

SEC Compliance

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But...

Goal of Today's Presentation

- I. Clarify the role of the SEC
- II. Demystify the SEC review process
- III. Touch on some of the more fundamental issues underlying the SEC disclosure requirements regarding reserves

Role of the SEC: Why are reserves the SEC's business?

The Securities Act of 1933

- Required that investors receive **financial and other significant information** concerning securities being offered for public sale; and
- Prohibited deceit, misrepresentations, and other fraud in the sale of securities.



Role of the SEC: Why are reserves the SEC's business?

The Exchange Act of 1934

- Created the SEC;
- Empowered the SEC to *require periodic reporting* of information by companies with publicly traded securities.



Role of the SEC: Why are reserves the SEC's business?

The Energy Policy and Conservation Act of 1975

Directed the SEC “to take such steps as may be necessary to assure the ***development and observance of accounting practices*** to be followed in the preparation of accounts by persons engaged, in whole or in part, in the ***production of crude oil or natural gas*** in the United States.”



Role of the SEC: Why are reserves the SEC's business?

Sarbanes-Oxley (SOX) Act of 2002



- Mandated the SEC review the periodic filings of all public companies on a regular basis.

Any Questions?

The SEC Review Process

Who and What is Involved?

What are the Steps of the Review Process?

The SEC Review Process: Impact of SOX

SEC. 408 of Sarbanes Oxley (2002)

- (a) The Commission shall review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 ...
- (c) ***In no event*** shall an issuer required to file reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 be reviewed under this section ***less frequently than once every 3 years.***

The SEC Review Process

Review of annual reports on Form 10-K or 20-F

- The filing will receive at a minimum an accounting review. There may also be an engineer and an attorney assigned as well.
- There will be at least two levels of review for each discipline.

The SEC Review Process

Step One: Identifying Issues

What does the staff consider?

- The company's disclosures in its 10-K, 10-Qs and 8-Ks
- The issues considered in prior reviews
- Publicly available information about the company such as the Annual Report to Shareholders, press releases, analysts' reports, analysts' calls, press articles, etc.

The SEC Review Process

- If the staff has no issues or questions, then no comments are issued. It is the Division's policy to only advise the company if it has comments.
- If the staff does have questions, it will issue a "comment letter."

The SEC Review Process

Comments may:

- **Identify omissions** or other areas where it believes that the company needs to **revise its disclosure**;
- Identify areas where the **disclosures are unclear** and ask for further clarification as to what the company is trying to say or how it determined that the disclosure complies with the requirements;
- Ask for **supplemental support or documentation** on a specific matter (Rule 12b-4 of the '34 Act)

The SEC Review Process

Two Observations:

- **Not trying to play “gotcha.”** The goal is to help you provide a better document that is more useful and informative for shareholders and potential investors. In the end, it is the company’s document and it has liability for what it contains.
- If you **do not understand** the staff’s comment, contact the staff.

The SEC Review Process

- The staff will ask you to **respond within 10 business days**. If you need more time...
- If you are asked to revise your disclosure, but you feel it is not warranted, **explain why in writing**. You may have information that will shine a light and explain why you do not feel such a revision is appropriate.

The SEC Review Process

The staff will consider your response.

- It may accept it and not pursue the issue further;
- It may ask for additional information; or
- It may reissue the comment explaining why it does not find the company's explanation persuasive.

The SEC Review Process

What if some of your response is confidential?

Availability of Rule 83 (FOIA)

- If you want parts of your response to be treated as confidential, you may request treatment under Rule 83 of FOIA.
- A few cautions:
 - You must follow the procedures set forth on the SEC website (<https://www.sec.gov/foia/conftrat.htm>). Failure to do so may jeopardize keeping that information confidential. You cannot request Rule 83 after the fact.
 - Your request should be specific, not overly broad.

The SEC Review Process

Return of supplemental information (Rule 12b-4 of the '34 Act).

- For example, maps, logs, etc.
- You can ask to have the information returned to you after the review is over.

The SEC Review Process

Return of supplemental information (cont.)

Two cautions:

- Must make this request when you provide the information.
- Staff has to determine that return of such information is consistent with the protection of investors.

The SEC Review Process

Possible outcomes of comment process:

1. All staff concerns are resolved and no amendment or future revisions are deemed necessary;
2. No amendment is deemed appropriate but the staff and company agree on revisions to future disclosure;
3. Amendment is deemed appropriate and the company is asked to file the amendment within ten business days or;
4. Reconsideration

The SEC Review Process

Closing Out the Review

- Staff will issue a letter advising the company that it is closing out the review.
- Correspondence pertaining to the review will be made public on EDGAR *no earlier than 20 business days* the completion of the review.
- **Rule 83** information is redacted but still subject to FOIA request

The SEC Review Process

Any questions?

SEC Reserves Requirements

Prior to 1978:

- Oil and gas disclosure requirements were contained in various different forms
- Some of the Commission's first Enforcement cases involved companies in the extractive industries

SEC Reserves Requirements

- Importance of the EPCA -> Congress specifically directed the Commission:

“To take such steps as may be necessary to assure the ***development and observance of accounting practices*** to be followed in the preparation of accounts by persons engaged, in whole or in part, in the ***production crude oil or natural gas*** in the United States.

- To be done in coordination with the FASB.

SEC Reserves Requirements

As a result, definition of oil and gas producing activities, reserves etc. -> Regulation S-X -> GAAP

SEC Reserves Requirements

Chronology of the SEC Rules for Oil and Gas Producing Activities
Since the EPCA

1978-2008 -> Very specific disclosures

- Defined oil and gas producing activities
- Specified acceptable technologies and methodologies of extraction
- Only proved reserves may be disclosed
- Valuation -> One day's price

SEC Reserves Requirements

Concept Release December 2007

Proposing Release June 2008

Adopting Release December 2008

SEC Reserves Requirements

Modernization of the Oil and Gas Reporting Rules

- Principles-based
- Rule 4-10 of Regulation S-X was updated and expanded
- More transparency
- Industry Guide 2 was updated, expanded and moved into in Regulation S-K

SEC Reserves Requirements

Some of the key changes:

- What you extract, not how you extract it
- Reliable technology
- Breakdown of reserves and production by product type
- Average pricing rather than a fixed price

SEC Reserves Requirements

More changes:

- Recognition of both deterministic and probabilistic estimation methodologies to support reasonable certainty
- Disclosure of internal controls
- Option to disclose probable and possible reserves
- Option to present a sensitivity analysis showing the impact of different prices

SEC Reserves Requirements

Let's talk about

PUDS

SEC Reserves Requirements: PUDs

Definition of Undeveloped Reserves: Rule 4-10(a)(31) of Regulation S-X

- Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.
- (i) Reserves on undrilled acreage shall be limited to those ***directly offsetting development*** spacing areas that are reasonably certain of production when drilled, unless evidence using ***reliable technology*** exists that ***establishes reasonable certainty of economic producibility at greater distances***.

SEC Reserves Requirements: PUDs

Definition of Undeveloped Reserves: Rule 4-10(a)(31) of Regulation S-X (continued)

- (ii) Undrilled locations can be classified as having undeveloped reserves ***only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.***
- (iii) Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined in paragraph (a)(2) of this section, or by other evidence using reliable technology establishing reasonable certainty.

SEC Reserves Requirements: PUDs

1. Five-year time horizon

- Why adopted?
- Where did five-year limitation come from?
- Specific circumstance?
 - See C&DI 131.03

(<https://www.sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm>)

SEC Reserves Requirements: PUDs

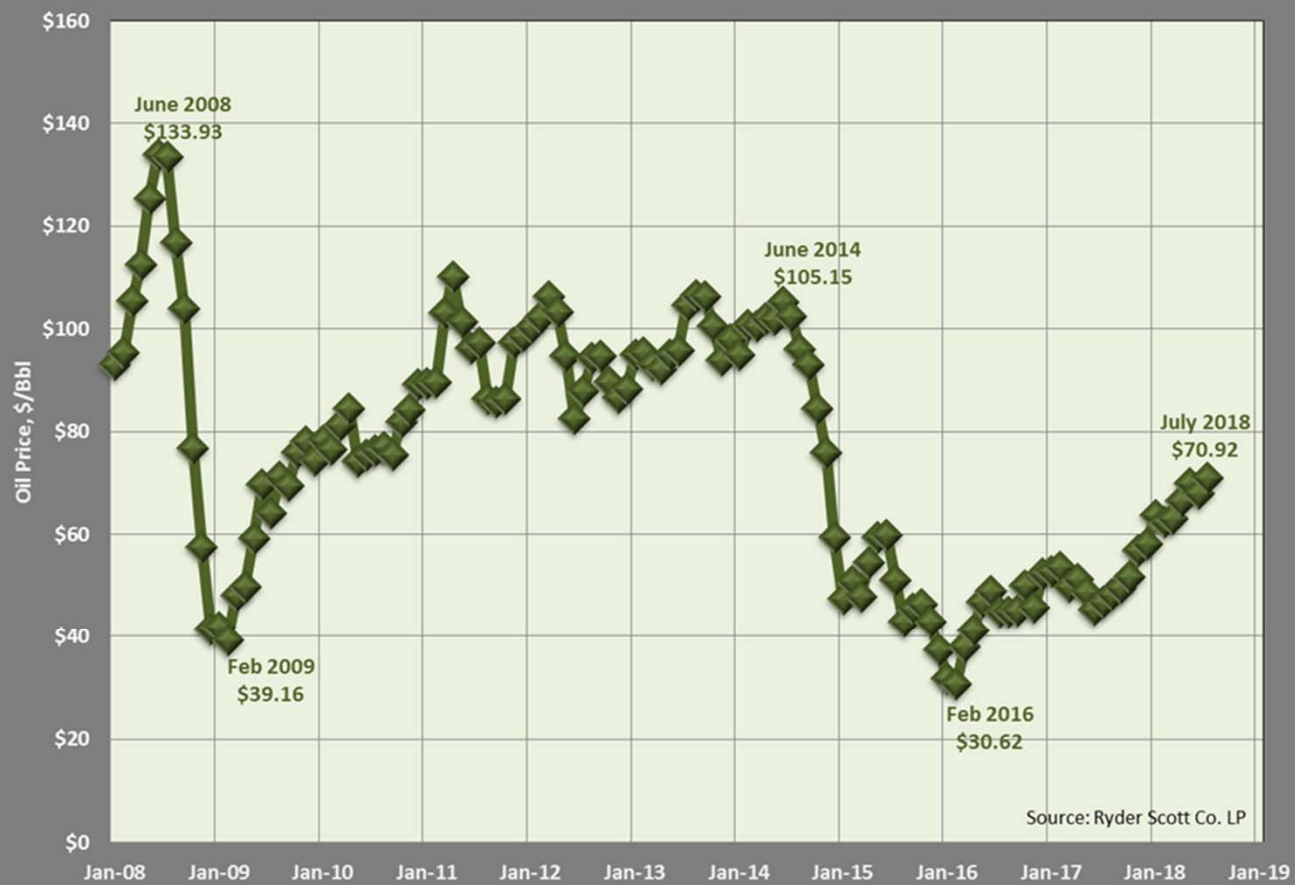
2. Has to be a development plan

- Not just thinking about it
- Timetable
- Estimate of costs
- Financing is reasonably certain to be available
- The Board has approved the plan



Historical Average Monthly Spot Price

WTI Cushing Spot Price (Oil \$/Bbl)



Source: Ryder Scott Co. LP

SEC Reserves Requirements: The 1200 Series

- Updated the requirements of prior Industry Guide 2 and brought them into Regulation S-K -> The 1200 Series
- Sought increased transparency for oil and gas producing activities:
 - Product type;
 - Clearer geographical breakdown by location for exploration, development and production;
 - Greater transparency on internal controls of reserve estimation process and qualifications of individuals overseeing that process;
 - Disclosure requirements re third party engineers.

SEC Reserves Requirements: Outside of Rule 4-10 & 1200 Series

Management's Discussion and Analysis

“In preparing MD&A disclosure, registrants should be guided by the general purpose of the MD&A requirements: to give investors an opportunity to **look** at the registrant **through the eyes of management** by providing a historical and prospective analysis of the registrant's financial condition and results of operations, **with particular emphasis on the registrant's prospects for the future.**” SEC Release Nos. 33-6835; May 18, 1989

SEC Reserves Requirements: MD&A

- (Item 303) Management's discussion and analysis of financial condition and results of operations.
- (a) (1) *Liquidity*. Identify any ***known trends or any known demands, commitments, events or uncertainties*** that will result in or that are reasonably likely to ***result in the registrant's liquidity increasing or decreasing in any material way***. If a ***material deficiency is identified, indicate the course of action*** that the registrant has taken or proposes to take to remedy the deficiency. ***Also identify and separately describe internal and external sources of liquidity***, and briefly discuss any material unused sources of liquid assets.

SEC Reserves Requirements: MD&A

Item 303(a) (cont.)

- (2) **Capital resources.** (i) Describe the registrant's **material commitments for capital expenditures** as of the end of the latest fiscal period, and indicate the general purpose of such commitments and **the anticipated source of funds needed to fulfill such commitments.**
- (ii) Describe any known material trends, favorable or unfavorable, in the registrant's capital resources. Indicate any expected material changes in the mix and relative cost of such resources. The discussion shall consider changes between equity, debt and any off-balance sheet financing arrangements.

SEC Reserves Requirements: MD&A

Link Between PUDs and MD&A

- Oil and gas exploration and development is capital intensive
- The PUD development plan needs to have identified the costs of development

SEC Reserves Requirements: MD&A

Link Between PUDs and MD&A (cont.)

- Where will the funds come from?
- Possible sources of funds:
 - Existing cash
 - Cash from operations -> what has been historical trend?
 - Sales of properties
 - Existing credit facilities
 - The debt and equity markets

SEC Reserves Requirements: MD&A

Link Between PUDs and MD&A (cont.)

Possible hurdles to obtaining financing:

- Existing debt levels
- Any restrictive covenants or contracts

SEC Reserves Requirements

Any questions?

Ten Things to Think About

1. **PUDS** -> Is the company truly committed?
2. **Probables and Possibles versus Proved** -> Level of certainty
3. **Check for inconsistencies from one section to another (including third party report)**
4. **Present reserves and production by product type**
5. **Material changes in PUDs year-to-year** -> Granularity

Ten Things to Think About

6. **SEC Price** -> Adjust for differentials
7. **Drilled but uncompleted (DUCs)** -> Drilling Alone is Not Enough
8. **Impairment?**
9. **MD&A** -> Address development plan costs, funding, etc.
10. **Check the “small” stuff** -> Sales Price, Years of Production, Production Costs, etc.

SEC Reserves Requirements

Any questions?

Useful Links

- Rule 4-10 of Regulation S-X:
<https://www.law.cornell.edu/cfr/text/17/210.4-10>
- The 1200 Series of Regulation S-K:
<https://www.law.cornell.edu/cfr/text/17/part-229/subpart-229.1200>
- Concept Release On Oil and Gas Reserves:
<https://www.sec.gov/rules/concept/2007/33-8870.pdf>
- Proposing Release: <https://www.sec.gov/rules/proposed/2008/33-8935.pdf>
- Adopting Release: <https://www.sec.gov/rules/final/2008/33-8995.pdf>
- Compliance and Disclosure Interpretations:
<https://www.sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm>

More Useful Links

- Division of Corporation Finance Webpage:
<https://www.sec.gov/page/corpfin-section-landing>
- Guidance on Preparing MD&A:
 - <https://www.sec.gov/corpfin/cf-manual/topic-9> (last updated 2008)
 - <https://www.sec.gov/rules/interp/33-8350.htm> (2003)
 - <https://www.sec.gov/rules/interp/33-6835.htm> (1989)