

February 19, 2008

Comments on SEC File No. S7-29-07

Concept Release on Possible Revisions to the Disclosure Requirements Relating to Oil and Gas Reserves

Submitted to:
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Questions:

1. Should we replace our rules-based current oil and gas reserves disclosure requirements, which identify in specific terms which disclosures are required and which are prohibited, with a principles-based rule? If yes, what primary disclosure principles should the Commission consider? If the Commission were to adopt a principles-based reserves disclosure framework, how could it affect disclosure quality, consistency and comparability?

Response:

Moving towards a principles-based system will not improve disclosure quality, consistency, and comparability without a corresponding effort on the part of the Commission to communicate with reserves evaluators how the Commission views specific issues. This can be done without compromising proprietary information. For example, the IRS issues Private Letter Rulings that shows industry how they view specific circumstances. If the Commission were to make public their position on issues where industry has raised questions on the appropriate treatment, in a manner that does not reveal the specific company or property involved, it would provide a valuable learning tool that evaluators could use to provide more compliant and uniform estimates. Efforts such as the current website releases and Staff Accounting Bulletin 12 are examples of the type of disclosure that can help evaluators, but more efforts would be necessary if a change from rules-based to principles-based guidance were to be made.

2. Should the Commission consider allowing companies to disclose reserves other than proved reserves in filings with the SEC? If we were to allow companies to include reserves other than proved reserves, what reserves disclosure should we consider? Should we specify categories of reserves? If so, how should we define those categories?

Response:

Many other countries allow the disclosure of non-proved reserves. Uncertainty is an inescapable part of oil and gas reserve evaluations, and the disclosure of potential (or lack thereof) in non-proved categories can provide investors with important information.

However, non-proved reserves are not as valuable as proved reserves. Many producers are concerned that any recognition of non-proved reserves would result in attempts by local taxing authorities to assess ad valorem taxes on the non-proved reserves. This is a legitimate concern, as it would be difficult to ensure uniform and equitable taxation, particularly if the disclosure of non-proved reserves was discretionary.

3. Should the Commission adopt all or part of the Society of Petroleum Engineers – Petroleum Resources Management System? If so, what portions should we consider adopting? Are there other classification frameworks the Commission should consider? If the Commission were to adopt a different classification framework, how should the Commission respond if that framework is later changed?

Response:

The SPE PRMS represents a very large gathering of industry expertise and experience. In the event the Commission decides that a change is desired, then adoption of the SPE PRMS should be strongly considered.

4. Should we consider revising the current definition of proved reserves, proved developed reserves and proved undeveloped reserves? If so, how? Is there a way to revise the definition or the elements of the definition, to accommodate future technological innovations?

Response:

Considering the work that went into the SPE PRMS, it would be a wasteful, duplicative effort to attempt to revise the current SEC reserves regulations rather than adopt some form of the SPE PRMS. The SPE Reserves Committee, the group responsible for the PRMS, has a demonstrated history of revising the reserves guidelines as necessary. If the SEC were to adopt the PRMS, either in part or in whole, then it should follow that if the PRMS is modified by the SPE Reserves Committee and those changes are approved by the member organizations (SPE, AAPG, SPEE, WPC) in the future, those changes should be automatically incorporated into the “SEC approved portions of the PRMS” unless explicitly rejected by the SEC

5. Should we specify the tests companies must undertake to estimate reserves? If so, what tests should we require? Should we specify the data companies must produce to support reserves conclusions? If so, what data should we require? Should we specify the process a company must follow to assess that data in estimating its reserves?

Response:

Every well is unique, and attempts to create a “cookbook” approach would result in a waste of resources (time, money, and manpower). For many mature producing properties, the only necessary data to determine a high confidence forecast of reserves is the monthly production history and a good tabulation of operating costs and revenues. Additional “tests” might not add any confidence to the forecast. For situations that require more data, there are many different forms of tests that can be performed to acquire that data. Engineers determine the appropriate tests based on many factors: costs, chance of obtaining useable data, risk of damaging the well or reservoir by the testing process, safety with regards to personnel and the environment, etc.

6. Should we reconsider the concept of reasonable certainty? If we were to replace it, what should we replace it with? How could that affect disclosure quality? Should we consider requiring companies to make certain assumptions? Should we prohibit others?

Response:

If the concept of reasonable certainty is abandoned, then by implication the alternative would be the adoption of a probabilistic approach where the level of certainty is expressed as a probability that the reserves will exceed the quantity X some defined percentage of the time. As an example, P90 reserves of 1 million barrels would mean that there is a 10% chance the reserves are less than 1 million barrels and the reserves will exceed 1 million barrels 90% of the time.

The probabilistic approach is a very useful tool, but in general, it is better suited to exploratory and / or field development projects. There is also the unresolved issue of the appropriate aggregation level for probabilistic reserves and the portfolio effect. As an example, a probabilistic evaluation for a particular field could be done on a well level, a reservoir level, or a field level; each generating a different reserve value.

A probabilistic evaluation generally requires much more time than a deterministic evaluation. If a probabilistic approach were required for all reserves reporting, there is not enough manpower in the industry to perform this task in a timely manner.

7. Should we reconsider the concept of certainty with regard to proved undeveloped reserves? Should we allow companies to indefinitely classify undeveloped reserves as proved?

Response:

The current guidelines require reasonable certainty of production for proved undeveloped reserves in offsetting production units but for continuity of production for other undrilled units. The staff has pointed out that there is no mitigating modifier for certainty for the continuity of production. The different uses of “certainty” has led to some confusion. Industry would be served by clarification as to what constitutes acceptable or unacceptable examples of “certainty of production”.

As to whether companies should be allowed to indefinitely classify undeveloped reserves as proved, companies should provide adequate documentation as to why reasonable certainty exists for reserves that will be drilled and produced beyond the company’s normal planning cycle (i.e., three to five years).

8. Should we reconsider the concept of economic producibility? If we were to replace it, what should we replace it with? How could that affect disclosure quality? Should we consider requiring companies to make certain assumptions? Should we prohibit others?

Response:

Economic producibility is a key concept that distinguishes reserves from resources. Industry has a good track record in developing technology to allow resources to become reserves, but the ability to forecast exactly when those advances will occur, and to what extent other market forces (higher or lower prices, operating and development costs) impact economic producibility, makes it appropriate that economic producibility remain a key criteria for reserves.

9. Should we reconsider the concept of existing operating conditions? If we were to replace it, what should we replace it with? How could that affect disclosure quality? Should we consider requiring companies to make certain assumptions? Should we prohibit others?

Response:

Existing operating conditions should be re-defined to allow for the consideration of historic averages. The averaging period should be restricted to no more than the latest 12 months of available data within the last 18 months of the evaluation date. For example, to prepare a reserve estimate as of December 31, 20xx, work may start in October. In October, accounting data for prices and operating costs may only be available up to July. In such a case, it might be appropriate to use the average operating costs and product prices from the last 12 months, ending in July, as representative for the average annual operating costs.

Of course, known events such as a change in operating conditions not reflected in the historical data available or contract terms that would make those estimates invalid should be incorporated as necessary.

10. Should we reconsider requiring companies to use a sale price in estimating reserves? If so, how should we establish the price framework? Should we require or allow companies to use an average price instead of a fixed price or a futures price instead of a spot price? Should we allow companies to determine the price framework? How would allowing companies to use different prices affect disclosure quality and consistency? Regardless of the pricing method that is used, should we allow or require companies to present a sensitivity analysis that would quantify the effect of price changes on the level of proved reserves?

Response:

Price volatility is a part of the oil and gas business and the mandated use of year end prices has, on occasion, caused a similar volatility in year-to-year reserves reporting. An average determined by the method suggested previously can be used to smooth some of this volatility. If companies are allowed to use their own price forecast, i.e. a price scenario that is expected to increase or decrease over time based on assumptions of market forces, then that price forecast should be part of their public disclosure.

11. Should we consider eliminating any of the current exclusions from proved reserves? How could removing these exclusions affect disclosure quality?

Response:

Hydrocarbons from unconventional sources such as tar sands can be accommodated by the PRMS. If the production process results in liquid or gaseous hydrocarbons that can be sent to a refinery like crude oil, or used in the same manner as conventional natural gas, then companies should have the flexibility to report those volumes as part of their reserves, assuming the same standards for economic producibility.

12. Should we consider eliminating any of the current exclusions from oil and gas activities? How could removing these exclusions affect disclosure quality?

Response:

Please see response to #11.

13. Should we consider eliminating the current restrictions on including oil and gas reserves from sources that require further processing, e.g., tar sands? If we were to eliminate the current restrictions, how should we consider a disclosure framework for those reserves? What physical form of those reserves should we consider in evaluating such a framework? Is there a way to establish a disclosure framework that accommodates unforeseen resource discoveries and processing methods?

Response:

Again, the PRMS can accommodate these situations. The distinction here is whether the local processing results in a product that can be then transported for refining, or if the processing alters the hydrocarbon to the point that no further refining is necessary. If local upgrading is necessary to allow the production to be transported, then it seems that recognition of those volumes as reserves would present a more complete disclosure of an organization's assets.

14. What aspects of technology should we consider in evaluating a disclosure framework? Is there a way to establish a disclosure framework that accommodates technological advances?

Response:

If the Commission were to consider adoption of PRMS, either in part or in whole, then there should be consideration in adopting updates that may be issued to the PRMS in the future. It is assumed that the PRMS will be modified in the future, if necessary, if found to be deficient in considering new technology that may be introduced.

15. Should we consider requiring companies to engage an independent third party to evaluate their reserves estimates in the filings they make with us? If yes, what should that party's role be? Should we specify who would qualify to perform this function? If so, who should be permitted to perform this function and what professional standards should they follow? Are there professional organizations that the Commission can look to set and enforce adherence to those standards?

Response:

The issue of involving a third party in the reserves process is a decision that each company should determine.

Regarding standards for reserve evaluators - as a former President of the Society of Petroleum Evaluation Engineers (SPEE), I believe that the SPEE has a track record of encouraging professional and ethical behavior, and continuing education for reserves evaluators. As a member of SPEE's Council of Past Presidents, a steering committee that provides long term planning recommendations to the current officers, I can assure the Commission that SPEE would consider assisting on issues regarding standards for reserve evaluators should the Commission wish to become involved in that area.

Other Topics for Consideration by the Commission:

Fit for purpose evaluation approach

The Commission should refrain from adopting guidelines that might make the reserves estimation process overly burdensome without corresponding benefits. For example, if the probabilistic approach were to be mandated, there is not enough manpower in industry to perform such evaluations.

I appreciate the opportunity to submit these comments. The opinions presented herein represent my personal views and may not reflect the opinions of my employer, Ryder Scott Petroleum Consultants.

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