- E - Oregon: (i) No Action Letter dated July 7, 1993
 (ii) Rule 441-15-010 [policy on opinions and requests]

- F - Utah: (i) No Action letter dated May 20, 1992
 (ii) Sec. 61-1-14(2)(S) [discretionary exemptions by the Division]

- G - Wyoming: (i) No Action Letter dated July 2, 1991
 (ii) Sec. 17-4-113(A)(xi) [definition of a security]
 (iii) No Action Request dated June 27, 1991 from Kunzman & Bollinger

- H - Sample Sale Agreement between EBCO and a seller;

- I - Sample Guide for Preparing Oil and Gas Properties for Sale provided to sellers;

- J - Sample Bidder Registration form (Bidder Identification and Acknowledgment, Buyers Terms and Conditions of Sale, and Investment Profile);

- K - Sample direct mail INVITATIONAL® brochures;

- L - Sample trade journal notices;

- M - Sample Sale Catalog of properties (provided to all bidders on auction day).

- N - Legal Opinion from Kunzman & Bollinger, Inc. Dated April 23, 1997

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In our opinion, the offer and sale of oil and gas properties by EBCO as discussed above does not involve the offer or sale of a security. The basis for our position involves two primary elements: First, a security is defined as an investment contract under the Arizona Act and the Federal Securities Act of 1933 ("1933 Act"). Since EBCO's transactions do not contain all the elements of an investment contract they should not be considered securities within the meaning of the Arizona Act. Second, both the Arizona Act and the 1933 Act define a security as a "fractional undivided interest in oil, gas or other mineral rights." Because EBCO's transactions do not involve a sale of fractionalized interests, they should not be deemed to be securities transactions.

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

- EBCO's transactions do not contain the elements of an investment contract. Therefore, since the Arizona Act defines a security as an investment contract, EBCO's transactions do not involve a security:

Section 44-1801 (22) of the Arizona Act defines the term "security" to include an investment contract. 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 investment contracts 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 purchaser is in the oil and gas business and has full access to information concerning the property from the seller and therefore is able to fend for himself; 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 (10th 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. Sellers in the auction and sealed bids conducted by EBCO are required to sell 100% of their ownership in the interest in the property being sold and all

purchasers must buy the properties on an "as is" basis. Consequently, there should not be any common enterprise or reliance on the efforts of others which are required for there to be an investment contract.

In Woodward v. Wright, 266 F.2d 108 (10th 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 stated this was not an investment contract. This case supports the conclusion that the properties sold through EBCO 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 auctions and sealed bids conducted by EBCO where properties are sold on an "as is" basis without additional economic inducement on the part of the seller or their parties. In the auctions the purchasers are clearly left to their own devices to realize a profit from the properties they purchase.

In Deutsch Energy Co. V. Masur, 813 F.2d 1567 (9th 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 sales by EBCO discussed above do not involve a pooling of funds for the joint benefit of the owners of the property. Nor is the success of the transaction dependent upon the development of the property. Additional favorable facts for avoiding investment contract classification include: (i) full information or access to information concerning the property is provided to the purchaser; (ii) the purchaser is sophisticated, experienced and knowledgeable concerning the oil and gas industry; and (iii) the purchaser is free to actually participate in the

Ms. Leslie Block
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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 EBCO do not involve fractionalized interests, they should not be deemed securities within the meaning of the Arizona Act and the 1933 Act:

Both Section 44-1801(22) of the Arizona Securities Act and Section 2(1) of the 1933 Act define a security as a "fractional undivided interest in oil, gas or other mineral rights." Further, 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 Securities Act of 1933, 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)].

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 interest. [Woodward v. Wright, 266 F.2d 108 (10th Cir. 1959)]. However, in Graham v. Clark, 332 F.2d 108 (6th Cir 1964), the court held that the transfer of all of 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), page 3 of this letter, the oil and gas properties offered for sale by EBCO should not be deemed to be fractionalized interests which would be securities within the meaning of Section 44-1801(22) of the Arizona Act.

- A no action position taken by the Division would be consistent with Colorado, New Mexico, Nevada and Utah—neighboring states to Arizona:

Colorado, New Mexico, Nevada and Utah have each issued correspondence to EBCO allowing the auction transactions. In Colorado, the commissioner issued an Order dated October 16, 1991 allowing for auctions of oil and gas properties to included Colorado residents. Simultaneously, we were provided a copy of a proposed new rule pertaining to oil

and gas auctions for our comments. Following a November 1 hearing before the Securities Commission, the exemption was enacted and became effective on January 1, 1992. [Section 3.10. Exemption for Oil and Gas Auctions]. Securities registration is not required of EBCO in Colorado.

In New Mexico, the commissioner issued EBCO a no action letter dated February 5, 1992 confirming that EBCO's transactions qualify for an exemption under Section 58-13B-27S of the New Mexico Securities Act. In Nevada, the Division took a no action position in its letter to EBCO dated October 2, 1996. The Division took this position based upon the facts presented describing an auction to be conducted by EBCO on November 7, 1996. Securities registration is not required of EBCO in either New Mexico or Nevada.

In Utah, agreeing with the investment contract analysis outlined in our request, the Director issued a no action letter concluding that EBCO's oil and gas auction transactions do not involve a sale of securities. The letter was issued pursuant to Utah Code Annotated, sec. 61-1-14(2)(S) and became effective May 20, 1992. Neither securities nor dealer registration is required in Utah for EBCO's transactions.

- A no action position by the Division would be consistent with Oregon and South Dakota—states with oil and gas production levels similar to Arizona:

Although the states of Oregon and South Dakota account for less than one percent of the U.S. crude oil and natural gas production, the state securities administrators in both states used discretionary authority to issue favorable opinions to EBCO for including their residents in the auctions. A no action position by the Division would be consistent with the positions taken by Oregon and South Dakota.

Pursuant to Oregon Administrative Rule 441-15-101, the Director issued a no action letter stating that the auction activities are not considered investment contracts and do not involve an offer or sale of securities for purposes of ORS Chapter 59. Neither EBCO nor auction participants are required to register as broker-dealers, and the property interests are not required to be registered as securities.

South Dakota Codified Laws, Sec. 47-31A-413(e) provides for the director to issue interpretative or no action opinions. EBCO's position was that investor protection would be accomplished through imposing suitability requirements on the purchasers and requiring a registered broker-dealer to conduct the auctions. The director agreed and took a no action position stating that securities registration would not be required and offers into South Dakota would be allowed for EBCO's transactions.

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- A no action position that EBCO's transactions do not involve an offer or sale of securities would be consistent with Oklahoma, Oregon, Utah and Wyoming—all of which have concurred with EBCO that the transactions do not constitute securities transactions:

The positions taken by Oregon and Utah have been discussed above. In October 1991, the Oklahoma Securities Commissioner issued an interpretative opinion that the interests sold in EBCO's auctions are not securities pursuant to section 2(r)(18) of the Act. This section provides that the definition of a security does not include oil, gas or mineral transactions between parties, each of whom is engaged in the business of exploring for or producing oil, gas or other valuable minerals as an ongoing business. The Administrator determined this definition included persons meeting one of the four qualification tests imposed by EBCO.

In Wyoming, the Administrator provided a no action letter to EBCO. Based upon the facts, the opinion concurred that EBCO's services did not involve the offer or sale of a security. A security was not involved since all the elements of an investment contract were not present as shown through investment contract analysis. Broker-dealer registration is not required of EBCO in Oklahoma, Oregon, Utah or Wyoming.

It is respectfully requested that the Division concur in our opinion that the offer and sale of oil and gas properties by EBCO as discussed above does not involve the offer or sale of a security within the meaning of section 44-1801(22) of the Arizona Act. We further request the Division issue a no action letter to that effect, pursuant to ¶9614(B) of the Arizona Act and state that the Division will not take any enforcement action with respect to such transactions and other similar transactions effected without compliance with the registration provisions of Sections 44-1841 and 44-1842 of the Arizona Act. A \$200 fee payable to the Arizona Corporation Commission has been enclosed pursuant to Section 44-1861 (L) of the Arizona Act.

If any further information is desired in connection with this matter, please contact me at (405) 720-8540.

Thank you for your consideration.

Sincerely,



David M. Smart
President

Enclosures

cc: Kunzman & Bollinger, Inc.

KUNZMAN & BOLLINGER, INC.
ATTORNEYS-AT-LAW
5100 N. BROOKLINE, SUITE 600
OKLAHOMA CITY, OKLAHOMA 73112
Telephone (405) 942-3501
Fax (405) 942-3527

April 23, 1997

Mr. David M. Smart
EBCO Resources, Inc.
6613 N. Meridian
Oklahoma City, Oklahoma 73116

RE: Arizona No Action Request

Dear Mr. Smart:

Pursuant to your request, we have reviewed EBCO Resources, Inc.'s ("EBCO") letter dated April 23, 1997, to the Securities Division (the "Division") of the Arizona Corporation Commission and the exhibits attached thereto (the "No Action Request").

Based in part on the legal authorities cited in the No Action Request, and assuming the auctions are conducted as described in the No Action Request, please be advised that it is our opinion, subject to the concurrence of the Division, that buying and selling oil, gas and other mineral interests through EBCO's auctions would not involve the offer or sale of a "security" as that term is defined in Section 44-1801 (22) of the Arizona Securities Act.

We consent to the use of this opinion in the No Action Request.

Very truly yours,



KUNZMAN & BOLLINGER, INC.