Monday, June 6, 2016 2016 SPEE Technical Session I  Salon I/II

8:30 AM The SEC Reserve Reporting Standards: Challenges of a Lower-for-Longer Price Environment, Facts and Circumstances to Consider John Hodgin

This presentation will examine the implications of the continuing low-price environment on a company’s ability to obtain financing and the impact that access to capital has on the classification and disclosure of a company’s undeveloped reserves.

As part of this discussion, we will review the relevant definitions and disclosure requirements related to undeveloped reserves with a particular focus on the issues relating to a company’s ability to fund its projects under Rule 4-10(a)(26) of Regulation S-X.

BIOGRAPHY
John Hodgin – Petroleum Engineer – SEC

John E. Hodgin is a Petroleum Engineer in the Office of Natural Resources, Division of Corporation Finance of the United States Securities and Exchange Commission in Washington, D.C.

Prior to joining the SEC in July 2012, Mr. Hodgin held a number of positions with Ryder Scott Company Petroleum Consultants in Houston, Texas. He served as the Managing Senior Vice President of the Geoscience Group, Corporate Executive Vice President and was elected President of Ryder Scott in 2005. John started his career with Gulf Oil Corporation where he was a development geologist in the New Orleans Division.

Mr. Hodgin earned a BS degree in Geology from Texas A&M University and is a licensed Professional Geologist and a licensed Professional Engineer in the State of Texas.

John has authored or co-authored a number of SPE, AAPG and Offshore Technology Conference (OTC) papers and has been published in Accounts, a publication of the Council of Petroleum Accounting Societies (COPAS), the Landman, a publication of the American Association of Professional Landmen (AAPL) and in the E-Section Report, a publication of the Oil, Gas & Energy Resources Law Section of the State Bar of Texas, on reserves related topics.

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The SEC Reserve Reporting Standards

Challenges of a Lower-for-Longer Price Environment
Facts and Circumstances to Consider

Presented By
John Hodgin
June 6, 2016
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Challenges of a Lower-for-Longer Price Environment

Today’s Presentation Will Focus on Rule 4-10(a)(26): “financing required to implement the project”
Introduction

This presentation will examine the implications of the continuing low-price environment on a company's ability to obtain financing and the impact that access to capital has on the classification and disclosure of a company's undeveloped reserves.

As part of this discussion, we will review the relevant definitions and disclosure requirements related to undeveloped reserves with a particular focus on the issues relating to a company's ability to fund its projects under Rule 4-10(a)(26) of Regulation S-X.

To facilitate our discussion, we present two hypothetical scenarios reconciling the changes in a company's undeveloped locations from one reporting period to the next.

Our first illustration describes a hypothetical scenario in which our example company proposes to revise the development plan used in the reserve report as of December 31, 2014 to reschedule undrilled 2015 proved undeveloped locations to new dates. Our example begins with an examination of the proved undeveloped locations scheduled in the reserve report as of December 31, 2014, reconciles the number of previously scheduled locations to the number of locations actually drilled during the year, analyzes the company's liquidity and capital resources, and reviews the relevant definitions and disclosure requirements leading to adoption of a revised development plan and schedule for use in the reserve report as of December 31, 2015.

Our second illustration describes a hypothetical scenario in which our example company proposes to revise the development plan and schedule used in the reserve report as of December 31, 2014 and reclassify the undrilled 2015 proved undeveloped locations to probable undeveloped. Our example incorporates a review of the company's liquidity, capital resources and the relevant definitions and disclosure requirements leading to adoption of a revised development plan and schedule for use in the reserve report as of December 31, 2015.

Our examples present a limited set of hypothetical scenarios for illustration purposes. Each company's particular facts and circumstances will impact its estimation and disclosure of undeveloped reserves from one reporting period to the next.

The presentation also examines the relevant definitions and disclosure requirements related to the disclosure of drilled uncompleted wells and the internal controls relating to the undeveloped reserves.
What is the company’s particular “story?”
Challenges of a Lower-for-Longer Price Environment
Facts and Circumstances to Consider

Illustration One
Reconcile the Previously Disclosed PUDs

Reserve Report
as of
December 31, 2014

Proved Undeveloped Grand Summary
As of
December 31, 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Loc</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>10</td>
</tr>
<tr>
<td>2016</td>
<td>10</td>
</tr>
<tr>
<td>2017</td>
<td>10</td>
</tr>
<tr>
<td>2018</td>
<td>10</td>
</tr>
<tr>
<td>2019</td>
<td>10</td>
</tr>
</tbody>
</table>

Scheduled Locations

2015 Actually Drilled PUD Locations

What about the 6 undrilled PUD locations?
Perform an Analysis of the Liquidity and Capital Resources Relating to Funding

➢ Does the company have enough capital/liquidity available to do the things they say they will do?
  – Capex
  – Debt servicing
  – Dividends or cash distributions

➢ What is the status of the company’s credit facilities/debt?
  – Fully drawn or remaining availability?
  – Risk of borrowing base redetermination?
  – Compliance with covenants at risk?
If Funding Is Available, Conduct a Review of the Relevant Definitions and Disclosure Requirements

2015 Undrilled Prior PUD Locations

Rule 4-10(a)(26)

Rule 4-10(a)(10)

Rule 4-10(a)(31)(ii)

C&DI 131.04

Revised Development Plan and Schedule
Complete the Requirements Check List

2015 Undrilled Prior PUD Locations

Revise Development Plan and Reschedule PUDs to New Date

Requirements Check List

- Rule 4-(10)(a)(26)
- Rule 4-(10)(a)(10)
- Rule 4-(10)(a)(31)(ii)
- C&DI 131.04
Revise and Adopt a New Development Plan and Schedule

Reserve Report
as of
December 31, 2015

2015 Undrilled Prior PUD Locations

Revise Development Plan and Reschedule PUDs to New Date

Calendar

1 2 3 4
5 6 7 8 9 10 11
12 13 14 15 16 17 18
19 20 21 22 23 24 25
26 27 28 29 30 31
Challenges of a Lower-for-Longer Price Environment

Facts and Circumstances to Consider

Illustration Two
What if the Company Proposes to Simply Change the Reserve Category?

Reserve Report as of December 31, 2015

2015 Undrilled Prior PUD Locations

Revise Development Plan and Reclassify PUDs to Probable
2015 Undrilled Prior PUD Locations

Revise Development Plan and Reschedule PUDs to Probable

Requirements Check List

- Rule 4-(10)(a)(26)
- Rule 4-(10)(a)(10)
- Rule 4-(10)(a)(31)(ii)
- C&DI 131.04
Other Requirements to Consider

2015 Undrilled Prior PUD Locations

Prior PUDs Reclassified to Probable Undeveloped

Rule 4-(10)(a)(31)(ii) “Scheduled to be drilled within five years”*
*Exceptions for nonproved considered

C&DI 131.04
What if Financing Is Not Available?

**Reserves**

- **TOTAL PETROLEUM INITIALLY-IN-PLACE (PIIP)**
  - DISCOVERED PIIP
    - PRODUCTION
      - **RESERVES**
        - Proven
        - Probable
        - Possible
    - CONTINGENT RESOURCES
      - 1C
      - 2C
      - 3C
    - UNRECOVERABLE
  - SUB-COMMERCIAL
    - UNRECOVERABLE
  - UNDISCOVERED PIIP
    - **PROSPECTIVE RESOURCES**
      - Low Estimate
      - Best Estimate
      - High Estimate
    - UNRECOVERABLE

**Range of Uncertainty**

**Increasing Chance of Commerciality**

**Rule 4-10(a)(26)**

“financing required to implement the project”

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[Diagram showing the categories and estimates of reserves, probabilities, and commercial chances.]

Not to scale
What About Drilled Uncompleted Wells?

Where are your DUCs?

- Rule 4-(10)(a)(26)
- Rule 4-(10)(a)(10)
- Rule 4-(10)(a)(31)(ii)

- Scheduled within five years of initial disclosure as PUDs
- Items 1203(c) and 1203(d)

- C&DI 131.04
Examine the Internal Controls Relating to Your Undeveloped Reserves

- **C&DI 131.03**

  - “the extent to which the company has followed a previously adopted development plan”
  - “internal factors (for example, shifting resources to develop properties with higher priority)”

- **Item 1202(a)(7) of Regulation S-K**

  - “internal controls the registrant uses in its reserves estimation effort”
Issues Relating to a Lower-for-Longer Price Environment

• What is the company’s particular “story?”

- **Rule 4-10(a)(26) of Regulation S-X**
  - “financing required to implement the project”

- **Rule 4-10(a)(31)(ii) of Regulation S-X**
  - “development plan has been adopted”

- **C&DI 131.04**
  - “mere intent to develop”

- **C&DI 131.03**
  - “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”
Facts and Circumstances to Consider

Today’s Discussion
- Applies to previously disclosed proved, probable and possible reserves, changes therein, and any newly added proved, probable and possible reserves
Questions?
Reference Documents

1 Division of Corporation Finance: Regulation S-K Subpart 229.1200 [17 CFR Part 229];

2 Financial Accounting Standards Board: Extractive Activities-Oil and Gas (Topic 932), Oil and Gas Reserve Estimation and Disclosures

3 Securities and Exchange Commission: Modernization of Oil and Gas Reporting; Final Rule [17 CFR Parts 210, 211 et al.]

4 Division of Corporation Finance: Compliance and Disclosure Interpretations; Issued Oct. 26, 2009; Updated May 16, 2013
http://sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm

5 Securities and Exchange Commission Statement about Management’s Discussion and Analysis of Financial Condition and Results of Operations
https://www.sec.gov/rules/other/33-8056.htm

6 Securities and Exchange Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations
https://www.sec.gov/rules/interp/33-8350.htm

Acknowledgements

Clipart
- Obtained from PresenterMedia
  - http://www.presentermedia.com

Commodity Prices
- SEC first-day-of-the-month and 12-month average prices
  - Obtained from Ryder Scott Company