



Update on SEC Five-Year Rule

Ryder Scott 2011 Reserves Conference

16 September

John Lee

University of Houston



Where Does the 5-Year Rule Appear?

- Answer: In the SEC's definition of undeveloped oil and gas reserves [S-X 4-10(a)(31)]




Undeveloped Oil and Gas Reserves [4-10(a)(31)]

- Undrilled locations classified as having (proved)* undeveloped reserves only if development plan has been adopted indicating they are to be **scheduled to be drilled within five years** unless **specific circumstances** justify longer time

* Author's Comment: Not in definition; reported to be staff position in teleconferences. **Exempts probable, possible reserves from 5-year rule.**

Undeveloped Oil and Gas Reserves [4-10(a)(31)]

Guidance (Question 131.03 in 26 Oct 2009 CD&I)



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. (continued following)

Undeveloped Oil and Gas Reserves [4-10(a)(31)]

Guidance (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: (cont'd) 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; **(continued following)**

Undeveloped Oil and Gas Reserves [4-10(a)(31)]

Guidance (Question 131.03)

- 
- **Answer: (cont'd)** 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]



Development Project [4-10(a)(8)]

- Means by which petroleum resources brought to status of “economically producible”
 - Examples
 - development of single field
 - incremental development in producing field
 - integrated development of group of several fields and associated facilities with common ownership
-

Development Project [4-10(a)(8)] Guidance

(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.

*Author's comment: staff may have meant 'development capital.'



Possible Interpretation of Guidance

- In North American onshore resource plays, drilling programs for individual wells or wells associated with common facilities are stand-alone projects
 - Development of entire economically productive areas, requiring substantially more than 5-years, will rarely, if ever, be exempt from the five-year rule
-

Examples from Recent Comment Letters:

Specific Circumstance Not Approved

- BP-19 July 2010-Comment Letter from SEC about bookings beyond 5 years
 - Responses 12 August, 14 December 2010
 - Arguments used
 - Volumes satisfy rule 4-10 criteria
 - Final investment decision made
 - Significant ongoing activity in each field
 - Historical company track record of completing large projects
 - Followed previously adopted development plan
 - Development constrained by facilities, rig availability, sales contracts
 - Drilling halt would cause significant loss of capital, return on capital

Specific Circumstances Not Approved

(Cont'd)

- Ultimate results
 - SEC asked BP to remove PUD reserves from filing for four of five fields, and asked for additional information on fifth field
 - BP, on 11 February 2011, agreed to remove PUD reserves not to be developed within five years of booking **from all five fields**



Specific Circumstances Approved

- Chevron-31 March 2010-Comment letter from SEC
 - Response 10 April 2010
 - Large scale projects in remote locations, challenging operating environments, external physical factors, no shifting of resources to higher priority projects
 - Locations: Kazakhstan, Venezuela, Nigeria and Angola (deep water), Philippines, Indonesia
-



Specific Circumstances Approved (Cont'd)

- Chevron (cont'd)-13 April 2010 response
 - In general, major projects include (1) infrastructure-dominated assets and (2) well-dominated assets
 - Infrastructure investments cannot change scale without potential significant potential loss of capital
 - Drilling programs can be accelerated or delayed without loss of previously invested capital or loss of return on capital
- No further objections by SEC



Specific Circumstances Approved (Cont'd)

- Marathon – 8 April 2010 Comment Letter – Equatorial Guinea
 - Response: 30 April 2010
 - Facilities-limited production in remote location
 - No further objections by SEC
-



Others with no Further Objection

- ConocoPhillips – SAGD in oil sands
 - Facilities limit
- Apache – Permian Basin, Gulf Coast onshore
 - Basis unclear



Tentative Conclusions

- SEC accepts arguments of infrastructure limits, especially in remote locations
 - SEC does not accept multiwell drilling programs in resource plays as single projects or as qualifying for exemption to five-year rule
-



Update on SEC Five-Year Rule

Ryder Scott 2011 Reserves Conference

16 September

John Lee

University of Houston

End