SPEE EUROPE

MINUTES OF MEETING

MARCH 9TH, OCTOBER GALLERY

Note: the minutes have been prepared under “Chatham House Rules” so attendee names have been omitted. However, the speaker’s name and the committee members’ names have been retained.

Chapter business

Paul Taylor, President, opened the meeting and welcomes the attendees.

Dom Salacz, Membership secretary, gave his report. There are now 36 full European members. Two new members are Carolina Coll and Jonathan Westbury – welcome to both.

One member has left, one application is going before the board and about 20 applications are in progress.

2017 Annual conference

Simon McDonald gave an update on the SPEE Annual conference, to be held in London. It is only 3 months away and to date there has been “encouraging” booking. The conference will be from the 10th to the 13th of June. Registration is open and the full cost of the conference will be $600. This year there will be emphasis on legal and accounting.

The Victoria Plaza Hotel offers preferential rates to SPEE conference attendees - £260/night – although the offer period is close to closing.

There are still many registration packages open, from £500 upwards.

All details are available on the SPEE website

https://secure.spee.org/2016-news/2017-annual-meeting-information

SPEE Head office update

Paul Taylor gave an update on business at Head Office.

The new president is Floyd Siegle, based out of Calgary. There are now 558 members (as of end 2016). This number is reasonably steady.

The Fair Value Monograph is being updated – this is a long process.

A committee has been formed to write a Monograph on Type Curves which will be issued in 2019.

Dom Salacz is to represent the SPEE on the UNECE EGRC committee.

Evening talk

John Baillie, of Verus Petroleum gave the evening's talk on "The small independent oil company perspective on reserves audit and CPRs"

John started by introducing Verus – its is a lean organization of 14 people, backed by the Norwegian Private Equity firm HitecVision. They have 8mmboe net, 2000 bopd production and three producing fields, Boa, Cormorant East and Duart, all in the North Sea.

Verus's business strategy is to try and do the right deal along with smart engagement with the supply chain. The Private Equity group give the company freedom but advise "make sure you've done it before" and "manage to milestones".

John then went into the body of the presentation and showed a real field with production data shown on a logarithmic scale and cumulative production shown on a linear scale. At various points in time he showed what decline curves would have predicted and then showed what the actual data was. The data showed the DCA to be wildly pessimistic, although comments from the floor noted that the inverse was also possible.

John continued to note that much of the North Sea growth is now in the hands of the small independent, backed by Private Equity. Growth comes from debt, debt comes from reserves and reserves need to reflect fair value – they cannot be conservative.

John explained the difference between Reserves Audits and CPRs at Verus. The Audits were annual affairs, a corporate requirement and designed to confirm the value of existing fields. These audits could be planned. The CPRs, however, were typically required when looking at an acquisition, and so by their nature were “short fuse”, ad-hoc, and for new assets.

John then went on to degrees of work required by the auditors or competent persons. He suggested that it was not always necessary to start from scratch, especially if the asset already had a significant amount of work done on it by the operator or partner.

John concluded in saying that he wanted his company to work closely with the auditor companies, to engage, to reflect true value and to be technically robust.

What he didn’t want was for the auditors to do the analysis “by cook book”, to re-invent the wheel, to negotiate over technical details or to discount reserves through conservatism.

John made the point that there will be some degree of conservatism throughout the process – oil company, CPR, bank and so there is little value left with which to acquire debt.

John then asked for questions from the floor.

One attendee gave his view of the banks’ position. There are three factors to aware of

1. As mentioned by John, the guardians of the money will be the Credit Committees. You need to get past these, but remember, oil and gas loans will be competing against non oil and gas.
2. If there is a degree of conservatism it is understandable. Banks have been burnt in the past giving loans to fields against oil that will never be produced.
3. Banks have back-end risk.

Another attendee noted that sometimes small operators will have an advantage. They also noted that for DCA to work the operating conditions need to stay the same.

An attendee asked the floor “who should pay for the CPR?”. Their point was that neither the buyer nor the seller were independent, so perhaps it should be the bank. John Baillie made the point that only in the success case would the bank get involved, so it has to be the buyer (or seller).

There was a general discussion about the level of interaction between parties. An attendee made the point that banks favour engagement with both the client and the auditor, to get behind the facts and figures and to get a feel for the transaction.

There was a discussion about Contingent Resources and whether the bank ever lent against these. One viewpoint was that banks generally do not, although you could have “contingent lending” against “contingent resources”. Another viewpoint was that in exceptional circumstances you might have some loans with a component of Contingent Resources.

At the end Paul Taylor thanked John Baillie for a very interesting and stimulating talk and discussion.

Hypothetical Field – Contingent Resources

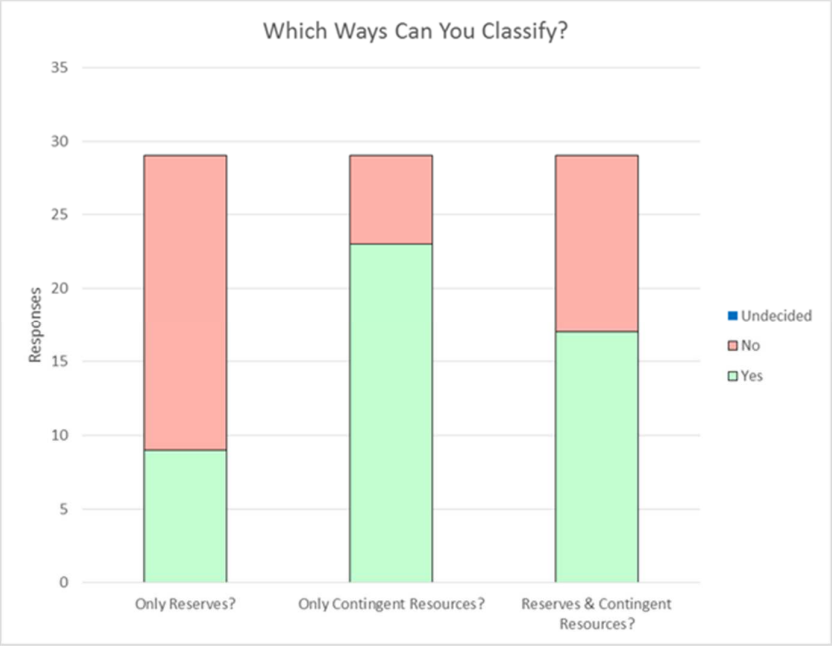
Paul Taylor went over the results of a survey on how to classify resources with a hypothetical field. A Company is developing an onshore field with a very thin oil rim (strong aquifer and large gas cap) with no direct commercial analogues. To keep things simple we will assume there are no commercial contingencies except the economics. A vertical well was tested and produced a small amount of oil but mostly gas (the gas has no value). The Company intends to sidetrack the discovery well horizontally and then drill 5 horizontal wells. The Company says it is committed to drilling the STK and all 5 HZ wells and has an FDP in place. There is a risk the volumes recovered will be uneconomic. How do you classify the resources?

There were 29 responses of which 15 were SPEE Members, 20 were with Consultancies, 8 with Oil & Gas Companies and one was in Banking. As a respondent you were allowed to decide which system to apply and 26 applied PRMS and 3 applied COGEH. There were no clear differences between how different groups responded e.g. SPEE Members versus Non-Members or Consultants versus Companies.

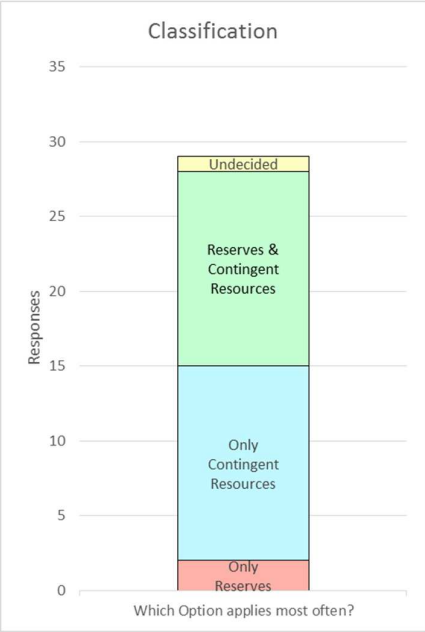
Three options were suggested and respondents were asked whether each option was a valid way to classify the resources and then which option they felt would apply most often. For the initial case "you decide volumes are economic on a P50 and P10 basis but uneconomic on a P90 basis". The options were as follows:

1. The Company convinces you the "Project" is all 6 wells (1 STK + 5 HZs). You assign 2P and 3P Reserves for the full project but do not assign any 1P.
2. The Company convinces you the "Project" is all 6 wells (1 STK + 5 HZs). You decide the recoverable volumes should all be classified as Contingent Resources until the STK has been drilled and the development concept has been established to be commercial.
3. You decide there are really 2 "Projects". Firstly 1 STK Well and then 5 HZ wells contingent on the success of the STK. You assign 2P and 3P Reserves for the 1 STK and assign Contingent Resources to the 5 HZ wells.

All the classification options were considered applicable:



If respondents selected only one option it was most likely to be Option 2 (only contingent resources). Four people felt that any of the three options could be applied (depending one would assume on the specific circumstances). The option felt to apply most often was evenly split between Option 2 (only contingent resources) and Option 3 (reserves and contingent resources).



As a further consideration, respondents were asked how the choice of classification would be impacted "if you decide the recoverable volumes are economic only on a P10 basis". Would you:

a) assign only contingent resources because you feel the project needs to first demonstrate commerciality (I assume you would have selected Option 2 previously)
b) assign possible reserves to the STK and contingent resources to 5 other wells (I assume you would have selected Option 3 previously)
c) assign only contingent resources because you do not believe standalone possible reserves should be assigned (I assume you would have selected Option 3 previously)

Eleven respondents went for option a), four respondents went for option b) and 13 respondents went for option c).

Paul concluded by saying the survey illustrates the range of different outcomes that can occur under a set of guidelines such as PRMS and that it is difficult to see how the guidelines could ever be written to handle all possible cases unequivocally.