

# SEC's New Oil and Gas Reserves Disclosure Rules

Brave New World for Producers

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# Presenters



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# SEC new oil & gas reporting requirements

- New Rules:

- Effective for registration statements filed on/after 1/1/2010, and 10-Ks/20-Fs for fye on/after 12/31/09
- Revise Rule 4-10 of Regulation S-X and Item 102 of Regulation S-K
  - Also codify Industry Guide 2 into new Subpart 1200 of Reg S-K and revise Form 20-F to require FPIs to comply with Subpart 1200
- Align many of the definitions contained in Reg S-X with standards endorsed by Petroleum Resources Management System (PRMS)

# Five Key Elements of Changes to Rules

- Broadening of technology standards
- Using a 12-month average price to determine reserves values
- Disclosing probable & possible reserves
- Disclosing price sensitivity disclosures
- Including non-traditional resources by focusing on final product instead of means of extraction

# Most significant changes to reporting requirements

- Rather than year-end spot price, price used in determining “economic producibility” of reserves shall be calculated using a 12-month average price (except where prices defined by contract)
- Definition of “oil and gas producing activities” will now include “non-traditional” and “unconventional” alternative sources of hydrocarbons, such as bitumen extracted from oil sands and oil and gas extracted from coal and shales
- Previously undefined term “reasonable certainty” is now defined to mean “high degree of confidence” to better align with the PRMS definition

## “Reasonable certainty” definition added

- New defined term “reasonable certainty” mirrors PRMS’s “high degree of confidence” standard
  - SEC: “high degree of confidence” means “much more likely to be achieved than not”
  - Permits the use of both deterministic and probabilistic methods for estimating reserves
  - For proved undeveloped reserves (PUDs) for areas beyond one adjacent drilling unit from a productive well, new rules replace existing “certainty test” with a “reasonable certainty” test

# Most significant changes to reporting requirements

- “Certainty” test for proved undeveloped reserves beyond one offset drilling unit is replaced with a “reasonable certainty” test
- Technologies permitted to establish reserves estimates and categories are broadened by the adoption of the new definition of “reliable technology”
- Optional disclosure of “probable” and “possible” reserves is now permitted
- New definitions for “developed” and “undeveloped” reserves have been provided

## “Proved Reserves” definition broadened

- No longer dependent solely on fluid contact information in a well penetration – now, new “reliable technologies” can be used to establish reasonable certainty of proved reserves
- Companies can claim proved reserves beyond immediately adjacent developed spacing areas if they can establish with reasonable certainty that such reserves are economically producible



## “Reliable technology” definition

- One or more technologies (including computational methods)
- Must have been field tested
- Must have been demonstrated to provide *reasonably certain results with consistency and repeatability* in the formation being evaluated or in an analogous formation
- Company must provide concise summary of technology or technologies used to create the estimate

# Most significant changes to reporting requirements

- Disclosures required of qualifications of chief technical person who oversees overall reserves estimation process
- Must file third party's report when a third party has prepared/audited the reserves estimates
- Tabular format required for reserves estimate disclosures
  - By each type of final product type (proved developed, proved undeveloped and total proved)
  - In the aggregate and by “geographic area”
  - Optional disclosure of probable or possible reserves is permitted in table, *but* the associated relative uncertainty with these estimates must be disclosed (*see next slide*)

# Summary of Oil and Gas Reserves as of FYE 12/31/09

Based on Average Fiscal-Year Prices

	Reserves				
	Oil	Natural Gas	Synthetic Oil	Synthetic Gas	Product A
Reserves category	(mbbls)	(mmcf)	(mbbls)	(mmcf)	(measure)
<b>PROVED</b>					
Developed					
Continent A					
Continent B					
Country A					
Country B					
Other Countries in Continent B					
Undeveloped					
Continent A					
Continent B					
Country A					
Country B					
Other Countries in Continent B					
<b>TOTAL PROVED</b>					
<b>PROBABLE</b>					
Developed					
Undeveloped					
<b>POSSIBLE</b>					
Developed					
Undeveloped					

# Optional Reserves Sensitivity Table

## Sensitivity of Reserves to Prices by Principal Product Type & Price Scenario

Price Case	Proved Reserves			Probable Reserves			Possible Reserves		
	Oil (Mbbbls)	Gas (Mmcf)	Product A (Measure)	Oil (Mbbbls)	Gas (Mmcf)	Product A (Measure)	Oil (Mbbbls)	Gas (Mmcf)	Product A (Measure)
Scenario 1									
Scenario 2									

# Accounting changes

- Full cost accounting

- SEC's full cost accounting rules adopted a pricing calculation based on new 12-month average for purposes of calculating limitation on costs that may be capitalized under the full cost method
- Retroactive revision of past reserves estimates not required; change should be treated as a change in the method of applying an accounting principle that is inseparable from a change in accounting estimate

# Accounting changes

- **Successful efforts accounting**

- In September, FASB issued Proposed Accounting Standards Update (ASU), Extractive Industries - Oil and Gas (Topic 932)
  - Matches guidance of former SFAS No. 19 with SEC's Dec. '08 rules changes; comments due 10/15/09; if proposed guidance is approved, it will be effective for fiscal years ending on/after 12/31/09
- Like SEC new rules, the Proposed ASU would:
  - Amend definition of proved reserves to require companies to use a 12-month average instead of a year-end price.
  - Amend definition of oil and gas-producing activities to include the extraction of hydrocarbons from oil sands, shale beds, and other areas
- Guidance would also call for energy companies to make separate disclosures about their reserves in geographic areas in which significant reserves are located (at a minimum if these represent 15% or more of their proved reserves)

## Proved reserves

- In supporting proved reserves, an “analogous reservoir” shares same traits as the reservoir in interest (*i.e.*, same geological formation & environment of deposition, similar geological structure & drive mechanism)
- Special narrative disclosures required if material amounts of PUDs remain undeveloped for 5 years or more after disclosure as PUDs
- Must disclose & generally describe internal controls used in company’s reserves estimation process

# Guidance for MD&A Disclosures

- Discuss sources to which changes in proved reserves and, if disclosed, changes in probable and possible reserves, are attributable, *e.g.*
  - changes in prices,
  - technical revisions, and
  - changes in status of concessions held (terminations, renewals or changes in provisions)
- Discuss technologies used to establish appropriate level of certainty for material additions to, or increases in, reserves estimates
- Prices and costs including effect on dd&a and full cost ceiling



# Guidance for MD&A Disclosures

- Discuss need to use enhanced recovery techniques to maintain production from wells, e.g. waterflood
- Discuss recent ability to convert PUDs to proved developed reserves, and if disclosed,
  - probable reserves to proved reserves, and
  - possible reserves to probable or proved reserves
- Discuss geopolitical risks that apply to material concentrations of reserves

# Guidance for MD&A Disclosures

- Discuss any material changes to line items in Summary of Oil and Gas Reserves and Other Activities tables (*i.e.*, reserves, production, drilling and other exploratory & development activities, present activities, properties, wells, operations and acreage tables)
- Discuss potential effects of different forms of rights to resources (*e.g.*, production sharing contracts) on operations
- Discuss minimum remaining terms of leases and concessions

# Questions Left Unanswered Under New Rules

- Further SEC guidance is needed immediately
- Issues with pricing and differentials need clarifying
- Proving economic producibility without a traditional flow test
- Reliable technology and documenting “consistency and repeatability”
- What does the SEC consider “specific circumstances” for extending PUD life past 5 years
- Filing of probable and possible reserves and associated issues

# Further SEC Guidance Needed Immediately

- Need for interpretations — Staff FAQ project
- Interpretation by comment letters — very slow process
- Uncertain status of Dr. Lee's unofficial commentary
- Current access to staff
- Recent staff review experience — 5 year PUD challenge

# Issues with Pricing and Differentials need Clarifying

- Pricing – unweighted 12 month first day of the month average
- Inactive markets and lack of appropriate price indicators
- Adjusting for differentials and foreign exchange
- Effects of historical average pricing in changing markets and possible alternate economic case
- Pricing convention likely applicable to Probable/Possible

# Proving Economic Producibility without a Traditional Flow Test

- Economic producibility — revenue must exceed, or be reasonably expected to exceed, operating costs
- Support by analogy or reliable technology absent flow test

# Reliable Technology and Documenting "Consistency and Repeatability"

- Reliable technology as a means of proving reasonable certainty
- SEC requirement to document "consistent and repeatable" technology performance
- How much empirical data is necessary?
- Must each company document reliability of same technology?

# Specific Circumstances for Extended PUD Life Past 5 Years

- Development plan sanction
- Financing as a reasonable expectation
- What does the SEC consider to be acceptable “specific circumstances” to book undeveloped reserves past the five year time horizon?



# Filing of Probable and Possible Reserves and Associated Issues

- Discrepancies – previous quotes vs. new bookings
- Inconsistencies in new guidelines
  - SEC explicitly states structurally lower areas of a reservoir can't be classified as probable?
  - Can probable and possible reserves be booked in a unpenetrated fault block without the adjacent portions being in communication with the known (proved ) reservoir?
  - Can probable and possible reserves be booked without the presence of proved reserves?