BLAST ENERGY SERVICES, INC.
Form 10KSB
April 17, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Form 10-KSB

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2006**

o TRANSITIONAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from_____ to

Commission file number: 333-64122

Blast Energy Services, Inc.
(Name of small business issuer in its charter)

California	**22-3755993**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

14550 Torrey Chase Blvd, Suite 330
Houston, Texas 77014
(Address of principal executive offices)

(281) 453-2888
(Telephone number)

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: None

Check whether issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-KSB or any amendments to this Form 10-KSB. x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). oYes xNo

Issuer's revenues for the most recent fiscal year: $3,243,487

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold on March 30, 2007 is $ 4,194,920.

The number of shares outstanding of each of the issuer's classes of common equity, as of December 31, 2006:

Common Stock: 67,609,904 shares, including 1,150,000 approved shares arising from the class action settlement, described below in greater detail.

No (1) annual report to security holders; (2) proxy or information statement; or (3) any prospectus filed pursuant to Rule 424(b) or (c) of the Securities Act of 1933; are incorporated by reference into any part of this Form 10-KSB.

Transitional Small Business Disclosure Format: oYes x No

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Item 1. Description of Business

Forward-Looking Statements

Certain statements concerning our plans and intentions included herein may constitute forward-looking statements, including, but not limited to, statements identified by the words “anticipate”, “believe”, “expect” and similar expressions and statements regarding our business strategy, plans, beliefs and objectives for future operations. Although management believes that the expectations reflected in these forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct. There are a number of factors that may affect our future results, including, but not limited to, (a) our ability to obtain additional funding for development and operations, (b) the continued availability of management to execute the business plan, (c) successful deployment and market acceptance of our products, and (d) the resolution of legal matters that may inhibit the execution of the business plan.

This annual report may contain both historical facts and forward-looking statements. Any forward-looking statements involve risks and uncertainties. Moreover, future revenue and margin trends cannot be reliably predicted.

Important Investor Information

On January 19, 2007, Blast Energy Services, Inc. (“we,” “us,” the “Company,” “Blast” and words of similar meaning) and its wholly owned subsidiary, Eagle Domestic Drilling Operations LLC, filed voluntary petitions with the US Bankruptcy Court for the Southern District of Texas - Houston Division, under Chapter 11 of Title 11 of the US Code in order that they may dispose of burdensome and uneconomical assets and reorganize their financial obligations and capital structure. Accordingly, we urge that caution be exercised with respect to existing and future investments in our equity securities.

Business Development

In September 2000, we were incorporated as Rocker & Spike Entertainment, Inc, a California corporation. Until December 31, 2000, our operations consisted of organizational matters and the search for an operating company with which to perform a merger or acquisition. Effective January 1, 2001, we purchased the assets and web domain of Accident Reconstruction Communications Network from its sole proprietor. Following that acquisition, we changed our name from Rocker & Spike Entertainment, Inc. to Reconstruction Data Group, Inc. At that time, we provided research, communication and marketing exposure to the accident reconstruction industry through our website and seminars.

In April 2003, we entered into a merger agreement with Verdisys, Inc. (“Verdisys”). Verdisys was initially incorporated as TheAgZone Inc. in 1999 as a California corporation. Its purpose was to provide e-Commerce satellite services to agribusiness. They changed their name to Verdisys in 2001, and in 2003, with the acquisition of exclusive rights to a proprietary lateral drilling process throughout most of the US and Canada, they changed their market focus to concentrate on services to the oil and natural gas (“oil and gas”) industry.

The merger agreement with Verdisys called for us to be the surviving company. In connection with the merger, our name changed to Verdisys, Inc., our articles of incorporation and bylaws remained in effect, the officers and directors of Verdisys became our officers and directors, each share of Verdisys’ common stock was converted into one share of our common stock, our accident reconstruction assets were sold, and our business focus changed to the oil and gas industry.

Effective June 6, 2005, we formally changed our name to Blast Energy Services, Inc. (“Blast” or “Blast Energy”) from Verdisys, Inc., in part to reflect our focus on the energy service business. We have shifted our business strategy away

from an agricultural related business toward energy services.

In August 2006, we acquired Eagle Domestic Drilling Operations LLC (“Eagle”), a drilling contractor which at that time owned three land rigs, and had three more under construction. The acquisition of Eagle added a major new segment to our business, which we expect to represent our primary business operations in the near term. Throughout this Form 10-KSB, references to our operations include the operations of Eagle, unless otherwise stated or the context suggests otherwise.

As part of the financial consideration for the purchase of Eagle, we entered into a Securities Purchase Agreement ("SPA") dated August 25, 2006 with Laurus Master Fund, Ltd. ("Laurus") to finance $40.6 million of the total purchase price of Eagle. Under the SPA, we issued a Secured Term Note ("the Note") dated August 25, 2006 in the original principal amount of $40.6 million with a final maturity in three years, with interest at prime plus 2.5%, with a minimum rate of 9%, currently equal to 10.75% as of the filing of this report, payable quarterly to Laurus. The principal was to be repaid commencing April 1, 2007 at a rate of $800,000 per month for the first twelve months from that date, $900,000 per month for the subsequent twelve months and $1,000,000 per month until the Note matures. The remaining balance of the Note is to be paid at maturity with any associated interest.

The SPA required the additional payment in cash fees to Laurus of 3.5% of the total value of the investment of $40.6 million at closing. The SPA further required the issuance of Common Stock Purchase Warrants ("Warrants") to purchase 6,090,000 shares of our common stock at an exercise price of $1.44 per share, and an additional 6,090,000 shares of common stock at an exercise price of $0.01 per share. The Warrants have a seven year term and we were required to file a registration statement to register the underlying shares within 60 days after closing and to obtain effectiveness with the SEC within 180 days after closing, which registration statement has since been filed and withdrawn, and which filing has since been abandoned by us. The Laurus financing was privately arranged through a broker who received a 2% commission in cash and warrants with a two year term to purchase 304,500 shares of our common stock at an exercise price of $0.01 per share.

In connection with our voluntary bankruptcy petition, described below, we ceased making payments under the Note as of December 31, 2006.

Recent Events

On January 19, 2007, Blast and Eagle, filed voluntary petitions with the US Bankruptcy Court for the Southern District of Texas - Houston Division (the "Court") under Chapter 11 of Title 11 of the US Code in order that we may dispose of burdensome and uneconomical assets and reorganize our financial obligations and capital structure (Case Nos. 07-30424-H4-11 and 07-30426-H4-11, respectively). This action also stayed any existing lawsuits filed against us and Eagle, regardless of jurisdiction. Moving forward, we and Eagle will continue to operate our businesses as "debtors-in possession" under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court.

We had previously used assumptions in the August 2006 acquisition of Eagle that included high revenue and full utilization rate expectations based upon the five two-year term drilling contracts Eagle had in place at the time. The subsequent cancellation of these contracts by Hallwood Energy/Hallwood Petroleum and Quicksilver Resources in the fall of 2006 reduced our revenue expectations and consequently our ability to meet the scheduled payments on the Laurus' Note. This cancellation was in violation of the terms of the drilling contracts and we and Eagle have subsequently filed suit for breach of those contracts.

In approximately January 2007, we received written notice from Laurus of various events of default under the SPA, Note and related agreements. Further discussions with Laurus resulted in the mutual decision that we should file for protection under the applicable bankruptcy law, as described above. Additionally, these discussions resulted in a consensual stipulation that will enable us to continue to use cash collateral during the course of the Chapter 11 case, subject to certain reservations and provisions for adequate protection of Laurus debts.

Additionally, we have reached an agreement with Laurus, which agreement has not been approved by the Bankruptcy Court, on the terms of an asset purchase agreement intended to offset the full amount of the $40.6 million senior Note, accrued interest and default penalties. Under the terms of this agreement, only the five land drilling rigs and associated spare parts will be sold to repay the Note, accrued interest and default penalties on the Note. The potential benefit of the customer litigation, the satellite communication business and the abrasive fluid jetting technology, described in

greater detail below, will remain with us subsequent to the sale of the rigs. The asset purchase agreement and plan of reorganization are subject to the approval of the Court, which we believe will be heard by the court before the end of April 2007.

On April 9, 2007, we entered into an amendment with David M. Adams, our current President and former Co-Chief Executive Officer, pursuant to which we amended the terms of Mr. Adam's January 17, 2004 employment agreement. Pursuant to the amendment, Mr. Adams will serve as our President until June 30, 2007, will be compensated at the rate of $80,000 per year, instead of the $200,000 per year that he was previously scheduled to make, will work on Company matters at least 2 days per week, will lose any unvested stock options as of March 31, 2007, and will have an unsecured claim at June 20, 2007, for six months of severance pay, one month of vacation pay, one half month of 2006 pay for a total value of $125,000, as well as 9 months of COBRA payments for medical and dental benefits under his employment agreement. Such agreement is subject to approval of the Bankruptcy court.

On April 1, 2007, subject to the approval of the Bankruptcy Court, we entered into a nine (9) month lease for office space for our corporate offices. Pursuant to the lease we agreed to lease approximately 2,000 square feet of office space in Houston, Texas at a cost of $2,000 per month, pursuant to a lease which expires on December 31, 2007. This lease substantially decreased the amount of rent we were paying pursuant to our previous lease agreement, which we believe will help us lower our overhead and meet our current expenses during the Bankruptcy proceeding.

Blast is currently in discussions to merge with another energy company that has oil and gas production as well as certain energy service technologies. Discussions are at an early stage and no assurances can be given that such a merger will be consummated or that the economic terms of such a merger would be favorable to Blast shareholders or creditors.

Description of Business

Our mission has been to provide quality services to the energy industry through our three divisions:

- contract land drilling services,
- down-hole solutions, such as our abrasive fluid jetting technology, and
- satellite communication services to remote locations.

Our strategy is to grow our businesses by maximizing our equipment capacity and controlling costs while analyzing potential acquisition and new technology opportunities in the energy service sector.

As a result of the recent acquisition of Eagle, we had hoped to establish a contract land drilling business. We currently own four US onshore drilling rigs with a fifth rig partially constructed and various spare parts. Substantially all of our rigs can operate in conventional crude oil and natural gas producing areas, where conventional and specialized drilling techniques are required to develop crude oil and natural gas resources efficiently. All of our drilling rigs are equipped to handle drilling for horizontal wells. Horizontal (or lateral) drilling is a specialized drilling technique intended to increase the exposure of the wellbore to the natural gas producing formation and increase drainage rates and production volumes. Moving forward, we hope to sell off all of these rigs and our partially constructed rig, as well as other various drilling equipment, pursuant to the asset purchase agreement with Laurus, described above, which we believe, if approved by the Bankruptcy Court, will satisfy our outstanding debts with Laurus. Assuming the asset purchase agreement is approved, we will cease all land drilling operations for the near future, although we may choose to have land drilling operations in the future, subsequent to the finalization of our reorganization plan.

Separate from the contract land drilling business, we have been striving to develop a commercially viable lateral drilling technology with the potential to penetrate through well casing and into reservoir formations to stimulate oil and gas production using abrasive fluid jetting ("AFJ") and the principles gained from the non-abrasive process used in the Landers lateral drilling technology, which we obtained the patented rights to in April 2003, as described below under "Patents and Licenses." After redesigning and improving the existing process and introducing AFJ technology, we now believe that we can deliver a valuable and cost effective production enhancement service to onshore oil and gas producers, particularly operators of marginal wells. We have recently completed the construction of a new generation specialty rig based upon modifications using existing coiled tubing technology as the primary platform. The

capabilities of our new rig include: one-inch coiled tubing with a working depth capability of approximately 8,000 feet; a fluid pressure pumping system; an abrasive slurry system; and a computer-controlled system to guide and control the down-hole formation access tool for precise casing milling and jetting services. The AFJ rig was deployed during the fourth quarter of 2006 and has undergone developmental tests with the US Department of Energy Rocky Mountain Oilfield Testing Center, outside Casper, Wyoming.

Another of our business segments is providing satellite communication services to energy companies. This service allows such energy companies to remotely monitor and control well head, pipeline, drilling, and other oil and gas operations through low cost broadband data and voice services, transmitted from remote operations where terrestrial or cellular communication networks do not exist or are too costly to install.

Following the approval of our planned asset purchase agreement with Laurus, which we can give no assurances will be approved; we will sell substantially all of our contract land drilling operations and operate solely in the down-hole solutions and satellite communication services industries. As a result, although we operated in the contract land drilling industry in a limited basis during 2006, the description of our current business operations below focuses more on our planned operations moving forward. Additionally, in the future, our broader vision is to introduce additional early stage technologies to the energy services sector, all of which would fit our mission of helping energy companies produce oil and gas more economically.

Energy Industry

We operate in the energy services industry which services the broader upstream energy industry, where companies explore, develop, produce, transport, and market oil and gas. This industry is comprised of a diverse number of operators, ranging from very small independent contractors to the extremely large corporations. While the majority of oil and gas production is produced by very large international oil companies, there are also a large number of smaller independent companies who own and operate a large number of new and existing wells.

As a smaller firm with a specialized service, we intend to provide contract drilling, down-hole solutions and satellite communication services to both small and large operators in the energy industry. As we grow, we intend to cater to all segments of the industry in situations where the application of our services will add value to our customers.

Demand for our services depends on our ability to demonstrate improved economics, primarily to the oil and gas production sector we serve. We believe that oil and gas developers will use our contract drilling and abrasive jetting service where the use of such services costs those developers less than other available alternative services and/or when they perceive such use will be able to cost effectively increase their production and reserves. We also believe the use of our technology will be influenced by macro-economic factors driving oil and gas fundamentals.

We believe that producing companies will react to the combination of the increased demand and the limited supply of oil and gas in a manner that requires them to utilize all segments of our business. We believe that oil and gas producers have and will continue to have great economic incentives to recovering additional production and reserves from known reservoirs rather than pursuing a more risky exploration approach. Our abrasive jetting technology may permit producers to add value by potentially recovering a significant additional percentage of the oil and gas from a reservoir. We believe that a large potential market exists in North America for our contract drilling services (which we are currently in discussions to sell to Laurus, as described above) and our ongoing abrasive jetting stimulation methods.

Activity in the energy services industry tends to be cyclical with oil and gas prices. In addition to the currently positive industry fundamentals, we believe the following sector-specific trends enhance the growth potential of our business sectors:

• While oil prices are unpredictable, they have remained and are projected to remain relatively high by historic terms for several years. Continuing high consumption and strong growth in Asian demand, limitations in delivery infrastructures and political unrest in major supplying countries are expected to be contributing factors.

• Gas prices, while volatile, are projected to remain high for several years due to the combination of strong demand and major supply constraints The situation is serious enough that former Federal Reserve Bank Chairman Greenspan has expressed concern as to its effect as a constraint to US economic growth during his testimony before the Joint Economic Committee of Congress on May 21, 2003 and in updates since that time.

• There is no substitution threat to oil and gas in the foreseeable future. In particular, any significant substitution by hydrogen or any other potential source is believed by management to be some decades away.

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Land Rig Drilling Services

We entered into the land rig drilling services sector in August 2006 with the acquisition of Eagle which owned three drilling rigs and had at that time an additional three under construction (one of which has been completed, one of which we have not completed, and the other of which is still under construction as of the filing of this report). Eagle had limited drilling operations during the remainder of the third and fourth quarters of 2006, and has since ceased all drilling operations. Moving forward, we plan to sell all four of our currently operational rigs and our rig under construction to Laurus to satisfy the debts which Eagle owes Laurus pursuant to an asset purchase agreement, as described above. Assuming the asset purchase agreement is approved by the Bankruptcy court, of which there can be no assurance, Blast will continue to retain the right to sue two parties Hallwood Energy/Hallwood Petroleum and Quicksilver Resources, with whom Eagle had previously entered into agreements prior to our purchase of Eagle, which were subsequently breached, leading to our inability to meet our ongoing payments to Laurus, and forcing us to enter Chapter 11, Bankruptcy.

From August 2006 until December 2006 we performed limited land rig drilling activities, which totaled approximately $2,200,000 in revenue, 68% of our total revenues for the year ended December 31, 2006.

Drilling contracts

Contracts for drilling oil and gas wells are obtained either through competitive bidding or through direct negotiations with customers. Typical drilling contracts provide for compensation on a "daywork" or "footage" basis. Contract terms we offered generally depended on the complexity and risk of operations, the on site drilling conditions, the type of equipment used and the anticipated duration of the work to be performed. Our contracts generally provided for the drilling of a single well or a series of wells and permitted the customer to terminate on short notice.

Daywork contracts. These are the most common form of contract, typically using the International Association of Drilling Contractors (“IADC”) standard form of contract. Under these contracts, we provided a drilling rig with required personnel to the operator, who supervised the drilling of the well. We were then paid based on a fixed rate of compensation per day while the rig is utilized.

Rig Information

A land drilling rig consists of engines, a hoisting system, a rotating system, pumps and related equipment to circulate drilling fluid, blowout preventers and related equipment. Our rigs use diesel engines as their main power source. Power requirements for drilling jobs may vary considerably, but most land drilling rigs employ two or more engines to generate between 500 and 2,000 horsepower, depending on well depth and rig design.

There are numerous factors that differentiate land drilling rigs, including their power generation systems and their drilling depth capabilities. The actual drilling depth capability of a rig may be less than or more than its rated depth capability due to numerous factors, including the size, weight and amount of the drill pipe on the rig. The intended well depth and the drill site conditions determine the amount of drill pipe and other equipment needed to drill a well. Generally, land rigs operate with crews of four to six people.

Down-Hole Solutions

Our down-hole solutions division intends to provide casing milling, perforation, well stimulation and lateral drilling services to oil and gas producers. As a co-owner of intellectual property with Alberta Energy Partners (“Alberta”) formerly known as Alberta Energy Holding, Inc., we also have exclusive worldwide licensing rights for the application of Alberta’s patent pending Abrasive Fluid Jet (“AFJ”) cutting technique to cut through well casing and formation rock in oil and gas wells. AFJ is being added to, and we believe will enhance the existing principles of

non-abrasive lateral jetting and completion techniques utilized by us and the industry as a whole. Applications of such abrasive cutting techniques are a proven feature in industries as diverse as munitions disposal in the military, offshore platform dismantlement in the salvage industry and cutting specialty glass and steel in the machining business. When we commercialize our technology, we would be among the first to commercially apply the proven abrasive jetting techniques to the energy producing business.

In 2006 we completed the construction of a new generation specialty rig based upon modifications using existing coiled tubing technology as the primary platform. The capabilities of our new rig include: one-inch coiled tubing with a working depth capability of 8,000 feet; a fluid pressure pumping system; an abrasive slurry system; and a computer-controlled system to guide and control the down-hole formation access tool for precise casing milling and jetting services. During November 2006, the Department of Energy operated Rocky Mountain Oilfield Testing Center (RMOTC), and Blast successfully tested the prototype rig at their location in Wyoming. While on location, down-hole video cameras verified the results of operations in the down-hole environment. In this case, the camera verified that Blast's new technology was able to cut holes, slots and windows in the well casing and confirmed further penetration into the rock formations beyond the well casing. The testing team believes that this can be an innovative new oil and gas drilling technology that when commercialized should facilitate lower production costs and increased access to reserves. We will retain the rights to our AFJ technology and the current rig subsequent to our planned entry into the asset purchase agreement with Laurus described above. As of the date of this report, our AFJ rig is currently awaiting some minor repairs and we are waiting for additional funding to continue testing and developing such technology, which we can provide no assurances will be forthcoming.

Major Customers

We currently have no active customers for our AFJ rig, as the rig has not yet been proven commercially successful.

Market

It has become clear in recent years that while the demand of oil and gas in the US continues to grow, its ability to meet this demand from existing and new sources is rapidly declining. This accelerated decline will require producers to seek new extraction methods or technologies to exploit oil and gas production from existing fields and we anticipate that our abrasive jetting process will help satisfy the need for these new technologies. According to the Department of Energy, there have been 2.3 million wells drilled in the US since 1949. "Historically, only some 30% of the total oil in a reservoir - the "original oil-in-place" - was recoverable. As pressure declines in the reservoir, the oil becomes costlier and costlier to produce until further production becomes uneconomic…recent advances now allow greater recovery from old reservoirs."

Competition

Our AFJ business is expected to operate in a niche that lies between the more expensive and higher impact conventional horizontal drilling business and the much cheaper and lower impact casing milling and perforation businesses. We believe that our abrasive jetting service, once proven, can provide significant reservoir exposure, and therefore greater production potential, similar to horizontal drilling at a cost closer to that of a perforation service.

Conventional horizontal or directional drilling is slower and significantly more expensive to the extent that it is only being used if its much longer drilling radius was required as is necessary in offshore or environmentally sensitive areas. Companies offering this service include Halliburton, Baker Hughes, Schlumberger and other independent service companies. However, our competitors are better financed, equipped and resourced than us.

Satellite Communications

Our final business segment provides satellite communication services to oil and gas producers. Historically, it has been common practice for oil and gas companies to manually gather much of their data for energy management, and communicate using satellite phones or cellular service where available. This is not only expensive but also causes a significant time lag in the availability of critical management information. The Blast Satellite Private Network ("BSPN") services utilize two-way satellite broadband to provide oil and gas companies with a wide variety of remote energy management communications and applications. Satellite's capability to provide secure broadband to any remote

location in the world gives it unique capabilities over terrestrial and cellular networks. Technology advancements now facilitate not only data, email and internet traffic but also Voice over Internet ("VoiP") and video streaming. Bandwidth traffic capabilities of base station have also increased significantly allowing larger and faster file and data transfer capabilities to compete with terrestrial systems. Satellites capability to operate off stationary and mobile remote dishes with no supporting infrastructure has proven invaluable in both disaster recovery and remote or continuously moving commercial operations.

Our satellite services can be optimized to provide cost effective applications such as VoIP, Virtual Private Networking "VPN" and Real-time Supervisory Control and Data Acquisition Systems, commonly referred to as "SCADA". SCADA permits oil and gas companies to dispense with a manual structure and move to a real-time, automated, energy management program. Utilizing SCADA, a service we currently offer, production levels can be optimized to meet the producer's current market demands and commitments.

At present, we acquire modem hardware from ViaSat, iDirect Technologies and Spacenet and install this equipment on our customers' onshore and offshore platforms. Space segment services are acquired from SES and Loral and hub services from Constellation, Isotropic Networks, Viasat and Spacenet.

We use satellite communications that are low cost and that ensure worldwide availability, even in geographic areas with a poor communications infrastructure. Our satellite services are based on industry standards to lower implementation costs and to simplify the integration into existing systems. Reliability and availability are critical considerations for SCADA. Satellite services are provided 24 hours a day, 7 days a week with 99.9% availability virtually anywhere in the world. Our satellite services offer fewer points of failure than comparable terrestrial services, provide uniform service levels, and are faster and more cost effective to deploy. Our satellite services are also very flexible and easily accommodate site additions, relocations, bandwidth expansion, and network reconfiguration.

Additionally, security, integrity, and reliability have been designed into our satellite services to ensure that information is neither corrupted nor compromised. Satellite communications are more secure than many normal telephone lines.

Major Customers

Our current satellite services customers include Apache Corporation, BP America Production Company, and General Electric Company, representing 18%, 20% and 9%, respectively, of our satellite revenues for the year ended December 31, 2006.. Contracts are usually for hardware, backhaul, and bandwidth. Virtually any oil and gas producer, of which there are thousands, is a potential customer for our satellite services.

Market

According to the Department of Energy there are more than two million oil and gas wells in existence in the US alone, many of which are located in remote or rural areas where communications and monitoring well status can be difficult and expensive. Such well locations could benefit from the economics of our real-time, high speed satellite connectivity services as compared to more conventional monitoring alternatives, such as, the time consuming and costly transportation of personnel to remote well locations, or the equipment and maintenance costs of laying land lines for real-time monitoring of remote well operations. Our focus is serving the needs of oil and gas producers worldwide to control their production effectively and to enhance customer satisfaction by providing worldwide real-time access to information. This market for satellite services is very competitive with increasing pressure on margins our larger competitors offer services at substantially discounted prices. We attempt to compete against such competitors by attempting to target niche markets and offering alternative solutions that solve customers' complex communication problems at more cost effective rates. We utilize satellite, Wi-Fi and other wireless technology for the last mile of wellhead connectivity for these customers and focus almost exclusively on the oil and gas market.

Competition

The satellite communication industry is intensely competitive due to overcapacity, but we believe that competition is less severe in the oil and gas producing sector. Other satellite services providers in the oil and gas industry include, Stratus Global, Tachyon, Schlumberger and Caprock. Caprock, Schlumberger and Stratus are focused on the top 20% of the market, particularly international and offshore platforms, and Stratus Global is focused on the offshore market using a traditional wireless network. We believe our satellite services offer advantages over those services by:

- Customizing the provided service to better meet the customer's needs;
- Offering superior speed;
- Providing single vendor convenience; and
- Offering lower up-front infrastructure and operating costs.

Insurance

Our oil and gas operations are subject to hazards inherent in the oil and gas industry, such as accidents, blowouts, explosions, implosions, fires and oil spills. These conditions can cause:

a) personal injury or loss of life
b) damage to or destruction of property, equipment and the environment
c) suspension of operations

In addition, claims for loss of oil and gas production and damage to formations can occur in the well service industry. Litigation arising from a catastrophic occurrence at a location where our equipment and services are being used may result in us being named as a defendant in lawsuits asserting large claims.

We maintain insurance coverage that we believe to be customary in the industry against these types of hazards. However, we may not be able to maintain adequate insurance in the future at rates we consider reasonable. In addition, our insurance is subject to coverage limits and some policies exclude coverage for damages resulting from environmental contamination. The occurrence of a significant event or adverse claim in excess of the insurance coverage that we maintain or that is not covered by insurance could have a materially adverse effect on our financial condition and results of operations.

Patents and Licenses

Effective August 25, 2005, we entered into a definitive agreement to purchase from Alberta Energy Partners (“Alberta”) an interest in the AFJ technology that provides us the unrestricted right to use the technology and license the technology worldwide to others. We expect to utilize the technology as the foundation for our energy services business.

As part of the agreement, we issued Alberta 3,000,000 shares of restricted common stock, with registration rights, and warrants to purchase 750,000 shares of our common stock at an exercise price of $0.45 per share. The warrants have a three-year term and vest when we receive $225,000 in revenue from our initial rig utilizing the technology, which has not occurred to date. We also agreed to pay Alberta a royalty payment of $2,000 per well bore or 2% of the gross revenues received in connection with each well bore, whichever is greater, in connection with the licensing of the technology. The parties also agreed to share any revenues received by us from licensing the technology, with Alberta receiving 75% of licensing revenues until it receives $2,000,000, at which time its proportion of the licensing revenue shall decrease to 50%, thereafter. Our ownership interest in the technology is 50%. Either party has a right of first refusal on any new applications of the technology by the other party, or any sale of the other party's interest in the technology. However, following our Chapter 11 restructuring filing, Alberta Energy Partners filed suit to rescind the Technology Purchase Agreement, which we entered into in August 2005. We intend to vigorously defend our ownership rights to this technology. A hearing on this matter has not yet been scheduled by the Bankruptcy Court.

On April 24, 2003, we entered into an agreement to license the Landers Horizontal Drilling Process, based on US Patent Nos. 5,413,184, 5,853,056, and 6,125,949, relating to certain oil and gas well production enhancement techniques and devices and related trade secrets with the inventor and holder of the patents and trade secrets, Carl Landers. The license gave us exclusive rights to apply the technology and the related trade secrets in all of the US (except for part of Colorado West of the Rockies, and Utah) and Canada. Mr. Landers also reserved the rights to certain applications in which he has a direct interest but may not compete with us. Any improvements to the technology remain the sole property of the licensor but are provided to us without additional licensing fees. The license terminates upon the expiration of the underlying patents, the earliest date being October 1, 2013.

On March 8, 2005, we entered into an Assignment of License Agreement ("Assignment") with Maxim TEP ("Maxim"). The President and CEO of Maxim is Daniel W. Williams, our former President and CEO. Under the assignment, we assigned to Maxim our rights in the license of the Landers Horizontal Drilling Process; all current and future negotiations for assignments, sublicenses or territorial royalty pertaining to the license and two lateral drilling rigs. As consideration, Maxim has paid $1,300,000 in principal payments and $500,000 in penalties for extending the payment deadlines and released a $270,000 credit obligation we owed to Maxim. We will retain a non-exclusive sublicense interest in the Landers Horizontal Technology provided we pay all required royalties in utilizing the technology.

We believe the AFJ technology and related trade secrets are instrumental to our competitive edge in the oil and gas service industry. We are highly committed to protecting the technology. We cannot assure our investors that the scope of any protection we are able to secure for our license will be adequate to protect it, or that we will have the financial resources to engage in litigation against parties who may infringe on our exclusive license. We also can not provide our investors with any degree of assurance regarding the possible independent development by others of technology similar to that which we have licensed, thereby possibly diminishing our competitive edge.

Governmental Regulations

Assuming we begin commercial drilling operations, we may be subject to various local, state and federal laws and regulations intended to protect the environment. Such laws may include among others:

- Comprehensive Environmental Response, Compensation and Liability Act;
- Oil Pollution Act of 1990;
- Oil Spill Prevention and Response Act;
- The Clean Air Act;
- The Federal Water Pollution Control Act; Louisiana Regulations; and
- Texas Railroad Commission Regulations.

These operations may involve the handling of non-hazardous oil-field wastes such as sediment, sand and water. Consequently, the environmental regulations applicable to our operations pertain to the storage, handling and disposal of oil-field wastes. State and federal laws make us responsible for the proper use and disposal of waste materials while we are conducting operations. As our operations are presently conducted, we do not believe we are currently required under applicable environmental laws to obtain permits to conduct our business. We believe we conduct our operations in compliance with all applicable environmental laws, however, there has been a trend toward more stringent regulation of oil and gas exploration and production in recent years and future modifications of the environmental laws could require us to obtain permits or could negatively impact our operations.