

5 February 2008

Client Bulletin

Oil and gas reserves disclosure: SEC requests comments on possible revisions

White & Case welcomes the SEC's December 2007 Concept Release, which seeks the views of market participants on proposed changes to the outdated oil and gas reserves disclosures rules. Tell us what you think and we will make your views known in our comment letter to the SEC.

On 12 December 2007, the U.S. Securities and Exchange Commission (the "SEC") published [Concept Release No. 33-8870](#) (the "Concept Release") to obtain information about the extent and nature of market participants' interest in revising the current oil and gas reserves disclosure requirements, which are principally found in Regulations S-K and S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934. The current disclosure requirements, which were originally adopted between 1978 and 1982, are being reviewed by the SEC in light of concerns that they are not fully aligned with current industry practice, and have not kept pace with changes within the oil and gas industry.

The SEC is accepting electronic and paper comments and we plan to comment on the Concept Release by the 16 February 2008 deadline.

Among the topics discussed in the Concept Release are:

- the definition of oil and gas reserves;
- the impact of technology;
- alternative classification systems; and
- the independent preparation, assessment and evaluation of reserves disclosure.

Definition of Oil and Gas Reserves

The Concept Release notes that oil and gas companies may only disclose "proved reserves", which must have a "reasonable certainty" of being recovered. The concept of reasonable certainty has been subject to extensive interpretation by SEC staff, which has imposed among other things a test of "economic producibility" that can generally be met only through actual production or a conclusive formation test based on a combination of drilling and well flow testing.

The Concept Release further notes that oil and gas companies can disclose "proved undeveloped reserves" for un-drilled units, but only where they can demonstrate with "certainty" that there is continuous production from an existing producing reservoir. SEC staff have used the test of certainty to exclude estimates based on new technologies (e.g., 3-D seismic) from being characterised as proved undeveloped reserves.

Impact of Technology

The Concept Release acknowledges that advances such as 3-D and 4-D seismic interpretation and computer reservoir simulation models now provide increased information about reservoirs and their boundaries.

Despite the introduction of new techniques that allow companies to



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exploit tar sands and oil shales using oil and gas drilling techniques, the Concept Release notes that the disclosure rules continue to prohibit the inclusion of oil contained in these deposits in proved reserves.

Alternative Classification Systems

The SEC's "proved reserves" and related definitions are based on concepts and definitions published by the Society of Petroleum Engineers (the "SPE") in 1978. The Concept Release acknowledges that the SPE has since that time made several revisions to its classification framework, including in its publication "Petroleum Resources Management System" released in February 2007. The SEC acknowledges that this framework is commonly used by participants in the oil and gas industry for a variety of purposes.

Independent reserves assessment

The Concept Release acknowledges that the current SEC oil and gas reserves disclosure rules do not require any independent expert assessment or review of a company's disclosed oil and gas reserves.

SEC Questions Posed

The SEC is seeking public comment on 15 specific questions, including the following:

- Should the SEC replace the current rules-based oil and gas reserves disclosure requirements with a principles-based rule? If yes, what primary disclosure principles should the SEC consider and how might such a change affect the quality, consistency and comparability of disclosure?

- Should the SEC consider allowing companies to disclose reserves other than proved reserves in filings with the SEC? If yes, what additional categories of reserves disclosure should the SEC consider?
- Should the SEC adopt all or part of the SPE's Petroleum Resources Management System? Are there other classification frameworks the SEC should consider?
- Should the SEC consider revising the current definitions of "proved reserves", "proved developed reserves" and "proved undeveloped reserves" and, if so, how?

The SEC has also welcomed comments on any other issues that commentators may wish to address.

Interestingly, the SEC has not taken this opportunity to request comments on the rules governing the disclosure of mineral reserves, which give rise to similar issues and concerns.

Our Experience

In our representation of various issuers operating in the extractive industries, we regularly encounter difficulties in applying the current SEC rules governing the disclosure of oil and gas and mineral reserves. We believe that these rules are in urgent need of review and so welcome the SEC initiative.

The issues we have encountered include the following:

- The prohibition under the current SEC rules of disclosure of oil and

gas and mineral "resources" (that have not yet met the stringent tests for "reserves") imposes a significant hardship on exploration and development companies and often deprives investors of valuable information; the result of this has been that many oil and gas and mining companies have avoided the U.S. capital markets in favour of the markets in Canada, the United Kingdom and other jurisdictions that permit the disclosure of resources in appropriate circumstances.

- The SEC rules fail to recognise the importance and value to investors of having an issuer's reserves reviewed and reported on by an independent, qualified technical expert that meets appropriate criteria (unlike the corresponding rules in Canada, the United Kingdom and certain other jurisdictions where such reports are a central feature of the disclosure regime and its regulatory framework).
- The SEC's approach to regulating the disclosure of oil and gas reserves and mineral reserves has diverged in ways that cannot, in our view, be justified on technical or operational grounds (this is in stark contrast to a number of other jurisdictions, where securities regulators have been seeking to achieve regulatory convergence in this area).

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Do not hesitate to contact the partners noted in this bulletin for further details, or if you would like us to take your views into account in our comment letter to the SEC.