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U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515–6115

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July 20, 2004

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856

The Honorable Patrick Henry Wood III
Chairman
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Dear Chairmen Donaldson, Herz, and Wood:

I am writing to acknowledge receipt of your respective responses to my request for information regarding the implementation of the accounting practices requirements of the Energy Policy and Conservation Act of 1975 and recent revisions of proved reserves by Royal Dutch/Shell Group and El Paso Corporation.

The June 15, 2004, letter from the Chairman of the Financial Accounting Standards Board (FASB) states that:

> ...the Board will continue to monitor the situation and evaluate whether it should initiate a standard-setting effort related to reporting of oil and gas reserves. The Board will consult with the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) before reaching a final conclusion....The FASB also is monitoring the International Accounting Standards Board's project on the extractive industries to determine whether there is an opportunity

> to improve the current accounting and reporting standards for oil and gas companies by converging to an international standard. (pp. 1, 2)

The time is past for lengthy study. I urge you to undertake a standard-setting project in consultation with the appropriate accounting and energy regulators with all deliberate speed.

The June 24, 2004, memorandum from the Director of the Division of Enforcement and the Chief Accountant of the SEC indicates that, with respect to the definitions of "proved oil and gas reserves" and "reasonable certainty":

> While the SEC staff has, from time to time, considered whether the definitions should be revised, we have not identified ways to significantly improve them. We believe these definitions are sufficiently understood to enable reasonably consistent disclosures by oil and gas companies. (p. 6)

Recent events and the increasing frequency of reserve write-downs would seem to belie this conclusion. The SEC memorandum notes at page 7 that "oil and gas reserves are often the most material assets of petroleum exploration and production companies" and that "significant misrepresentations of proved reserves could adversely impact investor confidence in the accuracy and reliability of the reserve data disclosed by industry participants." I am, however, underwhelmed, if not outright troubled, by the staff resources and level of review that the memorandum indicates is given to these critical matters. I also am struck by this understatement at page 9: "In view of the recent revisions of many companies in this industry, the internal controls over preparation of reserve estimates **may have been inadequate**." (emphasis supplied)

I believe that significant reforms are called for on all of these issues and would urge prompt action on the basis of what is learned in the ongoing civil and criminal investigations. I also am transmitting for your consideration a suggestion submitted to me by Mr. O.S. Wyatt, Jr. Thank you for your attention to this important matter and your consideration of my views and requests.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable Joe Barton, Chairman
Committee on Energy and Commerce

The Honorable Cliff Stearns, Chairman
Subcommittee on Commerce, Trade, and Consumer Protection

The Honorable Jan Schakowsky, Ranking Member
Subcommittee on Commerce, Trade, and Consumer Protection

The Honorable Ralph Hall, Chairman
Subcommittee on Energy and Air Quality

The Honorable Rick Boucher, Ranking Member
Subcommittee on Energy and Air Quality

O. S. WYATT, JR.
EIGHT GREENWAY PLAZA, SUITE 930
HOUSTON, TEXAS 77046

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MAY 2 1 2004

May 10, 2004

Congressman John D. Dingell
2328 Rayburn House Office Building
Washington, DC 20515-2216

VIA FAX: 313 278 3914
& U. S. MAIL

Dear John:

I appreciate very much your taking the time to return my call on Saturday. I was delighted to read in *Reuters'* article (May 7th,),"*Lawmaker Delves into Oil and Gas Accounting*" -- as usual, you keep up with everything.

I fully agree with your comments about "US Energy security, market integrity and investors protection" that raises disturbing issues with me, as well. However, I cannot resist giving you my thoughts on the reserve write-downs that seem to be occurring rather frequently these days.

A company should review its reserves annually and make full disclosure of the facts, as this is needed to properly evaluate production assets. Their disclosure should be confirmed by responsible, independent engineer. The SEC's reserve group should then review these reserves on a biannual basis. This would, no doubt, cause an increase in the SEC's budget but it would be well worth it to the shareholders of public corporations and the country's energy security, as well.

There are two accounting methods presently approved by the accounting industry. One is the "successful effort" basis. Simply put, it means when you drill a well that is a commercial producer, the cost goes on the books at that date. If it is a dry hole, it is written off at the time of abandonment. Reserves do not alter the accounting treatment.

The second method is defined as "full cost accounting". Simply put, you take your total investment in the production and divide it by the reserves (as shown in the attachment) and you establish a DD&A (Depletion, Depreciation and Amortization) on a unit basis. At this point, with this type of accounting, reserves become the most important factor.

A management under this accounting rule can take a reserve cut in 2003 and increase its "reported earnings per share" in the following year with no increase in cash earnings. It is merely bookkeeping adjustment which can easily be deceiving to the shareholders. The thing it can accomplish is to increase the value of management options or other benefits, but that just shows as an increase in book earnings and the company does not earn one dollar more.

In order that the unsophisticated shareholder is more properly informed, the accounting board of the SEC should require a company to show how the change in reserves affects the company's REAL income.

El Paso Corporation is a case in point. By cutting their reserves in 2003, they will report an estimated increase in 2004 earning by approximately $.64 per share. In reality, earnings do not increase, so investors will be misled. The SEC should require that this charge be highlighted and explained and not be in an insignificant footnote, so shareholders know the true performance of management.

I appreciated your calling this to the attention of the SEC so I am sending a copy of this letter to Congressman Joe Barton, Chairman of the Energy and Commerce Committee. I hope he will insist that when a reserve adjustment is made, the SEC will require full disclosure as to the effect of this change on a company's reported and actual income.

In closing, I wish to commend you, John, for taking an interest in a matter so vital to the energy security of the United States and so timely with the present situation in the world today.

Best regards,

cc: Congressman Joe Barton
2109 Rayburn Building
Washington, DC 20515
Fax: 202 225 3052

El Paso Corporation Production Analysis

	2001(1)	2002 (1)	2003 (2)	*Write Down* 41%	2004 (2)	
Full Cost Pool	$ 7,191,000,000	$ 7,376,000,000	$ 7,376,000,000		$ 7,376,000,000	
Reserves	5,894,262,295	4,313,450,292	4,313,450,292	***(1,768,514,620)***	2,544,935,673	(3)
DDA per Unit	$ 1.22	$ 1.71	$ 1.71		$ 2.90	(4)
Full Cost Pool Write Downs				***$ (3,024,160,000)***	$ 4,351,840,000	
Full Cost Pool after Write Down					$ 4,351,840,000	
Reserves after Write Down					2,544,935,673	
DDA per Unit after Write Down					$ 1.71	
Reduction in DDA per Unit from Write Down					$ (1.19)	
Estimated Annual Production MCF (5)	325,000,000					
Reduction in Annual DDA Expenses					$ (386,199,153)	
Shares Outstanding (approximate)	600,000,000					
EPS Pickup (approximate)					**$ 0.64**	

Notes:

(1) El Paso 2002 Annual Report
(2) Estimated as El Paso has yet to release 2003 financial information.
(3) Reserves after El Paso's announced 41% write down of approximately 1.8 TCF.
(4) Estimated DDA per unit before accounting book write down.
(5) El Paso mid reange guidance on 2004 production targets of 850 MMCF/day to 950 MMCF/day.