

SEC Correspondence: A Minefield of Information

Tom Gunningham

for SPEE European Chapter

Date: 28th March 2019

Consultants to the Petroleum industry

Disclaimer

All factual statements come from public data previously released/published/presented. The full public data should be reviewed and conclusions taken in context.

Opinions expressed are the speaker's alone and do not necessarily represent the views of Rockflow Resources Ltd

All Reserve and Resource Estimates carry a degree of risk and uncertainty

The information conveyed in the following presentation represents informed opinions about certain laws, regulations and interpretations but should not be considered as advice or counsel about any specific provision or topic. The applicability of the guidance provided herein should be considered on a case by case basis.



Outline

- SEC: Background and structure
- Rules and where to find them
- Other sources of SEC information
- What Comment Letters can and cannot demonstrate
- Examples of SEC investigations



SEC: Background

- Created in 1934 to:
 - Protect investors;
 - maintain fair, orderly, and efficient markets; and
 - facilitate capital formation.
- Monitors 35,000 companies in US
- 4,200 Employees
- Nominally 5 Commissioners all lawyers
- Petroleum Engineers in 2004?
- Petroleum Engineers in 2019?





Where to find data on the SEC rules

- Rule: 17 CFR 210.4-10 of Regulation S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934 is really a list of 32 oil and gas definitions.
 - Or Search for Title 17, Chapter II, Part 210.4-10 of the Code of Federal Regulations within https://www.ecfr.gov
- Many prefer the Modernization of O&G Reporting, with some explanation:
 - https://www.sec.gov/rules/final/2008/33-8995.pdf
- Also Compliance and Disclosure Interpretations:
 - https://www.sec.gov/divisions/corpfin/cfguidance.shtml
- Apart from SPEE website:
 - https://secure.spee.org/resources/reserves-definitions-committee-rdc

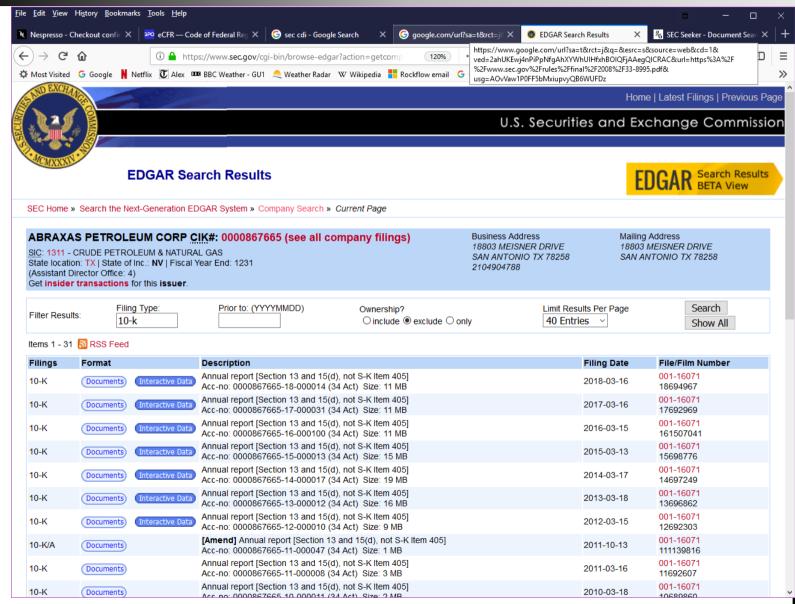


Other SEC data

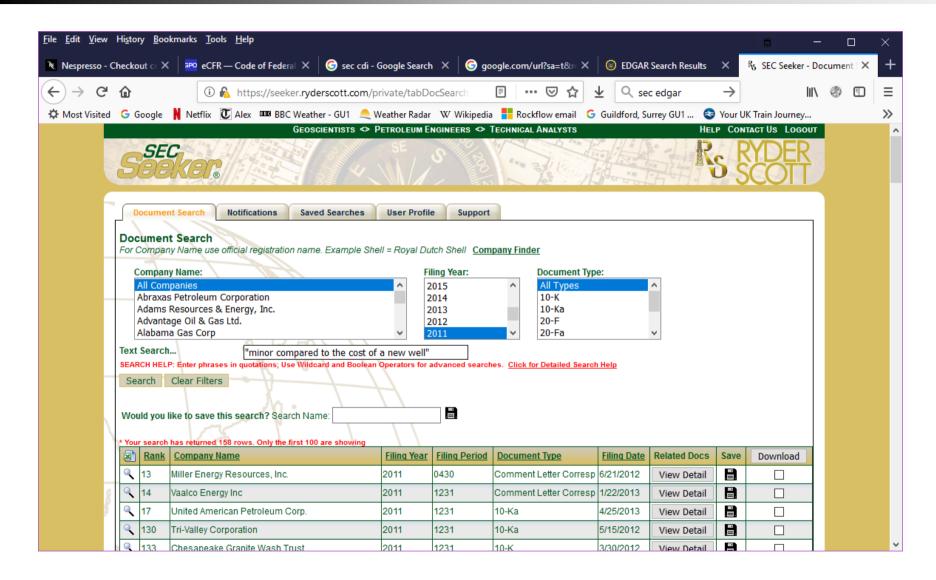
- Electronic Data Gathering and Retrieval System (EDGAR):
 - https://www.sec.gov/edgar/searchedgar/companysearch.html
- Or: Ryder Scott SEC Seeker (registration is free) but annual reports and comment letters only:
 - https://seeker.ryderscott.com/



SEC EDGAR Search Example



Use of SEC Seeker for text search example





Why be concerned with the SEC?

- Dozens of litigations since 2004 for oil and gas companies
- Many litigations are "Offering Frauds", with material misrepresentations, enticing people to buy shares

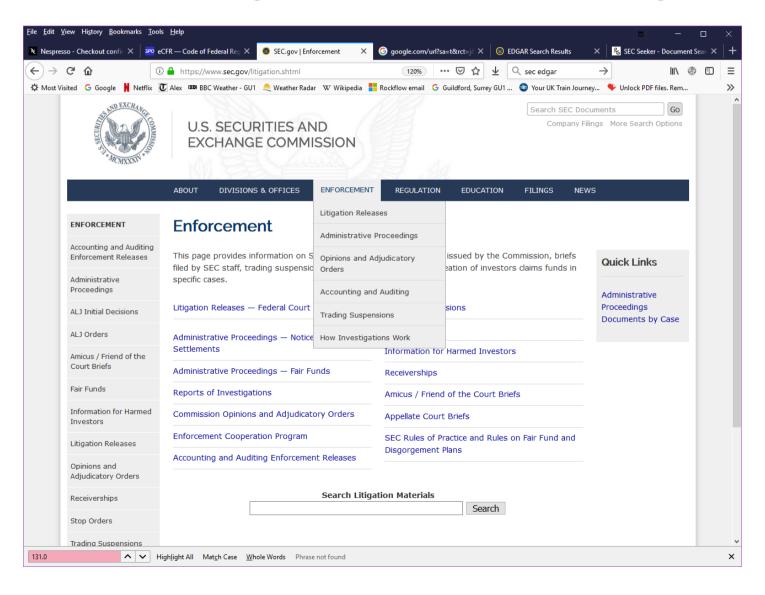


- Couple of Insider Trading cases in 2018
- One case of a company under-reporting flow rate estimates led to a fine of \$525 million
- SEC can challenge the company and key individuals. SEC can issue subpoenas for documents and people.
- And you may still be liable to the Department of Justice and/or Civil Actions



Where to find SEC data on investigations

• View Enforcements: Litigations and Administrative Proceedings:





Avenues of investigation

- SEC regularly send out comment letters of topics of interest to them (aka "hot buttons").
- SEC can send out specific questions arising from statements in annual/quarterly reports, particularly major changes.
- Any interested person could register a complaint concerning a company, which could initiate an investigation.
- The SEC has a large team of accountants/data analysts scouring through annual/quarterly reports looked for anomalous trends.
- SEC can initiate an internal investigation, resulting in Administrative Proceedings*.
- SEC can initiate a judicial enquiry, often via a Complaint* leading to a Litigation Release*.

[*which get published on the SEC site]



Can you rely on these sources of information?

C&Dl's:

- "These staff interpretations provide guidance to those who must comply with the federal securities laws. However, because they represent the views of the staff, they are not legally binding."
- "These interpretations reflect the views of the staff of the Division of Corporation Finance. They are not rules, regulations, or statements of the Commission. The Commission has neither approved nor disapproved these interpretations. These positions do not necessarily discuss all material information necessary to reach the conclusions stated, and they are not binding due to their highly informal nature. Accordingly, these positions are intended as general guidance and should not be relied on as definitive."
- Similar sentiments in Powerpoint disclaimers
- Comment Letters often finish with:
 - "We have completed our review of your filings. We remind you that our comments or changes to disclosure in response to our comments do not foreclose the Commission from taking any action with respect to the company or the filings and the company may not assert staff comments as a defense in any proceeding initiated by the Commission or any person under the federal securities laws of the United States."



SEC Comment Letters

- May have 4-8 letters to and from SEC and oil company
- Ending maybe similar to:
 - "We have completed our review of your filings and do not have any further comments at this time."
- You may have a problem when:
 - Correspondence extends beyond 12 months, and incorporates next year's report
 - SEC sign and cc: General Counsel
- You really do have a problem if SEC issue a "Wells Notice" (named after John Wells – not O&G specific)



SEC Reserves investigations

- Shell 2004: LR-18844
- El Paso 2008: LR-20642
- Miller Energy 2016: AP 33-10002, -89/90/91 (& PR 2017-142)
- Penn West Petroleum 2018: LR-24195
- Norstra Energy Inc 2015: LR-23290
- Centor Energy Inc 2018: LR-24209
- Plus 20-30 "Offering Frauds"



Case Study: Penn West Petroleum

- *** Case ongoing ***
- In July 2014, Penn West reported that it would restate its financial statements from 2012-2014.
- SEC allege that Penn West reclassified Opex as Capex (or royalties), resulting in lower Opex and increasing company's assets, although this seems to have been admitted.
- Correction led to 16-20% increase in reported Opex by Penn West's estimates.
- No connection with Reserves via ELT suggested.



Norstra Energy

- Microcap company
- SEC complained that Norstra's CEO made misleading claims to raise capital e.g.
 - "10,097 acres could hold as much a [sic] 8.5 billion barrels of original oil in place." acreage not yet acquired.
 - "SUCCESS RATE- 99% of all new wells drilled in the Bakken are profitable."
 - Lack of clarity that values for STOIIP are significantly greater than recoverable volumes
 - The Reserves Report was a "rough calculation" of STOIIP by a Geologist, who asked for corrections and disclaimers to be added when he saw his numbers made public. Website with claims was not changed for 6 months.
- Norstra fined \$3.1 million, two individuals fined \$50k & \$40k
 in 2016



Case Study: Miller Energy

- Miller Energy bought some Alaskan assets from a company in bankruptcy in 2009 for under \$5 million, in a competitive bid.
- Miller announced an increase in value of the company by \$480 million in 2010.
- SEC investigated. Comment letters and Administrative Proceedings.
- SEC found (by Jan 2016):
 - Asset value overstated. Miller used PV-10 as a measure of fair market value.
 - Miller double counted \$110 million of fixed assets, which were included within the PV-10 calculation.
 - Miller misled the Petroleum Consultancy, who performed the Reserves report, with knowingly low Opex and Capex estimates.
- SEC fined Miller \$5 million, 2 directors \$125k ea., and effectively disbarred two accountant auditors for 2-3 years (Via AICPA).



Case Study: Centor Energy Inc

- In Dec 2013, Centor signed an SPA for a 55% interest of a shale oil opportunity with 1C/2C/3C of 1.1-1.2-1.5 bn stb (gross)
- SEC complained that a presentation to shareholders was misrepresenting the 1.1+ bn stb as the Centor (net) share.
- Furthermore the resource assessment was stated to be independent, but in fact performed by the guy who retained the 45% remaining share.
- Claim upheld, Centor director fined ~\$31k (July 2018)
- 1. SEC filed charges about misleading statements in a PowerPoint presentation (8-K filings appear correct)
- 2. SEC filed charges about an asset with Contingent Resources hence SEC are not only interested in 1P Reserves, when C.R. are material to the company in question.

Conclusions

- SEC has the power to investigate and rule any company listed in the US.
- Investigations can lead to fines for a company, for individuals, and effective disbarment.
- Most SEC Comment letters finish with no further action.
- Some Comment letters require an amendment to annual/quarterly reports.
- And then again...
- Beware of what you tweet!







Thank you

Any Questions?

tom.gunningham@rockflow.com

CONSULTANTS TO THE PETROLEUM INDUSTRY