Marc Folladori

By the numbers, No. 1 issue of SEC comment letters: Reasons for changes in oil and gas reserves not specific enough

In September, **Marc Folladori**, then senior counsel at Haynes & Boone LLP, told the audience at the Ryder Scott reserves conference that the topic receiving the most comment letters from the U.S. Securities and Exchange Commission was treatment of annual changes in net quantities of total proved reserves as required by FASB ASC 932-235-50-5.

"The staff criticized many companies for their unsatisfactory explanations of reasons for annual changes in total reserves and PUDs," he said. "Where there were significant changes in categories — such as extensions, discoveries and revisions — the staff often asked for separate identification and quantification of each factor that contributed to significant changes."

Folladori annually tracks and documents SEC comment letters to oil and gas companies. For the most part, he said that SEC comments during 2017-2018 were similar to those issued the previous period.

The five-year rule for booking proved undeveloped reserves (PUDs) continued to be the subject of a good number of comments. SEC definitions require that undrilled locations can be classified as having PUDs if the company's adopted development plan indicates those locations are scheduled to be drilled within five years of their initial disclosure as PUDs.

Folladori said that in cases where a relatively large component of a company's PUDs were associated with drilled-but-uncompleted (DUC) wells, the SEC staff interpreted the "scheduled to be drilled" language to mean that wells to be drilled on those locations must be completed, and the PUDs related to those locations must be converted to developed status within five years.

The SEC also indicated in comment letters that if a company wasn't annually on track to develop its PUDS in five years or made limited progress in PUD conversions, the agency asked the company to provide support that it would meet its adopted development plan.

If the company was holding undeveloped acreage assigned to leases scheduled to expire in the near term, then SEC staff asked for explanation of the total PUDs assigned to those leases and the company's plan to extend expiration dates.

The SEC staff often inquired whether calculations of standardized measures took into account cash outflows for estimated asset retirement obligations.

FASB (Financial Accounting Standards Board) guidance requires separate disclosure of natural gas liquids (NGLs) reserves if the NGL quantities are significant, said Folladori.

"It appears that the SEC staff often construes 'significant' in this regard to mean the NGL reserves quantities equal or exceed 10 percent of a company's total proved reserves," remarked Folladori.

His and other conference presentations are posted on the Ryder Scott website at www.ryderscott.com/presentations/.

U.S. industry has bright outlook for prices and RBL

The latest survey from Haynes and Boone law firm offers a promising outlook for U.S. oil and gas producers seeking to maintain or increase their reserves-based lending (RBL) lines of bank credit.

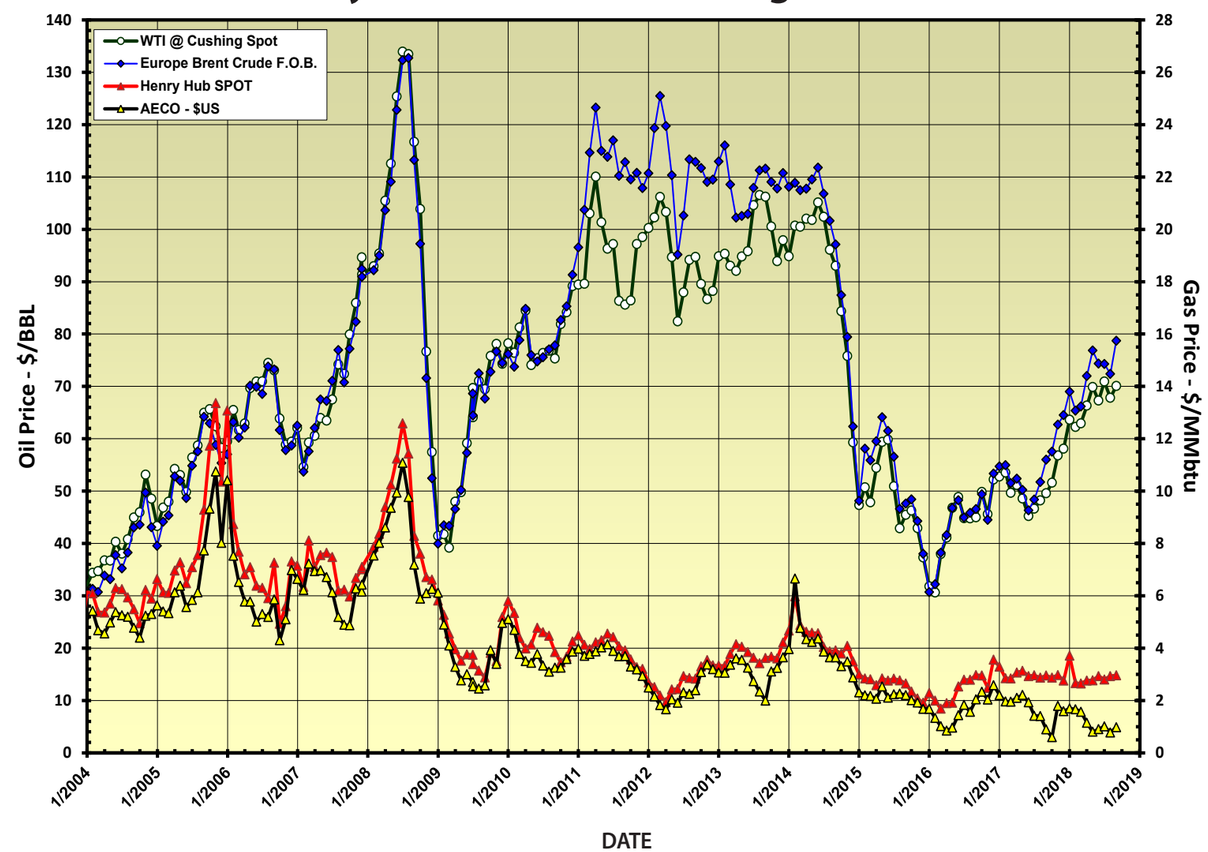
More than 78 percent of the 123 respondents expected borrowing bases to increase. Furthermore, 36 percent expect borrowing bases to increase by 20 percent or greater, which is consistent with the prior survey in April. Haynes & Boone polled producers, oilfield services companies, energy lenders, private equity firms and other industry participants and released the survey Sept. 26.

It can be accessed through a link in the press release at http://www.haynesboone.com/Press%20Releases/2018-fall-energy-roundup. Banks assess their loans twice a year to determine how much credit will be available based on the collateral values of oil and gas properties. Borrowing bases shift based on bank projections of estimated future oil and gas prices.

Other key findings from the survey were as follows:

- Strong oil prices are leading borrowers to hedge oil prices. Two-thirds of respondents indicate that borrowers have locked in prices for the majority of their 2019 production.
- Producers are expected to use cash flow from operations, bank debt, and private equity as their primary sources of capital in 2019.
- Midstream capacity constraint was, by far, the most frequently cited concern by respondents, outranking concerns related to services costs and commodity price volatility.

Price history of benchmark oil and gas in U.S. dollars



Published, monthly-average, cash market prices for WTI crude at Cushing (NYMEX), Brent crude and Henry Hub and AECO gas.