

STATE OF ARKANSAS
SECURITIES DEPARTMENT

IN THE MATTER OF
WAVE ENERGY CORPORATION,
a/k/a WAVE ENERGY, INC.,
JEFFREY SCOTT RAND and ALL PERSONS
EMPLOYED BY OR OTHERWISE
AFFILIATED WITH THAT ENTITY
OR JEFFREY SCOTT RAND

No S-04-085-06-CD01

CEASE AND DESIST ORDER

The Staff of the Arkansas Securities Department (the Staff) has received information and has in its possession certain evidence which indicates that WAVE ENERGY CORPORATION, a/k/a WAVE ENERGY, INC., and JEFFREY SCOTT RAND have violated provisions of the Arkansas Securities Act (the Act), codified at Ark. Code Ann. §§ 23-42-101, *et seq.* (Repl. 2000).

FINDINGS OF FACT

1. WAVE ENERGY CORPORATION, sometimes referred to as WAVE ENERGY, INC., (WAVE) is a Delaware corporation formed in November, 1998. Its present address is 7700 San Felipe, Suite 125, Houston, Texas 77063. At most times referred to herein, it was based in Hot Springs, Arkansas. Its last address there was 113 Buena Vista, P.O. Box 6003, Hot Springs, Arkansas 71913. WAVE's first office in Hot Springs was located at 121 Exchange Street, Hot Springs, Arkansas 719801, to which it moved in September, 2001. Before then, WAVE's office was at 2302 Martin Street, Suite 275, Irvine, California 92612.
2. JEFFREY SCOTT RAND (RAND) is presently a resident of Houston, Texas, but was at

most times referred to herein a resident of Hot Springs, Arkansas. RAND is the chairman of the board, president, treasurer, secretary, sole director and sole shareholder of WAVE.

DEFINITIONS

3. This matter concerns the offer and sale of various interests in several natural gas wells in Jim Hogg County, Texas. In discussing these matters, the following terms, which are commonplace in oil and gas ventures, will be used:
 - a. Authority for Expenditure (AFE). A budgetary document, usually prepared by the operator, to list estimated expenses of drilling a well to a specified depth, casing point or geological objective and then either completing, or abandoning the well.
 - b. Completion. The installation of permanent production equipment in order to begin delivery of crude oil or natural gas. The costs of completion are not paid unless and until the well is drilled, and testing of the well shows it to be commercially profitable.
 - c. Drilling and Testing. The work undertaken in good faith to drill an oil or gas well and then test it to determine if it will produce oil or gas in sufficient quantities that will make it commercially feasible to install permanent production equipment and produce oil or gas at a profit.
 - d. Fracturing. The pumping of crude oil, diesel, water, or chemical into a reservoir with such force that the reservoir rock is broken and results in greater flow of oil or gas from the reservoir. Commonly known as a frac (pronounced frack) or fracing (pronounced fracking), these procedures can occur before or after completion.
 - e. Joint Operating Agreement (JOA). An agreement governing the operations of a jointly owned oil or gas well project.

- f. Net Revenue Interest (NRI): The share of revenue, expressed in fractions or decimals, accruing to the working interest after deducting all lease burdens (royalty, overriding royalty, or similar burden).
- g. Operator. The person or company, either proprietor or lessee, actually operating a well. The operator is a working interest owner and is also responsible for physical maintenance of the well and other responsibilities as covered in the JOA.
- h. Overriding Royalty Interest (ORI): A non-operating interest in the production of an oil or gas well or lease that is not subject to development or operating costs and is similar to a landowner's royalty interest.
- i. Royalty Interest (RI): The share of the production or the revenue derived therefrom reserved to the lessor landowner under the terms of the mineral lease. Normally, royalty interests are free of all costs of production except production taxes, and is established in the lease by reserving a royalty which is usually expressed as a decimal or fraction.
- j. Spudding. What happens when the drill bit first breaks ground in the drilling of an oil or gas well.
- k. Turnkey Contract: A contract between participants in a oil or gas well drilling project and the promoter, who is usually but not always the operator, for the drilling, testing and completion of the well at a fixed cost to the participant. These costs include all expenses for drilling the well, testing it before putting it into production and equipping the well to produce oil and/or gas. In a turnkey project, investors become participants in the project by the investment of a finite amount of money, and the promoter bears the risk of any cost overruns, but also enjoys the benefits of lower than expected costs.

1. Working Interest (WI): A contractual right acquired from a leaseholder of mineral rights entitling the holder to conduct drilling and production operations on the leased property. Expressed as a decimal or fraction, the working interest owners bear the costs of exploration, development, and operating the well after completion in the amount of the decimal or fraction.

Rancho Blanco Well No. 2 - Private Placement Memorandum

4. In a private placement memorandum (PPM) dated 15 November 2000, WAVE offered 56 units of fractional undivided working interests in a gas well located in Jim Hogg County, Texas, known as the Rancho Blanco Corporation State Gas Unit No. 2 Well (RB2). From its offices in Hot Springs, Arkansas, WAVE caused this gas well venture to be marketed to residents of Arkansas and other states through at least January, 2004. Selling units for \$84,000 each, WAVE sought to raise a total of \$4,704,000. Whole and partial units in the RB2 were offered and sold by RAND, personally, sales agents working directly for WAVE under RAND's direction and by Lone Star Securities, a broker-dealer in Dallas. The offering was a private placement made pursuant to Regulation D and Rule 506, promulgated pursuant to §§ 3(b) and 4(2) of the Securities Act of 1933. Other significant features of this offering were set out in the provisions of the PPM, including:
 - a. Each unit was comprised of 0.5859% WI and a 0.4394% NRI in the RB2.
 - b. RB2 was to be a gas well situated in the Fandango Field or Prospect, located in Jim Hogg and Zapata Counties, Texas. The oil and gas leases from which the working interests and net revenue interests being sold in this private placement were derived were originally executed between the lessor, the Rancho Blanco Corporation, which represented the

landowners, the Zachry Family and the State of Texas, and the lessee, Fina Oil and Chemical Company (FINA), in 1995 and 1996. FINA and several partners drilled the first well on this acreage, the Fina Rancho Blanco Corporation State No. 1 (RB1). FINA had acquired the rights to drill in the Fandango Field from the 1995 and 1996 leases and had assigned some of those rights to its partners. WAVE represented in the PPM that the money to purchase these rights from FINA and its partners had already been raised from existing investors.

- c. The assignments and other rights were to come from a company named Bettis & Snyder, L.L.C. (BSL). According to the PPM, once WAVE determined that BSL had acquired clear title to these interests under the original oil and gas lease through prior agreements, WAVE would cause BSL to make assignments of those interests to Wave Partners, Inc. (WP) for the benefit of each investor. WP was a Texas corporation formed on 3 November 2000 for the purpose of serving as a nominee record interest owner for persons participating in oil and gas drilling programs sponsored by WAVE. Each unit in RB2 was to be represented as an assignment of a WI and a corresponding NRI made to WP for the benefit of the investors in RB2. The assignments were to be recorded in Jim Hogg County, Texas to put all third parties on actual notice of the interests of the purchasers of these units. A copy of the assignment was to be provided to each investor.
- d. Units in RB2 could be purchased for \$84,000 each, \$50,000 due and payable upon the tender of a subscription agreement and customer agreement and \$34,000 due and payable within 7 business days of notification of completion. The funds were to be placed in an escrow account until a minimum of 25 units were funded. Once the minimum had been

sold, the funds would be released to WAVE. At that point, WAVE was to place those funds into a segregated account for use in developing RB2 for the benefit of the purchasers of the units.

- e. WAVE represented in the PPM that the RB2 was a turnkey project.
- f. According to the PPM, either BSL, or WAVE was to be the operator of RB2.
- g. The operating agreement for RB2 was the existing operating agreement for RB1.

According to this agreement, the operator can be changed only by a vote of the owners of oil and gas interests comprising RB2, and the successor operator must be chosen from among those owners.

- h. Operating costs or expenses were defined in the PPM as “customary expenses” of operating the well after it has been drilled and completed, including the costs of reworking, workover or similar expenses, and these expenses are to be borne by the investors in an amount proportionate to their ownership interests. According to the operating agreement for RB2, which was attached to and made a part of the agreement set out by the PPM, any subsequent operations or projects taken after completion of the well reasonably projected to cost in excess of \$25,000 shall not be undertaken without the consent of all parties.
- i. Also in accordance with the operating agreement, the operator of RB2 could charge any party not paying its proportionate share of operating expenses a 300% penalty if the party did not pay its share of an operating expense on time. As defined in the operating agreement, this is a penalty of three times the amount of a party’s share of an operating expense, which is taken from that party’s production proceeds. For example, if a party

owes \$100 in operating expenses and refuses to pay that amount after notification by the operator, the operator can freeze that party's production revenues, which are calculated based on the party's net revenue interest, until \$300 of that party's production revenue has been generated and forfeited pro rata to the investors who paid their share .

- j. According to the PPM, the funds raised by WAVE would pay for approximately 50% of the actual costs of the well and would be applied as follows:

Drilling and Testing Costs	\$2,518,992	54.00%
Completion and Equipping Costs	1,479,408	31.00%
Payments to Placement Agents	<u>705,600</u>	<u>15.00%</u>
Total	<u>\$4,704,000</u>	<u>100.00%</u>

Rancho Blanco No. 2 - Actual Development

- WAVE's statement in the PPM that the money to purchase the rights from FINA and its partners needed to sell units in RB2 had already been raised from existing investors(¶4.b) necessarily implied that the funds paid by investors would be used to purchase those units from WAVE. This assertion of the use of funds was further supported by the PPM's section showing exactly how the funds raised from investors would be used. (¶4.j) Contrary to these statements, WAVE on 19 April 2001 used \$275,000 of investor funds to pay for acquisition of a part of the rights to the Fandango lease necessary to market units in RB2.
- It was represented in the PPM that upon the advent of two conditions precedent, i.e., 1) the payment of the investor's funds and 2) acceptable legal title in BSL, BSL would convey the WI and NRI in RB2 to WP as a nominee record interest owner for the benefit of the investors. These assignments to WP for the benefit of the investors were to be filed of record in Jim Hogg County, Texas, and all investors were to receive copies of the assignments.

(¶4.c) Although these two conditions precedent came to be, no assignments were made to WP for the benefit of the investors. As a result, virtually all the investors neither actually, nor beneficially own any WI or corresponding NRI in RB2¹.

7. Neither WAVE, nor BSL ever assumed the role of operator. Aspen Exploration, Inc. (ASPEN) of Plano, Texas was the operator from the beginning of drilling operations. Investors were not notified ASPEN was the operator, the PPM was not amended to reflect this change and ASPEN was not chosen in accordance with the operating agreement. (¶4.g)
8. The agreement between WAVE and ASPEN was to equally split the drilling and testing cost of RB2. WAVE failed to pay its fair share of the costs, saddling ASPEN with well over half the cost of drilling and testing the RB2. By the time the RB2 was nearing production, WAVE's debt to ASPEN was quite high. In February, 2004, in settlement of what WAVE owed ASPEN on this and several other wells, WAVE, ASPEN and BSL entered into an agreement re-assigning their respective interests in the oil and gas leases in the Fandango Field or Prospect, including the RB2, RB3 and other wells yet to be drilled as well as the RB1, which was already drilled and producing when WAVE first acquired the rights to drill in this field. (¶4.b) In accordance with this agreement, WAVE was transferred certain ownership interests in the RB1, RB2 and RB3 that included WI and NRI. For all other wells to be drilled in the Fandango Field or Prospect pursuant to the leases in question, i.e., RB4, RB5, RB6, etc., ASPEN was to be operator and have most ownership rights and WAVE was to have only a 5% ORI and a \$500,000 spudding fee for each well.

¹As a result of litigation, several investors now have their own assignments filed of record in Jim Hogg County, Texas.

9. After completion of RB2, RAND on behalf of WAVE sent notices to investors of a frac job said to be scheduled for 29 October 2004. It was said to cost WAVE in the range of several hundred thousand dollars. WAVE requested funds from the investors for this operation. RB2 had been completed in December, 2003, and it had begun producing in January, 2004. Because WAVE was not the operator of the RB2, it could not propose such an expensive operation. Further, such an expensive operation could not be undertaken without the consent of all investors. The investors were not asked for their consent to perform this frac in accordance with the operating agreement. (§4.h)
10. Actually, the only frac jobs that were performed on RB2 took place in March, 2004, and March, 2005. There were no frac jobs scheduled, performed or anticipated in October, 2004.
11. Later, when several of the investors had not paid what WAVE had requested from them for the October, 2004 frac job, WAVE charged them a 300% penalty in accordance with the operating agreement. (§4.i) WAVE also charged several investors a 300% penalty who had paid what WAVE had asked for the alleged frac. Because WAVE was not the operator of the well, WAVE could not charge any investor a 300% penalty for failing to pay its share of an operating expense for an operation performed after completion and during production. Only the operator, ASPEN, could charge an investor a 300% penalty.

Rancho Blanco No. 3

12. On 1 June 2002, WAVE issued a new private placement memorandum and made a new offering of working interests in another well in the Fandango Prospect, Rancho Blanco Corporation State Gas Unit No. 3 Well (RB3), seeking to sell 56 units of working interests for \$115,000 per unit, raising a total of \$ 6,440,000. In the selling of units in this project,

which spanned the completion of RB2 in December, 2003, WAVE, working through RAND and several others, never revealed to prospective investors the facts set out above in ¶¶4-13.

Rancho Blanco No. 4

13. As noted in ¶ 8, in February, 2004, WAVE, ASPEN and BSL entered into an agreement re-assigning their respective interests in the oil and gas leases in the Fandango Field or Prospect, including the RB2, RB3 and other wells yet to be drilled as well as the RB1, which was already drilled and producing when WAVE first acquired the rights to drill in this field. (¶4.b) This agreement was entered into in settlement of WAVE's indebtedness to ASPEN, as discussed above in ¶8. In accordance with this agreement, WAVE was transferred certain ownership interests in the RB1, RB2 and RB3 that included WI and NRI. For all other wells to be drilled in the Fandango Field or Prospect pursuant to the leases in question, i.e., RB4, RB5, RB6, etc., ASPEN was to be operator and have most ownership rights and WAVE was to have only a 5% ORI and a \$500,000 spudding fee for each well.
14. The 5% ORI was reduced to 4.675% because it was subject to the net revenue interest of Zachry Exploration, Inc. and BSL's carried working interest. This ORI could be sold, just as any WI could be sold. By the time of this order, WAVE had sold portions of its ORI in the newly drilled Rancho Blanco Corporation State Gas Unit No. 4 Well (RB4) to new investors and transferred portions of it in settlement of past disputed claims to existing investors in other WAVE projects. WAVE sold and transferred more ORI in the RB4 than it owned under the settlement agreement, collecting a bit over \$1 million for the interests he oversold.

Rancho Blanco No. 1 - Redrill Prospect

15. In the first half of 2004, WAVE forwarded a PPM purported to be for "The Rancho Blanco Corporation State Gas Unit No. 1 Redrill Prospect" to an Arkansas resident, who invested \$80,000 in this purported project in June, 2004. According to the PPM, WAVE was selling 56 units of fractional undivided working interests in RB1 for \$115,000 each. The offering was represented to be a private placement made pursuant to Regulation D and Rule 506, promulgated pursuant to §§ 3(b) and 4(2) of the Securities Act of 1933. Each unit was comprised of a 0.5859% working interest and a 0.4394% net revenue interest. According to the PPM, this was a "redrill" of the RB1 because the existing well was said to be unacceptable:

The well has produced about 4 BCF's [billion cubic feet] to date. Scaling is a big problem and the well needs to be cleaned out every 6 months. We are unsure as to which zones are contributing to the production and down hole problems keep us from reworking the well

* * *

A new well needs to be drilled on this 40 acre unit to fully capture all the remaining reserves in the reservoirs.

* * *

Realistically we should expect somewhere between 20 to 40 BCF's by drilling a replacement well within the 40 acre unit established for the Rancho Blanco Corporation State Gas Unit No. 1 well.

16. Actually, although WAVE owned some working interests in the RB1, WAVE was not the operator of the RB1 and had no drilling rights in the 40 acre unit on which the RB1 sits. WAVE had no right to propose or begin drilling another well to replace the RB1. In fact no "redrill" of the RB1 has ever been started, and the RB1 is still producing natural gas as of this date.

North Monte Christo, Morris No. 1

17. In June of 2002, BSL negotiated a lease acquisition agreement with Texas H.B.P., LLC (HBP), the owner of mineral leases covering what is known as the North Monte Christo prospect in Hidalgo County, Texas. WAVE and ASPEN were to each pay 50% of the costs of acquisition of the lease and prepay 50% of the estimated costs of drilling and testing set out in an AFE that each signed on or about 10 October 2002. After HBP agreed to extensions of the time in which WAVE and ASPEN had to prepay the estimated expenses as per the AFE until 17 January 2003, WAVE defaulted totally. After that, HBP, ASPEN and BSL renegotiated the lease on 22 January 2003 to allow ASPEN to participate and develop the North Monte Christo prospect pursuant to the mineral leases to it, but WAVE was not included and obtained no rights to the North Monte Christo prospect.
18. WAVE produced a turnkey memorandum and contract detailing its offer in the Morris No. 1 well. Wave was selling 68 units for \$100,000 each, raising a total of \$6.8 million. According to this memorandum, the investors and WAVE would end up owning 47.5% of the WI in the Morris No. 1. WAVE was referred to in the memorandum as the "Driller-Operator."
19. By 1 July 2003, WAVE had raised close to \$2 million for the Morris No. 1. Approximately \$675,000 of it went to pay for RAND's acquisition of a duck hunting club, and the rest went to pay for RAND's horse racing and breeding operation, WAVE's business expenses and other miscellaneous RAND personal expenses.
20. The Morris No. 1 well was indeed drilled, but the operator of the project was Rodessa Operating Company, a Texas company, and not WAVE. Although ASPEN owned interests in that well, WAVE acquired no rights of any kind in the North Monte Christo prospect.

APPLICABLE LAW

21. Ark. Code Ann. § 23-42-102(15)(A)(xvi) (Supp. 2003), defines as security in pertinent part as a certificate of interest or participation in an oil and gas lease or in payments out of production under such a lease.
22. Ark. Code Ann. § 23-42-507(2) (Repl. 2000) provides that it is unlawful for any person in connection with the offer or sale of any security to make any untrue statement or omit to state a material fact necessary in order to make the statements made not misleading in light of the circumstances under which they are made.

CONCLUSIONS OF LAW

23. The representation to RB2 investors in the PPM that WAVE had already raised the money with which to purchase the rights allowing WAVE to sell investors units of working interests in RB2 from existing investors (§4.b), when in reality WAVE used some of the money invested by investors in RB2 to pay for those rights (§5), was an untrue statement made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).
24. The representation to RB2 investors in the PPM that the working interests they were buying in the purchase of units in the RB2 project would be transferred from BSL and then to WP as a nominee record interest owner for the benefit of purchasers of units in RB2, and an assignment of these interests would be filed in Jim Hogg County, Texas, to put all third parties on notice of the interests of the investors (§4.c), when in reality the interests were never transferred for the benefit of the investors, leaving the vast majority of them with no working interests or net revenue interests (§6), was an untrue statement made in connection

with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).

25. The representations to RB2 investors in the PPM that WAVE would bear 50% of the drilling and development costs of RB2 (§4.j), when in reality WAVE did not forward investor funds to pay its fair share of the costs, (§8), was an untrue statement made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).
26. The representation to RB2 investors in the PPM that either BSL, or WAVE would be the operator of RB2 (§4.f), when in reality ASPEN was always the operator from the beginning of drilling operations (§7), was the omission of a material fact necessary to make the statement made in the PPM concerning the identity of the operator not misleading in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).
27. The failure of WAVE or RAND to inform prospective investors in RB3 of any of the facts set out herein concerning the sale of units in and the operation of RB2, including the facts set out in §§4-13, which show securities fraud in the selling of units in that well and in the operation of the well after completion, particularly the billing of a frac job that never occurred (§§9 and 10) and the placing of investors in a 300% penalty phase for failing to pay or in some cases actually paying for the phantom frac (§ 11), was the omission of material facts necessary to make the statements concerning the background and business experience of WAVE and RAND made in the RB3 PPM not misleading in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).
28. Inasmuch as the offer and sale of approximately twice the amount of ORI WAVE owned in the RB4 was the sale of something WAVE did not own, as set out in §§ 13 and 14, the offer

was an untrue statement made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).

29. Inasmuch as the offer to sell working interests in the "Redrill Prospect" of the RB1, as set forth in ¶¶ 15 and 16, was the offer to sell what WAVE did not own and could not effectuate because it was not the operator of the RB1 and did not have the contractual rights to allow it to propose to abandon the existing RB1 and drill another well in its place, the offer was an untrue statement made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).

30. Inasmuch as the offer to sell working interests in the Morris No. 1 well in the North Monte Christo Prospect, as detailed in ¶¶ 17-20, was the offer to sell what WAVE did not own, the offer was an untrue statement made in connection with the offer or sale of a security in violation of Ark. Code Ann. § 23-42-507(2) (Repl. 2000).

OPINION

As per the facts and law set forth above, the conclusion is inescapable that the respondents, WAVE ENERGY CORPORATION, a/k/a WAVE ENERGY, INC., and JEFFREY SCOTT RAND, have engaged in securities fraud in contravention of Ark. Code Ann. § 23-42-507 (Repl. 2000), and therefore should be ordered to immediately cease and desist all actions in connection with the offer or sale of securities in accordance with Ark. Code Ann. § 23-42-209(a)(1)(A) (Repl. 2000).

ORDER

IT IS THEREFORE ORDERED that WAVE ENERGY CORPORATION, a/k/a WAVE ENERGY, INC., and JEFFREY SCOTT RAND, as well as others whose identities are not yet known who are in positions of control of WAVE ENERGY CORPORATION, a/k/a WAVE ENERGY, INC, and who are employed by or otherwise affiliated with WAVE ENERGY CORPORATION, a/k/a WAVE ENERGY, INC., or JEFFREY SCOTT RAND, directly or through other companies, **CEASE AND DESIST** from any further actions in the state of Arkansas in connection with the offer or sale of the securities described above and any other securities.

WITNESS MY HAND AND SEAL this 12th day of December, 2006



Michael B. Johnson
ARKANSAS SECURITIES COMMISSIONER