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Houston  
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**2008 Ryder Scott Reserves Conference  
Evaluation Challenges in a Changing World**

**“Booking Reserves in the Rising Wave of Nationalism”**

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# Agenda



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- Recent Events
- SEC Reserves Bookability Criteria
- Fiscal Terms and Economic Method
  - PSC
  - Risked Service Contracts
- Example: Pemex

# *Before We Start*



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- The views expressed in this presentation are based on Ryder Scott Company's experience and may or may not be consistent with a ruling or interpretation that the SEC may eventually take on these matters.
- This presentation is intended to bring attention to recent events in the industry and generate some discussion.

# The Rising Wave



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“Booking Reserves in the Rising Wave of Nationalism”

## The St. Petersburg Times

Issue #1370 (34), Tuesday, May 6, 2008

MOSCOW — The government warned a unit of TNK-BP that it might lose oil-production rights after “gross violations” of licensing terms were found during an inspection.



Bolivia takes over four oil companies and one communication enterprise (updated)

Caracas, Venezuela, 1 May 2008. Today, the Bolivian government of Evo Morales Ayma formally nationalized four oil companies: Transredes (Shell), Andina (Repsol), Chaco (BP) and CLHB (British Ashmore Energy). From now on they will be under the direct control of the National Bolivian Oil Company - Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).



**"Venezuela Moves to Nationalize its Oil Industry"**

Latin America's shift from the Western sphere of influence and toward an independent path is a major current of the recent years.

## *In Defense of Marxism*

05 October 2005

### **49% of Canadians Support Nationalizing Oil Industry**

*In a recent poll. 49% of Canadians (and 67% of Quebecers) support nationalizing the oil industry.*

## **Red Menace**

April 12, 2007

***Leo-Paul Lauzon was a candidate for the NDP in the riding of Outremont in Montreal. He made the news during the last federal election for his vocal support of President Hugo Chavez, for his defense of the Cuban Revolution and for his support for the nationalization of oil.***

# Common Wisdom for Determining Bookability of reserves



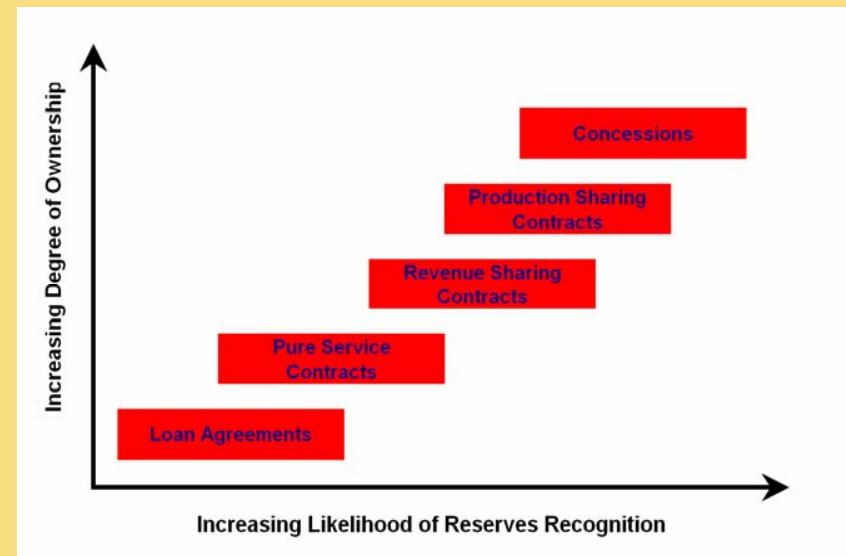
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## The Criteria

A full copy of this Statement can be found in: <http://www.fasb.org/pdf/SFAS 69.pdf> and <http://www.fasb.org/pdf/SFAS 19.pdf>

Criteria that supports the recognition of proved reserves or property indicators (SFASB 69 & 19):

- To have a clear mineral interest
- The right to extract oil and gas
- The right to take volumes in kind
- Exposure to risk and potential reward





## Key Question:

- Can a company book SEC reserves when the host government has explicitly declared whole ownership of those reserves?

## Guidance:

SFAS19 11.a Mineral interests in properties

- Properties include those agreements with foreign governments or authorities in which an enterprise participates in the operation of the related properties or otherwise serves as “producer” of the underlying reserves.
- In March 31, 2001, the SEC Staff Clarified:  
*“Under Production Sharing Agreements, a host government typically retains the title.... the economic interest method is the method acceptable to the staff because it is a closer representation of the actual reserve volume entitlement that can be monetized by a company.”*





## Guidance:

### SFAS69 Paragraph 102

- Some governments have nationalized or otherwise taken over, in whole or in part, certain properties in which oil and gas producing enterprises previously had mineral interests.
- In some countries, oil and gas producing enterprises can obtain access to oil and gas reserves only through such agreements and not through direct acquisition of mineral interests.
- If an oil and gas producing enterprise participates in the operations of a property....The fact that the reserves are available to an enterprise requires their inclusion to have a complete presentation of the enterprise's reserve position.

### SFAS69 Paragraph 104

- Certain governments restrict the disclosure of reserves located within their jurisdiction....Therefore, the Board decided to require disclosure of the existence of any governmental restriction..

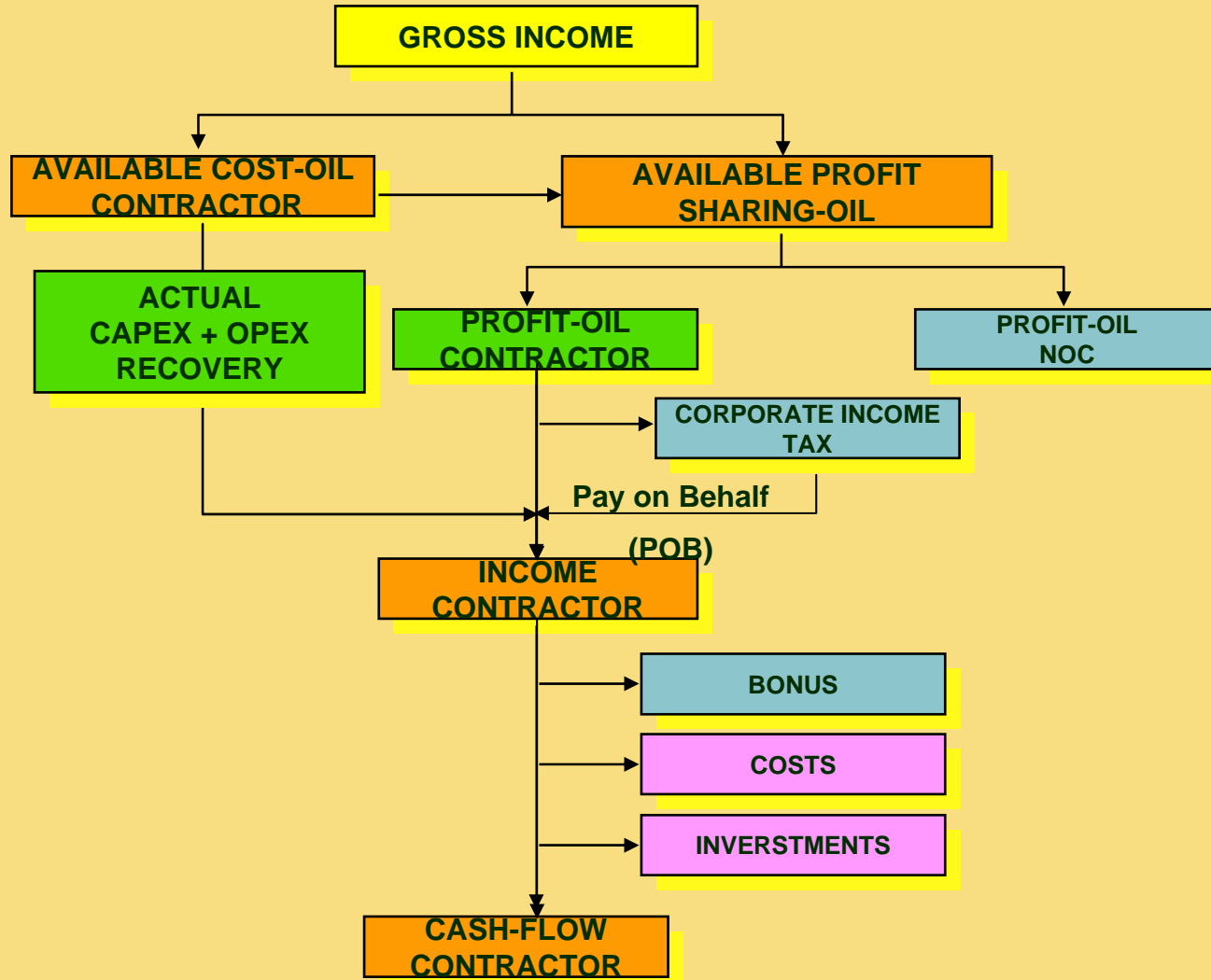


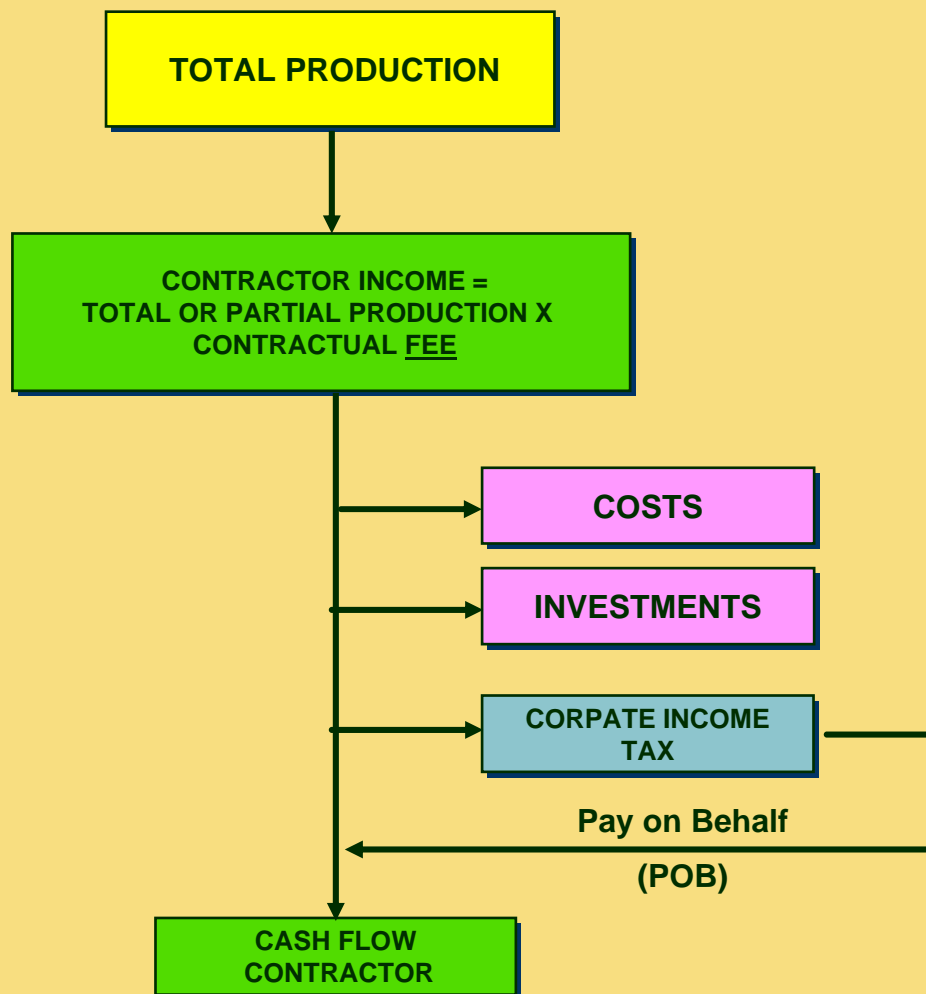
## Opinion:

- Clear Mineral Interest can be defined as Economic Interest if:
  - E&P enterprise participates as the “producer”
  - Economic outcome is tied to the results of operations
- Right to take volumes in kind reinforces bookability but is not always an option.
  - For example hydrocarbons restricted to domestic markets.
  - Look for custody transfer points.
- Estimate reserves using Economic Interest Method

- Which fiscal terms?
  - Use fiscal terms in effect on the as-of-date of the evaluation.
  - Review bookability of reserves under the new contract.
  - Incorporate new fiscal terms on the scheduled date for a change in contract.
- How about political risk?
  - If agreements are imminent proceed as discussed above.
  - If agreements are uncertain and/or confiscation is possible, reserves should not be booked beyond negotiations deadline.
    - Contingent Resources

# Typical Production Sharing Contract







- Does the company participate in E&P activities?
- Are the company's income subject to risk from the outcome of the E&P activities?
- Is this a traditional concession?
  - Yes, then net interest most likely working interest minus royalties.
  - If royalties are paid in cash, not in kind, then they may also be included as reserves.
- Is this a contract other than a concession?
  - What are the contractor's sources of revenue?
  - Entitlement barrels based on revenue divided by price
- Is the concession / contract stable at the as-of-date?
  - Yes, then reserves may be bookable.
  - No, consider contingent resources.

**As way of conclusion, let us explore the following example:**



***Recent demonstrations in Mexico against privatization of PEMEX.***



- Contract Obligations
  - Conduct geological, geophysical, reservoir and production engineering works.
  - Conduct field development, infrastructure and maintenance activities.
  - Responsible for all costs, damages and liabilities related to E&P operations.
  - Obligation to transfer the hydrocarbons at a predetermined Transfer Point (no volumes in kind).
- Contract Remuneration
  - Contractor is remunerated based on pre-determined fees based on activity type, production success and outcome of E&P activities. Cost recovery dependant on success and is not guaranteed.



- Can SEC reserves be booked?
  - Participation as producer? -- YES
  - Derive and economic interest? -- YES
  - Exposure to E&P technical, environmental & commercial risks? -- YES
  - Right to take volumes in kind? -- NO, but operator controls the hydrocarbons until delivered to a specified custody transfer point

- Arguably, the contract contains the fundamental elements required to book reserves under the reporting requirements of the SEC using the economic interests method.

- The



- Contract contains strong language describing that the Contractor will not be the proprietor of the production or the reserves. – OK, no problem?
- Contract may contain language barring company from booking reserves. -- ?



*Thank you*

*Questions & Discussion*