Recommended Evaluation Practices (REPs) represent the society of Petroleum Evaluation Engineers' (SPEE) suggested treatment of hypothetical reserve evaluation topics. SPEE recognizes that, due to the varied nature of actual reserve evaluation situations likely to be encountered, these REPs are presented merely as suggested approaches. The REPs are not standards or guidelines. The use of or adherence to this SPEE REP is not required in any situation. The REPs should not be considered a substitute for the evaluator's professional judgment. This REP is subject to future revision(s) by the SPEE.

SPEE Recommended Evaluation Practice #4 - Inclusion of Hedging Positions in Reserve Reports

Issue:

Producers have opportunities to enter into oil and gas hedging positions, generally through one of two ways, physical sales or by using financial instruments. A physical sale is simply a contract obligating delivery of oil or gas in a future period for a fixed price settlement. A financial hedge is accomplished by the purchase of a financial instrument denoted in a quantity of oil or gas to be delivered at a future date, at a price which is intended to be settled financially but may provide for physical delivery as an alternate method of settlement. The proceeds of the financial transaction settlement are combined with the proceeds of physical sales done at prevailing market prices to achieve the desired hedge price. Many oil and gas producers utilize these hedge contracts as a means of reducing future price uncertainties. These hedge contracts may or may not be tied to the production of specific properties.

Preparers of reserve reports[1] sometimes include the financial impact of these hedge contracts in the cash flow forecasts. Alternatively, the financial impact of hedge positions can be considered elsewhere in the company's financial reporting.

The U.S. Securities and Exchange Commission (SEC) has noted that their position on such hedge reporting with respect to reserve reports is that hedge positions should not be included in a SEC reserve report unless tied to specific properties .

The inclusion of a hedge position in a reserve report may result in some unexpected results. Calculated production taxes, ad valorem taxes, and interest reversion points may be materially different from the intended values if hedge prices are used.

SPEE Recommended Evaluation Practice:

Preparers of reserve reports may encounter situations that include hedging positions. At this time, SPEE makes no recommendation as to whether hedging positions should or should not be included in a reserve report – this issue is left to the preparer of the reserve report. In the event that the preparer of the reserve

[1] The terms "Preparers of Reserve Reports" or "Preparer" are used herein to signify the person(s) responsible for the contents of the report.

report chooses to include a hedging position, SPEE recommends that preparers of reserve reports which include hedge positions should prepare separate cash flow forecasts for the hedge position(s). These hedge position forecasts should be clearly identified as such, and also indicate whether the hedge is property specific, with the property clearly identified, or non-specific. Further, non-specific hedge positions should additionally be labeled "not for inclusion in SEC reserve reports". If there is more than one property specific hedge position, each property specific hedge should be forecasted separately. If there is more than one non-specific hedge, the non-specific hedges can be combined into a single cash flow forecast, or prepared separately at the discretion of the reserve preparer. If the report is prepared for SEC purposes, any non-specific hedge position cash flow forecasts should not be included in any summery level combinations. The cover letter accompanying the cash flow forecasts should reveal the presence and discuss the treatment of hedge positions in a manner that leaves the user of the report with a clear understanding of the issue.

In the event that the preparer of the report is aware of a hedge position, either specific or non-specific, but chooses not to include it in the report, the preparer of the report should give consideration to disclosure of such in the reserve report's cover letter.