

## Oil and Gas Rules

Last Update: October 26, 2009

These Compliance and Disclosure Interpretations ("C&DIs") comprise the Division's interpretations of the Oil and Gas Rules in Regulation S-X and Regulation S-K. The bracketed date following each C&DI is the latest date of publication or revision.

### QUESTIONS AND ANSWERS OF GENERAL APPLICABILITY

#### Regulation S-X

##### Sections 101-104. Rules 4-10(a)(1) to 4-10(a)(4) [Reserved]

##### Section 105. Rule 4-10(a)(5) Definitions — Deterministic Estimate

###### Question 105.01

**Question:** In a deterministic reserve evaluation, when you have determined specific, individual estimates for proved, probable and possible reserves, is it acceptable to sum up these separate reserve categories into one total reserve estimate?

**Answer:** No. Because the categories of proved, probable and possible reserves have different levels of certainty, it is not appropriate to sum up the individual deterministic estimates for these reserves into one total reserve estimate. The individual estimates for each category should be disclosed as separate estimates, with the difference in certainty for each estimate fully explained. [Oct. 26, 2009]

##### Sections 106-107. Rules 4-10(a)(6) to 4-10(a)(7) [Reserved]

##### Section 108. Rule 4-10(a)(8) Definitions — Development Project

###### Question 108.01

**Question:** For an issuer that intends to develop a large field involving the drilling of numerous wells in multiple stages, what constitutes a development project?

**Answer:** A development project is typically a single engineering activity with a distinct beginning and end, which, when completed, results in the production, processing or transportation of crude oil or natural gas. A project typically has a definite cost estimate, time schedule and investment decision; is approved for funding by management; may include all classifications of reserves; and will be fully operational after the completion of the initial construction or development. The scope and scale of a project are such that, if a project were terminated before completion, for whatever reason, a significant portion of the previously invested capital would be lost.

If an investment decision has been made to develop only a portion of the primary, secondary or tertiary reserves, the remainder of the reserves would not be considered to be proved reserves until such time as management has made an investment decision to develop those additional reserves, the requisite level of certainty has been demonstrated from the initial portion of the development or by other means, and the additional development is within five years of being initiated. [Oct. 26, 2009]

**Section 109-116. Rules 4-10(a)(9) to 4-10(a)(16) [Reserved]****Section 117: Rules 4-10(a)(17) and 4-10(a)(18) Definitions — Possible Reserves; Probable Reserves**

## Question 117.01

**Question:** Is it acceptable to assign probable or possible reserves below the Lowest Known Hydrocarbon (LKH) limit penetrated in a well bore under the new definition of the term "probable reserves"?

**Answer:** It may be acceptable to assign unproved reserves below the LKH if that volume of reserves meets the test for either probable or possible reserves. If there is no data below LKH, no reserves should be assigned. [Oct. 26, 2009]

## Question 117.02

**Question:** Can an issuer assign probable or possible reserves in an area in which it does not, or cannot, assign proved reserves?

**Answer:** Yes. However, disclosure of unproved reserves without associated proved reserves should be done only in exceptional cases, such as for (1) development projects where engineering, geological, marketing, financing and technical tasks have been completed, but final regulatory approval is lacking or (2) improved recovery projects, at or near primary depletion, that await production response. Reserves should not be assigned without well penetration of the subject reservoir (rock volume) in the contiguous area that yields technical information sufficient to support the attributed reserve category. Volumes that are not economically producible are not reserves of any classification and should not be disclosed. [Oct. 26, 2009]

## Question 117.03

**Question:** The definition of the term "probable reserves" does not include instructions regarding reserves below LKH. Does this mean that probable reserves cannot be assigned below proved areas, such as below LKH limit, and can be no higher classification than possible reserves?

**Answer:** No. Probable reserves may be assigned if reliable technology and data exist that, in the judgment of the evaluator, support characterizing those reserves as probable reserves. If no data exists below LKH, no unproved reserves can be assigned. [Oct. 26, 2009]

## Question 117.04

**Question:** Can an issuer assign probable or possible reserves to an un-penetrated fault block?

**Answer:** No. Un-penetrated, pressure-separated fault blocks should not be considered to contain reserves of any category until penetrated by a well. [Oct. 26, 2009]

**Sections 119-121. Rules 4-10(a)(19) to 4-10(a)(21) [Reserved]****Section 122. Rule 4-10(a)(22) Definitions — Proved Oil and Gas Reserves**

## Question 122.01

**Question:** What oil and gas prices should be used to estimate probable and possible reserves?

**Answer:** Unproved reserves should be evaluated using the same price as used for the evaluation of proved reserves. [Oct. 26, 2009]

#### Question 122.02

**Question:** Does the new definition of "proved oil and gas reserves" require issuers to change their existing procedures for determining costs?

**Answer:** No. [Oct. 26, 2009]

### Sections 123-124. Rules 4-10(a)(23) to 4-10(a)(24) [Reserved]

### Section 125. Rule 4-10(a)(25) Definitions — Reliable Technology

#### Question 125.01

**Question:** Does the staff intend to publish a list of reliable technologies that the SEC will accept for the determination of proved reserves?

**Answer:** No. An issuer has the burden of establishing and documenting the technology (or set of technologies) that provides reliable results, consistent with the criteria set forth in Rule 4-10 (a)(25) of Regulation S-X. This information should be made available to the Commission's staff upon request in support of any reserves estimates that the staff may be reviewing. [Oct. 26, 2009]

### Section 126. Rule 4-10(a)(26) Definitions — Reserves

#### Question 126.01

**Question:** Can a company claim proved reserves under a production sharing contract prior to obtaining approval from the host country?

**Answer:** No. Since production sharing contracts are entered into in countries where the government claims ownership of the mineral rights, all government approvals must be obtained prior to claiming proved reserves. [Oct. 26, 2009]

#### Question 126.02

**Question:** In the case of reserves above a highest known oil (HKO) limit, if it is equally likely that oil or gas is present above HKO, should the lower value product be assigned above HKO?

**Answer:** Yes, but only if the well or field is in a location where a market for that product exists. In particular, if there is no market for gas, or no way to transport gas to a market, then any assumed gas cap volume that may or does exist above a HKO cannot be classified as reserves. [Oct. 26, 2009]

### Sections 127-130. Rules 4-10(a)(27) to 4-10(a)(30) [Reserved]

### Section 131. Rule 4-10(a)(31) Definitions — Undeveloped Oil and Gas Reserves

#### Question 131.01

**Question:** Can an issuer assign proved undeveloped reserves to horizontal locations offsetting

the toe of an existing horizontal producing well if the location is moving in the direction of other successful, analogous producing horizontal wells?

**Answer:** Yes, if the technical evidence supports this assignment with reasonable certainty. [Oct. 26, 2009]

#### Question 131.02

**Question:** Does the standard, "reasonable certainty of economic producibility," in the definition of "undeveloped oil and gas reserves" mean that a registrant cannot assign probable or possible undeveloped reserves beyond areas containing proved undeveloped reserves?

**Answer:** No. Reliable technology can be used to establish (1) that probable reserves in undeveloped locations are as likely as not and (2) that possible reserves in undeveloped locations are possible but not likely. [Oct. 26, 2009]

#### Question 131.03

**Question:** In the definition of "undeveloped oil and gas reserves," what "specific circumstances" would justify a time period longer than five years to begin development of those reserves?

**Answer:** Although several types of projects — such as constructing offshore platforms and development in urban areas, remote locations or environmentally sensitive locations — by their nature customarily take a longer time to develop and therefore often do justify longer time periods, this determination must always take into consideration all of the facts and circumstances. No particular type of project per se justifies a longer time period, and any extension beyond five years should be the exception, and not the rule.

Factors that a company should consider in determining whether or not circumstances justify recognizing reserves even though development may extend past five years include, but are not limited to, the following:

- The company's level of ongoing significant development activities in the area to be developed (for example, drilling only the minimum number of wells necessary to maintain the lease generally would not constitute significant development activities);
- The company's historical record at completing development of comparable long-term projects;
- The amount of time in which the company has maintained the leases, or booked the reserves, without significant development activities;
- The extent to which the company has followed a previously adopted development plan (for example, if a company has changed its development plan several times without taking significant steps to implement any of those plans, recognizing proved undeveloped reserves typically would not be appropriate); and
- The extent to which delays in development are caused by external factors related to the physical operating environment (for example, restrictions on development on Federal lands, but not obtaining government permits), rather than by internal factors (for example, shifting resources to develop properties with higher priority). [Oct. 26, 2009]

#### Question 131.04

**Question:** The definition of "undeveloped oil and gas reserves" requires that the company have adopted a development plan with respect to the reserves. What constitutes adoption of a development plan?

**Answer:** The mere intent to develop, without more, does not constitute "adoption" of a development plan and therefore would not, in and of itself, justify recognition of reserves. Rather, adoption requires a final investment decision. [Oct. 26, 2009]

#### Question 131.05

**Question:** Would a company's decision to slowly develop a field in order to extend its economic life justify recognizing proved undeveloped reserves in the field beyond five years?

**Answer:** No. The company should not recognize undeveloped areas as proved undeveloped reserves if it does not anticipate initiating development in those areas within five years. [Oct. 26, 2009]

#### Question 131.06

**Question:** Rule 4-10(a)(31)(ii) states that "[u]ndrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are *scheduled to be drilled* within five years...." (emphasis added). In comparison, the Petroleum Reserves Management System of the Society of Petroleum Engineers and World Petroleum Council states that "[a] reasonable time frame for the *initiation of development* depends on the specific circumstances ..." (emphasis added). Is there a difference between the terms "scheduled to be drilled" and "initiation of development"?

**Answer:** No. [Oct. 26, 2009]

### Regulation S-K

#### Section 154. Items 1201-1208 — Disclosure by Registrants Engaged in Oil and Gas Producing Activities

##### Question 154.01

**Question:** For a recently drilled well, where there is only a limited amount of production data and the production rate is expected to decline in a hyperbolic manner but the evidence to date indicates only an exponential decline, can you assume that the production rate will eventually begin to decline in a hyperbolic manner and claim that as proved reserves?

**Answer:** Yes, but only at such time when additional production data, such as from offset wells, exists demonstrating that there will be a change in the manner of decline from exponential to hyperbolic. [Oct. 26, 2009]

##### Question 154.02

**Question:** Should reserve quantities attributable to equity method investees be combined with reserve quantities attributable to consolidated entities for purposes of identifying countries containing 15% or more of the registrant's reserves under Item 1202 of Regulation S-K.

**Answer:** Yes. [Oct. 26, 2009]

##### Question 154.03

**Question:** If an issuer engages a third party to prepare or audit its reserve estimates, or to conduct a process review, of a limited amount of its reserves, does it need to file the third party's report under Item 1202(a)(8) of Regulation S-K?

**Answer:** If the issuer discloses in its filing that it engaged a third party to prepare or audit its reserve estimates, or to conduct a process review, of a limited amount of its reserves, then the issuer must file the third party's report. [Oct. 26, 2009]

<http://www.sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm>

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