

JOHN MORGAN
SECURITIES COMMISSIONER

RONAK V. PATEL
DEPUTY SECURITIES COMMISSIONER

Mail: P.O. BOX 13167
AUSTIN, TEXAS 78711-3167

Phone: (512) 305-8300
Facsimile: (512) 305-8310



Texas State Securities Board

208 E. 10th Street, 5th Floor
Austin, Texas 78701-2407
www.ssb.texas.gov

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SOAH DOCKET NO. 312-14-3801

IN THE MATTER OF
BALANCED ENERGY, LLC
AND KIRK JOHNSON

§
§
§

ORDER NO. ENF-16-CDO-1745

TO: Balanced Energy, LLC
1121 S. Carroll Avenue, Suite 200
Southlake, Texas 76092

Kirk Johnson
1121 S. Carroll Avenue, Suite 200
Southlake, Texas 76092

ORDER MODIFYING EMERGENCY CEASE AND DESIST ORDER

Statement of the Case

On March 10, 2014, the Securities Commissioner ("**Commissioner**") of the Texas State Securities Board ("**TSSB**") entered an Emergency Cease and Desist Order ("**Emergency Order**") against the Respondents, Balanced Energy, LLC, ("**Respondent Balanced Energy**") and Kirk Johnson ("**Respondent Johnson**") (collectively, "**Respondents**"). In the Emergency Order, the Commissioner ordered them to cease and desist from:

1. Offering for sale any security in Texas until the security is registered with the Commissioner or is offered for sale pursuant to an exemption from registration under the Texas Securities Act ("**TSA**");
2. Engaging in any fraud in connection with the offer for sale of any security in Texas; and
3. Offering securities in Texas through an offer containing a statement that is materially misleading or otherwise likely to deceive the public.

On April 8, 2014, the Respondents, through their attorney, requested a hearing regarding the Emergency Order pursuant to Section 23-2 of the TSA. On May 28, 2014, the Texas

State Securities Board Staff ("**Staff**") filed a Notice of Hearing with the State Office of Administrative Hearings ("**SOAH**") for a hearing on the merits to begin on June 26, 2014, to be held before an Administrative Law Judge ("**ALJ**"). Subsequently, the parties requested numerous continuances to allow them to attempt to settle their dispute.

On January 28, 2016, ALJ Kerrie Jo Qualtrough convened a hearing on the merits of the case. Respondents appeared through their attorneys, Greg Weselka and Dan Waller, and Staff appeared through attorneys Travis J. Iles and Jeramy E. Heintz. The hearing concluded the same day, and the record closed on March 30, 2016, after the parties submitted their written closing and reply briefs.

The parties stipulated to Agreed Facts and Conclusions of Law¹ in the matter. Specifically, the Stipulations by the parties were:

STIPULATION OF AGREED FACTS

- A. Balanced Energy, LLC ("Respondent Balanced Energy") is a Domestic Limited Liability Company that maintains a last known address at 1121 S. Carroll Avenue, Suite 200, Southlake, Texas 76092. Respondent Balanced Energy claims that it is the first company in the oil and gas exploration and production industry to accept Bitcoin as payment for its prospects.
- B. Kirk Johnson ("Respondent Johnson") is the President of Respondent Balanced Energy. He maintains a last known address at 1121 S. Carroll Avenue, Suite 200, Southlake, Texas 76092.
- C. Respondents were offering for sale working interests in wells in the South Runway Prospect, located in Runnels County, Texas, and the North Guitar Prospect, also located in Runnels County, Texas.
- D. Respondents were telling investors that they could purchase the working interests in a well in the South Runway Prospect as follows:
 - i. Investors could purchase 6.25% working interest for \$30,038.00,
 - ii. Investors could purchase 12.50% working interest for \$60,076.00, and
 - iii. Investors could purchase 25% working Interest for \$120,152.00.
- E. Respondents were representing that the purchase of 6.25% working interest in a well in the South Runway Prospect could generate profits estimated as follows:

¹ The Stipulation of Agreed Facts and Conclusions of Law was an exhibit to the Staff's Closing Argument and Brief and to the Respondents' Post-Hearing Opening Brief, both filed with SOAH on March 9, 2016. The "Stipulated Findings of Fact" that appear in the Proposal For Decision prepared by the ALJ does not fully recite the list of stipulations.

- i. The purchase of 6.25% working interest could generate annual net income from \$18,476.33 to \$92,759.060, depending upon variations in the total barrels of oil per day, price per barrel of oil and other factors, and
 - ii. The purchase of 6.25% working interest could result in a net return of \$36,884.41 after the first year, or a first year cash return ranging from 77% to 117% of the amount of investment.
- F. Respondents were telling investors that they could purchase the working interests in the wells in the North Guitar Prospect as follows:
 - i. Investors could purchase 6.25% working Interest for \$31,771.00,
 - ii. Investors could purchase 12.50% working interest for \$63,542.00, and
 - iii. Investors could purchase 25% working interest for \$127,084.00.
- G. Respondents were representing that the purchase of 6.25% working interest in the wells in the North Guitar Prospect could generate profits estimated as follows:
 - i. The purchase of 6.25% working interest could generate annual net income from \$15,504.75 to \$144,148.91, depending upon variations in the total barrels of oil per day, price per barrel of oil and other factors, and
 - ii. The purchase of 6.25% working interest could result in a net return of \$37,997.35 after the first year, or a first year cash return ranging from 76% to 118% of the amount of investment.
- H. The working interests in the South Runway Prospect and the North Guitar Prospect had not been registered by qualification, notification or coordination, and no permit had been granted for their sale in Texas.
- I. Respondents were accepting payment through Bitcoin, a digital currency system that incorporates cryptography and is designed to enable users to send money over the Internet without using a credit card or bank account. They had posted a Quick Response Code on social media to allow investors to pay for their investments using Bitcoin.
- J. The Texas State Securities Board previously entered a cease and desist order in December 2006 ("2006 C&D") against Kirk Johnson. The 2006 C&D did not allege fraud or any materially misleading or deceptive disclosure against Kirk Johnson.
- K. The 2006 C&D was 7 years and 3 months old at the time of the Texas State Securities Board's March 10, 2014 Emergency Cease and Desist Order against Balanced Energy, LLC, and Kirk Johnson ("ECDO").

STIPULATION OF AGREED CONCLUSIONS OF LAW

- A. Rule 506(b) of Regulation D under the Securities Act of 1933 authorizes an issuer to sell covered securities to an unlimited number of accredited investors and no more than, or the Issuer reasonably believes that there are no more than, 35 non-accredited investors without complying with the state securities registration requirements, provided that, among other things, the issuer does not engage in general solicitation.
- B. The United States Securities and Exchange Commission promulgated new rules regarding the use of general solicitation for offering covered securities that became effective on September 13, 2013.
- C. The new rules added Rule 506(c) of Regulation D under the Securities Act of 1933, which authorizes an issuer to engage in general solicitation in offering and selling covered securities without first complying with the state securities registration requirements, provided that, among other things, all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors.
- D. The investments in working interests were “securities” as that term is defined by Section 4.A of the Texas Securities Act.

The ALJ issued a Proposal for Decision (“**PFD**”) on May 10, 2016.

On May 25, 2016, Staff and Respondents filed exceptions to the PFD. On June 9, 2016, Respondents filed replies to the Staff’s exceptions. On June 10, 2016, the Staff filed replies to the Respondents’ exception. The ALJ responded to the Staffs’ exceptions and the Respondents’ response by letter dated June 23, 2016, overruling all exceptions.

The Commissioner finds that the ALJ did not properly apply or interpret applicable law in her analysis of whether conduct by Respondents established a sufficient basis for the issuance of an emergency cease and desist order under Section 23-2.A(1)(A) or Section 23-2.A(2) of the TSA. Furthermore, the issue of future bad actor disqualification under 17 C.F.R. §230.506(d)(1)(iii)(B) as a result of the final order in this matter was not properly before SOAH and is moot given the ALJ’s proposed modifications to the Emergency Order. Accordingly, certain Findings of Fact and Conclusions of Law, as more specifically addressed below, have been modified.

In accordance with the authority in Section 2001.058(e) of the Texas Government Code, the Commissioner removed nine Findings of Fact, modified one Conclusion of Law, and removed two other Conclusions of Law.

The Findings of Fact and Conclusions of Law from the PFD, as modified by the Commissioner, are as follows:

FINDINGS OF FACT

1. The Commissioner of the Texas State Securities Board (TSSB) entered an Emergency Cease and Desist Order (Emergency Order) against Balanced Energy, LLC, and Kirk Johnson (Respondents) on March 10, 2014.
2. The Emergency Order advised Respondents of their right to a hearing.
3. Respondents timely filed a request for hearing.
4. Respondents and the TSSB Staff waived the requirement that the hearing be held within 10 days of the receipt of the Emergency Order.
5. On May 28, 2014, Staff sent Respondents a notice of hearing that contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the factual matters asserted.
6. On January 28, 2016, Administrative Law Judge (ALJ) Kerrie Jo Qualtrough convened the hearing on the merits. Respondents appeared through their attorneys, Greg Weselka and Dan Waller, and Staff appeared through its attorneys, Travis J. Iles and Jeremy E. Heintz. After the conclusion of the hearing on the merits, the parties submitted an agreed briefing schedule. The ALJ adopted the parties' schedule, and the record closed on March 30, 2016, after the parties submitted their closing arguments and responses.
7. Balanced Energy is a domestic limited liability company that maintains a physical address at 1121 S. Carroll Avenue, Suite 200, Southlake, Texas 76092. Balanced Energy claimed that it was the first company in the oil and gas exploration and production industry to accept Bitcoin as payment for its prospects.
8. Mr. Johnson is the president of Balanced Energy. He maintains a physical address at 1121 S. Carroll Avenue, Suite 200, Southlake, Texas 76092.
9. Respondents were offering for sale working interests in wells in the South Runway Prospect, located in Runnels County, Texas, and the North Guitar Prospect, also located in Runnels County, Texas.
10. Respondents were telling investors that they could purchase the working interests in a well in the South Runway Prospect as follows:
 - Investors could purchase 6.25% working interest for \$30,038;
 - Investors could purchase 12.50% working interest for \$60,076; and
 - Investors could purchase 25% working interest for \$120,152.

11. Respondents were representing that the purchase of 6.25% working interest in a well in the South Runway Prospect could generate profits estimated as follows:
 - The purchase of 6.25% working interest could generate annual net income from \$18,476.33 to \$92,759.06, depending upon variations in the total barrels of oil per day, price per barrel of oil, and other factors, and
 - The purchase of 6.25% working interest could result in a net return of \$36,884.41 after the first year, or a first year cash return ranging from 77% to 117% of the amount of investment.
12. Respondents were telling investors that they could purchase the working interests in the wells in the North Guitar Prospect as follows:
 - Investors could purchase 6.25% working interest for \$31,771;
 - Investors could purchase 12.50% working interest for \$63,542; and
 - Investors could purchase 25% working interest for \$127,084.
13. Respondents were representing that the purchase of 6.25% working interest in the wells in the North Guitar Prospect could generate profits estimated as follows:
 - The purchase of 6.25% working interest could generate annual net income from \$15,504.75 to \$144,148.91, depending upon variations in the total barrels of oil per day, price per barrel of oil, and other factors; and
 - The purchase of 6.25% working interest could result in a net return of \$37,997.35 after the first year, or a first year cash return ranging from 76% to 118% of the amount of investment.
14. The working interests in the South Runway Prospect and the North Guitar Prospect had not been registered by qualification, notification, or coordination, and no permit had been granted for their sale in Texas.
15. Respondents were accepting payment through Bitcoin, a digital currency system that incorporates cryptography and is designed to enable users to send money over the Internet without using a credit card or bank account. They had posted a "Quick Response Code" on social media to allow investors to pay for their investments using Bitcoin.
16. The TSSB had previously entered an agreed cease and desist order in December 2006 against Kirk Johnson and Sundance Resources, Inc. This 2006 order did not allege that Mr. Johnson or Sundance Resources engaged in fraud or fraudulent practices, or made any materially misleading or otherwise deceptive statements.

17. The 2006 order stated that Mr. Johnson had violated section 7 of the Texas Securities Act (TSA) by selling unregistered securities.
18. The 2006 order was seven years and three months old at the time of the TSSB's March 10, 2014 Emergency Order against Respondents.
19. Respondents advertised the working interests at the Texas Bitcoin Conference and were continuing to advertise the working interests through other means of general solicitation, including a webpage and social media that were accessible by the general public.
20. Respondents were offering the investments in working interests to purchasers who were not accredited investors. Mr. Johnson claimed that more than one existing investor was an unaccredited investor, and he offered the working interests to at least one Texas resident whom he knew was not an accredited investor.
21. Respondents were not taking reasonable steps to verify that all purchasers were accredited investors.
22. In connection with the offer for sale and sale of working interests in the wells in the South Runway Prospect and the North Guitar Prospect, Respondents disclosed that an investor could lose his entire investment and indicated the locations of dry holes in the area of the two prospects.
23. Respondents relied on an attorney to prepare their offering materials, including the disclosures.

CONCLUSIONS OF LAW

1. The TSSB has jurisdiction over Respondents and the subject matter of this disciplinary action pursuant to the provisions of the TSA. Tex. Rev. Civ. Stat. art. 581-1 *et seq.*
2. The State Office of Administrative Hearings has jurisdiction over matters related to the hearing in this proceeding, including the authority to issue a proposal for decision with findings of fact and conclusions of law. Tex. Gov't Code ch. 2003.
3. On receiving a request for a hearing from a person who is the subject of an Emergency Cease and Desist Order, the Commissioner of the TSSB must serve notice of the time and place of the hearing. The hearing must be held not later than the 10th day after the date the Commissioner receives the request for a hearing unless the parties agree to a later hearing date. Tex. Rev. Civ. Stat. art. 581-23-2(D).
4. Respondents were given adequate notice of the hearing. Tex. Gov't Code §§ 2001.051-.052.

5. At the hearing, the Commissioner has the burden of proof and must present evidence in support of the order. Tex. Rev. Civ. Stat. art. 581-23-2(D).
6. After the hearing, the Commissioner must affirm, modify, or set aside in whole or part the emergency order. Tex. Rev. Civ. Stat. art. 581-23-2(E).
7. Respondents' conduct violated section 7 of the TSA. Tex. Rev. Civ. Stat. art. 581-7.
8. Respondents' conduct, acts, and practices threatened immediate and irreparable public harm. Tex. Rev. Civ. Stat. art. 581-23-2(A).
9. The violation of TSA section 7 constituted a sufficient basis for issuing the Emergency Order. Tex. Rev. Civ. Stat. art. 581-23-2(A)(3).
10. The findings of fact, conclusions of law, and ordering paragraphs of the Emergency Order should be upheld, as modified by the Administrative Law Judge, and as modified by the Securities Commissioner through this order.

MODIFICATIONS TO FINDINGS OF FACT

Pursuant to the provisions of Government Code Section 2001.058, the Commissioner has modified the ALJ's Findings of Fact as follows:

Findings of Fact 24 and 25

As submitted by the ALJ in the PFD, proposed Findings of Fact 24 and 25 read as follows:

24. Respondents did not intentionally mislead or deceive the public.
25. Respondents did not intend to commit fraud or engage in fraudulent practices.

These Findings of Fact have been deleted because the ALJ did not properly apply or interpret applicable law. Respondents' intent to mislead, deceive, commit fraud, or engage in fraudulent practices is not relevant to a determination of whether Respondents' conduct established a sufficient basis for the issuance of an emergency cease and desist order and is not relevant to any other material issue in this matter.

Pursuant to Section 23-2.A(1)(A) and Section 4.F of the TSA, sufficient proof is established that a respondent is engaging in or is about to engage in fraud or fraudulent practice if information is known to a respondent, if it is the conscious objective or desire of the respondent to not disclose the information to a prospective purchaser, and if there is a substantial likelihood that the information not disclosed would have been viewed by a reasonable investor as significantly altering the total mix of available information used in deciding whether to invest.

Similarly, sufficient proof is established under Section 23-2.A(2) of the TSA if a respondent has made an offer of securities involving either a statement that is misleading in light of

information not disclosed—where there is a substantial likelihood that the information not disclosed would have been viewed by a reasonable investor as significantly altering the total mix of available information used in deciding whether to invest—or a statement that is otherwise likely to deceive the public.

The intention of the Legislature in enacting the TSA was to prevent fraud on the Texas public.² Courts are to construe the TSA consistent with its purpose to protect investors.³ The remedial goals of the TSA are focused on investors rather than sellers.⁴ Neither Section 23-2 nor Section 4.F of the TSA impose any requirement that proof must exist of a respondent's *specific intent to defraud the public* before the Commissioner can act to protect investors from false or misleading statements or from non-disclosure of material information in connection with the sale of securities, and no such requirement can appropriately be inferred. Where the Legislature intended to limit the liability of sellers for a material untruth or omission in the sale of securities, it has expressly acted to do so.⁵

Findings of Fact 26, 27, 28, 29, 30, 31, and 32

As submitted by the ALJ in the PFD, proposed Findings of Fact 26, 27, 28, 29, 30, 31, and 32 read as follows:

26. Respondents did not engage in fraudulent, manipulative, or deceptive conduct in regards to the sale of the working interests.
27. Upon issuance of the Emergency Order, Respondents took steps to remedy any harm caused by their actions. Respondents hired new counsel to draft new offering materials. Respondent also made rescission offers to the current investors by offering to refund their investments. In addition, Respondents removed the offering materials from the website and discontinued the use of Bitcoin.
28. Respondents immediately tried to address the findings in the Emergency Order.
29. Respondents' actions did not actually harm an investor.
30. Respondents have eliminated or substantially reduced the potential for harm.
31. Respondents cooperated with the TSSB. Respondents took steps to prevent future occurrences of the violations.

² See Senate Bill No. 294, Chapter 269, §40. Declaration of Emergency and Effective Date of the Act, Acts of the 55th Legislature, Regular Session, 1957.

³ Tex. Rev. Civ. Stat. Ann. art. 581-10-1.B (West 2010).

⁴ *Shields v. State*, 27 S.W.3d 267, 274 (Tex. App.—Austin 2000).

⁵ See Tex. Rev. Civ. Stat. Ann. art. 581-33.A(2) (West 2010) (relating to civil liability for certain sellers of securities).

32. Respondents have taken steps to comply with the securities laws in the future.

These Findings of Fact have been deleted because they relate to the issue of future bad actor disqualification under 17 C.F.R. §230.506(d)(1)(iii)(B) and contain language that is not relevant to any material issue in this action. This issue was not a matter properly before SOAH. As the ALJ noted in the PFD, this issue was not referred to SOAH, neither party directed the ALJ to statutory authority authorizing a contested case hearing on the issue of bad actor disqualification, and determining whether to affirm the Emergency Order did not require resolution of this issue.

Additionally, the issue is moot given the modifications made herein to the initial Emergency Order. The disqualification in 17 C.F.R. §230.506(d)(1)(iii)(B) applies only to final orders based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct. As modified, the final order in this matter is based on a violation of Section 7 of the TSA which prohibits offering unregistered securities for sale in the state. The order as modified is not based on fraudulent, manipulative, or deceptive conduct, therefore disqualification does not arise as a consequence of this order.

MODIFICATIONS TO CONCLUSIONS OF LAW

Technical changes to the proposed Conclusions of Law have been made without being detailed below. Such non-substantive changes include a grammatical correction and a reference to the modifications being made to the Emergency Order by the Commissioner. Substantive changes to the Conclusions of Law are detailed below, along with a recitation of the specific reasons and legal bases for the changes.

Pursuant to the provisions of Government Code Section 2001.058, the Commissioner has modified the ALJ's Conclusions of Law as follows:

Conclusion of Law 9

As submitted by the ALJ in the PFD, proposed Conclusion of Law 9 read as follows:

9. The violation TSA section 7 constituted a sufficient basis for issuing the Emergency Order. Tex. Rev. Civ. Stat. art. 581-23-2(A)(2).

The Commissioner modified this Conclusion of Law to reflect the proper authority for issuance of the Emergency Order. Respondents' violation of Section 7 constituted a sufficient basis for issuing the Emergency Order under Section 23-2.A(3) of the TSA. Under Section 23-2.A(3), the Commissioner may issue an emergency cease and desist order to a person whom he reasonably believes is engaging or is about to engage in an act or practice that violates the TSA or a Board rule. Section 23-2.A(2) of the TSA, the provision cited in the proposed Conclusion of Law, permits the Commissioner to issue an emergency cease and desist order to a person whom he reasonably believes has made an offer containing a statement that is materially misleading or is otherwise likely to deceive the public. There are no Findings of Fact to support issuance of the order under Section 23-2.A(2).

Conclusions of Law 11 and 12

As submitted by the ALJ in the PFD, proposed Conclusions of Law 11 and 12 read as follows:

11. This order does not constitute a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct. 17 C.F.R. §230.506(d)(1)(iii)(B).
12. Disqualification under 17 C.F.R. §230.56(d)(1) should not arise as a consequence of this order. 17 C.F.R. §230.506(d)(2)(iii).

These Conclusions of Law have been deleted because the issue of future bad actor disqualification under 17 C.F.R. §230.506(d)(1)(iii)(B) was not a matter properly before SOAH. As the ALJ noted in the PFD, this issue was not referred to SOAH, neither party directed the ALJ to statutory authority authorizing a contested case hearing on the issue of bad actor disqualification, and determining whether to affirm the Emergency Order did not require resolution of this issue.

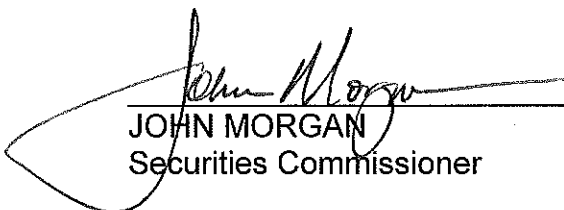
Additionally, the issue is moot given the modifications made herein to the initial Emergency Order. The disqualification in 17 C.F.R. §230.506(d)(1)(iii)(B) applies only to final orders based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct. As modified, the final order in this matter is based on a violation of Section 7 of the TSA which prohibits offering unregistered securities for sale in the state. The order as modified is not based on fraudulent, manipulative, or deceptive conduct, therefore disqualification does not arise as a consequence of this order.

ORDER

IT IS THEREFORE ORDERED that the Emergency Cease and Desist Order No. ENF-14-CDO-1731 issued against BALANCED ENERGY, LLC and KIRK JOHNSON on March 10, 2014, shall be modified according to the PFD, as modified by the Securities Commissioner, as set forth above.

ACCORDINGLY, IT IS ORDERED that Respondents immediately CEASE AND DESIST from offering for sale any security in Texas until the security is registered with the Securities Commissioner or is offered for sale pursuant to an exemption from registration under the Texas Securities Act.

SIGNED and ENTERED by the Securities Commissioner this 14th day of July, 2016.


JOHN MORGAN
Securities Commissioner

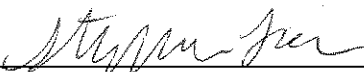
CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been sent to the Respondents by certified mail, return receipt requested, at their last known addresses on Page 1 of this Order; to the Respondents' attorneys of record via email and certified mail, return receipt requested to their addresses that appear below; to the Staff by hand-delivery; and by interagency mail to the State Office of Administrative Hearings, at the address noted below, on this the 14 day of July, 2016.

Greg Weselka
Dan Waller
Secore & Waller, L.L.P.
Merit Tower
12222 Merit Drive, Suite 1350
Dallas, Texas 75251
greg@secorewaller.com
dan@secorewaller.com
Attorneys for Respondents

Travis J. Iles
Jeremy E. Heintz
State Securities Board
208 East 10th Street, Fifth Floor
Austin, Texas 78701

State Office of Administrative Hearings
P.O. Box 13025
Austin, Texas 78711-3025



Stephanie Tourk
Assistant General Counsel
Texas State Securities Board