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RESERVES SET FOR BIG BOOST: SEC TO REVISE OIL & GAS DISCLOSURE REQUIREMENTS

SECURITIES LAW ALERT

This summer, the U.S. Securities and Exchange Commission (“SEC”) proposed new rules to its oil and gas reporting requirements to reflect the significant changes in technologies related to oil and gas reserve discovery and quantification made over the past several decades. ***The SEC’s proposed rules aim to provide investors with a more accurate picture of oil and gas reserves that companies hold and will likely result in a boost to the reserves reported by the many publicly-traded oil and gas companies that are regulated by the SEC.***

“The ability to accurately assess proved reserves is an important part of understanding any energy company’s financial position,” said SEC Chairman Christopher Cox. “But the current oil and gas disclosure rules often interfere with an investor’s analysis because they are tied to outdated technologies.”

The proposed revisions are as follows:

- **Oil Sands to be Classified as Reserves:** Previously excluded resources, such as oil sands, are to be classified as reserves. The current SEC rules limit oil and gas firms to reporting only proved reserves from conventional sources. This approach excludes oil shale, oil sands, and other potentially rich sources of oil and gas. At this time, these resources are considered to be mining reserves. The proposed new rules would shift the focus of oil and gas producing activities to the final product of such activities, regardless of the extraction technology used. Consequently, bitumen, oil, and gas extracted from oil sands, coalbeds, and shales would be reported as oil and gas reserves. ***Reclassifying the estimated 175 billion barrels of oil contained in the Canadian oil sands as oil reserves instead of mining reserves will have a significant impact to the balance sheets of the numerous energy companies currently invested in Canada’s oil sands.***
- **New Technologies to be Allowed to Prove Reserves:** As it now stands, the SEC requires that a company determine its proven reserves based on the results of production or flow testing from actual wells and appraisal drilling. The proposed revisions would permit use of new technologies to determine reserves. For instance, they would allow for the use of three-dimensional seismic interpretation tools that make it easier to locate and estimate new energy sources. Companies will have to show that the new technologies have been demonstrated empirically to lead to reliable conclusions about reserves volume.

This Alert provides only general information and should not be relied upon as legal advice. For more information, contact your Patton Boggs LLP attorney.

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- **Disclosure of Probable Reserves to be Allowed:** Currently, oil and gas companies report only estimated proved reserves to the SEC. Under the proposed new rules, companies will also be permitted to voluntarily disclose probable reserves and possible reserves. Companies often use these reserves as a basis for decisions to invest in resource development. Permitting disclosure of probable and possible reserves enables companies to provide investors with more insight into the potential reserves base.
- **Oil and Gas Reserves to be Priced using Average Price based on Last 12 Months:** The current pricing method specified by the SEC uses prices based on a single day at year-end. Many in the industry believe that this pricing method is volatile and outmoded, and it does not reflect the basis of business decisions. Under the new proposed rules, reporting will be based upon the average price during a company's last 12-month fiscal period rather than year-end prices. This will maximize the comparability of reserve estimates among companies and mitigate the distortion of the estimates that arises when using a single pricing date.
- **Disclosure of Qualifications of Auditor of Reserve Estimates to be Required:** The new rules would require disclosure regarding the independence and qualifications of the person primarily responsible for preparing the reserves estimates or conducting a reserves audit, based on current Society of Petroleum Engineering data. Due to the proposal to broaden permissible technologies for establishing reserves volume, a heightened level of judgment was deemed appropriate to ensure the proper application of new technologies. If a company uses an independent third-party to prepare reserves estimates or conduct reserves audits, additional disclosures regarding the objectivity of the third-party will be required.

The foregoing is only a highlight of the proposed SEC rule (Release Nos. 33-8935 and 34-58030, originally issued as a Concept Release in December 2007), which can be found at <http://www.sec.gov/news/press.shtml>. The final rule may be in place as early as the end of the year.

Please contact Michael Smith of Patton Boggs LLP at 646.557.5120 if you would like more information on the new rule and its anticipated consequences.

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