August 20, 2008

Ms. Florence Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-15-08 – Modernization of the Oil and Gas Reporting Requirements

Dear Ms. Harmon:

The American Petroleum Institute (API) is pleased to provide comments to the Securities and Exchange Commission on the rule proposal entitled *"Modernization of the Oil and Gas Reporting Requirements."* The API is a national trade organization representing over 400 companies involved in all aspects of the oil and natural gas industry including exploration, production, refining, marketing, distribution and marine activities.

The reporting of oil and gas reserves is very important to our member companies, investors, and other users of financial statements and is vital to the efficient functioning of the U.S. securities markets. The API commends the Commission for their efforts in developing the rule proposal. We believe it is a significant step forward in modernizing the oil and gas reporting requirements for the many changes that have occurred in the industry since the existing rules were established in the late 1970's. We believe the staff's process to revise the rules has been comprehensive and thoughtful. We also believe the proposal positively addresses most of the key recommendations which the API offered on the earlier Concept Release.

However, we are concerned about the extensive new disclosure requirements included in the proposal, most of which were not discussed in the Concept Release. Cumulatively, the new disclosures are onerous in their scope and will necessitate a significant implementation and training effort by our member companies. For example, many of the proposed disclosures require a degree of granularity not currently present in our reporting and consolidation processes. This will necessitate costly changes to these systems. We believe data disclosures that go beyond what companies use to manage the business on a day to day basis are inherently excessive. We note that the cost-benefit analysis section of the proposal estimates

that the new rules will require an incremental effort of 35 hours per registrant. We believe this is significantly understated and that for some of our member companies the incremental effort could be as high as 15,000 to 20,000 hours per company. More importantly, we believe some of the proposed disclosures are of little value to financial statement users, do not justify the high implementation costs and can cause competitive damage to the disclosing company in some instances. These disclosures would likely make the U.S. financial markets and U.S. oil and gas companies less competitive internationally and would seem to be inconsistent with recent Commission efforts to reduce the complexity of the U.S. reporting system.

In developing our response to the rule proposal, we have focused on the more troubling of the new disclosure requirements. Accordingly, we have not attempted to answer every question posed by the staff. To develop our comments, the API convened a special Ad Hoc Working Group. The comments reflect the unanimous views of the participating companies listed on Attachment I.

Key Aspects Supported by the API

We believe the rule proposal positively addresses many areas of concern that were raised in previous industry studies and that were discussed in the Concept Release. In particular, the API supports the following aspects of the proposal:

Consistency with SPE PRMS. Most of the proposed technical and definitional changes are consistent with the Society of Petroleum Engineers' (SPE) Petroleum Resources Management System (PRMS) for the reporting of proved reserves. We believe this alignment will assist in the acceptance, understanding and implementation of the new rules. The PRMS was developed by leading industry technical experts and is the most widely accepted benchmark for classifying reserves in the global energy industry.

Principles-based. Most of the proposed changes in the reserves recognition guidelines appear to be principles-based in nature and thus will be robust and flexible in addressing future industry technology changes.

Optional Reporting of Probable/Possible Reserves. The proposed optional reporting of probable and possible reserves is not the API's preferred solution (i.e. limiting reporting to proved reserves only in documents filed with the Commission); however, it is an acceptable alternative to mandatory reporting. We continue to believe that financial statement users would not be well served by the mandated inclusion of such reserves due to their increased uncertainty and the breadth of methodologies and evaluation techniques that may be employed in their calculation. It is also felt that such reporting could expose companies to additional, unwarranted litigation due to their increased risk and uncertainty. However, under the staff's proposal, companies that desire to disclose such information in their filed documents would not be precluded from doing so.

Use of 12-Month Average Prices. The proposal to use 12-month average prices to calculate reserves (instead of year-end prices) is a significant improvement. The current use of year-end single-day prices introduces short-term price volatility into the reserves estimation process, which is inconsistent with the long-term nature of the oil and gas business. The use of 12-month average prices would reduce much of this volatility while maintaining the comparability of disclosures among companies.

Inclusion of Tar Sands and Other Non-traditional Resources. The proposed inclusion of oil shale, tar sands and other such resources in oil and gas reserves will improve the quality and completeness of disclosures as it will present upstream operations to investors and other financial statement users on the same basis that company management views such operations. The investment community also views hydrocarbons produced from such resources as an integral part of the upstream oil and gas production business.

Revised Definition of Proved Undeveloped Reserves. The proposed definition of proved undeveloped reserves will better align with the definition of proved reserves and with the SPE PRMS framework. This alignment will improve the internal consistency of the guidelines by establishing one threshold (i.e., reasonable certainty) for all categories of proved reserves. This will eliminate the anomaly in the current guidelines that prevents proved reserves for un-drilled units more than one offset location from a proved developed well from being recorded unless it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Alignment of the definitions at the level of reasonable certainty will better allow for the application of professional judgment and will make the guidelines more consistent with a principles-based disclosure system.

No Requirement for Third Party Reserves Reviews. The rule proposal does not require the use of independent third party reviews to support company reserves estimates. We support this approach as we believe that the professional technical staffs of companies are in the best position to estimate reserves because of the inherent complexity of the evaluation process and the breadth and complexity of resources owned by most industry companies. Also, a requirement for third party evaluation would be inoperable as the capacity of existing third party reserves evaluation consultants is far short of what would be needed to handle existing registrants.

Key API Recommendations

Our key recommendations to improve the rule proposal are summarized below and focus primarily on the new disclosure requirements.

Dual Reporting Bases. The rule proposal would require reserves to be calculated on two different bases: one using 12-month average prices for disclosure purposes and

one using single-day, year-end prices for accounting purposes (primarily the calculation of unit-of-production depreciation and depletion rates). This effectively doubles the required amount of record keeping by registrants and is the single costliest feature of the rule proposal. We believe a two-price system would severely task the people, systems and governance processes of our member companies, which already are strained to meet the 60-day filing deadline for the Annual Report on Form 10-K. Further, this requirement would break the link between the required disclosures and the underlying accounting, which we believe is inconsistent with an effective and transparent reporting model. We are not aware of any other area in the accounting literature in which the accounting and related disclosures are calculated on different bases. Additionally, a requirement for dual reporting bases is inconsistent with the intent of paragraph 7 of FAS 25, "Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies," which requires that the definition of reserves for the application of FAS 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies," be consistent with the definitions adopted by the SEC for its reporting purposes.

We believe that the use of average prices for accounting purposes, consistent with the reserves disclosures, would not result in material differences in unit-of-production depreciation expense from period to period versus the use of year-end prices. To the contrary, the use of average prices would reduce the magnitude of changes that may otherwise be caused by large fluctuations in year-end prices. In any event, we do not think that depreciation expense based on single-day, year-end prices yields a conceptually better accounting result than one based on average prices. Therefore, we believe that the use of two different pricing bases would not add any meaningful value to financial statement users while placing a significant new burden on registrants. For these reasons, we strongly recommend that the accounting and disclosure requirements be aligned on the 12-month average price basis.

<u>Time Period for Calculating 12-Month Average Price.</u> The rule proposal would require the 12-month average price to be based on month-end prices for the reporting year in question, ending on December 31 for calendar year companies. We believe this basis continues to make it very difficult for companies to recalculate their reserves in time to meet the 60-day filing deadline for the Annual Report on Form 10-K, particularly in light of all the other new disclosures. Work can not effectively commence until the December 31st price is finalized. As the frequency of production sharing contracts and other more complex concession agreements increases across the industry, our member companies are finding that the recalculation of reserves is becoming an increasingly difficult and time consuming activity.

Consistent with our earlier recommendations on the Concept Release, we continue to believe that the 12-month period should run from October 1 of the previous year to September 30 of the reporting year for companies with a fiscal year ending on December 31. We would alternatively suggest that the staff consider changing the

12-month average price to an average of beginning-of-month prices, ending with December 1 for a calendar year company. This approach would achieve the desired averaging effect, would align with the fiscal year, and would help preparers better manage their year-end workloads by giving them an additional 30 days to complete reserves estimates. We also believe that beginning-of-month pricing is preferable for use in a 12-month average price calculation as month-end market prices are more subject to unusual daily price volatility from the close-out of trading positions and other month-end trading activities.

Expanded Reporting of Proved Undeveloped (PUD) Reserves. The proposal would require extensive new disclosures on PUDs, including a recap of all PUDs that are older than five years, the reasons for their lack of development, development plans, and a discussion of any material changes to PUDs in the reporting period. The proposal also requires a new table recapping the movement of PUDs to proved developed reserves for each of the last five years, plus the related current year investment that was required to achieve the conversion. The aging and tracking of PUDs by their year of recognition and the tracking of related investment dollars would be a complex new reporting requirement that would necessitate costly changes to both accounting and reserves information systems. We also see several definitional issues associated with capturing related investment dollars given that PUD investments can often span several calendar years before transfer to proved developed reserves. Given the increasing scale and term of industry development projects, we believe these disclosures will apply to an increasingly significant portion of reported reserves, further expanding the complexity of the proposed disclosures. Lastly, we believe these additional disclosures will be of limited incremental value to financial statement users in assessing a company's success in developing resources given the other multi-year production and proved reserves information already provided.

We recommend the staff modify the requested disclosures by eliminating the proposed five-year table of PUD movements and the detailed recap of PUDs over five years old. We recommend replacing it with a requirement to discuss the quantity of PUDs, any material PUD changes during the year and the progress made during the year in converting PUDs to proved developed reserves. We suggest this information be disclosed with the proved oil and gas reserves quantities table required by FAS 69, "Disclosures about Oil and Gas Producing Activities." We believe this approach would be more consistent with a principles-based approach and of more value to financial statement users.

Increased Granularity of Reserves Disclosures. The proposal would require a significant increase in the granularity of reserves disclosures including separate disclosure by conventional accumulations and continuous accumulations, by product (e.g. oil, gas and bitumen), by geographic area and by proved developed and proved undeveloped reserves. We believe that segmentation along so many parameters makes the resulting disclosures too complex, reduces the information content for financial statement users and unnecessarily increases the cost and complexity of

company record keeping. We recommend that the staff eliminate the proposed segmentation by conventional and continuous accumulations as we believe this split will be of limited value to financial statement users. We believe the disclosures should continue to be differentiated by end-product (i.e. oil and gas) rather than by the nature by which the volumes are extracted. Similarly, we recommend elimination of this subcategory for the proposed disclosures on wells and acreage.

Increased Geographic Granularity of Disclosures. The proposal also increases the granularity of disclosures by introducing a new definition for the term "geographic area." Under this definition, separate line item disclosure would be required for (1) any country with proved reserves that are 15% or more of the company's total oil or gas reserves and (2) any sedimentary basin or field containing 10% or more of the company's total oil or gas proved reserves. Once determined, this same geographic segmentation must be applied to numerous other disclosures, including production, prices, lifting costs, drilling activity, description of present activities, producing wells and acreage. Much of this information is not currently maintained at the sedimentary basin or field level due to the significant costs involved with such segmentation and the lack of relevancy to managing the day to day business. Such segmentation would likely require many subjective cost allocations, creating a false impression of precision.

We believe the establishment of bright line tests for reserves disclosures is inconsistent with a principles-based system. We also believe that the rigid application of the resulting geographic segmentation to all other disclosures will result in less-than-optimal segmentation in many instances. For example, the geographic dispersion of data for the other disclosure items may be very different than for reserves, resulting in disclosures that are too granular in some areas or too aggregated in others. In addition, we believe there is a strong potential for competitive damage to companies from disclosure of information at the field or basin level. Such disclosures can undermine the negotiating positions of companies in future property sale transactions, unitization agreements or other asset transfers. Also, information about individual fields or basins is sensitive data that is often subject to restrictions by the national governments that have awarded the concession rights.

We recommend that the staff continue to require proved reserves disclosures by the country or regional aggregations currently specified in FAS No. 69, "Disclosures about Oil and Gas Producing Activities." We also recommend that the determination of geographic segmentation for all other disclosures be left to management's judgment, consistent with the current disclosure rules. Management can best decide the appropriate segmentation for each disclosure item, based on its knowledge of the business and assessment of the data distribution for each disclosure category. This would be more consistent with a principles-based approach.

Increased Granularity of Well Disclosures. The proposal would require a substantial increase in the granularity and complexity of well disclosures. In addition to the current categories of exploratory and development wells, two new categories, extension wells and suspended wells, would be added. Disclosures would have to be further segmented by oil wells and gas wells. Lastly, a separate table would be required for each geographic area. Rather than expanding the existing disclosures as proposed, we believe the staff should give consideration to completely eliminating the requirement for well disclosures. We do not believe that the existing or proposed well data provides any substantial insights to financial statement users in assessing the economic value of a company's operations, and therefore does not justify the costs incurred by companies to assemble it.

Our view is in part driven by industry technology changes that reduce the significance and relevance of well count data for the vast majority of companies filing with the SEC. As drilling technology continues to progress, companies have been able to significantly reduce the number of wells needed to develop a field. Examples of changes in technology include new horizontal drilling techniques, with multiple perforation points in the same well bore, and the use of long - range deviated well bores from one central drilling site, often with multiple subsurface deviations from a primary well bore. Given the need for fewer wells, a tabular, numeric comparison of well counts over time could present a misleading indicator of actual field development activity to investors.

If elimination of the drilling activity disclosure is viewed as too extreme, we would alternatively suggest that the current drilling disclosure requirements be left unchanged. We believe the proposed increase in the granularity and complexity of well disclosures is not cost/benefit justified and does not provide useful, relevant information for financial statement users. Further, we believe there are a number of potential definitional problems with some of the new well categories that would lead to inconsistent implementation by industry companies. For example, the new requirement to further segregate the exploratory well category between those wells testing for "new sources of oil and gas" versus those wells that are "merely the extension of an existing field" is a distinction that will require much more specific rule-making by the staff before it could be consistently applied in practice. In addition, the proposed new disclosure category of "suspended wells" is vague and confusing. For example, it is unclear how individual wells would migrate to and from this category over time. We also believe the use of the terminology "suspended wells" may be confused with the same terminology that appears in FAS 19, but which applies to a different population of well bores. Instead of introducing such confusion, we believe that the proposal should instead clarify the text in Item 1205(c)(v) to state that the "number of wells drilled" which have been suspended during a year will include any well bore where (1) drilling and drilling test analysis have ceased and (2) future substantive drilling activity is unlikely. In modifying the proposal in this way, the potential confusion with the FAS 19 terminology would be avoided.

Disclose Technology Used to Support Material Reserves Additions. The proposal would require disclosure of the technology that a company has used to support the recognition of material reserves additions. We believe this requirement is impractical to implement since the recognition of reserves is typically based on the use of multiple technologies, data sources and interpretation methods. It would therefore be difficult, if not inaccurate, in most cases to attribute a reserves booking to a single technology. Alternatively, disclosure of the multiple technologies and interpretation methods employed for material reserves additions would make the disclosures so complex and cumbersome to be of little value to even the most sophisticated financial statement users. Given the above complexities, we believe that industry companies would implement this requirement in a variety of ways, leading to inconsistent disclosures.

We also believe there would be several implementation problems with this requirement given the proprietary nature of some reserves evaluation technologies. If a company is using a service company's proprietary technology, the company may not be able to obtain permission from the service company to disclose the use of such technology. For new company-developed technologies, disclosure could cause the loss of competitive advantages. The proposed requirements to disclose the particular technologies used to support reserves estimates for specific geographic areas, countries, fields or basins could also put companies at a significant competitive disadvantage, particularly if other competitors are operating in the same areas. We also do not believe that investors are generally in the best position to determine whether the use of a specific technology was appropriate for a specific location. Such determination requires specialized knowledge and technical expertise that investors typically would not have.

From the discussion in the rule proposal, it appears that this requirement was added as an anti-abuse measure against companies that may be too aggressive in adding new reserves under the proposed new definition of "reliable technology." Similar to other judgmental accounting or reporting areas, company personnel and management are in the best position to make reasonable judgments based on their own company's specific facts, technologies and circumstances. Abuse prevention should be adequately handled by the existing requirements for companies to have in place an effective system of internal controls. For the above reasons, we recommend that the staff delete this disclosure requirement. Rather than explicitly requiring or prohibiting specific data, tests or assumptions or requiring the disclosure of the technology utilized for the booking of reserves, we believe that management should be allowed to consider all available information in making judgments about reserves categorizations. This process naturally entails technical judgment in determining how much weight to give to various sources of information and under what circumstances. We believe this approach is most consistent with achieving a principles-based disclosure system.

<u>Disclosure of Qualifications of Reserves Estimators.</u> The proposal would require disclosures about the objectivity and qualifications of the personnel primarily responsible for each company's reserves estimates. We agree that the establishment of minimum qualification standards for reserve estimators is an important aspect in ensuring that reserves are calculated according to generally accepted engineering and evaluation principles. However, we believe that the proposed disclosures are overly burdensome. For large filers, the number of in-house estimators could easily be in the hundreds. From a practical perspective, requiring reserves preparers or auditors to meet all of the qualifications outlined in the proposal would be a significant challenge, especially for filers with large international operations staffed by local personnel who have no access to licensing bodies. Additionally, there is currently no way to reconcile certification standards between different countries, states, and professional societies. We also understand that disclosure of personal qualifications would be a violation of privacy laws in some countries. Finally, we view the proposed requirements as adding little information that is of real value to financial statement users.

We believe making reserves estimation judgments is a process similar to making accounting judgments. Accounting personnel making difficult judgments also need to be objective and qualified, yet there is no requirement to publicly disclose information about their qualifications. Instead, management has to assume responsibility for ensuring there are adequate accounting and disclosure controls in place and to make a public certification to that effect. The reserves estimation disclosures are subject to the same management certification process and should not be subject to duplicative disclosure and certification processes. If the staff continues to believe that some additional disclosure is warranted, we suggest that the staff consider an alternate disclosure that would allow filers to disclose their internal control systems applicable to reserves estimation and reporting. We believe this would be a more appropriate topic for discussion, would more broadly address the issues contemplated in the proposed disclosures from a management perspective and thus would be more consistent with the objectives of a principles-based disclosure system. If this is not an acceptable alternative, we recommend that, at a minimum, the staff clarify in the rule proposal that the proposed disclosures be required only for the technical person primarily responsible for managing the company's reserves estimating process. Application of these disclosure requirements to a broader population would be overly burdensome for the reasons noted previously.

<u>Optional Reporting of Probable/Possible Reserves.</u> As noted previously, the proposal would provide companies the option to report probable and possible reserves in Commission filings. We appreciate that the staff has not proposed such reporting to be mandatory. However, we believe the staff should clarify in the final rule proposal that the option to report such reserves in Commission documents does not preclude companies from continuing to disclose such information in non-filed documents, which is the current practice of many companies. To do otherwise would likely result in a reduction of industry information that is publicly available to financial statement users.

Need to Clarify Approach to the Reporting of Equity Company Reserves. The proposal is silent on the treatment of equity company reserves and other related information. It appears no differentiation is made between consolidated subsidiaries and equity companies and that only the combined total is to be reported for each disclosure item. We strongly support this combined reporting approach and recommend that the final rules make this explicit. We believe that separate disclosure of consolidated subsidiaries and equity companies, as required in the existing guidelines, has been confusing to financial statement users. We believe an approach that fully integrates equity company data into each disclosure would improve the clarity and the quality of disclosures, particularly since companies view the economic value and importance of equity company reserves and related activities to be equal to those of consolidated subsidiaries. We note this may require an amendment to the examples in FAS 69. The examples in FAS 69 do not expressly prohibit the addition of reserves quantities for consolidated companies and equity affiliates, but the staff in comment letters has interpreted the examples to prohibit such arithmetic addition.

Expanded Requirements for Management's Discussion and Analysis (MD&A). The proposal greatly expands the MD&A disclosure requirements for oil and gas companies. Many of the requested disclosures are at such a detailed level (for example, discussion of the performance of individual producing wells, including water production and the need to use enhanced recovery techniques) that it would not be meaningful or relevant information for a financial statement user. Also, some of the new MD&A requirements are complex and costly to implement (for example, the disclosure of anticipated capital expenditures to convert PUDs to proved reserves). In addition, several of the disclosures could cause competitive harm to the disclosing company (for example, anticipated exploratory activities; well drilling and production; anticipated capital investment in PUDs; remaining terms of leases and concessions; price and cost data). We recommend the staff delete these new disclosure requirements or alternatively limit the list of potential disclosures to items that could be material to an investor and which would be cost/benefit justified. We also note that some of the requested discussion on changes in proved reserves overlaps with requirements found in FAS 69. We think this is a good example of an area where it would be helpful for the staff to work with the Financial Accounting Standards Board (FASB) to align the rule proposal with the related accounting standards to minimize the complexity of the resulting regulatory system.

Definitional Issues. We believe there are several definitional issues that the staff should address in finalizing the rule proposal to avoid confusion and/or potential conflicts with other rules and standards.

- Section II. H, Proposed Definition of Reserves, states there is a requirement to have "the legal right to produce." This definition would appear to exclude many economic interests allowed under existing regulations. We recommend this requirement be changed to "the legal right to produce or a revenue interest in the production."

- The determination of the boundary lines around oil and gas production operations is an important feature of the disclosure rules. We believe the proposed definition in the rule proposal omits some well-established guidance found in the existing rules. Accordingly, we recommend that the definition of the oil and gas production function shown in Instruction 1 to paragraph (a)(16)(i)(a) be replaced with the current definition in Regulation SX 4-10 (1)(c) and FASB 19:

  > "For purposes of this section, the oil and gas production function shall normally be regarded as terminating at the outlet valve on the lease or field storage tank; if unusual physical or operational circumstances exist, it may be appropriate to regard the production functions as terminating at the first point at which oil, gas, or gas liquids are delivered to a main pipeline, a common carrier, a refinery, or a marine terminal."

Conclusion

The API appreciates the Commission's efforts to revise the current disclosure rules and to provide us this opportunity for comment. Representatives of the API and its member companies would welcome the opportunity to discuss this response further with the Commission staff and/or to be available to answer questions.

Very truly yours,

Patrick T. Mulva
Chairman, API General Committee on Finance

cc:	Mr. Glenn Brady	Extractive Activities Research Project, IASB
	Mr. Robert Garnett	IASB
	Mr. George Batavick	FASB

Attachment I

API Ad Hoc Working Group
for
SEC Rule Proposal "Modernization of the Oil and Gas Reporting Requirements"

Participating Companies

Anadarko Petroleum Corporation

BP p.l.c.

Chevron Corporation

ConocoPhillips

Devon Energy Corporation

Exxon Mobil Corporation

Hess Corporation

Marathon Oil Corporation

Murphy Oil Corporation

Occidental Petroleum Corporation