

The following reports on national and environmental issues will be presented to the SIPES Board of Directors at the Annual Meeting on June 21, 2010. Vice President of National Energy Kenneth J. Huffman, authored the National Energy Report, and J. R. Cleveland submitted the Environmental Committee Report. The views and opinions expressed are those of the authors. Some of the information presented is in the public domain and is available from a variety of sources; other references were selected by the authors, and are noted on their reports.

■ NATIONAL ENERGY

Spring's arrival has once again ushered in changes in the weather and landscape that can be felt and seen. The changes not only make it feel comfortable to be outside, but also make it uplifting to one's spirit. This spring also has brought some interesting changes in the way the Energy Information Agency (EIA) reports natural gas production.

The EIA has used their Form EIA-914 since 2005 to collect monthly natural gas producing information from operators. These data are then compiled using a very complex methodology to generate monthly natural gas production estimates. The goal of the EIA is to "provide monthly accurate information not more than 60 days after the close of a report month."

It appears Form EIA-914 is a survey of larger producers and the EIA then makes certain assumptions to reflect the rest of the industry. This process has led to their omitting contributions, both positively and negatively, of smaller but significant producers. The result has been an imbalance between the supply and demand numbers that EIA reconciles with a "Balancing Item" in their Natural Gas Monthly (NGM) report. In the past this has led to an overstatement of supply, or understatement of consumption.

The Independent Petroleum Association of America (IPAA), Marc Papa, chairman and CEO of EOG Resources, and other independent producers and analysts have been vocal in their attempts to point out the concerns with the EIA's method of reporting the natural gas market data. The IPAA wrote a letter to Richard Newell, EIA administrator, on March 8, 2010 requesting: 1) the Balancing Item needs to be reviewed monthly, 2) estimation of production use data that is 6 to 8 months old rather than 2 to 7 years old, and 3) make monthly rather than annual revisions.

Toby Shute (Motley Fool, 4-10-2010) reported that Mark Papa had predicted a 3.1 BCF per day decline (19%) for 2009. In a parallel article Carolyn Cui (Reuters, 4-5-2010, in the *Wall Street Journal*) wrote that the EIA data showed that gas supply rose 4 % in 2009, despite a 60% decline in onshore gas rigs. The conflicting numbers have perplexed many analysts, and justifiably, as the error is estimated to be somewhere between a few percentage points up to 20%. The EIA acting director of the Form-914, Gary Long, led a review of the EIA methodology and has stated that the old model overstates production.

On March 29, 2010, the EIA reported that after conducting the review of their methodology used in EIA Form-914, they would use a new methodology for April 2010, reporting for February production. When this report is issued, their plan is to have revised the January production estimates, and there are expectations that some of these revisions will be significant. The new methodology greatly parallels changes sought by the IPAA and addresses their concerns, including: 1) Monthly-Sample, updating every month using recent information, 2) Estimation-estimation of non-sampled companies using data 6 to 18 months old, and 3) Timing-calibration will be monthly rather than annually.

The EIA's focus on surveying the major companies and extrapolating their data across the industry failed to pick up the changes in the industry itself. The majors in the onshore and offshore shelf have divested numerous older properties at a time when independents have expanded into and emphasized the shale gas plays. The contributions to the market by companies like Chesapeake, EOG Resources, Petrohawk Energy, Cabot, and many other independents into the shale gas plays have resulted in

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Top 20 U.S. Natural Gas Producers

Daily U.S. Natural Gas Production (a)

Company	(b)	Ticker	4Q'09 MMCF/D	3Q'09 MMCF/D	4Q'08 MMCF/D	4Q'09 vs. 3Q'09 % Change	4Q'09 vs 4Q'08 % Change	2009 Reported U.S. Net Proved Natural Gas Reserves	Proved U.S. Natural Gas Reserves Ranking
ExxonMobil (c)	2	XOM	3,665	3,681	3,382	(0.4%)	8.4%	24,189	1
Chesapeake	1	CHK	2,440	2,286	2,130	6.7%	14.6%	13,510	3
BP	2	BP	2,313	2,278	2,243	1.5%	3.1%	15,216	2
Anadarko	1	APC	2,076	2,144	2,197	(3.2%)	(5.5%)	7,764	6
Devon	1	DVN	1,894	1,999	2,107	(5.3%)	(10.1%)	8,127	5
ConocoPhillips	2	COP	1,831	2,043	2,095	(10.4%)	(12.6%)	10,742	4
EnCana	1	ECA	1,616	1,524	1,677	6.0%	(3.6%)	5,713	8
Chevron	2	CVX	1,405	1,420	1,320	(1.1%)	6.4%	2,698	14
Williams	3	WMB	1,177	1,148	1,156	2.5%	1.8%	4,255	9
EOG	2	EOG	1,075	1,128	1,231	(4.7%)	(12.7%)	6,350	7
Shell	2	RDS	1,064	1,017	1,071	4.6%	(0.7%)	2,258	18
Southwestern	1	SWN	966	793	624	21.9%	54.9%	3,650	11
Apache	1	APA	689	699	583	(1.5%)	18.1%	2,438	17
Occidental	2	OXY	645	653	596	(1.2%)	8.2%	2,799	12
El Paso	3	EP	585	619	636	(5.5%)	(8.0%)	2,052	19
Petrohawk	1	HK	577	488	333	18.4%	73.4%	2,700	13
Newfield	1	NFX	500	462	477	8.2%	4.8%	2,605	15
Ultra	1	UPL	496	477	422	4.0%	17.5%	3,737	10
Questar	1	STR	488	426	445	14.5%	9.6%	2,525	16
Noble	1	NBL	386	397	404	(2.8%)	(4.5%)	1,534	20
Totals / Average			25,888	25,682	25,129	0.8%	3.0%	124,862	

(a) Based on 4Q'09 company reports

(b) Independents 1, majors 2, pipelines 3

(c) Pro forma for XOM's acquisition of XTO

Adapted from Chesapeake Energy AAPG Presentation 4/12/2009

Table 1

increases and decreases to the supply and pricing for natural gas.

The significance of the contributions from the independents is well demonstrated by reviewing the top twenty (20) natural gas producers based on their daily rate (see **Table 1**). Many of this active group lost ground between the fourth quarter of 2009 versus the third quarter of 2009. El Paso and Petrohawk are the only companies that have increased the number of rigs drilling for gas in the six months prior to March of 2009. It will be interesting to watch for the results of the changes made based on the new EIA methodology and whether this reduces the errors many have noticed in the monthly production numbers.

Markets

The Gross Domestic Product, which represents the total value of goods and services over a specific time period, is on the way up in 2010 after a decrease in 2009. Currently the GDP is nearly \$14.5 Trillion U.S. dollars annually. The economic recovery is increasing the demand for oil and gas resulting in an obvious increase in prices. January saw record consumption in natural gas of 2.836 TCF. Yet, due to a 12 % increase in imports prices were held to a \$5.53 per MCF (Henry Hub Spot Price) average for that month. February averaged \$4.93 and March \$4.27 with working storage hitting 1615 TCF the last week of withdrawals,

March 12 to 18, 2010. Since that week the injection rate has exceeded withdrawals. The EIA predicts natural gas prices to remain low for several months. This is expected to affect the drilling activity negatively resulting in a production decline through 2010.

The good news is that West Texas Intermediate (WTI) crude oil spot prices are holding strong in the \$80 to \$85 per barrel range. Expectations are that with the improving economy world wide the market should see some stability in the pricing through much of 2011. This has some of the shale gas players moving towards oil plays as Chesapeake announced a few weeks ago.

IEA reported a concern that the oil market may be currently overpriced. Global demand for 2010 is expected to grow by 1.7 million barrels a day on a year to year basis. This has been true for the first quarter, but global supply is up nearly 2.0 million barrels a day for the same period.

One of the big unknowns in the market this summer is whether the increase in demand for domestic transportation fuels will be offset by a higher cost to the consumer. Will they pay the increase or stay at home? A dollar increase per barrel in crude prices translates to about 2.4 cents per gallon at the pump.

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ENVIRONMENTAL COMMITTEE REPORT


The balance between low-cost energy and protecting the environment is considered one of the greatest challenges facing mankind today. Most people agree on the need to move toward a lower-carbon future, but the transition will be difficult and expensive.

There is a great amount of interest in increasing the use of renewable energy sources, but the main drawback is the high cost associated with the development of these sources. Most renewables require large government subsidies and tax incentives to compete with fossil fuels.

The abundance of natural gas and coal keeps the price of fossil fuels relatively low. In order to force the nation to switch to renewable energy sources, the government will have to continue to subsidize renewables while placing more taxes on fossil fuels. The current administration's actions to limit drilling on federal leases and the congressional attempts to regulate hydraulic fracturing have been described as methods to limit future oil and gas production resulting in higher fuel cost.

In today's economy, the American public has no appetite for any climate change plan that involves more taxes, more regulation, and a possible lower standard of living. In a recent Gallup Poll 51% of Americans see the weak economy and high unemployment as the nation's biggest concern. Only 3% mentioned the environment as the leading problem. Many see environmental action as a job killer or as a costly tax on energy.

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Natural gas is the most environmental-friendly fossil fuel and will play a major role in the transition from high to low carbon energy production. Electrical power producers are projected to switch to natural gas from coal in order to reduce the emissions of greenhouse gases. Natural gas will also provide a stable backup energy supply for solar and wind energy providers, which depend on an unstable supply of sunlight and steady winds.

The Energy Information Agency predicts that in 2035 fossil fuels will provide 78% of U.S. energy, down only slightly from 84% today. Although there is a lot of talk and effort going into the transition to renewable energy sources, fossil fuels will continue to dominate the energy future.

