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BEFORE THE SECURITIES AND EXCHANGE COMMISSION

IN RE EL PASO CORPORATION
(FW-02754)

WELLS SUBMISSION ON BEHALF OF HUDDLESTON & CO., INC. AND PETER D. HUDDLESTON

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INTRODUCTION

Members of the Staff of the Commission's Enforcement Division ("Staff") have notified Huddleston & Co., Inc.[1] ("HudCo") and Peter D. Huddleston ("Peter Huddleston," "Peter" or "Mr. Huddleston") (collectively, "the Huddlestons") that they intend to recommend to the Commission that it bring a federal court injunctive action or an administrative cease and desist proceeding alleging that the Huddlestons aided and abetted or caused violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 13(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder. The Staff also intends to recommend to the Commission that it bring a Rule 102(e) proceeding against the Huddlestons.

This Submission explains why HudCo and Peter Huddleston believe that actions against them are not supportable and are not in the Commission's or the investing public's interest. In short, there is no tenable evidence of which the Huddlestons are aware that they aided and abetted or caused the alleged securities law violations of others or otherwise engaged in improper professional conduct. For these reasons, the Huddlestons request that the Staff determine not to proceed or be denied authorization to proceed against them.[2]

[1] Though the Staff's notice refers to the entity as B.P. Huddleston & Co., its correct name is Huddleston & Co., Inc.

[2] The Staff has declined to inform the Huddlestons of or to describe (i) why it believes the Huddlestons aided and abetted or caused a securities law violation or engaged in improper professional conduct; (ii) the evidence that it believes supports the proposed charges; or (iii) the topics or areas that it would find most useful for the Huddlestons to address in this Submission. Accordingly, this Submission addresses what the Huddlestons perceive the Staff may rely upon and what its concerns are, based upon the Staff's questioning in the testimony of Peter and B.P. ("Pete") Huddleston, Peter's father.

Because HudCo and Peter Huddleston have done nothing wrong and because of the profound adverse impact that even a settled civil or administrative enforcement action would have on them both professionally and, in Peter's case, personally, they are committed to defending themselves vigorously, even if doing so means litigating against the Commission or the Staff. But the fact that the Huddlestons could and would successfully defend against the contemplated charges will never remedy the harm resulting from those charges being brought in the first place. Accordingly, the Huddlestons request that this matter be terminated as to them with no enforcement recommendation or action.

SUMMARY OF POSITION

The Huddlestons did not aid and abet or cause any securities law violation. Indeed, they had absolutely no incentive to do so and had every incentive *not* to do so. They have spent the last 40 years building a pristine reputation for service to the oil and gas community and the public. The Huddlestons cooperated fully with both El Paso's internal investigation of reserve reporting and with the Staff's investigative efforts. They were engaged in no joint venture or other business that depended on the success of any El Paso securities issue, or of El Paso generally, for its success. By the standards of the Society of Petroleum Engineers ("SPE"), and indeed by any rational standard, they were plainly independent of El Paso. The revenue stream contributed by the El Paso business was in itself modest and a small fraction of the Huddlestons' yearly income or net worth.

The Staff's recommendation is premised on the notion that reserve engineers are accountants. But they are not. Unlike accounting, which looks at what *has* occurred, reserve engineers estimate what is *expected to occur*, and theirs is an inexact science

requiring compounded judgments based on limited data. This inherent uncertainty of reserve estimation caused the SEC to reject use of reserve recognition accounting in 1981 and instead to require reporting of proved reserves and present value estimates as unaudited supplemental information to a reporting entity's financial statements. Honest, good faith diligent reserve estimates of the same properties conducted at the same time by sets of qualified engineers vary significantly, and estimates vary even more when compared from year to year. Correspondingly, academic and SEC studies consistently demonstrate that investors place their trust in known facts such as actual production, pricing and book values, not reserve estimates. Unlike financial statements, which Regulation S-X requires to be certified by accountants, oil and gas exploration and production companies are not required to either use or refer to the work of outside reserve engineers, who therefore lack the leverage that accountants have to effectively require reporting entities to adopt or modify accounting procedures – even particular entries such as loss reserves.

Even without the responsibility or leverage of a financial auditor, the Huddlestons nevertheless were able to persuade Coastal Corporation ("Coastal") and El Paso Corporation ("El Paso") to substantially moderate their reserve bookings through moral suasion, both generally and within the "suspect" areas that seem to be the Staff's focus. By El Paso's own admission, in the three years preceding the EOY 2003 reserve write-down, the reserve estimation process resulted in the write-down of 1.7 TCF of reserves – roughly equal to the EOY 2003 write-down. The Huddlestons brought to El Paso's attention, in 1999 (through Coastal) and again in 2003, the company's tendency to aggressively book reserves. In the specific areas that seem to be of concern to the

Staff, the Huddlestons caused substantial initial and continuing reduction in the reserve estimates prior to EOY 2003. These reductions were achieved in significant part because the Huddlestons well exceeded their professional responsibilities, spending hundreds to thousands of hours on each EOY report and investigating base-line data in a very high percentage of audited properties. This high degree of professionalism explains, in part, why the SEC, the U.S. Department of Justice and even HudCo's successor as El Paso's auditor – Ryder Scott – have all retained the Huddlestons to act as experts on their behalf.

Under these circumstances, it is apparent that the Commission or the Staff simply could not meet the scienter and other proof requirements of the enforcement actions that the Staff intends to recommend. It is highly doubtful that the Commission or the Staff would be able to meet the basic requirements for proof of an underlying fraud, in part because of the paucity of factual basis and in part because of El Paso's consistent warnings to the market about the volatility of reserve estimates. It is even more unlikely that the Commission or the Staff could prove that the Huddlestons had the requisite actual knowledge of the fraud or an intent to "cast their lot" with El Paso in the purported fraud. Nor is there a basis for a cease and desist order against the Huddlestons in light of, among other things, the record of their diligence, their adherence to all applicable standards of care, and the total absence of intent to commit fraud on their part. Finally, Rule 102(e) sanctions are inappropriate here, not just because the factual record is devoid of any proof of "improper conduct" by the Huddlestons, but because the claims would for the most part be barred by the

applicable statute of limitations and because, as it applies to reserve engineers, Rule 102(e)'s well-established constitutional infirmity has not been cured.

The United States Attorney's Office (USAO) for the Southern District of Texas initiated its own investigation of the El Paso reserve write-downs. In July 2004, it subpoenaed the same records that came to be subpoenaed later by the Staff and issued subpoenas to El Paso as well. In March 2005, the USAO conducted a day-long interview of Peter Huddleston and many interviews of El Paso employees highly placed in management or in the reserve estimation process. After an investigation that spanned nearly a year, the USAO determined that it was not appropriate to press charges against anyone associated with the formulation of El Paso's reserve estimates. The Commission and the Staff should now reach the same conclusion.

STATEMENT OF FACTS

I. THE HUDDLESTONS HAVE A LONG HISTORY OF EXPERTISE AND DEDICATION TO THE PUBLIC TRUST AND TO ADVANCING THE ART OF RESERVE ENGINEERING, SO MUCH SO THAT THE COMMISSION ITSELF HAS RETAINED THEM AS EXPERT WITNESSES IN THE FIELD

Pete Huddleston is the co-founder and Chairman of HudCo. Pete and his wife, Flossie, formed and have co-owned HudCo since 1967. Pete has been licensed by the Texas Board of Professional Engineers since 1964 and has conducted reserve engineering since that time.

Pete Huddleston served on the SEC's Oil and Gas Advisory Committee from 1979 through 1980 and the FASB—Oil and Gas Task Group for 1979 through 1981.[3] HudCo largely financed the drafting and publication of the initial SPE Standards for the

[3] The SPE standards were initially adopted in 1977 but revised in 2001 to make them compatible with the joint SPE/World Petroleum Council definitions for petroleum reserves.

Estimation of Petroleum Reserves in the late 1970s. (Pete Huddleston Tr. at 71/5-12, 147/14-24, 150/5-10.) Pete Huddleston received the SPE's Economic and Evaluation Award in 2001 and the AIME Economics Award in 2002.

From 1981 through 1998, Pete taught petroleum engineering to students at Texas A&M University and donated sums far exceeding his salary back to the University. He has trained roughly 15% of the petroleum engineers currently practicing in the United States. Pete has testified as an expert in over 200 cases on oil and gas matters since 1978 and has published more than 142 articles on various aspects of the oil and gas reserve business. He has made presentations to virtually every entity whose work touches or concerns reserve reporting, including the SEC.

Peter Huddleston, Pete and Flossie's son, led the El Paso and Coastal reserve reviews under Pete's guidance during the operative time period. He obtained his petroleum engineering degree from Texas A&M in 1980, is licensed by the Texas Board of Professional Engineers, is a member of the SPE, and serves on the Texas A&M Petroleum Engineering Industry Board and on the Advisory Board of the Bush School of Government and Public Service. The Commission requested that Peter serve as an expert on its behalf in *SEC v. KS Resources,* CV-95-8608 WDK (AJWx) (C.D. Cal. Dec. 19, 1995), and *SEC v. Environmental Energy Inc.*, CV 98-6060CM (BQrx) (C.D. Cal. July 28, 1998). He testified on behalf of the United States Department of Justice with respect to reserve issues (*United States v. Seigel*, CR-99-507-ER (C.D. Cal. July 30, 2001)) and was retained by the reparations commission of the United Nations to estimate the loss of reserves caused by Iraq's attack on neighboring Kuwait during 1991. He has served as an expert in more than 25 cases.

Since 1967, the Huddlestons have completed more than 12,000 reserve reports for public and private clients, banks, and financiers. Their estimates have been accepted for every purpose for which such reports are ordinarily prepared. Until this investigation, no government or regulatory entity, professional licensing authority, customer, lender, financier, or investor has *ever* complained about the substance or technique of a Huddleston reserve estimate or audit.

The Huddlestons separate their reserve engineering work from their exploration and production activities, with HudCo handling all reserve work and Peter Paul Petroleum Co. ("PPPCo") doing exploration. PPPCo currently owns interests in more than 2,500 properties and 525,000 mineral acres. PPPCo has been entrusted with the management of hundreds of millions of dollars by individual and institutional investors. In the more than 30 years it has been involved with private partnerships in the oil and gas exploration and production business, it has never fielded a complaint by any governmental or regulatory entity or any partner concerning the partnerships, much less one concerning its honesty or integrity. Not one of the more than 400 partners with whom it has been affiliated has ever asked to withdraw from a partnership, and many of the partnership interests involved have passed to second- or third-generation owners.

The Huddlestons' orientation is reflected in their cooperation throughout this investigation by the Staff and beforehand. They met not once, but twice with the attorneys at Haynes and Boone who were retained by the audit committee to assess El Paso's handling of the reserve estimation process and whose investigation was tainted in many respects. For example, the Haynes and Boone attorneys violated the

confidential nature of the investigation by contacting another HudCo customer to advise it that the Huddlestons were “in trouble” with respect to their investigation.

The Huddlestons also fully cooperated with the Staff. They produced more than 255,000 pages of documentation in response to the Staff’s subpoena. In addition to researching all electronic files on their existing computer systems, the Huddlestons retrieved and recaptured data from 95 tapes used to “back up” their system and conducted a word-based search of HudCo files using 397 different word search prompts associated with El Paso. Peter Huddleston spent three and one-half days, and Pete Huddleston a full day, answering the Staff’s questions relating to the audit process. All of this effort, of course, consumed a great deal of time, effort and money.

In short, these are a family and company that have spent the past 40 years serving the public and developing a pristine reputation for preeminence, high quality, and expertise in the field of reserve reporting. There is no rational reason for believing, as the Staff apparently does, that HudCo and Peter Huddleston suddenly became bumbling incompetents, to the point of extreme recklessness, or worse, decided to forsake the reputation they had worked hard to build over four decades to become knowing participants in El Paso’s alleged fraud. As detailed below, that the Staff takes this position is particularly puzzling given the small portion of the Huddlestons’ revenue or net worth attributable to their reserves reporting work for El Paso. In short, the Huddlestons had no economic or other motive to facilitate any wrongdoing at El Paso and had every incentive to do – and in fact did do – the same high-quality work that they had done for Coastal, El Paso and countless other customers over the previous four decades.

II. THE HUDDLESTONS' WORK FOR COASTAL AND THEN EL PASO WAS CONSISTENTLY CAREFUL AND STUDIED

HudCo conducted reserve engineering for Coastal beginning in 1967 and continued to do work for El Paso after Coastal merged into El Paso in 2000. In assessing the conduct of any reserve engineer's actions, it is important to note that a substantial difference exists between "estimating" oil and gas reserves and "auditing" those reserves. SPE, *Standards for the Estimation of Petroleum Reserves*, §§ 1.1, 2.2(b), (c) (2001) (hereafter, "SPE 2001"). A Reserve Estimator is "a person who is to be in responsible charge for estimating and evaluating reserves and other Reserve Information." *Id*. at § 2.2(b). An auditor, on the other hand, "is a person who is designated to be in responsible charge for the conduct of an audit with respect to Reserve Information estimated by others. A Reserve Auditor either may personally conduct an audit of Reserve Information or may supervise and approve the conduct of an audit by others." *Id*. at § 2.2(c). In preparing both data and estimates themselves, Coastal and El Paso represented and warranted that "all information" provided to HudCo was "complete and correct in all material respects and [did] not contain any untrue statement of material fact or omit to state a material fact required for [HudCo] to perform" its audit. Attachment 1, Service Agreement by and between Coastal Oil & Gas Corporation and Huddleston & Co., Inc. ("Service Agreement") at Arts. 4-5, Exhibit C (Mar. 23, 1998).

HudCo established a defined procedure for the conduct of reserve estimates at Coastal and later at El Paso. Prior to 1998, a team of engineers headed by Pete Huddleston and after 1998 by Peter Huddleston, John Krawtz, and Mark Bunch (all widely experienced licensed professional engineers), was engaged to conduct the

estimates involved during the fourth quarter of each applicable calendar year. HudCo was not retained to review quarterly reports during the time period in question, nor was it engaged to comment on the structure of Coastal's or El Paso's engineering group. Instead, HudCo was engaged solely to prepare certain estimates for the purpose of comparing them with El Paso's number for the preparation of end-of-year results. *Id.* In short, HudCo prepared estimates that were then compared to El Paso's internal estimates and when substantial differences occurred, it sparked debate over the method and inputs used in the two respective reserve estimates.

SPE standards make it clear that as an auditor, rather than estimator, HudCo was entitled simply to review "reserve information estimated by others" for its reasonableness and the use of accepted methods. SPE 2001 § 2.2(c). Yet, despite these limitations, HudCo was able to accomplish more, and indeed as much as it could have accomplished, given the constraints. HudCo was provided not only with estimated reserves prepared by the El Paso technical staff and the appropriate back-up calculations but also with information concerning the location of the wells, well logs, production records, pressure tests, maps locating the wells to be estimated, material balance information and other similar data. In an extraordinarily high percentage of cases, HudCo developed from this information its own independent estimates of reserves for the properties audited. The work was typically done onsite, as is not uncommon in the oil and gas industry for a project of this magnitude,[4] and HudCo would record its reserve estimates in the ARIES software system used by El Paso to house information. Throughout its tenure as a reserve estimate auditor, HudCo worked closely

[4] At the time of the audits, El Paso typically had nearly 10,000 wells within its database.

with Steve Hendrickson, Frank Falleri, Charlie Latch, Joe Mills, Ace Alexander, Jim Flynn and Bill Donnelly, and it was these individuals who were in charge of the Coastal and El Paso reserve groups. It was these individuals with whom the Huddlestons worked to obtain reserve information and reconcile reserve estimates, and none of them has been charged with manipulating reserves or any wrongdoing of any kind.

From 1967 through 1997, HudCo performed the reserves estimates for Coastal, and these estimates were reported in its SEC filings. In 1998, however, HudCo was tasked to (1) perform estimates for the purpose of an audit rather than perform estimates that would themselves be reported and (2) ensure that no engineer working on Coastal (or later El Paso) did work for another company having interests in that same well. Attachment 1 (Service Agreement) at Arts. 4, 15. Prior to 1998, HudCo ensured that the reserve estimates for joint working interest owners in the same well were identical, but after 1998 it could not continue that task because of its newly-defined role. *Id*. at 15.

After HudCo completed its reserve estimates for a year end, it submitted them to Coastal or El Paso management. If management disagreed with HudCo's estimates, then, as is the norm in the industry, HudCo permitted company engineers to present additional information they believed HudCo had not yet considered. In some cases, this information caused HudCo to revise its numbers, but in most cases it did not. HudCo produced both a summary letter of its estimate of proved reserves as well as a "line item" report showing the estimates for each of the properties upon which it had performed work. Its efforts were consistently well-documented – HudCo produced to

the Staff more than 255,000 pages of data and work product relating to its audits from 1997 to 2003.[5]

Both by adherence to Generally Accepted Engineering Principles ("GAEP") and by contract, all of the Huddlestons' work for Coastal and later El Paso was strictly confidential, and the Huddlestons were precluded from using the information for a purpose other than as directed by the client. SPE 2001 at § 4.5; Attachment 1 (Service Agreement) at Art. 14B.

No HudCo reserve figures were ever reported to the investing public. At no time did HudCo give input into, or have any control over, the calculation of Coastal's or El Paso's historic cost figures, full cost ceiling calculations, depreciation, depletion and amortization figures or any other accounting calculation or data used to determine earnings or any other accounting matter reported to the public.

III. EL PASO'S WRITE-DOWN OF PROVED RESERVES IN FEBRUARY 2004

In February 2004, El Paso wrote down its proved reserves by 34.9% – 1,824 BCFe – from a starting balance of 5,233 BCFe. The Staff appears to believe that preexisting reserve numbers were "wrong" and subsequent estimates "right" and reasons from this premise that El Paso's earlier financial statements must necessarily have substantially and intentionally overstated its assets or earnings. By the same token, the Staff also apparently infers from the write-down that HudCo's audit of El

[5] Some criticism by the Staff is implicit in its questioning of the Huddlestons about their recordkeeping practices. The Huddlestons' recordkeeping well exceeded its contractual requirements with Coastal and El Paso, which required only that the Huddlestons keep their work for three years after completion. Attachment 1 (Service Agreement) at Art. 8D. The SPE provides no guidelines on the length of time a reserve auditor should retain its records. SPE 2001 at § 6.5. Rule 4-10 of Regulation S-X does not speak to the existence of outside reserve auditors or set any specific recordkeeping requirements for them.

Paso's reserve estimates must have been "botched" in contravention of GAEP and that HudCo and Peter Huddleston therefore engaged in improper professional conduct.

With due respect to the obviously substantial effort the Staff has made to understand this complex science, the Huddlestons believe the Staff's analysis suffers from three pervasive errors: (1) treating reserve engineers as though they were financial accounting auditors for public companies, (2) treating reserve estimates as though they were historic accounting numbers, and (3) treating reserve revisions as though they involve the extinguishment of assets when, in fact, they are changes in the perception of recoverability having little financial effect or materiality. When these misperceptions are corrected, it becomes apparent that the Huddlestons complied with all applicable GAEP (as did their audit work) and that they did not engage in any improper professional conduct.

It has also become apparent that the Staff presumed the write-down not only to be correct, but also to be in good faith, when substantial reason exists to believe otherwise. The reserve write-downs of 2004 point not to fraudulent preexisting reserves but to opportunistic earnings manipulation by El Paso's newly-enshrined management. Academic literature documents the strong tendency of newly-appointed management to "take a bath" on discretionary write-downs so that subsequent earnings will outperform expectations. Suzanne Sevin, *Earnings Management: Evidence from SFAS No. 142 Reporting*, MANAGERIAL AUDITING J., Vol. 20, No. 1 at 47 (Jan. 2005) (finding statistical data strongly supported discretionary write-downs of goodwill by new management under the "take a bath" theory); David Aboody & Ron Kasznik, *CEO Stock Option Awards and the Timing of Corporate Voluntary Disclosures*, J. ACCT. & ECON., Vol. 29,

No. 1 at 1 (2000) ("Overall, our findings provide evidence that CEOs of firms with scheduled awards make opportunistic voluntary disclosures that maximize their stock option compensation … by delaying good news and rushing forward bad news ….").

Former Commission Chairman Arthur Levitt has recognized and validated these findings:

> Companies remain competitive by regularly assessing the efficiency and profitability of their operations. Problems arise, however, when we see large charges associated with companies restructuring. These charges help companies "clean up" their balance sheet -- giving them a so-called "big bath."
>
> Why are companies tempted to overstate these charges? When earnings take a major hit, the theory goes Wall Street will look beyond a one-time loss and focus only on future earnings.
>
> And if these charges are conservatively estimated with a little extra cushioning, that so-called conservative estimate is miraculously reborn as income when estimates change or future earnings fall short.

Arthur Levitt, "The Numbers Game," remarks delivered at the New York Center for Law and Business, Sept. 28, 1998 (http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt).

El Paso's own announcements before and after the write-down make it plain that its management consciously "took a bath" by overstating reserve reductions. El Paso hired Doug Foshee to be its CEO in September of 2003, granting to him 1 million stock options at the company's then trading price of $7.34 per share, and another 1 million shares of restricted stock.[6] These incentives dwarfed Mr. Foshee's annual salary of $900,000, and his choice to weight compensation for its "upside" potential is not surprising. A previous study of Mr. Foshee's management of Nuevo Exploration during 1997 through 2000 described it as "hav[ing] a high degree of risk tolerance.

[6] El Paso Corp., Definitive Proxy Statement (Form 14A), at 22 (2004).

They are willing to accept the downside risk of additional volatility in the incentive plan if doing so means getting a significant share of the upside." John McCormack & Ian Gow, *EVA in the E & P Industry, the Case of Nuevo Energy*, J. APPLIED CORP. FIN., Vol. 13, No. 4 at 76, 79 (Winter 2001). El Paso announced stock option awards, and the setting of prices for those awards – perhaps prophetically – on April 1 of each year. On April 1, 2004 (a month and a half after the reserves were written down), Foshee was granted an additional 187,500 options at the strike price of $7.09 (a price the Staff believes was influenced downward by reserve revision announcements).

When El Paso announced the reserve revision, it told the market that the revision would cause future earnings to increase. "The restatement will result in a lower depletion rate and reduced exposure to ceiling test charges in the future than would have been the case absent the restatement."[7] Indeed, the write-down has had precisely the effect promised, and El Paso's management has used the floor of reserves set in 2004 to tout the company's improved earnings and reserve additions. *Phoenix Rising, Interview of Doug Foshee*, OIL & GAS INVESTOR, April 2006 ("…we reported our year end reserves, which were up 22% at an all-in finding and development cost of $2.36 and a significantly increased reserve life." … The most important thing that will happen for us in 2006 is a year of achievement in E&P."); Doug Foshee, President & CEO, *The Turnaround is Over*, HOUSTON PLANNING FORUM, June 21, 2006, at 14 ("E&P EBITDA up 20%+ year-to year, Annual average production volumes up 8 to 11%, Reserve growth of 5 to 10%"). Days ago, the company touted its "Rapidly Improving E&P Business," claiming that its finding and development costs were "competitive given *nine year*

[7] El Paso Corp., Annual Report (Form 10-K), at 53 (Sept. 30, 2004).

reserve to production ratio" and stating that earnings were "among most profitable of industry peers." Comments of Douglas Foshee, Webcast, 37th Annual Bank of America Investment Conference, Sept. 18, 2007, slides 15-17 (emphasis added).

Mr. Foshee's compensation has dramatically risen precisely as would be predicted by the construction of an artificially low starting point. The options granted him in 2003 and 2004 (including those scheduled to vest) are now worth over $11.8 million.[8] In short, the reserve write-downs were taken not because EOY 2002 reserve estimates were "wrong" but because management wanted to establish an artificially low hurdle to ensure that it would fully exploit its stock-based incentives.

DISCUSSION

I. RESERVE ENGINEERS ARE NOT FINANCIAL ACCOUNTING AUDITORS BY RULE OR FUNCTION

Reserve engineers lack the regulatory authority or responsibilities of accountants. As the Staff is well aware, "[v]arious provisions of the federal securities statutes mandate that financial statements incorporated in Commission filings be certified by an independent public or certified accountant." *In the Matter of Ernst & Young LLP*, Init. Dec. Rel. No. 249, Admin. Proc. File No. 3-10933, slip op. at 27 (Apr. 16, 2004). Because "Congress granted the independent auditor an important public trust in the framework it enacted for the federal regulation of securities" and because reporting entities are required to have certified financial statements, accountants have been referred to as "gatekeepers" to the public securities markets. *Id.* Reserves, however, are part of *un*audited supplementary financial information, and oil

[8] El Paso Corp., Proxy Statement (Form Def. 14A), at 48 (Mar. 27, 2007).

and gas companies are not required to seek or to report the opinion of an outside reserve engineering firm.

The requirement that reporting entities have GAAP-certified financial statements gives the accounting firms that audit them enormous clout over the reporting entities' decisions. If an accounting firm refuses to sign off on or issue a clean audit opinion on financial books and records, the result is most likely late-filed or unfiled quarterly or year-end reports, because no legitimate accounting firm can be hired, be brought up to speed and certify the company's financial records after such withdrawal. These failures to file often trigger default on bond or bank debt of the reporting entity, which in turn may cost tens of millions of dollars to remedy. *See*, *e.g.*, Key Energy Servs., Inc., Current Report (Form 8-K), at Ex. 99.1 (Oct. 19, 2006). Accounting firms and reporting entities know of this leverage, and accounting firms can and often do use it to effectively mandate that a reporting entity change its accounting procedures or particular entries, including loss reserves and the like.

Reserve engineers have no such responsibility or power. Unlike financial accounting auditors, they are not — by law, custom, or otherwise — gatekeepers. Oil and gas exploration companies are not required to report the results of outside reserve engineers or even to retain them. Rather, Regulation S-X, Rule 4-10 merely requires that reserves be reported in a certain manner. *See* 17 C.F.R. § 210.4-10 (2007).[9] Thus, if a producer comes to strongly disagree with the results of the outside engineer's work, it may dismiss the engineer and report its own estimate without even mentioning

[9] Several oil and gas exploration companies report reserves without reference to the work of an outside reserve engineer at all. *See, e.g.*, Exxon Mobil Corp., Annual Report (Form 10-K), at 88 (Feb. 28, 2007); Chevron Corp., Annual Report (Form 10-K), at FS-70 (Feb. 28, 2007); Apache Corp., Annual Report (Form 10-K), at F-46 (Mar. 1, 2007).

an outside reserve engineer. The regulatory scheme leaves reserve engineers with little authority other than moral suasion. Moreover, a reserves auditor, if one is used, has no control over the way reserve data is used by the reporting firm in compiling reported financial calculations. The key components of earnings, namely the calculation of depletion, depreciation and amortization (or "DD&A" charges that are the cost component of the reporting entity's earnings calculation), are controlled entirely by the reporting entity without input from the reserves auditor.

The Staff apparently believes that HudCo should have invoked leverage against Coastal or El Paso that it never had. Worse, it has concluded that the Huddlestons aided and abetted or caused securities law violations because they failed to use power they never had. Although the Huddlestons achieved substantial continuing moderation of the El Paso reserves in each of the three years before they were replaced, they did so purely through moral suasion and by escalating issues within company management, where appropriate.

We also infer from the tenor of some of its questioning that the Staff believes that GAEP are as detailed and provide the same quality of guidance to reserve engineer auditors that GAAP provide to financial accounting auditors. This is not so. FASB pronouncements, AICPA standards and other provisions of GAAP and GAAS cover 4,000 pages and provide detailed guidance to management, internal accountants, and external auditors for virtually every foreseeable nuance of financial reporting. By sharp contrast, SPE guidelines covering oil and gas reserve engineering cover 18 pages and make the indeterminate nature of the art apparent. Regulation S-X covers 100 pages within the Code of Federal Regulations, but the portion of Rule 4-10 relating to reserve

estimation covers less than three pages and is explicitly open-ended, containing mostly definitions of permissible inputs into reserve calculations. *Compare* 17 C.F.R. § 210.1-01 *et seq*. (1985) *with* 17 C.F.R. § 210.4-10. (2007). Both Rule 4-10 and the SPE Standards describe basic decision-making parameters that reserve estimators or auditors are to use, but they do not, and cannot, describe how data is to be interpreted, weighted and used to create final reserve estimates.

Finally, by their terms, independence rules applied to accountants do not apply to reserve engineers. In the wake of the Enron failure and ensuing losses, Congress reaffirmed the role of accountants as gatekeepers to the securities market. In particular, the very close business and non-business connections between Arthur Andersen, Enron's outside accounting firm, and Enron caused Congress to ask the SEC to further expand and refine conflict-of-interest rules for accountants. Strengthening the Commission's Requirements Regarding Auditor Independence, Securities Act Release Nos. 33-8183 *et seq.* (Final Rule Jan. 28, 2003). The resulting independence requirements for auditors are extensive but apply only to those who perform financial "audits." 17 C.F.R. § 210.2-01 (2007). The term "audit," in turn, is defined by Regulation S-X as an examination of the "financial statements by an independent accountant in accordance with generally accepted accounting principles …." 17 C.F.R. § 210.1-02 (2007). With respect to reserve engineers, the SEC has adopted no such independence rules. While the SPE does have far less detailed independence guidelines, they are merely aspirational. As we detail below, though the SPE's independence guidelines are not binding, the Huddlestons nevertheless fully complied with them.

II. RESERVES ARE SUBJECTIVE *ESTIMATES* OF WHAT IS *EXPECTED* TO OCCUR, NOT STATEMENTS OF EVENTS THAT *HAVE* OCCURRED

Ordinarily, the Commission investigates whether a reporting entity has properly accounted for and stated some feature of its earnings or cost structure. In these investigations, the Commission has the benefit of knowing what *has* occurred and can compare it to what should have been reported to see if fraud was present. GAEP make clear that reserve engineering is not like accounting because it involves an *opinion* about what the reporting entity *expects* will occur *in the future* based upon a complex set of calculations.

> Although these generally accepted petroleum engineering and evaluation principles are predicated on established scientific concepts, the application of such principles involves extensive judgments and is subject to changes in (i) existing knowledge and technology; (ii) economic conditions; (iii) applicable statutory and regulatory provisions and (iv) the purposes for which the Reserve information is to be used …. Reserve Information is imprecise due to the inherent uncertainties in, and the limited nature of, the database upon which the estimating and auditing of Reserve information is predicated.

SPE 2001, §§ 1.2, 1.3 (2001). "Since reserves are only estimates, such cannot be audited for the purpose of verifying exactness." *Id.* at § 6.1. Thus, to be successful in a civil action, the Commission would be required to prove that El Paso created *fraudulent estimates* and that the Huddlestons *actually knew* (as opposed to being negligently or even recklessly unaware) that these estimates were fraudulent (*see infra* at 48-49) and that the Huddlestons failed to perform a function – verifying exactness – that GAEP say cannot be done; this is an intrinsically difficult standard to meet, but particularly so when the estimates are as complex as those involved here.

A. Professionally Competent Good Faith Reserve Estimates Often Produce Widely Divergent Results

Oil and gas wells are typically drilled in diameters of less than 10" and as many as five miles deep. They may drain as little as a few acres of surrounding subsurface area to as many as a thousand acres or more. While no one can precisely know the condition of rock around the wellbore, let alone the condition of rock 40 to 1,000 acres surrounding the wellbore, the reserve engineer must use available data to estimate the characteristics of the rock near the wellbore owned by the reporting entity.

While there are five methods of reserve analysis recognized in professional literature, a brief analysis of the complexities of what is arguably the "simplest" of these reserve methods illustrates the inherently uncertain nature of ascertaining proved reserves.

The volumetric method uses the following formula and is typically employed after a well is drilled but before sufficient production history exists to establish a production decline curve.

Gas Reservoirs

$G_{IP} = 1546\Phi(1-S_w)/Tz$

$G_p = G_{IP}Ah(RF)$

Oil Reservoirs

$O_{ip} = 7758\Phi(1-S_w)/B_o$

$O_p = O_{IP}Ah(RF)$

Where:
A - Areal extent (acres)
B_o - Oil formation volume factor (reservoir barrel/stock tank barrel)
G_{IP} - Gas in place (Mcf/acre-foot)
G_p - Recoverable gas (Mcf)
h - average reservoir thickness (feet)
O_{ip} - Oil in place (barrels/acre-foot)
O_p - Recoverable oil (barrels)
RF - Recovery factor (decimal)
S_w - Water Saturation (decimal)
T - Reservoir temperature (°Rankine)
z - Gas deviation factor or compressibility factor
Φ - Porosity (decimal)

The reserve engineer must review a "log" lowered through the wellbore that takes readings that are reflected in a series of irregular lines tied to the depth of the wellbore in which the readings have been taken to determine the number of feet of "pay" – hydrocarbon-bearing rock. Attachment 2. The readings produced by the log are also used to determine porosity and water saturation. Thus, even the "simplest" of reserve calculations requires the reserve engineer to make many different judgments about the character of rock located many thousands of feet beneath the surface of the earth. Differences in judgments of as little as 5 to 10% about feet of pay, resistivity, areal drainage, porosity or formation water resistivity can create massive differences in the final estimate of reserves. *See* Attachment 3 (changes in assumptions of 10% or less in volumetric calculation inputs result in total variance of 71%). Historically,

> even with the best of core and log data in rather uniform reservoirs, it is doubtful that the initial gas in place can be calculated more accurately than about 5% and the figure will range upward to 100% or higher depending on the uniformity of the reservoir and quantity and quality of the data available.

B.C. CRAFT & M.F. HAWKINS, APPLIED PETROLEUM RESERVOIR ENGINEERING 47 (1st Ed., 1959).

Even estimates done by qualified engineers of mature producing properties containing multiple wells and long production histories vary widely. The Staff appears to believe that if 20 reserve engineers were handed the same data set, their resulting reserve estimates would vary from one another by only a modest amount. This is simply not reality, and that fact is recognized by agencies of the United States government as well as academic treatments of the subject.

The Energy Information Agency of the United States Department of Energy is the entity responsible for "providing objective, timely and relevant data, analysis and projections for the Department of Energy, other government agencies, the United States Congress and the public." *Annual Energy Outlook – 2004: Hearing Before the Senate Comm. on Energy and Natural Resources,* 108th Cong. 1 (2004) (statement of Guy Caruso, Administrator). In referring to El Paso and Shell write-downs of 2003 and 2004, the EIA noted that

> These recalculations are notably large; however, companies revise reserve estimates from time to time. *Revisions occur due to the inherent difficulty of precisely defining the concept of proved reserves and to the methodological difficulty of estimating proved reserves, because this estimation is subject to uncertainty even with improvements in technology*.

Id. (emphasis added). Estimates of the nation's natural gas reserves by the United States Geological Survey and the Potential Gas Committee of the Colorado School of Mines differ by more than 55 *trillion* cubic feet or over 20% of the American reserve base (322 vs. 266.2 TCF). David Morehouse, *The Intricate Puzzle of Oil and Gas Reserves Growth*, U.S. ENERGY INFO. ADMIN. NAT. GAS MONTHLY, July 1997, at xiii. These substantial differences in oil and gas reserve estimates are simply a byproduct of the science and do not imply the existence of fraud; to the contrary, they *vitiate* any inference of fraud from the write-down that occurred here.

The variability of good faith oil and gas reserve estimates is repeatedly demonstrated in results of reserve work done in oil and gas "data rooms." When oil and gas exploration and production companies wish to sell properties, they open a data room containing well log, production and other raw data of the kind ordinarily used by reserve engineers to make end-of-year estimates for reporting purposes. Invitees review the information and bid on the properties offered for sale. Despite the fact that interested purchasers send the engineers most familiar with the properties and are similarly motivated to obtain the "best deal," resulting bids often vary by as much as 100%. Bids on one large south Texas property in the mid-1990s varied from a low of $425 million to a high of $760 million, or by a factor of 1.78 to 1. These data room outcomes highlight the impossibility of inferring fraud merely because a new reserves auditor, arriving at the scene long after the fact, comes up with different reserve estimates – even substantially different reserve estimates – than the original auditor.

B. Reserve Estimates Done over Time Reflect Even Larger Changes Because Data Inputs to the Reserve Calculations Change

Bids from data room participants are static comparisons – engineers view the same raw data at the same time under identical economic conditions. Comparing end-of-year results from one year to the next (the situation facing the Staff here) is even more complex because each year adds production, developmental, and performance data. During a given year, a company may produce 20% or more of its reserve base, so the question becomes whether new wells have replaced the reserves existing at the end of the previous year. This problem was particularly acute for El Paso reserve analysts because it often produced 20% or more of its reserve base in an existing year

and had one of the largest domestic drilling budgets in the United States during these periods. Attachment 4.

Academic analysis of the history of reserve estimation indicates that substantial year-to-year shifts in reserve estimates are the norm, not the exception. The first extensive study on the subject was conducted in 1980 and covered all reporting oil and gas exploration and production companies. It indicated that substantial year-to-year revisions, on the order of -82% to +37% of the previous year's reserve quantity, were common and that a standard deviation in the pool of 17% in annual revisions was present. Stanley P. Porter, HIGHLIGHTS OF A STUDY OF THE SUBJECTIVITY OF RESERVE ESTIMATES AND ITS RELATION TO FINANCIAL REPORTING 4 (Tulsa, Arthur Young & Company, 1980). The study concluded, *inter alia*, that "[r]evisions in reserves are a common occurrence and are a result of the subjective judgment process involved and are not an indictment of the estimator." *Id*. Of 380 fields tested over a six-year period, 73% contained at least four revisions and 95% at least one revision. *Id*. at 33. In over 38% of the 178 instances studied, companies reversed the *direction* of their revisions on *the same field* from year to year. *Id*.

A follow-on study for the period 1985 through 1994 re-tested the data to determine whether scientific and technical advances had reduced reserve variability. It concluded that for 239 firms over a ten-year period, the worldwide absolute year-to-year revisions in reserves versus beginning-of-year numbers averaged a mean of 7.33% and at a standard deviation of 12.42%. Nasser Spear, *An Empirical Examination of the Reliability of Proved Reserve Quantity Data*, PETROLEUM ACCT. & FIN. MGMT. J., Vol. 18, No. 2 at 1, 4 (Summer 1999). This most recent study concluded that "[w]hile the

empirical analysis revealed that there is a high degree of uncertainty in the reserve estimates the analysis showed that the reserve estimates contain a low level of bias the entire sample period." *Id.* at 21 (emphasis added).

There are numerous meaningful anecdotal examples of year-to-year reserve revisions,[10] but two are explained here because they involve Ryder Scott – an organization that the Staff evidently believes employed practices that are free from criticism.[11] First, in 1997 and 1998, El Paso had yet to merge with Coastal, and HudCo had no connection to the formulation of El Paso's reserve estimates – they were audited by Ryder Scott. In 1998 and 1999, El Paso's EOY estimate of discounted future net value from proved reserves was written down by $1.3 billion, or 8.92% of the company's market capital or by a total of 34% from 1997 through 1999. Attachment 5 (*compare* rows 1 and 3 – FNR undiscounted). Ryder Scott presumably employed the same GAEP in 1997 and 1998 that it used in 2003 and also presumably complied with SEC regulations in both years. No allegations of fraud were made, and no SEC investigation was undertaken into these 1997 through 1998 write-downs. Why? Because none were appropriate. Even high quality, good faith estimates vary substantially from year to year because of the introduction of new development and production data.

The second example illustrates the difficulty of the reserve engineering task. In 1974 through 1975, Ryder Scott did the reserve work for Good Hope Refineries on its

[10] For example, in 2004, Exxon Mobil Corporation wrote down its reserves of 9.889 BBOE by 751 MMBOE. Exxon Mobil Corp., Annual Report (Form 10-K), at 88 (Feb. 28, 2007) (EOY 2003 vs. 2004). Using standard conversion techniques (1 BOE = 6 MCFE), this was a 4.56-TCF write down – over *2.68 times* the El Paso 2003 reserve write-down. We have found no record of an investigation or threatened action by the SEC against Exxon Mobil.

[11] Ryder Scott has been sued at least twice on claims that it was negligent. Notably, in each instance, Ryder Scott turned to HudCo to represent it as expert.

"Lobo" trend properties in Zapata and Webb Counties, Texas. From February through July 1975, Ryder Scott's "PV 10" estimate of value of its natural gas reserves dropped from $219,688,336 to $94,064,435, or by more than 58%. *Good Hope Indus. Inc. v. Ryder Scott Co.*, 389 N.E.2d 76, 79 n.8, 10, 378 Mass. 1 (1979). Between 1973 and 1998, however, these properties produced over *3.5 trillion cubic feet* of natural gas for Good Hope before being sold to Conoco Phillips in 1997 for an *additional* $1.1 billion on an estimated 2.7 TCF of additional reserves. *See* TransAmerican Energy Corp., Annual Report (Form 10-K), at 1 (May 5, 1998).[12]

The inherent uncertainty of reserve estimation also limits the degree to which a reserve auditor's opinion may influence the client's estimate. Though SEC regulations permit the booking of only those reserves that are "reasonably certain" to be recovered under existing economic and physical conditions, the inherently uncertain and judgment-driven character of reserve engineering makes it extraordinarily difficult for outside reserve engineers to categorically reject judgments made by experienced company engineers as "unreasonable" – especially when they employ the same standard estimation tools used by the auditor. Even assuming, incorrectly, that the reserve engineer/auditor has the power to "correct" his client's estimate of reserves, this battle of opinions inherently produces few well-defined "wrong" outcomes that empower reserve engineers to do so.

[12] Good Hope Refineries Inc. changed its name to TransAmerican Natural Gas Company and later to TransAmerican Energy Corp.

C. El Paso's Reserve Estimate Revisions Were Not Seen by Investors As Financially Material, and for Good Reason

The EOY 2003 write-downs had virtually no effect upon El Paso's actual financial strength because they merely caused a re-categorization of reserves, and many of those "written-off" reserves have returned to El Paso's books since then.

El Paso classifies itself as a "Natural Gas-Transmission" firm (SEC Code 4922). At the end of 2003, it had four business segments – pipeline ownership and operation, merchant energy or trading, field operations and exploration and production. The market's perception of El Paso as a troubled energy trader like Enron dominated its response to El Paso's reported results. From 2000 through 2004, El Paso's stock price tracked Enron's stock price to a stunning degree. Attachment 6. From March 2001 to June 30, 2003, El Paso's market capitalization plummeted from $35.1 billion to $4.8 billion (86%) despite large additions to proved reserves. Attachments 5-6.

It is unclear that investors viewed El Paso's announced reserve revisions as material. Numerous academic studies of reserve revisions have demonstrated little correlation between the amount of stated reserves or revisions in those reserves and stock performance. *See:*

- Joseph Maglio, *Capital Market Analysis of Reserve Recognition Accounting*, 24 J. ACCT. RES., Supp. 102 (1986) (in general, the results in this paper indicate that the RRA data do not measure the market values (and changes in market values) of sample firms as predicted by the theory);

- Greg Clinch & Joseph Maglio, *Market Perceptions of Reserve Disclosures under SFAS No. 69*, 67 THE ACCT. REV., No. 4 at 852 (Oct. 1992) (in a test of 131 crude oil and natural gas exploration and production companies from 1984 through 1987, statistically significant correlation existed between production and stock price, but "there is little evidence that proved reserves or proved developed reserves are informative ….");

- Trevor Harris & James Ohlson, *Accounting Disclosures and the Market's Valuation of Oil and Gas Properties*, 62 THE ACCT. REV., No. 4 at 663 (Oct.

1987) (finding relationship between reserve amounts and market values "statistically insignificant" and noting that "the market does not rely on quantity of proved reserves when valuation measures are available");

- Wayne Shaw & Heather Wier, *Organizational Form Choice and the Valuation of Oil and Gas Producers*, 68 THE ACCT. REV., No. 3 at 663 (July 1993) (results consistent with Harris and Ohlson – book values are relevant to investors, but the "coefficients on the PV and the DIV variables [present value and dividends per barrel as measure of economic return] were not significant in any of the four years studied, 1985-1988).

These studies were undertaken of pure exploration and production companies (SIC classification 1311), but the association between reserve amounts and market valuation or returns is even weaker when tested on companies like El Paso that have other large industry components. Michael Doran, Daniel Collins & Dan Dhaliwal, *The Information of Historical Cost Earnings Relative to Supplemental Reserve-Based Accounting Data in the Extractive Petroleum Industry*, 63 THE ACCT. REV., No. 3 at 410-11 (July 1988); Nasser Spear, *The Market Reaction to the Reserve-Based Value Replacement Measures of Oil and Gas Producers*, 23 J. BUS. FIN. & ACCT., No. 7 at 964 Table 4 Col. 5. (Sept. 1996) ("This finding suggests that the total change in reserve value is not informative, in terms of explaining the unexpected security returns surrounding the release week of the annual reports of all O&G Companies.").

Indeed, the Commission itself has noted the absence of a connection between reserve write-downs and stock performance. On May 6, 1986, the Commission denied the request of various oil and gas producers to temporarily suspend the application of Rule 4-10's cost ceiling test because of the rapidly declining price of oil and natural gas. The Office of the Chief Economist of the SEC sought to determine whether the decision to retain the cost ceiling test, and the ensuing national average reserve write-down of 19.4%, caused the drop in share prices that followed the SEC's announcement. Office

of the Chief Economist of the SEC, *The Effects of the SEC's Full-Cost Ruling and Write-Downs on Stock Prices of Oil and Gas Firms*, at 9 (1986). The Commission tested the market response for 173 oil and gas firms using full-cost accounting and another 47 firms using successful-efforts accounting and concluded that investors bought or sold based upon significant *exogenous* factors – not reserves. "[T]he capital market made its own stock price write downs in anticipation of reduced earnings as oil prices fell, not when the SEC decided to reaffirm a rule which would force some accounting write downs." *Id*. at 9. It will be extraordinarily difficult for the SEC to claim that a reserve write-down constituting 4.4% of El Paso's total book value negatively affected its stock prices when its own studies prove that an industry-wide write-down more than four times this size had no effect on them.

Moreover, should an enforcement action be undertaken, the SEC would be required to prove materiality in a distinctly "noisy" financial environment for El Paso. In 2003, the company took losses of $1.3 billion in connection with its exit from the merchant energy business. When the 2004 revision was finalized, El Paso also announced that it had sustained over $700 million in hedging losses, which, unlike the reserve revisions, involved hard-cash losses that directly impacted current earnings.[13] The company had also announced that it was leaving the merchant energy market but had hundreds of millions of dollars in long-term contracts to conclude – the financial impact of which could continue to produce losses if prices changed in the future. Further, it is error to assume that investors reacted to the substance of the reserve write-down as opposed to the announcement of a revision itself. A substantial investor

[13] El Paso Corp., Annual Report (Form 10-K), at 1 (Sept. 30, 2004).

reaction occurs whenever restatements are made that are related to the *fact* of restatement, not its *substance*. E.H. Feroz, K. Park & V.S. Pastena, *The Financial Market Effect of the SEC's Accounting and Auditing Enforcement Releases*, 29 J. ACCT. RES., Supp. 107 at 124 (1991) ("the market reacts negatively to the SEC's investigation *even with prior knowledge* of the error") (emphasis in original).

Finally, unlike other accounting write-downs in which booked assets become valueless, when El Paso's reserve revisions were announced, the proved reserves were most likely re-categorized as probable or possible reserves. The World Petroleum Council utilizes a probabilistic rather than determinative measure of reserves, and it characterizes "proved" reserves as having a 90% chance of being recovered and "probable" reserves a "better than 50%" chance of being recovered.[14] Thus, unlike ordinary accounting write-downs in which the asset becomes worthless, the lands owned by El Paso remained extraordinarily valuable and were more likely than not to produce hydrocarbons. The lands owned by El Paso at the end of 2003 had not changed, only the company's published judgment of them had.

Subsequent reports show that many of the reserves re-booked as "probable" in 2004 have returned to the "proved" category. While the Huddlestons have requested, but have not been given access to, subsequent EOY "line" reserve reports, the subsequent data generated from El Paso's 10-K reports indicates re-booking of reserves as "proved." Thirty-six percent of El Paso's proved reserves are now in the "undeveloped" category, as compared to 21% after the EOY 2003 write-down – an

[14] *Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information Approved by SPE Board in June 2001*, Revision as of Feb. 19, 2007, § 5.8 ("proved plus probable reserves (2P) may represent the best estimate for many purposes, including regulatory reporting in some countries").

increase of 71% since 2004. Attachment 7. The reserve life indices (which show how long reserves will last at current production rates) were at 9.6 and 9.4 years for 2005 and 2006, respectively, figures that are higher than at any time in which the Huddlestons were involved with El Paso. *Id*. Accordingly, the write-down itself was arguably incorrect or, at minimum, greatly overstated.

III. THE STAFF'S CONCERNS WITH RESPECT TO THE HUDDLESTONS, AS WE UNDERSTAND THEM, ARE NOT WELL-FOUNDED

Questioning by the Staff points to concerns over (1) the question of the Huddlestons' independence and (2) reserves reported for the (a) "Castlegate," (b) "High Mountain," (c) coal bed methane, and (d) "South Texas" properties. As we now show, these concerns are not well-founded. Because the Staff has declined to identify its concerns with any clarity during the Wells process (or otherwise than in questioning during testimony), the Huddlestons respectfully request that if the Staff believes there are other issues it believes would support an enforcement recommendation, they be given the opportunity to address them in writing.

A. The Huddlestons Substantially Moderated El Paso's More Aggressive Reserve Estimates During the Three Years on Which the Staff Has Focused

The bottom line is that by any objective standard, the Huddlestons did what they could, in the most forceful manner they could, to counter Coastal and El Paso's tendency to aggressively book reserves. When, in 1999, a series of practices by Coastal threatened the reserve process, Pete Huddleston brought the matter to the highest level of authority on reserve issues at Coastal (COO Rod Erskine) in a written letter hand-delivered and secured his agreement that the practices would be stopped. (Pete Huddleston Tr. at 45/2-17, Staff Exhibit 208.) Subsequently, the Huddlestons

sought an audience with El Paso CEO Bill Wise to discuss their concerns that reserve estimates were too high, but Mr. Wise refused. (Pete Huddleston Tr. at 192/15–193/16.) These efforts to warn El Paso management were all the Huddlestons could do. Unlike financial auditors, reserve engineers do not sit in on Board of Directors and Audit Committee meetings, and the Huddlestons were constrained by their contract and SPE standards to keep all aspects of their work confidential. Attachment 1 (Service Agreement) at Art. 14(A); SPE 2001 at § 4.6.

According to El Paso's internal records, the process in which the Huddlestons were engaged induced El Paso to write down its reserves from 2000 through 2002 by 5.8%, 13.9% and 11.5%, respectively. EPPR0000706. During 2001, as a result of the process, El Paso reduced its initial year-end estimate of proved reserves by 912 BCF. *Id*. It is difficult to understand how the Huddlestons can be accused of engaging in improper conduct when their actions consistently resulted in Coastal and El Paso significantly reducing their reserve estimates by significant amounts.

B. The Huddlestons Maintained Independence from the Company in Accordance with Generally Accepted Engineering Principles

Regulation S-X does not provide standards of independence for reserve engineers. As a consequence, any effort by the Commission to initiate an action against the Huddlestons on these premises would fail at the threshold (*see supra* at 19).

Nonetheless, the Huddlestons maintained their independence in accordance with GAEP as defined by the SPE. The 2001 SPE Standards define ten different conditions which, if extant during the term of their professional engagement, mean that the reserve auditor would not "normally" be considered independent. SPE 2001 at § 4.3(a)-(j).

The Huddlestons were clearly free of any conflict defined in subsections 4.3(b)-(j) of the standard, and only its potential connection under subsection 4.3(a), which precludes reserve engineers from "acquiring property for which reserves are to be estimated," deserves comment. During the 1970s and ending in 1984, PPPCo acquired interests previously owned by Coastal.[15] These interests were acquired long before the engagements relating to the investigation and at least 15 years before the 2001 SPE Standards on conflicts of interest were formulated. The possibility of conflict was clearly disclosed in HudCo's Service Agreement with Coastal, the contract that formed the basis for all future reserve estimation efforts. Attachment 1 (Service Agreement) at App. A. Neither PPPCo nor HudCo keeps records to determine whether it owns joint interests in any well with Coastal or El Paso. PPPCo has identified to the Staff all properties in which it has an ownership interest in the Monte Cristo, Jeffres and Natural Buttes fields, but the Staff has not identified any overlapping ownership between PPPCo and El Paso. *See* HUD78531-78909.

During 2003, HudCo acquired and then sold a small amount of El Paso stock on behalf of its employee pension fund. Attachment 8. These purchases were short-lived

[15] A discussion of the ownership of interests in oil and gas properties is essential to understand PPPCo's position as a co-owner of mineral properties (if, in fact, co-ownership with Coastal or El Paso existed). Direct competitors having no fiduciary obligation to one another can and frequently do own interests in the same well. Landowners lease properties to an exploration and production company, commonly retaining between a 1/8th and 1/4th royalty (cost free) interest in the property. Because leasing activities are competitive, they often result in various companies acquiring a "checkerboard" leasing position, forcing exploration companies to "pool" their interests to create drillable positions. When this occurs, joint interest owners execute a "Joint Operating Agreement" or "JOA" in which one company (usually the one with the largest working interest percentage in a drilling unit) is selected as the "operator." This company keeps all records, handles sales and their proceeds and proposes new wells or the work-over of existing wells in the unit. Other E&P companies – "non-operators" – either opt in or out of the specific project proposed by the operator based upon whether they think it is likely to be successful. These agreements make clear that the participants make decisions on their own and in strict accordance with their percentage interest in the wells and that the parties are neither partners nor joint venturers and do not owe one another any fiduciary obligation.

and tiny – only 1/20th of 1% of the Huddlestons' net worth – and are immaterial under the applicable standard. SPE 2001 at § 4.3, n.2. The timing of the sales – occurring as they did long before HudCo was replaced as auditor or any particular securities issue was contemplated by El Paso – make it apparent that no use of insider information, market timing, or other actual or potential conflict of interest was involved.

The Staff's questioning implied that the size of El Paso's account influenced the Huddlestons' behavior. If this is in fact the charge being made, it is nonsensical. Case authorities have given short shrift to this argument. *SEC v. Coffman*, 2007 WL 2412808, at *14 (D. Colo. Aug. 21, 2007) (judgment entered against SEC following bench trial in case involving valuation of mining properties, with the Court stating that it gave the company's financial auditor's "profit from Stansbury very little weight in evaluating whether he acted with scienter"); s*ee also Fidel v. Farley*, 392 F.3d 220, 232-33 (6th Cir. 2004) ("allegations that the auditor earned and wished to continue earning fees from a client do not raise an inference that the auditor acted with the requisite scienter. … Absent any allegations that Ernst & Young's fees from Fruit of the Loom were more significant than its fees from other clients or that Fruit of the Loom represented a significant portion of Ernst & Young's revenue, it is difficult to surmise how Ernst & Young's desire to keep Fruit of the Loom as a client would be any different from its desire to keep any client and thus be indicative of fraud."); *Melder v. Morris*, 27 F.3d 1097, 1104 (5th Cir. 1994); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990). Were it otherwise, all professionals would be subject to a finding of scienter in every case.

The 2001 SPE Standards make it absolutely apparent that even substantial economic relations may exist between reserve engineer and operator without destroying independence. SPE 2001 at § 4.3. Here, El Paso accounted for 16% or less of HudCo's gross revenue in any one year in question. HudCo's El Paso revenue , in turn, was no more than 4.7% of the Huddleston affiliates' income. During the operative time period, when the value of all affiliated companies and properties is included, the Huddlestons maintained a net worth of more than $100 million, making either the annual gross or net income produced by the El Paso audit utterly immaterial to them. The Huddlestons had no incentive to tarnish their professional reputations, perhaps permanently, to preserve this modest amount of income or to placate the client, and there is no evidence from the documents, the testimony, or otherwise that they did so or that they felt any pressure to capitulate to the company at the threat of being fired.

Finally, it appears that the Staff believes that the Huddlestons displayed a lack of independence in that they permitted the company to choose some of the reserves that would be audited. From 2000 through 2002, HudCo audited between 83.4 and 100% of El Paso's reserve base. This portion of properties audited compares very favorably with other major or independent exploration and production companies. Attachment 9. El Paso consistently chose to have its larger properties both in terms of size and value audited, a choice supported by GAEP. SPE 2001 at § 6.4(h) ("Reserve Auditors … should give priority to each property or group of properties of an entity having (i) large reserve value in relation to the aggregate properties of such Entity …."). The small remaining portion of unaudited properties meant that changes in their value were likely to be immaterial. Even a 30% change in the remaining 15% of unaudited reserves

would result in only a 4.5% potential write-down in total reserve estimates. The final objective of property selection – to obtain audits of a representative sample of El Paso's properties – occurred throughout the process. *See* SPE § 6.4.

C. The Huddlestons Gave Proper Input Concerning the Booking of the "Castlegate" Formation[16]

"Castlegate" nomenclature aside, the sands discovered by El Paso during 1999 in the Natural Buttes field were the lowest known productive interval of the Mesa Verde formation — highly productive sands owned by Coastal, then El Paso, for more than 30 years. Their booking was entirely appropriate and became increasingly conservative until the properties were sold for a large profit in 2002.

The Natural Buttes field was first drilled by Coastal during the early 1970s, and hundreds of developmental drills continued to be drilled well into the 1990s. Attachment 10-1. The productive sands within the Natural Buttes field, prior to the drilling undertaken in 1999, included the Wasatch, Green River and Mesa Verde sands. These sands are highly laminated sand shale sequences formed in a transgressive/regressive marine depositional environment. The history of drilling within all the Natural Buttes formations illustrated that a single wellbore was so likely to encounter several stringers of sands that Coastal and El Paso enjoyed a better than 95% completion rate for wells drilled in the field during the 1990s. Attachment 10-2.

In 1999,[17] Coastal drilled deeper, completing five wells that penetrated what it came to call the "Castlegate" formation but which could as easily be called the "Lower

[16] Because those charged directly with mishandling reserves in specific geographic areas are responding directly to these charges, the Huddlestons' treatment of the four geographic areas of concern is summary.

[17] These bookings occurred *five years* before the period in which the Staff claims stock prices reacted to a reserve revision and were not even on El Paso's books at the time the 2004 revision was announced.

Mesa Verde" sands. Attachment 10-3. Each of the wells illustrated SEC-approved characteristics to be classified as proved reserves, either through well log analysis, pressure tests or production. Attachment 10-3. Most importantly, core samples and paleontological analysis illustrated that these deeper sands were created in the same depositional environment as their shallower peers, a critical finding which meant that the shallower Mesa Verde sands were strong indicators of how their deeper peers would perform. (Peter D. Huddleston Tr. at 240/13–242/1). In 2000, the company drilled additional wells into the formation that helped further define the sands. Attachment 10-4.

Coastal opined that the five wells proved 1 TCF of reserves, reasoning that because the Castlegate sands were deposited in the same depositional environment as the Upper and Lower Mesa Verde, the entire field would achieve drilling results similar to those encountered over the prior 30 years in shallower sands.[18] The Huddlestons disagreed with this assessment and estimated that the field within a polygon formed by the wells already drilled could be treated as containing 382 BCF of proved reserves, the continuity of which was established within the polygon. These reserves consisted of 12 BCF of proved producing reserves and 370 BCF of proved undeveloped locations. In 2000, Ryder Scott, acting on behalf of El Paso in the upcoming merger between Coastal and El Paso, indicated to El Paso that it felt these reserves were "probable" but

[18] The Staff's questioning in testimony suggests that the Staff has received hearsay testimony of the El Paso engineer who proposed to book these 1 TCF of reserves to the effect that Peter Huddleston supposedly recited that "we can if we want to go to jail." We understand that in response to a series of leading questions by the Staff, the witness "seemed" to recall what he referred to as a "cynical" or joking comment of this kind. Of course, the Huddlestons were not present at the testimony and therefore had no opportunity to probe the witness' memory, which was plainly equivocal despite the leading questions, or otherwise to examine the witness regarding the meeting. Mr. Huddleston flatly denies any such statement. (Peter D. Huddleston Tr. at 392/4-11). The notion that Mr. Huddleston would make such a statement is nonsensical.

not “proved” but that the ultimate recovery from the formation might well prove much larger than the company’s estimate of proved reserves.[19] This opinion was not shared with the Huddlestons until well after the fact. From 1999 to 2001, HudCo’s estimates of proved reserves attributable to the “Castlegate” formation were reduced from 382 to 279 BCF, or by 27%, to reflect drilling results and further reduced to 228 BCF, or by 40% of their original bookings, before the properties were sold at the end of 2002.

Attachment 10-3 (overhead view) illustrates the Staff position. It believes that only those proved developed (shown in red) and directly offsetting proved undeveloped locations (shown in blue) should have been booked, not the proved undeveloped locations within the polygon. Attachment 10-5. SEC regulations permit the booking of “one off” undeveloped locations if “continuity of production from the existing productive formation” is established between an existing proved well and the “one off” location. 17 C.F.R. § 210.4-10(a)(iii)(4) (2007). The regulation does not define the term “continuity of production,” but in March 2001 (long after the Castlegate was initially booked), certain members of the staff of the Division of Corporation Finance provided guidance relating to the term.[20] The guidance says that for a “one off” PUD location to be booked,

[19] Ryder Scott indicated in this same letter that all other reserves booked by Coastal and audited by HudCo were booked consistently with SEC standards, a position that appears to have been ignored or disregarded by the Staff.

[20] The Huddlestons understand that others who have been served Wells notices are addressing the role of "guidance" in some depth, and they incorporate those comments here. While the Corp Fin staff guidance deserves respect, attention, and consideration – as the Huddlestons gave it – it lacks the force of law and does not warrant *Chevron*-style deference. *Christensen v. Harris County*, 529 U.S. 576, 583 (2000). Indeed, this guidance specifically disclaimed that it represented the view of the Commission or of any Commissioner. Several decisions in the civil action and civil enforcement contexts have ruled that staff guidance is of no moment in setting the standard by which a party's behavior is to be judged. *WHX Corp. v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004) (SEC's reliance on the fact that tender offeror refused to follow SEC guidance as proof of scienter did not pass "even a weak rationality standard"); *Ontario Teacher's Bd. v. IG Holdings*, 2000 WL 1234592, at *6 (S.D.N.Y. Aug. 31, 2000).

“pressure communication” between the undeveloped location and an existing proved developed well must exist.

Respectfully, but frankly, we submit that the guidance is wrong for two practical reasons. First, no engineer, indeed no human, can determine whether an as-yet-undrilled well will be in pressure communication with an existing producer. This information can be determined only by the use of pressure transient interference tests between the two affected wells over the life of their production. Second, in the Castlegate context, the guidance conflicts with GAEP, Rule 4-10, and itself.

Rule 4-10 specifically permits engineers to book as proved, in the absence of information on fluid contacts, the lowest known horizon of producing sands. 17 C.F.R. § 210.4-10(a)(2)(ii) (2007). The 1999 drilling within the Castlegate sands affirmatively lowered the known horizon of the Mesa Verde sands, and the regulation entitled El Paso to treat them as proved. In addition, GAEP empowered, if not required, the Huddlestons to consider the highly analogous Wasatch, Green River and Upper Mesa Verde sands and their 30-year history of production when booking the Castlegate. SPE 2001 at § 5.3. Under the Staff’s interpretation of the Corp Fin staff guidance, however, the company and the Huddlestons would have been precluded from considering the analogous upper and lower Mesa Verde sands.

> As most engineers who deal with the classification of reserves have come to realize, it is difficult, if not impossible, to write reserve definitions that easily cover all possible situations. Each case has to be studied as to its own unique issues. This is true with the Society of Petroleum Engineers' and others' reserve definitions as well as the SEC's definitions.

Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance ("The Guidance"), Section II "Guidance About Disclosures" at Subsection F, ¶ 3 (Mar. 31, 2001) at

http://www.sec.gov/divisions/corpfin/guidance/cfactfaq.htm#P267_55290. Neither SEC regulations nor the Corp Fin staff's guidance requires reserve engineers to blind themselves to clearly relevant data. More to the point, reserve engineers, whether within the company or outside it, should not be made the subject of enforcement actions for considering data that both GAEP and Rule 4-10 authorize them to consider.

The last year the Castlegate formation was audited was 2001, when HudCo's "PV-10" estimate of the El Paso Utah gas properties was $310 million. Attachment 11. During 2002, the same properties were sold for $502 million to a disinterested third-party purchaser.[21] To any objective observer, a sale at this price answers the question whether the company and the Huddlestons were reasonable in booking Castlegate reserves. A subsequent unaffiliated producer, desiring to acquire the properties as cheaply as possible, bought them at a price that indicated it valued the reserves as being far *greater* than those estimated by El Paso. The purchaser would not have paid this sum for the properties had it not been, in Rule 4-10's terms, "reasonably certain" that the reserves were worth more than it paid for them.[22]

Finally, the undeveloped portion of the Castlegate sands – the portion with which the Staff takes issue – were an immaterial portion of El Paso's reserve base, constituting only 4.7% of Coastal's 1999 EOY reserves, 2.1% of El Paso's 2000 reserves and 0.7% of El Paso's 2001 reserves. *Compare* Attachment 11 *with* Attachment 12.

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[21] El Paso Corp., Current Report (Form 8-K) (Nov. 6, 2002).

[22] The Huddlestons did not participate in the company's 2003 response to the SEC concerning the booking of "one off" reserves either in the Castlegate sands or otherwise and have no comment on that issue.

D. The Huddlestons Gave Proper Input Concerning Booking of the "High Mountain" Properties

During late 1998,[23] Coastal made what it referred to as its "High Mountain" acquisition from Conoco. Coastal's internally-estimated reserves were initially booked by the acquisitions group which had performed the due diligence on the acquisition. The Staff has vocalized two criticisms: (1) Coastal booked the High Mountain reserves at much greater levels than the seller, and (2) the proved undeveloped locations included in booked reserves were not properly documented.[24]

When a producer spends cash for acquired properties, it is the purest possible evidence to an auditor of its good-faith belief that enough proved reserves exist to justify the expenditure. No company willingly overpays for reserves but instead buys them expecting that actual reserves will exceed estimated reserves by enough to create an acceptable return. Coastal had no incentive to pay as though 400 BCF of reserves were recoverable under the self-defeating belief that some lesser amount existed.

The Staff's concern that Coastal booked undocumented locations is misplaced. Pete Huddleston testified that the High Mountain reserves were a bone of contention during the end-of-year 1998 proceedings and that he therefore personally undertook the necessary engineering review. HudCo was presented with maps spelling out the locations of all undeveloped wells for which proved reserves were assigned and agreed with some and rejected others. (Pete Huddleston Tr. at 74/17–75/16, 137/24–140/16.)

[23] These bookings occurred *six years* before the period in which the Staff claims stock prices reacted to a reserve revision and were not even on El Paso's books at the time the 2004 revision was announced.

[24] The Huddlestons have also indirectly heard the charge that they "permitted" El Paso to book proved undeveloped locations based upon seismic information alone. Pete Huddleston conducted the 1999 review of the High Mountain properties and testified that he had specifically removed all locations based solely upon seismic information. (Pete Huddleston Tr. at 195/23–196/3.)

The Huddlestons had never in their 35-year history of estimating or auditing Coastal or El Paso reserves permitted unmapped locations to be booked and did not begin with the High Mountain acquisition. The Huddlestons had no control over whether Coastal or El Paso kept the maps illustrating these locations for an investigation commencing six years after the booking.

The Huddlestons last reviewed the Colorado properties at the end of 2001, estimating that they contained 219.5 BCFe of proved reserves with a corresponding "PV-10" estimate of $124.725 million. On April 17, 2002, Encana, one of the largest independent oil and gas exploration and production companies in Canada, agreed to purchase the Colorado properties, including a gas gathering system, for the price of $292 million. Attachment 13. Encana, which had substantial experience in multi-zone formations of the kind involved, estimated that the purchase gave it an additional 500 BCFe of reserves.[25] Encana publicly announced that it would soon drill 50 wells in the field and that it believed production in the property could be tripled within three years. Attachment 13. These arms-length assessments, backed by the payment of cash, strongly support the reasonableness of El Paso's determination of proved reserves in the Colorado properties and dispel any notion that they were fraudulently booked.

Finally, like the Castlegate sands, the High Mountain reserves would not have been a material component of El Paso's reserve base, much less its asset base, to any

[25] Under the Canadian equivalent of Rule 4-10, exploration and production companies are permitted to book 100% of their proved reserves and 50% of their probable reserves. Thus, Encana may, for example, have booked 400 BCFe of proved reserves and 200 BCFe of probable reserves.

investor. From 1999 to 2001, they constituted 5.2%, 7.6% and 3.5%, respectively, of Coastal's or El Paso's reserve base. Attachment 12.

E. Coal Bed Methane Reserves Were Properly Estimated, and the Huddlestons Urged El Paso to Follow SEC Guidance Even Though They Disagreed with it

The Staff is critical of bookings relating to El Paso's coal bed methane properties on the Vermejo Ranch in northern New Mexico, believing that (1) the inclusion of a "one off" PUD location within the field was improper and (2) HudCo too slowly reduced estimates, for audit purposes, of the area drained by existing wells.

The Huddlestons' estimates of the reserves within the Vermejo Ranch properties were based upon stratigraphic tests, core samples, actual production and the use of the analogous "Evergreen" coal bed methane field existing immediately north of the field. Each of these methods is authorized by Rule 4-10 and existing SPE Standards. HudCo's reports to management disclosed precisely the bases for its opinion that second-tier locations were proved. Ryder Scott booked the same or similar "one off" locations in its 1999 audit of the Vermejo Ranch before HudCo began reviewing these properties.

The size of the 2003 write-down was triggered by the conclusion that Vermejo Ranch wells had to be drilled on 80-acre rather than 160-acre spacing because each well would not drain 160 acres. Since El Paso did not have permission from the owner of Vermejo Ranch to drill on 80-acre spacing, it was required to write off roughly half of its booked reserves in the field. The Staff is critical of the Huddlestons for not writing down its estimate, for audit purposes, of the proved producing reserves for coal bed methane more quickly.

The initial estimates of proved reserves for the Vermejo Ranch were set using volumetric analyses and stratigraphic and core sample testing of the coal bed seam itself, as well as analogy to the highly productive Evergreen coal bed methane field located immediately to the north of Vermejo Ranch. The Vermejo Ranch properties did not immediately exhibit decline curves consistent with either the Evergreen analog properties or the volumetric analysis of core samples. El Paso attributed the diminished production capacities of these wells to production problems, including ineffective water recovery mechanisms, insufficient water disposal and improper compression.

By the end of 2002, it was not at all clear that the wells could not drain 160 acres. HudCo was not initially required by GAEP to test El Paso's claims of operational limitation. SPE 2001 at § 6.2 ("Reserve auditors may accept, generally without independent verification, information and data furnished by the Entity with respect to ownership interests, oil and gas production, historical costs … future operations … and other specified matters."). Indeed, HudCo's contract required El Paso to provide truthful, accurate, and complete information concerning operations. Attachment 1 (Service Agreement) at Art. 5.D. Only if "questions [arose] as to the accuracy or sufficiency of information or data furnished by the Entity" were they to be independently verified. *Id*. El Paso's representations were, in light of HudCo's extensive experience in coal seam developments, both reasonable and predictable. Having conducted detailed studies of production and development practices in the Evergreen area, field analyses of several properties, and reserve work on properties in Alabama, Colorado, New Mexico, Oklahoma, Wyoming, France, and Poland, HudCo was well aware that the history of the development of coal bed methane fields was replete with examples of

increased productivity following the resolution of operational issues. The Evergreen field is a good example. Its wells initially produced an average of 75 mcfpd per well due to operational constraints but, after operational restraints were lifted, its wells averaged 350 mcf per day.

The Staff's complaints regarding the booking of "one off" PUDs in the Vermejo Ranch lay bare faults in the Corp Fin guidance but also illustrate the Huddlestons' advice that El Paso adhere to it. Rule 4-10 specifically authorizes reserve engineers to use stratigraphic tests and core samples to determine whether reserves are proved. 17 C.F.R. §§ 210.4-10(a)(2)(i), (a)(13) (2007). GAEP strongly supported the use of the Evergreen field as an analogy. SPE 2001 at § 5.7. The guidance, which purports to require proof of pressure communication among undrilled wells, effectively requires the reserve engineer to ignore this data and thereby ensures that investors will receive inaccurately low reserve information. Nonetheless, the Huddlestons forwarded the guidance to El Paso and advised it not to book "one-off" PUDs in light of the Corp Fin staff guidance statement. Again, it is difficult to understand the Staff's perception that the Huddlestons engaged in improper conduct when their consistent advice to El Paso was to comply with the Corp Fin guidance statement.

F. The Huddlestons Gave Proper Input Concerning the Booking of El Paso's South Texas Reserves

El Paso was the industry leader in exploration and development operations in the Vicksburg and Wilcox formations in South Texas. Not only had the company successfully discovered and developed a number of such fields, it had also successfully implemented technology which resulted in substantial production from intervals of the Vicksburg formation that had previously not been shown to be productive. The

procedures for the estimation of reserves included consideration for volumetric calculations, analogy to previous completions and analysis of historical performance data, when such information became available.[26]

In some instances, well performance failed to meet expectations either with respect to decline rates or historically determined production profiles as determined by analogy to prior completions. When this occurred, HudCo properly revised the estimates downward to reflect actual performance. The revision of reserve estimates (either up or down) over time to reflect the performance of individual wells is a common and necessary practice within the practice of reservoir engineering.

IV. THE SEC AND THE STAFF COULD NOT SHOULDER THEIR RESPECTIVE BURDENS IN A CIVIL ENFORCEMENT ACTION OR ADMINISTRATIVE PROCEEDING

A. The Commission Would Not Be Able to Discharge its Burden of Proving an "Aiding or Abetting" Case

The Staff's questioning of the Huddlestons implies a belief that it might be successful in a federal court action against them by proof of mere recklessness or even mere negligence. This supposition is wrong. "Aiding and abetting liability under

[26] During the investigation, the Staff subpoenaed records from Output Exploration L.L.C. relating to reserve estimates that HudCo had performed for it on properties in which Output Exploration L.L.C. and El Paso were co-working interest owners. The reserve estimates prepared for El Paso were, when adjusted for ownership percentages, on the order of 3 to 4 times higher than those prepared for Output. The Staff infers that the Output reserves were "right" and that the El Paso reserves with respect to the same wells were "wrong" and "inflated" due to pressure from El Paso. The two estimates prove precisely the opposite, as well as the extreme danger of oversimplified comparisons. Subsequent production records indicate that the estimates done by HudCo for El Paso were "right" – as of January 2007, the audited wells had recovered 93% of HudCo's estimated ultimate recovery for them, and several are still producing. The Output estimates were extremely conservative due to the nature of the interest audited and information provided. Output owned a small (on the order of 1%) "reversionary" or "back in" interest in these properties that was to bear fruit if and only if the properties reached "payout." Such small interests warrant very little attention by reserve engineers who, by SPE standards and ordinary practice, focus upon the larger-value properties in an audit. Moreover, the Output reserve estimate was based entirely upon public production data, and the HudCo engineer involved (due to contractual restrictions placed on HudCo by El Paso) did not have the benefit of log information, geology, drilling plans or other background data supporting the El Paso estimates. When reserve engineers are faced with a scenario of limited or restricted data, their inevitable response is to become more conservative.

Section 10(b) must be based upon a showing of three elements: '(1) the existence of a securities law violation by the primary wrongdoer; (2) knowledge of the violation by the aider and abettor; and (3) proof that the aider and abettor substantially assisted in the primary violation.'" *SEC v. Cedric Kushner Promotions Inc.*, 416 F. Supp. 2d 326, 334 (S.D.N.Y. 2006); *accord SEC v. Fehn*, 97 F.3d 1276, 1288 (9th Cir. 1996). Here, the Huddlestons believe that the Commission would be incapable of proving any of the three elements.

As indicated, to sustain its burden of proof on a claim that the Huddlestons aided and abetted or caused a securities fraud, the Commission would first have to prove securities fraud by the alleged primary violator. As the Wells Submissions of El Paso and the other individuals show, the Commission would not be able to meet this burden because, among other things, it would not be able to show that the company or these individuals made a material misstatement or acted with scienter.

Without conceding that the Commission would be capable of proving the basic elements of securities fraud, El Paso's disclosure of risks in connection with the reserve estimates makes the representations contained within them immaterial as a matter of law. The "bespeaks caution" doctrine applies to enforcement actions just as it does to private securities fraud claims. *SEC v. Merchant Capital LLC*, 483 F.3d 747, 767-68 (11th Cir. 2007). Even if a projection of future events might otherwise be considered a misrepresentation, additional disclosures may nonetheless make them immaterial as a matter of law. *Id*. In each of its annual disclosures, El Paso clearly noted that its reserves were a part of "unaudited" financial information and gave specific warnings

designed to explain to investors the difficulty of estimating reserves and of the likelihood that they may change substantially:

> There are numerous uncertainties inherent in estimating quantities of proved reserves and in projecting future rates of production and timing of development expenditures, including many factors beyond our control. The reserve data represents only estimates. Reservoir engineering is a subjective process of estimating underground accumulations of natural gas and oil that cannot be measured in an exact manner. The significant changes to reserves, other than purchases, sales or production, are due to reservoir performance in existing fields and from drilling additional wells in existing fields.

El Paso Corp., Annual Report (Form 10-K), at 126 (Mar. 15, 2002); El Paso Corp., Annual Report (Form 10-K), at 80 (Mar. 22, 2001); El Paso Corp., Annual Report (Form 10-K), at 85 (Feb. 22, 2000). Given these repeated and specific disclosures, even overt misstatements (not that any have been proven) would likely be immaterial as a matter of law. *Id*.

Even if the Commission could establish that El Paso committed a primary violation, it would still face insurmountable obstacles in any aiding and abetting case against the Huddlestons. The law has become clear that reckless conduct is insufficient to trigger aiding and abetting liability. Rather, the Commission would have to prove that the Huddlestons possessed *actual knowledge* of wrongdoing. *Fehn*, 97 F.2d at 1288. Thus, in *Cedric Kushner Promotions*, 417 F. Supp. 2d at 334-35, the court held "that recklessness, even for fiduciaries, is no longer sufficient" and that "knowing misconduct must now be shown" to establish aiding and abetting liability. In *SEC v. Tambone*, 417 F. Supp. 2d 127, 137 (D. Mass. 2006), an aiding and abetting complaint was dismissed because the SEC had failed to "plead with the requisite degree of particularity that the defendants had 'actual knowledge' of the improper activity by the primary violators or of their roles in that activity." In *SEC v. Morris*, 2005 WL 2000665, at *8 (S.D. Tex.

Aug. 18, 2005), the court dismissed aiding and abetting claims against a former Halliburton CFO because conclusory allegations of accounting decisions and GAAP violations "relate[d] to ordinary business activities without specifying facts that would show [his] knowledge of or participation in improper activity." The court specifically noted that "an aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved." *Id*. Finally, in *SEC v. Coffman*, the court, in holding that the SEC had failed to prove an aiding and abetting violation against a company's financial auditor in connection with the valuation of mining properties, adopted the "actual knowledge" standard employed in all of these other cases. *SEC v. Coffman*, *supra*, 2007 WL 2412808, at *10. As described throughout this Submission, there is simply no evidence that the Huddlestons possessed any *actual knowledge* of wrongdoing by El Paso or any El Paso employee.

Finally, the Staff has not pointed to any fact or set of facts that would permit the required finding that the Huddlestons substantially assisted in the alleged primary violation. At no time did the Huddlestons sign off on any publicly-filed statement by El Paso, and no Huddleston reserve estimate was ever publicly reported. *See Cedric Kushner*, 417 F. Supp. 2d at 336 (summary judgment against SEC aiding and abetting claim because, *inter alia*, defendant did not provide substantial assistance – his role "was very limited" and he "was not involved in preparing or reviewing the financial or accounting statements that contained the alleged misstatements or omissions. [Defendant's] contribution to the filing was limited to gathering backup documentation for [the company's] accountants and auditors, and answering questions about

subsequent events and pending litigation").[27] The Huddlestons had absolutely no stake whatsoever in the success or failure of El Paso and were not involved in any business arrangements with the company that might have created an incentive for them to falsify reserve information. Instead, in most years, they merely consented to the use of their name in reports that (accurately) indicated the percentage of El Paso properties they audited and that the company's estimates were no more than "X" percent different from HudCo's. The Commission will be held to the "particularly exacting" standard of pleading facts that, if proven, would show either an independent duty to disclose the information or a "conscious intent" to assist the alleged primary violation by "throwing in one's lot" with the alleged primary violators. *Tambone*, 417 F. Supp. 2d at 136-37 (Rule 12(b)(6) dismissal of SEC claim). Not one fact of this kind exists.

B. There Is No Basis to Issue a Cease and Desist Order against the Huddlestons

Section 21C(a) of the Exchange Act states that if the Commission finds that any person has violated any provision of the Exchange Act or a rule or regulation thereunder, it may enter a cease and desist order against "such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation." Thus, the Staff must prove that (1) El Paso committed an underlying violation of the securities laws;

[27] No case can be made that the Huddlestons caused a violation of Securities Act Section 17(a). Section 17(a) prohibits the making of false statements in a securities offering. First, references to their audit were neither required nor sufficient for the offerings. Had the Huddlestons never existed, much less provided audits, El Paso could have proceeded with the offerings making whatever claims it wished concerning the status of its proved reserves. Further, the Huddlestons played no role in the drafting of any El Paso offering and were never asked to comment upon, certify, or correct any statements made by El Paso in any offerings of the company. At most, the Huddlestons gave their consent to allow El Paso to refer to the HudCo name and report in El Paso's SEC filings. The presence or absence of consent had no effect on whether El Paso committed a Securities Act violation. Nor can it be said that the presence of such a consent in any way caused El Paso to violate any of the securities laws.

(2) the Huddlestons' conduct was a cause of the violation; and (3) in causing the violation, the Huddlestons knew or should have known that their conduct would contribute to the violation. If the Staff establishes these threshold requirements, it must then demonstrate that a cease and desist order is appropriate under the factors articulated in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). The Staff cannot meet these burdens.

It bears emphasis at the outset that the Courts of Appeals have of late been quite strict in their scrutiny of Commission cease and desist orders and have readily vacated such orders where either (1) there is an absence of substantial evidence to support the Commission's findings or (2) the Commission has failed to properly apply the *Steadman* factors. *See, e.g., Howard v. SEC*, 376 F.3d 1136 (D.C. Cir. 2004); *WHX Corp. v. SEC*, *supra*, 362 F.3d 854; *Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952 (7th Cir. 2004). *See also Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1098-99 (D.C. Cir. 2005). The Commission's Administrative Law Judges have taken these decisions to heart. As Chief Law Judge Murray put it in denying the Staff's request for a cease and desist order against a CPA in *In the Matter of Rita J. McConville*, "[t]he decision in [*WHX*] warns against the imposition of cease-and-desist orders as a knee-jerk response to a finding of a violation." 2004 WL 2173463, at *42 (Sept. 27, 2004).[28]

[28] In *McConville*, the Commission ultimately imposed, and the Seventh Circuit affirmed, a cease and desist order in light of substantial evidence that the respondent, a company's CFO, acted with an "extreme departure from the requisite standard of ordinary care" when she knew of specific facts that rendered false and misleading her representations to the company's outside auditors and representations in the company's Form 10-K filings for which she was responsible. *McConville v. SEC,* 465 F.3d 780, 788 (7th Cir. 2006).

1. The Huddlestons Did Not "Cause" a Violation

Neither the Commission nor the courts have unequivocally articulated what it means to be a "cause" of a violation within the meaning of Section 21C. In fact, the standard is ill-defined in at least two separate respects: (1) the law is not clear regarding what nexus must exist between the respondent's conduct and the primary violation; and (2) neither the statute nor any Commission pronouncement or judicial decision construing it has explained what conduct may subject one to liability for being a "cause" of another party's violation of the securities laws. Under any reading of the statute, the Staff cannot establish that the Huddlestons caused El Paso's alleged securities law violations.

While the Commission and the courts have not provided a clear statement regarding the requisite nexus between a respondent's conduct and the alleged primary violation, there seems to be general agreement among Administrative Law Judges that not every act that contributes to a violation of the securities laws is a "cause" of that violation within the meaning of the regulations. *In re Steinberg*, Init. Dec. Rel. No. ID-196, 2001 WL 1739153, at *37 (Dec. 20, 2001) (rejecting the Staff's argument that "cause" should be defined broadly in light of the "knew or should have known would contribute" language of the statute and stating that "it is incorrect to assert that any act which contributes to the violation is a 'cause' of that violation for purposes of imposing sanctions");[29] *see also In re Fuller*, Init. Dec. Rel. No. ID-201, 2002 WL 177928, at *8 (Aug. 2, 2002) ("While a direct nexus between the respondent's conduct and the

[29] The Staff appealed the Initial Decision in *Steinberg* and lost because the Commission was divided 2-2 and the Order Instituting Proceedings was accordingly dismissed. *See In re Steinberg*, 2005 WL 1580767 (July 6, 2005). Of the Commissioners participating in that matter, only Commissioner Atkins, who voted for dismissal, remains on the Commission.

violation is not required, something more is required than conduct that was a factor to some degree."). While some Law Judge decisions reject a proximate cause standard,[30] the authorities make clear that the Staff must prove that the Huddlestons' conduct was more than a mere contributing cause of the alleged violation.

It therefore appears that the standard to be applied is somewhere between *a* contributing cause and *the* proximate cause, but where that spot lies has little precision.

Steinberg is instructive. In that case, Judge Mahony concluded that the auditors had not been a cause of the company's violations of the Exchange Act's books and records requirements even though they had relied on management's representations regarding the economic substance of the transactions at issue without conducting any independent audit testing of their own. The Law Judge credited both the auditors' testimony that they had no contemporaneous knowledge of the false reporting and their experts' opinion that the audit work was consistent with GAAS. The Law Judge concluded, therefore, that the auditors' reliance on management was reasonable, there was no violation of applicable professional standards, and the auditors were consequently not a cause of the company's books and records violations. *Id*. at *43.

Consistent with the holding in *Steinberg*, there is no basis to find that the Huddlestons were a cause of El Paso's alleged violations of the federal securities laws absent a finding that they *knew* of such violations or violated GAEP. As demonstrated above, there is no evidence to support either such finding. Indeed, the Huddlestons' audit work consistently resulted in El Paso lowering its reserve estimates. Thus

[30] *See Steinberg*, 2001 WL 1739153, at *38; *In the Matter of Harrison Securities*, Init. Dec. Rel. No. ID-256, 2004 WL 2109230, at * 47 (Sept. 21, 2004).

Steinberg makes clear that the Huddlestons cannot be deemed to have been a cause of El Paso's alleged violations of the securities laws.

Considered in the context of these authorities, it is clear that the Staff cannot meet its burden under Section 21C as to either nexus or conduct.

2. The Huddlestons Did Not Have the Requisite State of Mind

Even if the Staff could establish that the Huddlestons had "caused" a violation of the securities laws in the manner contemplated by Section 21C, it cannot demonstrate that they had the requisite mental state. "It is assumed that scienter is required to establish secondary liability for causing a primary violation that requires scienter." *In re IFG Network Sec.*, SEC Release No. ID-273, 2005 WL 328278, *23 (Feb. 10, 2005) (citing *In re KPMG Peat Marwick LLP*, SEC Release No. 43862, 2001 WL 47245, *19 (Jan. 19, 2001), *recon. denied,* SEC Release No. 1374, 2001 WL 223378 (Mar. 8, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002), *reh'g en banc denied* (July 16, 2002)); *see also In re Robert W. Armstrong, III*, SEC Rel. No. ID-248, 2004 WL 737067, at *12 (April 6, 2004); *and Howard*, 376 F.3d at 1141, 1143. Here, the Staff intends to request that the Commission charge the Huddlestons with causing violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder – both of which plainly require the Staff to prove scienter. Since the Staff must establish the scienter of the primary actors to prove a violation of these provisions, it must also establish that the Huddlestons acted with scienter to prove that they caused the alleged violation.

This burden is not to be taken lightly. The Staff failed to meet its burden of showing scienter in *In re Albert Glenn Yesner, CPA*, 2001 WL 587989 (Init. Dec. May 22, 2001) *issued as final Commission decision,* 2001 WL 698308 (June 19, 2001).

Yesner was charged with, among other things, being a cause of others' violations of the antifraud provisions. The Law Judge found that Yesner did not act with scienter and therefore declined to impose a cease and desist order for violations of the antifraud provisions of the Exchange Act. The Law Judge reached this conclusion despite Yesner's *admission* not only that he was aware that the company's accounting was inconsistent with both GAAP and company policy but also that he relied, with no follow-up whatsoever, on unsubstantiated representations from others in the company that the accounting error was immaterial and that required documentation had been provided to the company's outside auditor. *Id.* at *28-*29. No such egregious facts are even alleged here.

As discussed above – and particularly in light of the facts set forth in *Yesner* – it is apparent that the Staff cannot prove scienter here and that it therefore could not prevail in any cease and desist proceeding against the Huddlestons.

The Commission has held that "negligence is sufficient to establish 'causing' liability under Exchange Act Section 21C(a), at least in cases where a person is alleged to 'cause' a primary violation that does not require scienter." *KPMG*, 2001 WL 47245, at *19. Negligence, of course, requires a breach of some applicable standard of care. Here, as shown throughout this Submission, the Huddlestons complied with GAEP, namely, the SPE standards, and with all applicable SEC regulations. Thus, there is no basis from which to conclude that they acted negligently.

3. Application of the *Steadman* Test Does Not Support Imposition of a Cease and Desist Order

Even if the Staff could prove that the Huddlestons not only caused a primary violation but also acted with scienter, it would then need to demonstrate that a cease

and desist order is appropriate under the *Steadman* factors. Those factors include: (1) the egregiousness of the challenged conduct; (2) the isolated or recurrent nature of the alleged infraction; (3) the degree of scienter involved; (4) the sincerity of assurances against future violations; (5) recognition of the wrongful nature of the conduct; and (6) the likelihood of future violations. *Steadman*, 603 F.2d at 1140.

Courts applying *Steadman* have recognized that to obtain a cease and desist order, the Commission must establish at a minimum that there is some risk of a future violation absent the order. *WHX Corp. v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004). In *WHX*, the D.C. Circuit vacated a cease and desist order and rejected the Commission's contention that the risk of future violation element is satisfied "if (1) a party has committed a violation of a rule, and (2) that party has not exited the market or in some other way disabled itself from recommission of the offense." *Id.; see also Steadman*, 967 F.2d at 647-48 (to satisfy sixth *Steadman* factor, there must be "some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive"). The D.C. Circuit observed that the "Commission itself has [previously] disclaimed any notion that a cease-and-desist order is 'automatic' on the basis of such an almost inevitably inferred risk of future violation." *WHX Corp.*, 362 F.3d at 589 (quoting *KPMG*, 289 F.3d at 124-25).

There is little likelihood of a recurrence in this case for several reasons. First, the amount and scope of HudCo's public engineering work has dwindled such that only three clients reporting their reserves remain. HudCo's participation in this proceeding and the attendant costs have left it wary of ever conducting public reserve audit work in the future. If it does so, the underlying investigation and analysis of its actions have

heightened its sensitivity to the issues that the SEC, at least as expressed by the Staff, deems important.

The other *Steadman* factors similarly counsel against the entry of a cease and desist order. The conduct at issue was not egregious – as mentioned, the Huddlestons consistently persuaded El Paso to reduce its reserve estimates and otherwise exercised sound professional judgment (albeit judgments that the Staff, which to our knowledge has no experience in this field, disagrees). And, there is no evidence of reckless or other conscious misbehavior, as discussed above. For these reasons, too, entry of a cease and desist order would be inappropriate.

C. There Is No Basis for an Attempt to Sanction the Huddlestons Pursuant to Rule 102(e)

The Staff has indicated its intent to recommend institution of a Rule 102(e) proceeding against the Huddleston. If the Commission decides to do so, it would be proceeding in uncharted waters. "Although Rule 102(e) reaches all types of professionals who might practice before the Commission, including engineers or expert witnesses, there have been only a few cases in the rule's 63-year history that did not involve either a lawyer or an accountant." Amendment to Rule 102(e) of the Commission's Rules of Practice ("Adopting Release"), 1998 WL 729201, at *38 n.16 (Dissenting Statement of Commissioner Johnson). We have identified only three instances in the Commission's entire history in which the Commission has sanctioned an engineer under Rule 2(e), the predecessor of Rule 102(e), and none of those instances (one from 1993 and the other two from the 1970s) involves a situation

remotely comparable to that involved here.[31] The circumstances of this matter do not provide the basis for the kind of pathbreaking action the Staff contemplates.

Rule 102(e) serves a remedial purpose and is not intended for punishment. *See* Adopting Release at *4 n.26. As Chief Law Judge Murray stated in denying the Staff's request for a Rule 102(e) sanction against a CPA, Rule 102(e) sanctions are not to be imposed lightly because the imposition of such sanctions is a "severe" measure that "tarnishes an accountant's professional career for life." *McConville, supra,* 2004 WL 2173463, at *42. The same is true of a reserve engineer. Rule 102(e)(1) permits the Commission to censure a person or to deny that person, temporarily or permanently, the privilege of appearing or practicing before it if it finds the person "(i) not to possess the requisite qualifications to represent others; or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder." The Staff has not identified which of these provisions it deems applicable in this case. We see absolutely no basis for an accusation that the Huddlestons lack the requisite qualifications, character, or integrity and therefore assume that the Staff intends to proceed on the basis of either a belief that the Huddlestons engaged in improper professional conduct or (as pertinent here) to have willfully aided and abetted a federal securities law

[31] In *In re Martin G. Browne*, 1993 WL 346599 (Sept. 9, 1993), the Commission imposed a Rule 2(e) sanction on an engineer who falsely held himself out to be a petroleum engineer when in fact he was not a licensed engineer. In *In re Robert McDowell, Jr.*, 1978 WL 197754 (Feb. 2, 1978), a "follow-on" proceeding, the Commission accepted the respondent's settlement offer of resigning from appearing or practicing before the Commission after the Commission had obtained a consent injunction against him for unspecified conduct and charges. In *In re Francois D.V. De LaBarre*, 1976 WL 160361 (Aug. 19, 1976), the Commission imposed a Rule 2(e) bar on a respondent who was both an attorney and an engineer for filing false and misleading Schedules 13D with the Commission, *i.e.*, for conduct wholly unrelated to the engineering profession.

violation. We have already addressed why there is no basis for any finding that the Huddlestons aided and abetted a federal securities law violation. *See supra* at 46-48. As we now show, there is also no basis for finding that they engaged in any unethical or improper professional conduct.

1. The Staff Cannot Establish that the Huddlestons Engaged in Any Unethical or Improper Professional Conduct

There is no articulated standard, under either Rule 102(e) itself or the case law thereunder, for determining when a reserve engineer has engaged in improper professional conduct. Under Rule 102(e)(iv), there are three forms of "improper professional conduct" – (1) "[i]ntentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards"; (2) "a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted"; and (3) "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission" – but that provision explicitly applies *only* to licensed *accountants*. It does not apply to reserve engineers, and the checkered history underlying the adoption of Rule 102(e) makes clear that any attempt to apply these provisions to reserve engineers would be facially improper as a matter of law. *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994) ("*Checkosky I*"); *Checkosky v. SEC*, 139 F.3d 221 (D.C. Cir. 1998) ("*Checkosky II*").

In the *Checkosky* decisions, the D.C. Circuit dismissed the Commission's effort to sanction two accountants under Rule 102(e) because the Commission had failed to specify with sufficient clarity the mental state required for imposition of a Rule 102(e)

sanction. The SEC amended Rule 102(e) in 1998 to comply with *Checkosky II* but, as stated, the clarification expressly applies only to *accountants*. Thus, Rule 102(e), in particular its standard of "improper professional conduct," remains in its unenforceable pre-1998 state of ambiguity as applied to a reserve engineer. *See Checkosky II*, 139 F.3d at 225-26 ("There is no justification for the government depriving citizens of the opportunity to practice their profession without revealing the standard they have been found to violate"). Any attempt by the Staff to fashion a definition of "improper conduct" for reserve engineers in this case would constitute impermissible retroactive rulemaking. *SEC v. Marrie*, 374 F.3d 1196, 1207 (D.C. Cir. 2004). Thus, any effort by the Staff to initiate an action against the Huddlestons for alleged "improper professional conduct" under Rule 102(e) would be impermissible. *Checkosky II*, 139 F.3d at 227.

At all events, there is no basis for concluding that the Huddlestons engaged in unethical or improper professional conduct under *any* lawful, applicable standard. As shown throughout this Submission, there is no evidence that the Huddlestons departed from GAEP or otherwise engaged in any form of improper professional conduct. To the contrary, the record shows that they faithfully complied with GAEP in all respects.

2. The Applicable Statute of Repose Precludes Imposition of Rule 102(e) Sanctions for Conduct Occurring before February 14, 2002

The Staff's questioning indicates that it is focusing on the 1998-to-2003 period. The Staff has obtained a tolling agreement from the Huddlestons to allow the Commission to bring any charges it could have brought as of February 14, 2007. Under the applicable five-year statute of repose, therefore, any conduct occurring before February 14, 2002, cannot form the basis for Rule 102(e) sanctions. (Nor could such

conduct form the basis for any penalty, monetary or otherwise, in a civil injunctive action.)

Under 28 U.S.C. § 2462, a "proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued ...." In *Johnson v. SEC*, 87 F.3d 484, 492 (D.C. Cir. 1996), the D.C. Circuit held that Section 2462 applies to SEC proceedings seeking to censure and suspend the respondent. In so holding, the Court of Appeals stated: "Congress and the courts have long considered the suspension or revocation of a professional license as a penalty," and that the "collateral consequences of censure and suspension ... suggest its punishment-like qualities." *Id*. at 489 n.6. Thus, the D.C. Circuit has squarely held that a Rule 102(e) sanction is punitive for purposes of Section 2462. *See Johnson*, 87 F.3d at 492.

Though we are unaware of any decision applying 28 U.S.C. § 2462 to a reserve engineer's audit – because there simply have been no such cases – as regards allegations concerning a financial auditor's conduct during the course of an audit, the limitations period runs from the date the audit opinion was issued. *See In re Michael J. Marrie*, 2001 WL 1130957, at *24 (Init. Dec. Sept. 21, 2001) ("the Commission's 'claim first accrued' when ... [the accountant] certified C&L's unqualified report, thereby giving up the ability to take further corrective action[]"), *rev'd on other grounds*, 2003 WL 2174185 (SEC July 29, 2003), *rev'd on other grounds*, 374 F.3d 1196 (D.C. Cir. 2004). HudCo end-of-year reports for work done in years 1998 to 2001 were typically completed by the beginning of the following calendar year. It is well-settled that each audit year is distinct and that multiple but separate audits do not constitute a continuing

course of conduct for purposes of statutes of limitation. *See, e.g., Williamson v. PricewaterhouseCoopers, LLP*, 9 N.Y. 3d 1, __ N.E.2d __, 2007 WL 1624759, at *5 (June 7, 2007); *see also In re Marrie*, *supra* (concluding that continuous representation does not exist once audit opinion is issued and auditor "thereby giv[es] up the ability to take further corrective action"); *FDIC v. Deloitte & Touche*, 834 F. Supp. 1129, 1150 (E.D. Ark. 1992). Accordingly, any sanction that the Staff might seek to impose based upon the Huddlestons' conduct occurring before February 14, 2002, is time-barred. This limitation effectively precludes the Commission from claiming that improper conduct existed with respect to the 1999, 2000 or 2001 bookings of the Castlegate, High Mountain, South Texas or coal seam reserves.

CONCLUSION

The Commission recently announced the hiring of Dr. W. John Lee to begin a fellowship for the purpose of evaluating the current status of reserve reporting. *Reservoir Solutions,* Vol. 10, No. 3, at 1 (Sept. – Nov. 2007). As Dr. Lee has recently noted, current guidelines were implemented in 1978 and many in the industry believe that the guidelines should be revisited and updated. The Huddlestons welcome this sentiment and agree with it. Here, the Staff seems intent upon expanding and refining Rule 4-10 through the attempted enforcement of guidance rather than through appropriate rulemaking. Without question, the preferred and more reliable method of achieving better reserve reporting for the investing public is via the rulemaking process.

For each of the foregoing reasons, the Huddlestons request that the Staff recommend and the Commission take no enforcement action, civil or administrative, against them.

Respectfully submitted,

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ATTORNEYS FOR HUDDLESTON & CO., INC. AND PETER D. HUDDLESTON

October 1, 2007

WGL
10/23/98

SERVICE AGREEMENT

BY AND BETWEEN

COASTAL OIL & GAS CORPORATION

AND

HUDDLESTON & CO., INC

ATTACHMENT
1

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SERVICE AGREEMENT
Between
COASTAL OIL & GAS CORPORATION
and
HUDDLESTON & CO., INC.

THIS SERVICE AGREEMENT (this "Agreement") is made and entered into this 9th day of December, 1998, by and between Coastal Oil & Gas Corporation, a Delaware corporation with principal offices located at Nine Greenway Plaza, Houston, Texas 77046, on behalf of itself and its exploration and production affiliates, ANR Production Company, a Delaware corporation, CIG Exploration, Inc., a Delaware corporation, Coastal Oil & Gas USA, L.P., a Delaware limited partnership, (collectively "Company") and Huddleston & Co., Inc., a Texas corporation with principal offices located at 1111 Fannin Street, Suite 1700, Houston, Texas 77002 ("Contractor").

RECITALS

WHEREAS, Company is engaged in the oil & gas exploration and production business; and

WHEREAS, Company desires to contract with a company to perform petroleum reservoir engineering services; and

WHEREAS, Contractor is in the business of performing such services for the oil & gas industry, and desires to perform such services for Company in accordance with the terms and conditions of this Agreement.

NOW, THEREFORE, in consideration of the premises and the mutual promises contained herein, the parties agree as follows:

1. TERM. The term of this Agreement shall commence upon the Effective Date (as defined below) and shall continue in full force and effect until December 31, 1998, and from year to year thereafter until terminated by either party upon forty-five (45) days prior written notice to the other. December 31 of each year shall be considered an anniversary for all purposes in this Agreement. Upon termination, all obligations and liabilities between the parties hereto shall cease and terminate, except for the obligations of the Company under paragraph 8, and the obligations of the parties under Sections 10 and 14.

2. EFFECTIVE DATE. This Agreement shall become effective upon the date first written above.

3. SERVICES. Contractor is a petroleum engineering consulting firm which will perform consulting and petroleum engineering services as requested by Company ("Services").

4. SCOPE OF AGREEMENT.

A. This Agreement supersedes and replaces any and all prior agreements between the parties.

B. At any time and from time to time during the term of this Agreement, when Company desires Services to be performed by Contractor, a Company officer or his designee shall give Contractor an oral or written request for the Service. Commencement of the Services by Contractor shall be deemed to be an acceptance of the terms and conditions of the request for Services and an agreement hereunder by the Company to pay for those services in accordance with the terms and conditions hereof.

C. Unless otherwise agreed, Contractor shall provide all labor, including without limitation, all maintenance, supervision, and engineering support.

D. Company may terminate a request for Service, effective immediately upon Contractor's receipt of notice from Company, in the event that (i) Contractor is in breach of this Agreement, or (ii) in Company's sole discretion, the Services are not being performed in a manner satisfactory to Company.

E. Any and all Services performed by Contractor for Company after the Effective Date of this Agreement, whether under verbal or written instructions, shall be deemed to be performed pursuant to the terms and conditions of this Agreement.

F. Company agrees to furnish to Contractor all information reasonably requested by Contractor and to provide Contractor with access to the Company and its officers, directors, employees and legal counsel as may be necessary or desirable in order to complete the Services requested.

5. REPRESENTATIONS AND WARRANTIES.

A. Contractor represents and warrants that it is in the business of performing consulting and petroleum engineering services for the oil and gas industry; that it is and will remain properly licensed, permitted or otherwise authorized under all applicable federal and state laws and regulations to perform all of the Services which it agrees to perform; that all of the Services shall be performed in a workmanlike manner in accordance with good engineering and oil field practices; that the Services shall be performed with due diligence and without undue delays or interruptions; that it has and will maintain adequate equipment in good working order and fully trained personnel capable of performing these Services; and that the Services shall be performed as economically as possible with the minimum number of employees, materials and equipment reasonably necessary to safely and correctly perform these Services.

B. Contractor represents and warrants that the Services performed by Contractor for Company are fit for the purpose intended.

C. Contractor represents and warrants that it is and will continue to be in compliance with *The Texas Engineering Practice Act, Article 3271a, Vernon's Annotated Texas Statutes* and that the Services shall be performed in compliance therewith.

D. Company hereby represents and warrants that all information provided to Contractor in the scope of its engagement shall, to the best of its knowledge, be complete and correct in all material respects and will not contain any untrue statement of a material fact or omit to state a material fact required for Contractor to perform the Services.

6. COMPENSATION.

A. In consideration of Contractor's satisfactory performance of the Services, Company agrees to pay Contractor, as full and complete compensation for such Services, an amount based on prices reflected on Exhibit "A" attached hereto, or such other price as may be agreed upon in writing by Company and Contractor.

B. Exhibit "A" is a listing of hourly or daily rates to be charged for the various man power utilized by Contractor in performing the Services. These rates will remain in place until new rates are agreed upon between the parties at least forty-five (45) days prior to an anniversary of this Agreement or as otherwise agreed to by the Parties. Any increase in rates will be made to reflect seniority or market conditions.

C. In the event of termination prior to completion of the Services, Company shall pay Contractor an amount based upon the number of hours satisfactorily performed for Services up to the effective date of termination, and Company shall be relieved of

any liability to Contractor for any Services performed after the effective date of termination.

7. BUDGET.

A. Beginning in 1999, Contractor will prepare an annual budget or forecast of total expense expected for the ensuing annual period for the customary and regular Services provided on behalf of the Company based on expected work load and billing rates. Enough detail will be provided so as to enable Company to fully evaluate the expected cost. This budget will be submitted to Company by September 1 of each year that this Agreement is effective.

B. On a quarterly basis, Contractor will prepare and submit to Company an estimated actual cost versus budget report with explanation of significant cost overruns for the current year.

C. Contractor and Company agree that a Company representative may request Services from the Contractor outside the ordinary scope of the Services regularly provided, which Services shall be fully authorized and governed by the terms and conditions of this Agreement, but which shall not be included in the Budget.

8. BILLING AND PAYMENT; RECORD KEEPING; AUDIT.

A. Contractor shall invoice Company for Services performed no more often than once every thirty (30) days. Contractor's invoice shall be accompanied by reasonable information to support the amounts invoiced.

B. Company shall pay such invoices net thirty (30) days after its receipt thereof. Invoices not paid within ten (10) days of the due date shall bear interest at an annual rate equal to the lesser of (i) the prime rate of Citibank, N.A., New York, NY plus two percent (2%), or (ii) the maximum legal interest rate, computed from

the due date until payment is received. Company's payment of each invoice shall be subject to concurrence with the correctness and accuracy of the amounts invoiced by Contractor. Interest shall not accrue on invoices which cover Services not accepted by Company. If there is a dispute over whether the Services were properly authorized or over the quality of the Services, Company shall provide prompt written notice and Contractor shall suspend work on the Services in question until the invoice is resolved to the satisfaction of the parties hereto. Non-contested invoices or the parts thereof which are not contested for all time expended prior to the written notice shall be payable in full.

C. Contractor hereby authorizes Company to deduct or withhold from any amount due to Contractor, without liability for interest, all amounts for which Company may become liable to third parties by reason of Contractor's performance of the Services or failure to perform its obligations under this Agreement.

D. Contractor shall keep and/or maintain books, records, receipts, time logs, etc. related to its performance of the Services and any expenses charged to Company hereunder in accordance with commonly accepted accounting and oil field practices, and shall retain such records for a period of three (3) years following completion of the Services, and for so long thereafter as a dispute may exist between the parties. Company and its designated representatives shall have the right at all reasonable times to inspect, copy, and audit the records of Contractor pertaining to the Services rendered hereunder and/or the accuracy of any invoice or payment.

9. INDEPENDENT CONTRACTOR. It is understood and agreed that Contractor is an independent contractor in the performance of each and every part of this Agreement, and that Contractor's employees shall be subject to Contractor's sole and exclusive supervision, direction, and control and shall not be deemed, in fact or in law, to be employees of

Company. Company shall have the right generally to oversee and inspect the performance of the Services of Contractor to insure the satisfactory completion thereof, it being understood and agreed that Company is not associated or connected with the actual performance or details of the Services to be performed pursuant to this Agreement, as Company is interested in and looking only to the end result to be accomplished. Contractor shall be solely liable for all labor, material and other expenses in connection with Services performed by Contractor pursuant to this Agreement. It is expressly agreed that neither Contractor nor any of Contractor's employees shall be entitled to any Company benefits normally extended by Company to its own employees and that the compensation set forth above is the total consideration payable hereunder.

10. LIABILITY AND INDEMNITY. In those matters in which a party is required to indemnify the other party, the indemnifying party shall protect, defend, indemnify, and hold the indemnified party harmless from and against any and all Claims (as defined below) against the indemnified party, and shall pay all costs, expenses, fines, penalties, and interest incidental thereto and judgements resulting therefrom. The indemnified party shall have the right, at its option and at its sole expense, to participate in the defense of each such Claim. EXCEPT TO THE EXTENT OTHERWISE EXPRESSLY PROVIDED IN THIS ARTICLE, ANY INDEMNITY GRANTED TO A PARTY HEREIN IS GIVEN REGARDLESS OF THE CAUSE OR REASON, OR WHO MAY BE AT FAULT OR OTHERWISE RESPONSIBLE UNDER ANY CONTRACT, STATUTE, RULE, OR THEORY OF LAW, INCLUDING WITHOUT LIMITATION, THE SOLE, JOINT, OR CONCURRENT NEGLIGENCE OF THE INDEMNITEE, WHETHER ACTIVE OR PASSIVE, STRICT LIABILITY, LATENT, PATENT, OR PRE-EXISTING DEFECTS OR CONDITIONS.

A. Contractor shall indemnify Company Group from and against any and all Claims asserted by or arising in favor of Contractor Group on account of the illness,

injury, or death of any person, unless such illness, injury, or death is caused by Company Group's gross negligence or willful misconduct.

B. Company shall indemnify Contractor Group from and against any and all Claims asserted by or arising in favor of Company Group on account of the illness, injury, or death of any person, unless such illness, injury, or death is caused by Contractor Group's gross negligence or willful misconduct.

C. Contractor shall also indemnify Company Group against loss or damage to Company Group's property where such loss or damage is the result of willful or negligent acts or omissions of Contractor. Where such loss or damage is attributable to multiple parties, including the Company, liability shall be allocated among the parties according to a determination of each party's respective fault.

AS USED HEREIN:

"Claim" shall mean all liabilities, claims, demands, damages, losses, liens, causes of action, suits, judgments, and costs or expenses of any nature, kind, or description (including without limitation, reasonable attorney fees, court costs, fines, penalties and interest) that may be brought or asserted against indemnitee by any person or legal entity whomsoever based upon, resulting from, arising out of, related to, or connected with, directly or indirectly, the performance of the Services hereunder;

"Company Group" shall include Company, its parent, subsidiary, and affiliated companies, and its and their partners, joint venturers, non-operating working interest owners, co-lessees, contractors, and subcontractors, and the owners, shareholders, directors, officers, employees, agents, representatives, invitees, and underwriters of all the foregoing, and their heirs, legal representatives, successors and assigns;

"Contractor Group" shall include Contractor, its parent, subsidiary, and affiliated companies, and its and their subcontractors, and the owners, shareholders, directors, officers, employees, agents, representatives, invitees, and underwriters of all the foregoing, and their heirs, legal representatives, successors and assigns.

11. ATTORNEY FEES. In the event that the defense and indemnity of the indemnitee under the applicable indemnity provisions herein is tendered to the indemnitor and the indemnitor denies or otherwise does not accept the tender, then in addition to the indemnity and costs of defense owed by the indemnitor, the indemnitor shall also be obligated to pay all costs and expenses, including reasonable attorney fees, incurred by the indemnitee in pursuing its claim for indemnity against the indemnitor.

12. EXEMPLARY DAMAGES. Notwithstanding anything to the contrary, neither party shall be liable to the other for exemplary or punitive damages.

13. INSURANCE.

A. Contractor shall, at its sole cost and expense, procure and maintain in force at all times during the Term hereof sufficient insurance as may be required to protect Contractor and Company Group against any and all third-party Claims arising out of or in any manner connected with the performance of the Services hereunder. All such insurance shall be written with companies satisfactory to Company, and shall be of the types and in the minimum amounts set forth in **Exhibit "B."**

B. All insurance required hereunder shall (i) provide a minimum of thirty (30) days notice to Company prior to cancellation or material change, (ii) except for Workers Compensation, name Company Group as an additional insured, (iii) contain a waiver of subrogation as to Company Group, and (iv) be considered primary insurance in relation to Company Group's insurance. The requirements of subsections (ii) through (iv), above, are restricted to those risks which

Contractor has expressly agreed to bear or against which Contractor has agreed to indemnify Company Group. Any and all deductibles in Contractor's insurance shall be solely for the account of Contractor.

C. Contractor shall furnish Company with Certificates of Insurance evidencing the insurance required herein. In the event that Contractor fails to provide Company with such certificates, Company has the right, but not the obligation, to obtain insurance on behalf of Contractor, and to charge the cost to Contractor.

D. Company agrees to self-insure or carry insurance equivalent to that insurance required to be carried by Contractor hereunder.

14. CONFIDENTIAL INFORMATION.

A. Contractor agrees to keep all information obtained from Company or acquired in connection with or as a result of performing the Services ("Information") in strict confidence. Contractor shall not divulge, nor permit any member of Contractor Group to divulge the Information, or any part thereof, to any party other than an employee of Company without the prior written consent of Company.

B. Contractor will not at any time use the Information for any reason or purpose, directly or indirectly, other than for performing the Services pursuant to this Agreement. Specifically, Contractor agrees not to use Information obtained from Company for the financial benefit of itself or others.

C. Contractor will require that all of its employees assigned to work on Services for the Company sign a confidentiality agreement in which they agree to the confidentiality requirements set forth in (A) and (B) above.

15. MULTIPLE INTEREST OWNERS.

A. The parties to this Agreement recognize that Contractor is an organization of independent petroleum engineers that provides services to many different individuals and entities in the oil and gas industry. Contractor hereby agrees that in the event it is engaged to provide engineering or consulting services to different owners of the same properties on which it performs Services for Company, that Contractor will assign an engineer, or if necessary a group of engineers, to work exclusively on the account of Company, and those persons assigned to Company shall maintain all information and analysis provided by and developed on behalf of Company confidential to those persons engaged on behalf of Company, and not divulge Company information to any other person employed, retained or connected with Contractor.

B. Attached hereto as Exhibit "C" is a list of properties or fields which, in the sole discretion of Company, are of special importance to it. In addition, this Exhibit identifies the individuals or entities other than Company, if any, for whom Contractor provides engineering or consulting services on the same properties. Exhibit "C" will be amended as appropriate from time to time and both parties shall cooperate to ensure that the Exhibit is complete and accurate.

16. COMPLIANCE WITH LAWS. In the performance of the Services, Contractor shall comply, and shall require each of its employees, agents, representatives, subcontractors, and invitees to comply, with the requirements of any and all applicable laws, regulations, rules, and orders of any governmental body having or claiming to have jurisdiction over the performance of Services under this Agreement. Contractor further agrees to release, defend, indemnify, and hold Company Group harmless from and against any and all claims arising out of or in connection with any asserted or established violation of any such laws, orders, rules, or regulations by Contractor. To the extent that this Agreement covers Services subject to provisions of Executive Order No. 11246 dated September 24, 1965,

as amended and supplemented, the provisions of Sec. 202, subparagraphs (1) through (7), of said Order are, with the rules, regulations and orders of the Secretary of Labor thereunder, made a part hereof as fully as if copied herein in full.

17. GOVERNING LAW; VENUE. The Laws of the State of Texas, excluding its conflicts-of-law rules which might apply the laws or refer the matter to a different jurisdiction, shall govern the validity, construction, and enforcement of this Agreement and the rights and obligations of the parties hereunder. The venue of any litigation between the parties shall be in Harris County, Texas.

18. FORCE MAJEURE. If either party is rendered unable, in whole or in part, by reason of Force Majeure to carry out its obligations hereunder, other than the obligation to pay money, the party claiming Force Majeure shall give the other party prompt notice of same with reasonably complete particulars, and the obligations of the parties, in so far as they are affected by the Force Majeure event, shall be suspended during, but no longer than, the continuance of the Force Majeure event. The party claiming Force Majeure shall use reasonable diligence to remedy the Force Majeure event as quickly as possible; provided, however, that the preceding shall not require such party to settle labor disputes contrary to its wishes. The term "**Force Majeure**" as used herein shall mean any cause which is not due to the negligence and not reasonably within the control of the party claiming Force Majeure after the exercise of reasonable diligence.

19. NOTICES. All notices required to be given hereunder shall be in writing. Notices shall be given in person, or sent by courier, mail, or facsimile to the party to be notified at its address as set forth above, or such other address as may be designated to the other party. Notices shall be deemed given when received by the party to be notified; provided, however, that notices received after 5:00 PM or on a non-business day shall be deemed to be given the following business day; and provided further, that if notices cannot be

given after reasonable effort at such address, notices shall be deemed constructively given three (3) days after being deposited in the United States mail, postage prepaid.

20. MISCELLANEOUS.

A. Entirety. This Agreement consists of this document and its attached exhibits and/or addendums, if any, which are hereby incorporated herein. This Agreement sets forth the entire and complete agreement of the parties as to the subject matter hereof, and supersedes any and all proposals, negotiations, and representations of the parties prior to the execution hereof, including without limitation, prior drafts of this Agreement.

B. Amendments. No amendment or modification of this Agreement shall be valid unless evidenced in a writing specifically identifying this Agreement signed by an officer of Company and Contractor.

C. Headings. The article headings contained herein are included for purposes of convenience only, and shall not effect the construction or interpretation of any of the provisions of this Agreement.

D. Assignment. Contractor shall not assign this Agreement nor subcontract the whole or any part of the Services to be performed by Contractor hereunder, without Company's prior written consent, which consent shall require the execution of a service agreement in substantially the same form as this Agreement.

E. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns.

F. Survival. The provisions of this Agreement which are intended to extend beyond its termination, including without limitation, the liability, indemnity, warranty,

and confidentiality provisions, and the enforcement of rights and obligations incurred hereunder which are not fully discharged prior to the termination of this Agreement, shall survive termination to the extent necessary to effect the intent of the parties and/or enforce such rights and obligations.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

CONTRACTOR:

COASTAL OIL & GAS CORPORATION

By: C. E. Lindberg

Carl E. Lindberg
Vice President

COMPANY:

HUDDLESTON & CO., INC.

By: Peter Huddleston

Peter Huddleston
President

wgl\agmt\huddle98.msa

EXHIBIT "B"

INSURANCE REQUIREMENTS

a. **Worker's Compensation Insurance:**

Worker's Compensation Insurance as required by Statute and Employer's Liability Insurance in an amount no less than $100,000.

b. **Commercial/Comprehensive General Liability Insurance:**

Bodily Injury & Property Damage
Combined Single Limit Each Occurrence $1,000,000.00.

Such policy will include Contractual Liability, Products and Completed Operations, Independent Contractor's Protective, Broad Form Property Damage, Premises and Operations. Said policy shall contain a severability of interest clause as applicable under this Contract.

c. **Commercial/Public Automobile Liability Insurance**, including owned, hired, rented or non-owned automotive equipment.

Bodily Injury & Property Damage
Combined Single Limit Each accident $1,000,000.00.

d. **Excess Liability Insurance:**

Excess Liability Insurance coverage in excess of the limits and terms in (a) through (c) above, with a combined single limit for Bodily Injury and Property Damage of at least $1,000,000.00 for each occurrence.

ACORD CERTIFICATE OF LIABILITY INSURANCE

DATE (MM/DD/YY) 12/08/1998

PRODUCER (281)463-9857 FAX (281) 463-3771
rroll Insurance Agency, Inc.
906 FM 529
n, TX 77095

ATTN: xi Pearce Ext: 510

INSURED
Peter Paul Petroleum Company (et al)
Huddleston & Co, Inc.
1111 Fannin Suite 1700
Houston, TX 77002

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.

COMPANIES AFFORDING COVERAGE

COMPANY A: Lexington Ins. Co./Burke-Daniels
COMPANY B: CNA/Contiental Casualty
COMPANY C: CNA/National Fire
COMPANY D:

COVERAGES

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED, NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

TYPE OF INSURANCE	POLICY NUMBER	POLICY EFFECTIVE DATE (MM/DD/YY)	POLICY EXPIRATION DATE (MM/DD/YY)	LIMITS	
GENERAL LIABILITY [X] COMMERCIAL GENERAL LIABILITY [ ] CLAIMS MADE [X] OCCUR OWNER'S & CONTRACTOR'S PROT	5354093	11/17/1998	11/17/1999	GENERAL AGGREGATE PRODUCTS - COMP/OP AGG PERSONAL & ADV INJURY EACH OCCURRENCE FIRE DAMAGE (Any one fire) MED EXP (Any one person)	$ 2,000,000 $ 1,000,000 $ INCLUDED $ 1,000,000 $ 50,000 $ EXCLUDED
AUTOMOBILE LIABILITY [X] ANY AUTO [ ] ALL OWNED AUTOS [ ] SCHEDULED AUTOS [X] HIRED AUTOS [X] NON-OWNED AUTOS	BUA1075096526	11/17/1998	11/17/1999	COMBINED SINGLE LIMIT BODILY INJURY (Per person) BODILY INJURY (Per accident) PROPERTY DAMAGE	$ 1,000,000 $ $ $
AGE LIABILITY [ ] ANY AUTO				AUTO ONLY - EA ACCIDENT OTHER THAN AUTO ONLY: EACH ACCIDENT AGGREGATE	$ $ $
EXCESS LIABILITY [X] UMBRELLA FORM [ ] OTHER THAN UMBRELLA FORM	5638777	11/17/1998	11/17/1999	EACH OCCURRENCE AGGREGATE SIR	$ 5,000,000 $ 5,000,000 $ 10,000
WORKERS COMPENSATION AND EMPLOYERS' LIABILITY THE PROPRIETOR/ PARTNERS/EXECUTIVE OFFICERS ARE: [X] INCL [ ] EXCL	WC1075096560	11/17/1998	11/17/1999	[X] WC STATUTORY LIMITS [X] OTHER EL EACH ACCIDENT EL DISEASE - POLICY LIMIT EL DISEASE - EA EMPLOYEE	 $ 1,000,000 $ 1,000,000 $ 1,000,000
OTHER					

APPROVED AS TO INSURANCE RISK MGMT.

DESCRIPTION OF OPERATIONS/LOCATIONS/VEHICLES/SPECIAL ITEMS
ON. INSD. (GL, AUTO & UMBR) & WAIVER OF SUBROGATION (GL, AUTO & WC) & 30 DNOC IN FAVOR
CERTIFICATE HOLDER

FAX # (713) 297-1341

CERTIFICATE HOLDER

The Coastal Corporation
its Subsidiaries & Affiliates
Attn: Parneli Heisey
9 Greenway Plaza
ston, TX 77046

CANCELLATION

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING COMPANY WILL ENDEAVOR TO MAIL 30 DAYS WRITTEN NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT FAILURE TO MAIL SUCH NOTICE SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE COMPANY, ITS AGENTS OR REPRESENTATIVES.

AUTHORIZED REPRESENTATIVE
John D. Carroll/VRP

HUD1 017051

Huddleston & Co., Inc.

Employee Billing Rates
As of July 1, 1998

Employee	Title	Billing Rate, $/hr
B. P. Huddleston	Chairman	250
Peter D. Huddleston	President	175
B. F. Shell	President*	175
Erle E. Kellogg	Senior Vice President	150
M. Drayton Prator	Senior Vice President	150
Wm. Paul Huddleston	Vice President	150
Thomas G. Bell	Vice President	135
Greg A. Mitschke	Vice President*	135
John P Krawtz	Vice President	120
Greg S. Floyd	Vice President	120
Peter H. Currie	Vice President	100
Glenda S. Dole	Chief Financial Officer*	100
Gregory A Krupps	Controller*	90
Brenda A. Johnson	Vice President*	90
Richard R. Lonquist	Petroleum Engineer	120
Lloyd R. Hale	Petroleum Engineer	120
Tom S. Campbell	Petroleum Engineer	100
Jay C. Graham	Petroleum Engineer	90
Stan S. Valdez	Petroleum Engineer	80
Wayne L. Mitschke	Petroleum Engineer	80
Jeffrey A. McClellan	Systems Analyst	90
Ray A Meche	Systems Analyst	60
JoAnna Simco	Division Order Manager*	70
Valerie G. Beard	Accountant	60
Kristi L. Hopfe	Technical Assistant	60
Jean Y. Swenson	Technical Assistant	50
Wendy S. Foltz	Accountant	60
Ami J. Grinsfelder	Title Analyst	50
Marti B. Boyd	Technical Assistant	50
Lisa L Currie	Technical Assistant	50
Kelly J. Hall	Accountant	60
Eve S. Kellogg	Technical Assistant	50
Debra S. Lafon	Technical Assistant	50
Yvette L Medina	Technical Assistant	50
Mary I. Micak	Accountant	60
Sara M. Reinhardt	Technical Assistant	50
Kelly Schorre	Accountant	60
Rebecca M. Tristan	Production Analyst	60
Diane B. Williams	Accountant	60
Sandra G. Yee	Production Analyst	60

* Employed by Peter Paul Petroleum - may be assigned to special projects on an as needed basis.

EXHIBIT "C"

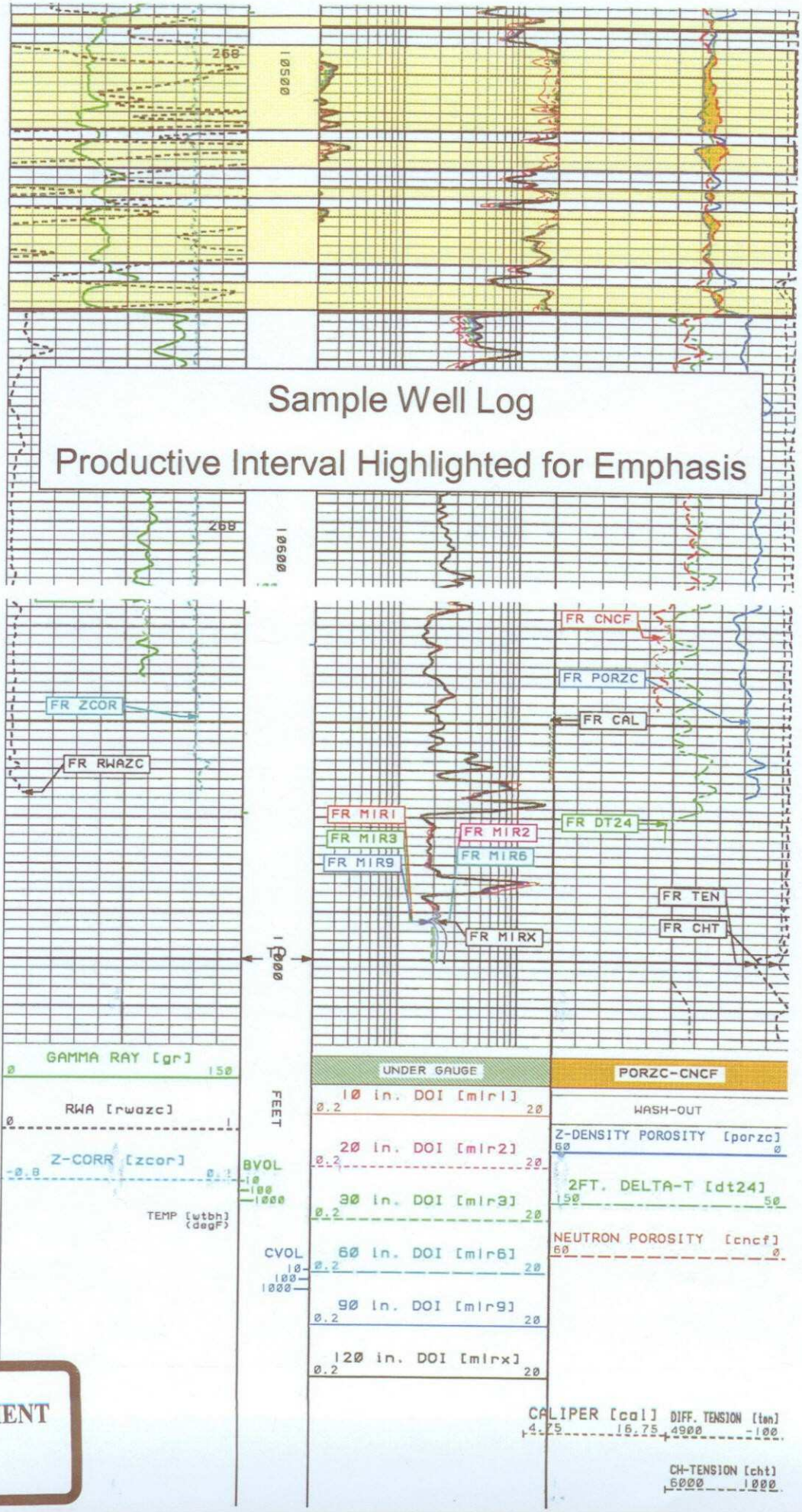
TOP 85% RESERVE PROPERTIES

September 21, 1998

PROPERTY	CUM NET RESERVES - %
JEFFRESS AREA TOTAL	20
NATURAL BUTTES	28
MAIN PASS 223 & 250	31
WEST CAMERON 503/504	34
HIGH MOUNTAIN	54
BOB WEST	61
WEST CAMERON 498	63
MONTE CHRISTO	66
ALTAMONT/BLUEBELL	70
MECOM	72
EAST CAMERON 193	74
HIGH ISLAND 263/272	75
HIGH ISLAND 309	76
MAIN PASS 198	77
VIOSKA KNOLL 823	78
HIGH ISLAND 317	79
HIGH ISLAND 368, 368 S/2, & 367	80
CIERVO GRANDE	81
CAGE RANCH	82
HIGH ISLAND 523	83
MAIN PASS 225	84
VERMILION 288	84
EUGENE ISLAND 364	85

Properties which Huddleston & Co. Inc. Or its subsidiaries and or affiliates own an interest or provides engineering or consulting services:

Republic Royalty - Jeffress, Bob West
Posse Energy Ltd. - Monte Christo, Natural Buttes, Jeffress



ATTACHMENT 2

Effect of Variation of Parameters used in Volumetric Calculations

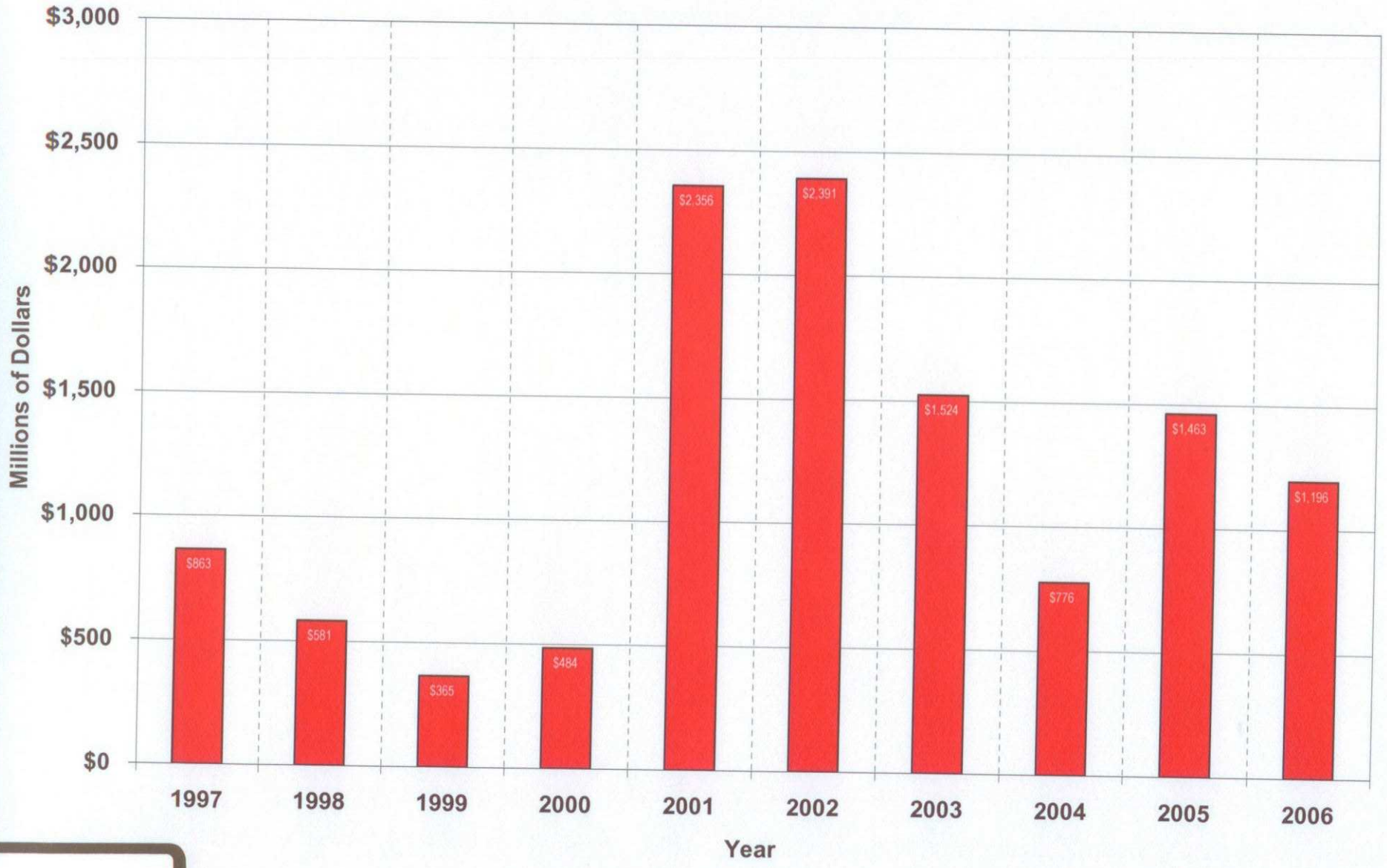
	Case 1	Case 2	
Assumptions			
Average Net Pay (h), ft	30	33	10% Variation
Drainage Area (A), acres	40	44	10% Variation
Porosity (Φ), %	0.22	0.24	9% Variation
Resistivity (Rt), ohm-meters	7	7.35	5% Variation
Formation Water Resistivity (Rw), ohm-meters	0.05	0.055	10% Variation
Formation Pressure (P), psia	9500	9500	
Formation Temperature (T), psia	230	230	
Gas Gravity	0.6	0.6	
Recovery Factor (RF), %[3]	0.65	0.76	16% variation
Calculated Values			
Compresibility Factor (Z)[6]	1.371	1.371	
Formation Factor[1]	20.7	13.3	
Water Saturation, %[2]	38%	32%	
Gas in Place, Mcf/ac-ft[4]	2,103	2,549	
Recoverable Gas, Mcf[5]	1,641	2,813	TOTAL VARIANCE 171%

Notes:

1) Case 1: Archies equaton - $1/\Phi^2$; Case 2: Humble equation - $.62/\Phi^{2.15}$
2) Water Saturation - $(F^*Rw/Rt)^{0.5}$
3) Case 1: Based on experience; Case 2 Calculated on basis of 1500 psi abandonment
4) Gas in Place = $(1546\Phi P(1-Sw))/((T+460)Z)$
5) Recoverable Gas = GIP(A)(h)(RF)
6) Compressibility factor determined from correlation

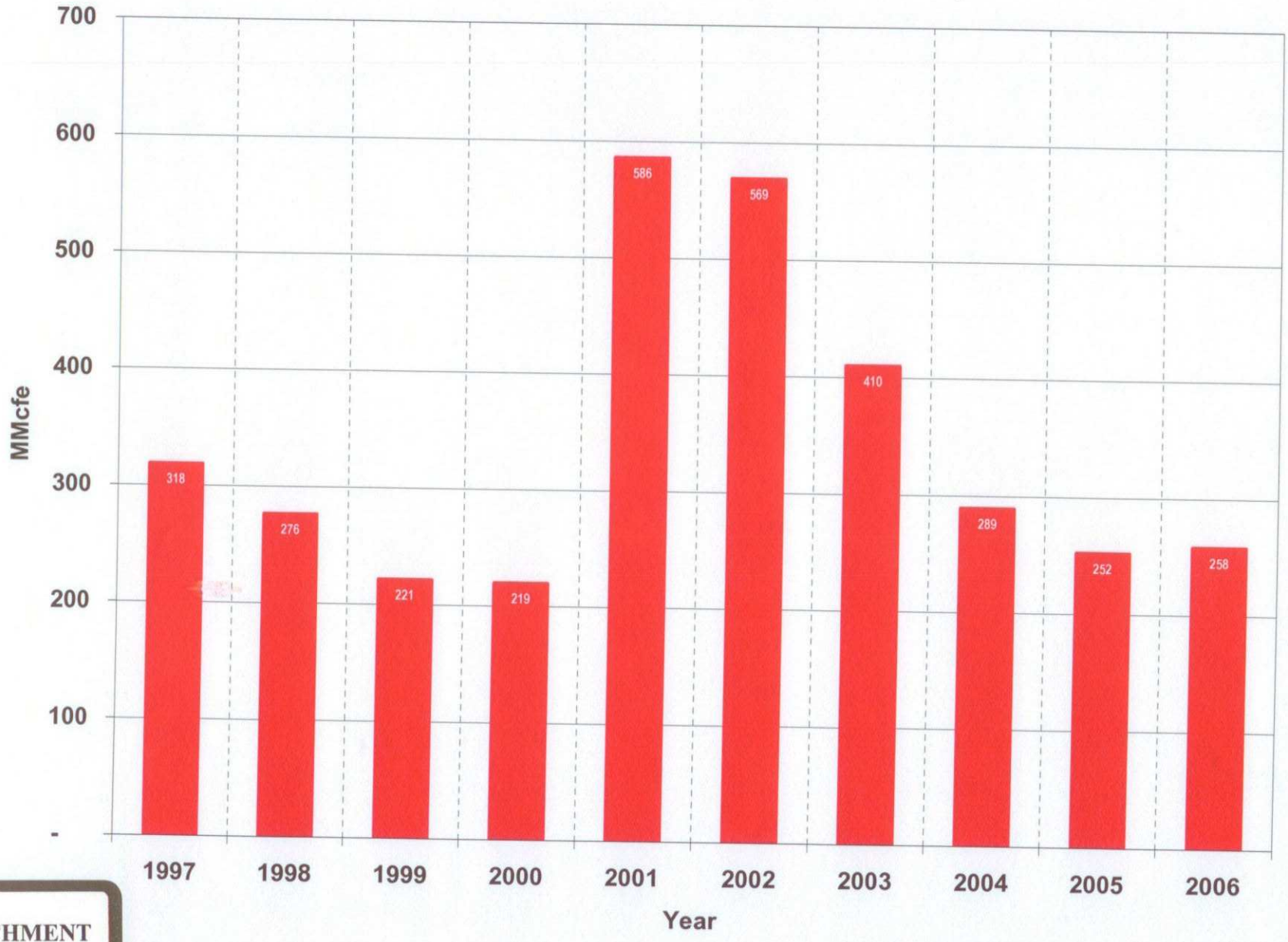
ATTACHMENT 3

E&P Capital Expenditures



ATTACHMENT
4

Annual Production, MMcfe



ATTACHMENT
4

El Paso Corporation and Production Figures 1997-2006 **

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Production										
Total MMcfe	318	276	221	219	586	569	410	289	252	258
Restated					*634*					
Prices										
Natural Gas (without hedges)	2.26	1.95	2.05	2.26	4.26	3.17	5.51	6.02	7.92	6.77
Natural Gas (with hedges)					3.81	3.35	5.40	5.94	6.69	6.50
Oil, Condensate, NGL	17.95	12.22	15.46	17.98	22.83	21.28	25.96	34.44	45.86	55.95
Revenues										
Gross	756	535	473	1,603	2,398	1,934	1,925	1,735	1,787	1,854
Expenses w/o DD&A	116	91	98	310	323	284	35	461	504	645
Net Cash Flow	640	444	375	1,293	2,075	1,650	1,890	1,274	1,283	1,209
DD&A	341	292	210	212	660	748	360	548	612	645
DD&A per Mcfe production	1.07	1.06	0.95	0.97	1.13	1.31	0.88	1.90	2.43	2.50
Proved Reserves, Bcfe										
Developed	1,829	1,271	1,085	1,178	2,967	3,109	1,650	1,727	1,675	1,546
Undeveloped	768	341	368	581	2,493	1,804	702	454	740	869
Total	2,598	1,612	1,453	1,759	5,460	4,913	2,351	2,181	2,415	2,415
% Undeveloped	30%	21%	25%	33%	46%	37%	30%	21%	31%	36%
Reserve Life Index										
Developed	5.75	4.60	4.90	5.40	5.06	5.46	4.00	6.00	6.60	6.00
Developed & Undeveloped	8.20	5.80	6.60	8.00	9.32	8.63	5.70	7.50	9.60	9.40
Standardized Measure*	2,199	1,162	1,251	14,988	5,369	6,694	4,808	3,888	6,052	4,225
FNR Undiscounted	3,258	1,779	1,907	9,923	8,886	11,663	7,297	5,892	9,712	6,357
FNR per Mcfe Reserves	1.25	1.10	1.31	5.64	1.63	2.37	3.10	2.70	4.02	2.63
Shares Outstanding										
Diluted	224	226	228	509	538	605	639	639	646	678
Standardized Measure, $/Share	9.82	5.14	5.48	11.89	9.98	11.06	7.50	6.08	9.37	6.23
Reserves ÷ No. of Shares, Mcfe/Share	11.60	7.13	6.37	3.46	10.15	8.12	3.68	3.41	3.74	3.56
Gas Price, $/Mcfe	2.26	1.95	2.05	2.26	4.26	3.17	5.51	5.94	6.69	6.50
Cash Flow per Mcfe Reserves	0.25	0.28	0.26	0.74	0.38	0.34	0.80	0.58	0.53	0.50
Cash Flow per Share	2.86	1.96	1.64	2.54	3.86	2.73	2.96	1.99	1.99	1.78
Reserve Revisions		(349)	(65)	(46)	(392)	(203)	(999)	(43)	8	n/a
% Revision		**-22%**	**-5%**	**-3%**	**-7%**	**-4%**	**-42%**	**-2%**	**0%**	

**Standardized Measure for 2000 of $14,988 billion restated to $6,053 billion; discussion of reason for restatement was not located.*

NOTES:

Ceiling Test Charges:
- 12/31/98: -$1,035,000,000
- 12/31/99: -$ 352,000,000
- 12/31/03: -$1,700,000,000

** All figures taken from 10-K filings

ATTACHMENT 5

Reserve Revisions

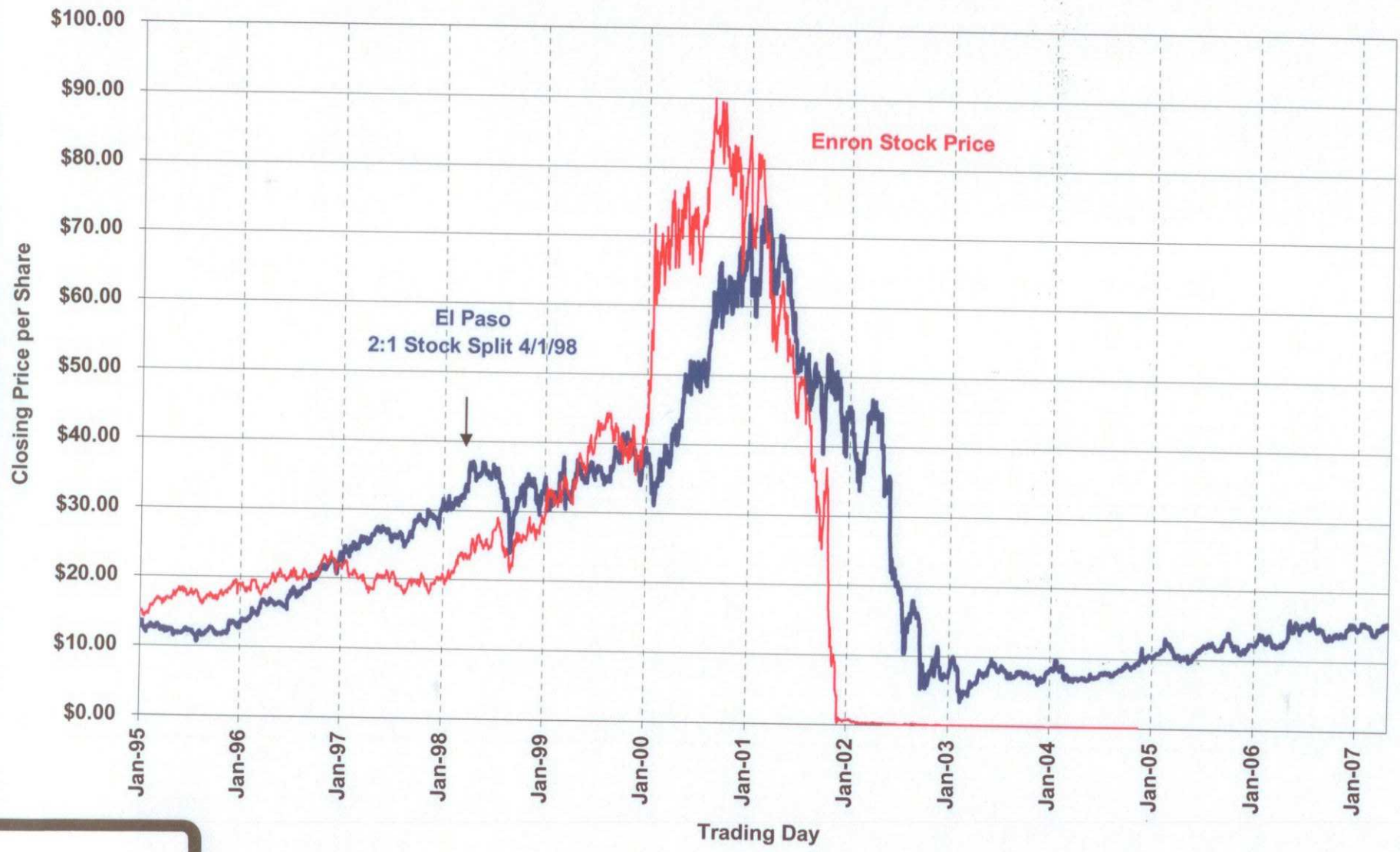
Oil and gas reserve revisions in 1998 and 99 resulted in a $1.3 billion write down of assets, equating to 8.92% of total assets, and a $1.7 billion write down in 2003, equating to 4.38% of total assets, as shown in Figure 3.

Comparison of El Paso Reserve Revisions and Write Down of Assets 1998-99 Compared to 2003

Year	Balance Sheet Assets - $Billions				
	Write Down	Pre Write Down	Post Write Down	Fraction after Write Down	% Write Down
1998	1.035	15.819	14.784	0.935	6.54
1999	0.352	14.807	14.455	0.976	2.38
Total 1998-99					**8.92**
2003	1.7	38.784	37.084	0.956	**4.38**

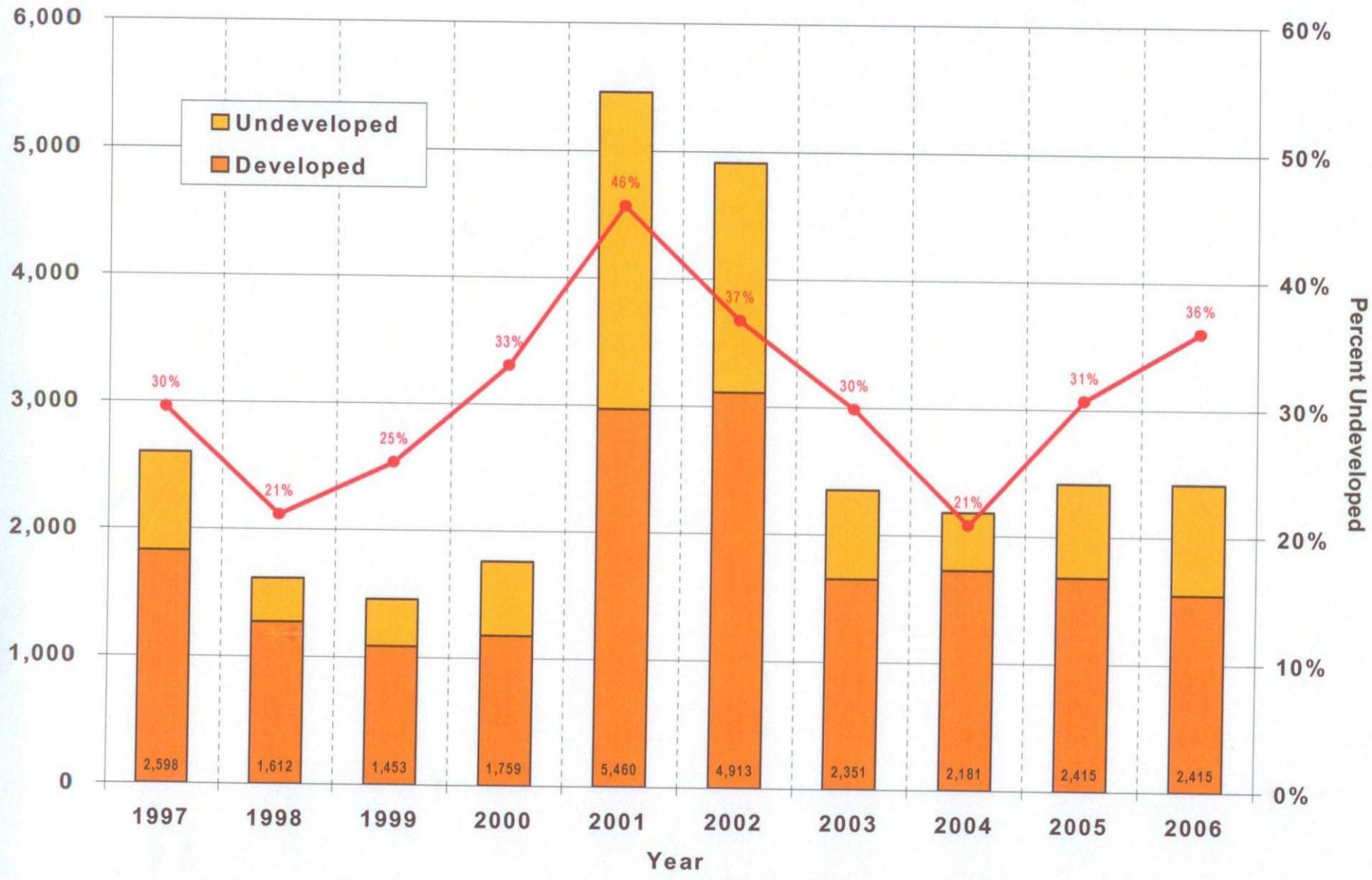
Comparison of El Paso's Stock Price with Enron's

(Prices prior to 4/1/98 Adjusted for El Paso Stock Split)



ATTACHMENT
6

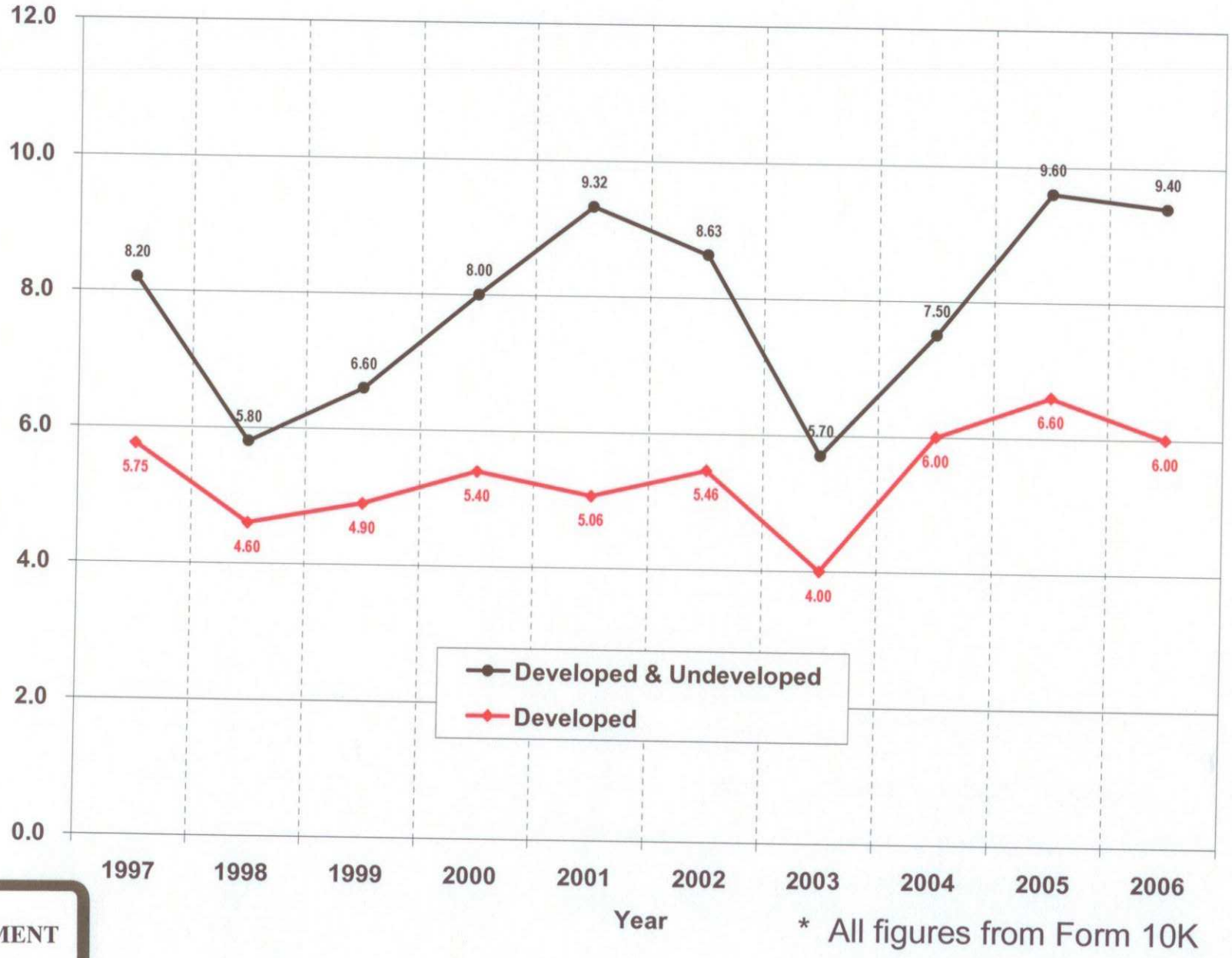
Proved Developed and Undeveloped Reserves *



* All figures from Form 10K

ATTACHMENT
7

Reserve Life Indexes *



* All figures from Form 10K

ATTACHMENT
7

EBPH CO.'S EMPLOYEE PENSION PLAN INVESTMENTS IN EL PASO CORP. [1]

Description	No. of Shares	Purchase Date	Purchase Amount ($)	Sale Date	Sale Amount ($)	Gain/ (Loss)
1. El Paso Corp.	3000	07/24/02	$32,171.25	06/05/03	$28,657.39	(3,513.86)
2. El Paso Energy Cap Trust	900	11/14/02	$19,607.25	06/05/03	$27,544.76	$7,937.51
3. 4.75% Conv. Pfd Ser C	100	11/14/02	$2,194.00	06/05/03	$3,060.53	$866.53
Total	**4000**		**$53,972.50**		**$59,232.68**	**$5,290.18**

[1] Resource Management Account 2003 Year End Summary HUD78355 (Confidential treatment requested under FOIA).

ATTACHMENT 8

BPHCO PERCENTAGE OF AUDITED PROPERTIES AS COMPARED TO OTHER INDUSTRY PARTICIPANTS.

Year of Audit	Coastal El Paso [1]	Exxon[2]	Chevron[3]	Anadarko[4]	EOG Res.[5]	Chesapeake Operating[6]	Devon Energy[7]
2000	84.35	0	0	0	49	72	80
2001	86.7	0	0	0	71	72	76
2002	100	0	0	0	73	73	73
2003	100	0	0	50/70	72	74	70

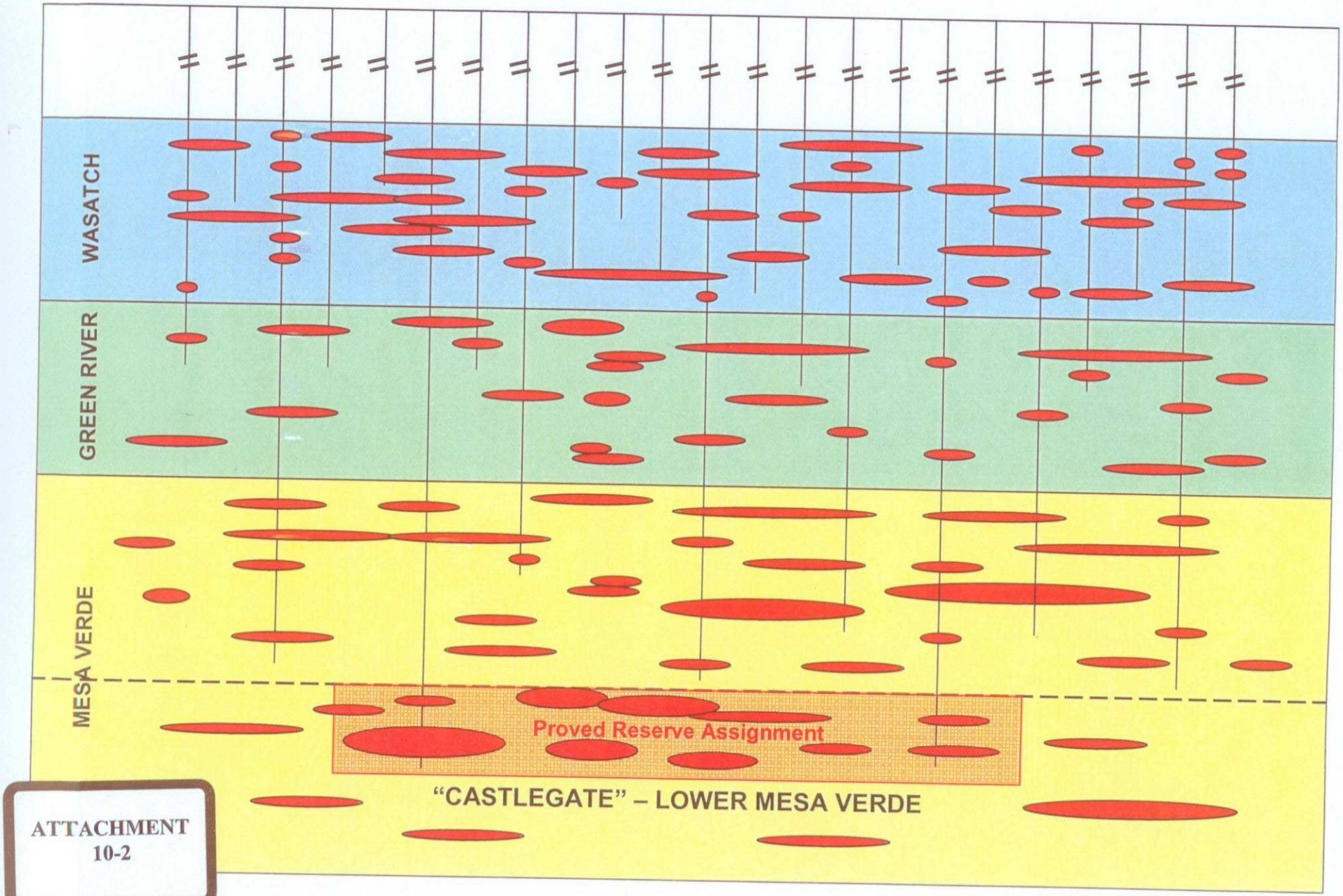
[1] El Paso 2004 10K, p. 186; Year End Report as of 12/31/2001 and HUD72495; HUD066052
[2] Exxon Mobil Corporation 10K-2004p. F-73; 2003 10-K p. F-62; 2002 10-K p 58.
[3] Chevron Corp. 2004 10K p. FS 62-67; 2003 10-K P. FS 52-54; 2002 10K p. FS 56-57.
[4] Anadarko Petroleum Corporation, 2004 10-K, p. 104 (50% of existing reserves, 70% of reserve additions);2003 10-K p. 103-106; 2002 10-K p. 112-115; 2001 10-K p. 81-84. A member of Netherland Sewel & Associates began to sit on a 6 person committee for Anadarko during 2003 along with 5 Anadarko employees.
[5] EOG Resources Inc. 2004 10-K p. F-31;2002 10-K, Ex. 99.1, Current Report on 8-K, p. 37.
[6] Chesapeake Energy Corporation, 2005 10K, p. 106.;2004 10-K, p. 100; 2004 10-K p. 93.
[7] Devon Energy Corporation, 2004 10-K, p. 128 (domestic)(includes both reserves audited by or prepared by outside consultants); 2003 10-K p. 116.

ATTACHMENT
9

ATTACHMENT 10-1

NATURAL BUTTES FIELD

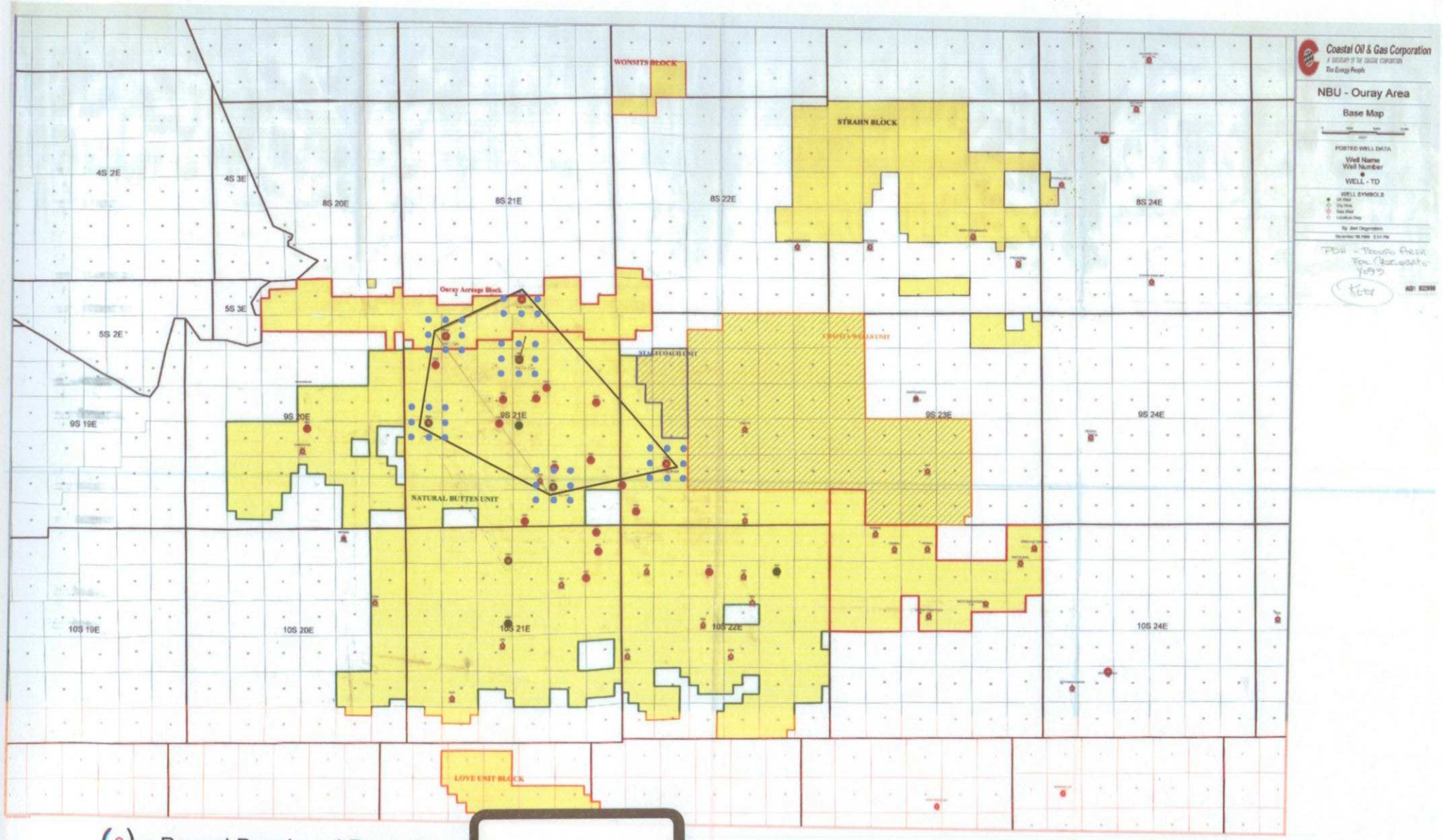
Illustrative Cross Section



ATTACHMENT
10-2

Natural Buttes Field

1999 Castlegate Potential Direct Offset Locations Applying "Guidance"



(°) = Proved Developed Producing

(•) = Proved Undeveloped

ATTACHMENT 10-3

Result of Guidance: 6 Proved Developed Locations
45 Proved Undeveloped

Castlegate → Lowest Marker of Mesaverde — Dwayne Joel / John

Top of Mancos shale

- top of Castlegate - highly fractured (Upper lobe)
- blanket (not lenticular)

N. Buttes - penetrated, but not produced in Castlegate

Ouray #5-67 - 1st Castlegate well - all open (Wasatch to CG)
#34-79 - CG only
NBU 29
NBU 18
CIGE 2 NDE
NBU 26

NBU 2-94 - PUD in section as Conoco well.

Ouray 34-79 Castlegate only

NBU 2-53 - Horizontal well (3,000' lateral) top lobe ~250'-300' Thick

Coal interval directly above top of Castlegate (source)

Becomes Iles A in Colorado

6000# - 6600# @ 11,000' (11.2 PPG mud hold it.)

NBU 3-21 vertical CG well drilling

NBU #29 (early '70's) drld into top of Castlegate - blocked by shale

Matrix .02 md Perm (.007 - .006 = Kg)

#5-67 - .60 psi/ft frac pressure
- 65' frac length
- 1.5 mmcf/D initial (750 Mcf/D ~ avg 1st Month)

40 AC = 2.5 bcf GIP
Volumetrics G'lo = 120' net
Sw = 42%

ϕ ~ 7%, .02 md Perm.

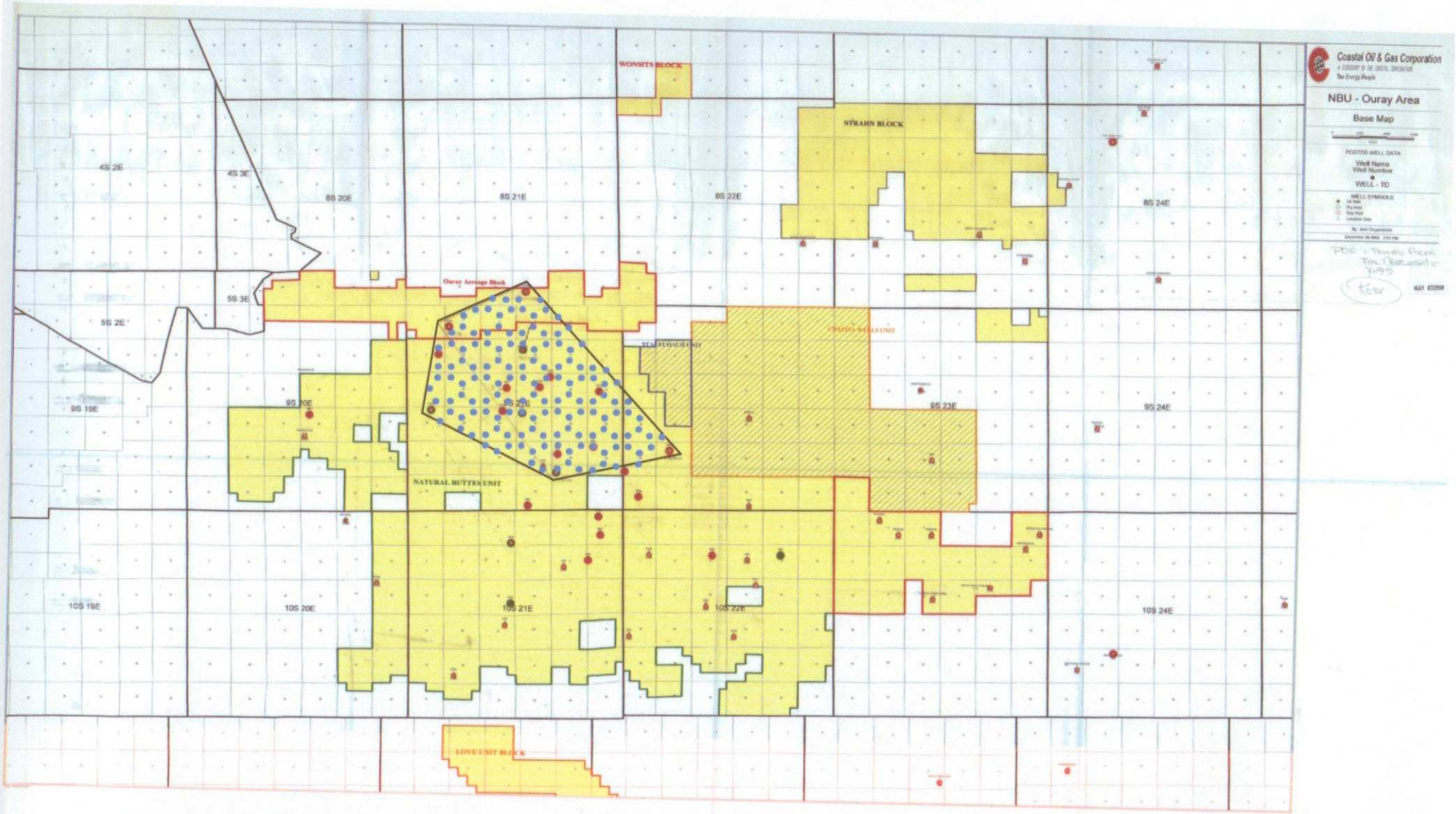
→ no build up tests yet.

- 34-79 ~1.0 mmcfD natural (no water)

HUD1 022159

ATTACHMENT 10-4

Natural Buttes Field
1999 Castlegate Developed and Undeveloped Locations (Approved) and Additional EOY 2000 Drilling



○ = Proved Producing Developed EOY 2000

● = Proved Undeveloped Within Polygon

ATTACHMENT 10-5

El Paso Production Company

Castlegate Formation*

Huddleston Audited Reserves and Revenues

	Net Reserves		Total Gross Revenue	Operating Expenses	Total Exp/Tax	Capital Costs	FNR Not Discounted	FNR Disc. @ 10%
	Oil, bbls	Gas, MMcf	$	$	$	$	$	$
1999								
Proved Developed Producing	0	6,543.1	13,353,896	2,276,230	2,100,542	100,000	9,853,947	4,653,437
Proved Developed Nonproducing	0	5,814.6	11,906,634	2,252,069	428,076	400,000	8,826,490	4,131,960
Proved Undeveloped	0	369,929.4	763,809,807	147,849,026	27,583,695	98,023,125	451,313,370	150,125,272
Total	0	382,287.1	789,070,337	152,377,325	30,112,313	98,523,125	469,993,807	158,910,669
2000								
Proved Developed Producing	31,205	16,658.0	108,487,282	7,027,198	15,471,488	0	93,015,788	37,812,999
Proved Developed Nonproducing	0	903.3	5,999,321	414,034	651,607	350,000	4,997,713	4,564
Proved Undeveloped	2,917	245,189.9	1,668,802,870	94,328,093	231,855,608	168,394,114	1,288,037,370	338,716,444
Total	34,122	262,751.2	1,783,289,473	101,769,325	247,978,703	168,744,114	1,386,050,871	376,534,007
2001								
Proved Developed Producing	88,083	17,693.8	39,354	6,076	9,235	0	30,118	13,016
Proved Developed Nonproducing	0	0.0	0	0	0	0	0	0
Proved Undeveloped	32,910	261,451.0	560,096	62,150	100,842	175,264	279,438	40,152
Total	120,993	279,144.8	599,450	68,226	110,077	175,264	309,556	53,168

* 2001 Proved Undeveloped projections include contributions from Wasatch, Green River and Mesa Verde Formations, as appropriate

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El Paso Production Company

Castlegate and Colorado Properties

As a Percentage of Total Projected Reserves and Discounted Revenues

Year	Castlegate - Huddleston Estimate				Colorado - Huddleston Estimate				Total - Corporate Estimates	
	MMcfe	PV10, M$	% of Total MMcfe	% of Total PV 10	MMcfe	PV10, M$	% of Total MMcfe	% of Total PV 10	MMcfe	PV10, M$
As of 12/31/99 - Coastal Only										
Proved Developed Producing	6,543.1	4,653			59,639.1	77,686.5			1,321,077.4	1,365,849.1
Proved Developed Nonproducing	5,814.6	4,132			22,741.9	38,218.8			506,777.0	663,463.3
Proved Undeveloped	369,929.4	150,125			104,000.5	98,378.3			1,782,476.9	1,266,228.1
Total	382,287.1	158,910.7	10.6%	4.8%	186,381.4	214,283.5	5.2%	6.5%	3,610,331.3	3,295,540.5
As of 12/31/00 - Combined Coastal and El Paso										
Proved Developed Producing	16,845.2	37,813.0			117,689.7	222,773.1			2,550,478.4	10,155,403.9
Proved Developed Nonproducing	903.3	4.6			30,475.9	68,957.4			784,780.3	2,710,593.7
Proved Undeveloped	245,207.4	338,716.4			342,181.3	586,550.2			3,119,360.9	3,286,413.9
Total	262,955.9	376,534.0	4.1%	2.3%	490,347.0	878,280.7	7.6%	5.4%	6,454,619.6	16,152,411.5
As of 12/31/01 - Total Company (Includes Coastal and El Paso)										
Proved Developed Producing	18,222.3	13,016			139,551.8	101,947.0			2,803,155.0	3,247,707.8
Proved Developed Nonproducing	0.0	0			13,171.4	10,822.0			711,285.5	900,607.0
Proved Undeveloped	261,648.5	40,152			66,772.5	11,956.0			2,817,278.2	1,763,599.9
Total	279,870.8	53,168.0	4.4%	0.9%	219,495.7	124,725.0	3.5%	2.1%	6,331,718.7	5,911,914.7

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ENCANA

2002 News Releases

EnCana expands production and land base in U.S. Rockies
500 billion cubic feet of natural gas equivalent reserves acquired

CALGARY, Alberta (April 17, 2002) - EnCana Corporation (TSE, NYSE: ECA) announced today that its U.S. subsidiaries are expanding production and land holdings in the U.S. Rocky Mountain region with the purchase of approximately 500 billion cubic feet of long-life, natural gas and associated natural gas liquids reserves and about 338,000 net acres of land in northwest Colorado.

Wholly-owned subsidiaries of EnCana Oil & Gas (USA) Inc., which is an indirect wholly-owned subsidiary of EnCana Corporation, have reached agreement to purchase Colorado assets from subsidiaries of El Paso Corporation (NYSE: EP) for approximately C$461 million (US$292 million) in cash. The acquisition includes developed and undeveloped reserves, a gathering system, a gas plant and approximately 180,000 net acres of undeveloped land in the Piceance Basin. The acquisition complements EnCana's current Piceance Basin gas production at Mamm Creek and the surrounding area near Rifle, Colo.

"The U.S. Rockies are a major component of our North American natural gas growth strategy and this acquisition solidifies our position as a leading producer in the region," said Randy Eresman, President of EnCana's Onshore North America division. "These are high working interest operated properties containing liquids-rich reserves in the early stages of development. EnCana has achieved great success applying its tight gas development expertise to multi-zone formations of this nature. These properties offer growth potential similar to our Mamm Creek field where we have significantly expanded production and reserves since we acquired it about 15 months ago."

EnCana estimates the assets have approximately 500 billion cubic feet of proven plus one-half probable (established) gas equivalent reserves. Approximately 85 percent of the reserves are gas, with the balance associated natural gas liquids. Current daily production is about 38 million cubic feet of gas equivalent. During the remainder of 2002, EnCana plans to drill an estimated 50 wells on the acquired lands, and anticipates increasing daily production to about 55 million cubic feet of gas equivalent by the end of 2002. Production, which is centred in the North Douglas Creek Arch north of Grand Junction, Colo., is sold under short-term agreements.

"This acquisition is of a similar character to our previous U.S. Rockies acquisitions. In-fill drilling and further exploitation have the potential to triple production from this property in the next three years," said Roger Biemans, President of EnCana Oil & Gas (USA) Inc.

Subject to receipt of regulatory approvals and certain other conditions, the transaction is expected to close by the end of May 2002. The transaction will be funded from cash on hand and available credit facilities. A map illustrating the location of the acquisition is on the EnCana Web site www.encana.com.

EnCana is one of the world's largest independent oil and gas companies with an enterprise value of approximately C$30 billion. It is North America's largest independent natural gas producer and gas storage operator. Ninety percent of the Company's assets are in four key North American growth platforms: Western Canada, offshore Canada's East Coast, the U.S. Rocky Mountains and the Gulf of Mexico. EnCana is the largest producer and landholder in Western Canada and is a key player in Canada's emerging offshore East Coast basins. In the U.S., EnCana is one of the largest gas explorers and producers in the Rocky Mountain states and has a strong position in the deepwater Gulf of Mexico. The Company has two key high potential international growth platforms: Ecuador, where EnCana is the largest private sector oil producer, and the U.K. North Sea, where the Company is the operator of a very large oil discovery. The Company also conducts high upside potential New Ventures exploration in other parts of the world. EnCana is driven to be the industry's best-in-class benchmark in production cost,

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per-share growth and value creation for shareholders. EnCana common shares trade on the Toronto and New York stock exchanges under the symbol ECA.

Advisory

This news release contains forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements in this news release include, but are not limited to, statements with respect to: the estimated size and composition of the reserves to be acquired pursuant to the transaction described in this news release (the "Transaction"); the production growth potential of the assets being acquired pursuant to the Transaction (including the potential to triple production in the next three years); projected increases in daily production of gas and natural gas liquids by the end of 2002; plans to drill additional wells to increase production; projected increases in gas production by 2005; potential exploration; and the expected closing date of the Transaction.

Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Although EnCana believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in this news release include, but are not limited to: the risk that regulatory approvals and other conditions required to complete the Transaction may not be obtained in a timely manner, or at all; the risk that the Transaction will be delayed or will not be completed; general economic, business and market conditions; volatility of oil, natural gas and liquids prices; fluctuations in currency and interest rates, product supply and demand; competition; risks inherent in foreign operations, including political and economic risk; the ability to expand production; the ability to expand or replace reserves; the ability to enter into or renew leases; the timing and costs of pipeline construction; the ability to make capital investments and the amounts thereof; the results of exploration, development and drilling; the ability to secure adequate product transportation; changes in regulations; uncertainty in amounts and timing of royalty payments; and such other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by EnCana and its indirect wholly-owned subsidiary, Alberta Energy Company Ltd. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this news release are made as of the date of this news release, and EnCana does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this news release are expressly qualified by this cautionary statement.

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