

CSA provide guidance on resource disclosures, possible reserves

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Although the disclosure of reserves has been mandated in Canada for a considerable period of time, both pursuant to National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* (NI 51-101) since September 2003 and prior to that pursuant to National Policy 2B, those policies have not, until recently, ventured further down the commerciality spectrum to provide guidance in respect of contingent and prospective resources.

Not surprisingly, while disclosure in relation to proved and probable reserves, and to a lesser extent possible reserves, has improved, the same cannot be said of resource disclosures. Just as investors have benefited from the enhanced comparability of reserve reports by virtue of the consistency of disclosure in relation to reserves, so they have suffered from the relative lack of guidance in relation to resource disclosures and the resultant diminished comparability and consistency.

While the Canadian Securities Administrators (CSA) amended NI 51-101 in 2005 and 2007, in part to enhance the guidance provided in respect of resource disclosures, not until the publication on February 27, 2009 of CSA Staff Notice 51-327 – *Oil and Gas Disclosure: Resources other than Reserves Data* (the Staff Notice) have the CSA provided comprehensive supplementary guidance.

Having observed both inconsistent reporting and recurring deficiencies in resource disclosures by reporting issuers, the Staff Notice aims to provide sufficient guidance to resolve both issues, in particular to avoid misleading information and to enhance comparability between issuers. In doing so, the Staff Notice provides guidance in the following areas:

1. Stand-alone possible reserves¹

The Staff Notice warns that in most instances, it is misleading to report possible reserves on a stand-alone basis. One can certainly appreciate the motivation behind the warning, as an estimate of possible reserves is usually a large number that, while attractive at first blush to a lay investor, has a very low probability of actually ever being produced.

The Staff Notice is certainly consistent in this respect with prior guidance issued by the CSA² and, in the case of annual reserve reporting on form 51-101F1, the requirements of NI 51-101 itself. However, the Staff Notice goes further than its predecessors in delineating the exceptions in which disclosure may be permissible, including where: (a) a project's economics prevent proved and probable categorization but together with the possible reserves the project is economically viable and a development decision has been

made; (b) minor incremental expenditures will permit the development of the possible reserves in the near future; and (c) possible reserves are part of an accumulation to which the issuer has rights and adjacent parts of that accumulation to which it has no rights have been attributed proved or probable reserves.

In any case, where possible reserves are being disclosed on a stand-alone basis, issuers should ensure that appropriate disclosure is provided both about the lack of proved and probable reserves, including the reasons why such categorizations were not made, and about the likelihood of production of such reserves.

2. Disclosure of High, Best and Low case category estimates

On a property by property basis, the Staff Notice discourages the reporting of a High estimate³ of recoverability at the exclusion of both a Best and Low estimate on the basis that investors may not appreciate that the High estimate is not in fact the best measure of the volume of resources that will actually be recovered from the property, potentially skewed as it may be by the presence of a large volume of possible reserves.

With respect to the aggregation of resource estimates across properties, although NI 51-101 provides guidance in relation to reserves, it is relatively silent on resources. The Staff Notice addresses this by indicating that in respect of probabilistic aggregations, the NI 51-101 principles applicable to reserves are equally applicable. However, in respect of arithmetic aggregations of High estimates in particular, it recognizes that simple aggregation will result in totals that might mislead investors by bloating resources beyond the expected range of actual outcomes. To the extent that an issuer nonetheless elects to disclose such aggregations, the Staff Notice mandates clear cautionary language. Alternatively, aggregation across properties is acceptable without cautionary language in relation to proved and probable reserve disclosure or Best estimates of resources, as these are generally approximations of a mean estimate and, therefore, not misleading.

3. Adding together resources of different classes

NI 51-101 does not provide any guidance as to the summation of resources across different classes. Recognizing that reserves, contingent resources and prospective resources each have very different chances of commerciality based on the interplay of the chance of development and the chance of discovery, the failure to recognize these differences can lead to very misleading aggregated disclosure.

However, to the extent that a reporting issuer decides to nevertheless add resources across different classes, the Staff Notice mandates the use of cautionary language appropriate to whether the aggregation is unrisks or risks and the classes that are being aggregated, and the description of those resources as “remaining recoverable resources (unrisks)” or “remaining recoverable resources (risks)”, respectively. In either case, the use of High estimates is to be discouraged given that it is almost invariably misleading.

4. Partially risks prospective resources

The Staff Notice notes that on occasion, reporting issuers have disclosed prospective resources that are risks only for the chance of discovery and not the chance of development. In such circumstances, reporting issuers should ensure that appropriate cautionary language is provided that makes clear that the resource estimate is only partially risks and that there is no guarantee that development will occur.

5. Use of the term “Best Estimate”

The Staff Notice cautions against the use of the term “Best Estimate” in disclosing either arithmetic or probabilistic aggregations of resource estimates unless appropriately risks during the aggregation process to adhere to the strict definition of the term.

6. Technology under development for contingent resources

Although normally contingent resources are assigned on the basis of established technology, in some circumstances they can be assigned on the basis of “technology under development”. In order to be classified as contingent resources on the basis of the latter, the technology must have been developed and verified by testing as feasible for future commercial applications to the applicable reservoir. In addition, NI 51-101 requires that the reporting issuer be committed to developing the technology required to recover the contingent resource within a reasonable period of time.

7. Classification to the most specific class and category of resource

NI 51-101 requires that resources be classified to the most specific class (i.e. reserves, contingent resources, prospective resources and unrecoverable resources) in order to clearly address the chance of commerciality of each resource estimate. By doing so, large and undifferentiated disclosures of undiscovered and discovered petroleum initially-in-place (PIIP), which provide relatively little information about the relative chance of commerciality of the resources, are avoided.

The CSA recognize in the Staff Notice, however, that in exceptional circumstances the classification of discovered PIIP into reserves, contingent resources or unrecoverable resources is not possible. Those exceptional circumstances are limited to situations in which it is not possible to define a project for the recovery of the resource, where a project means a program of work that can be evaluated to demonstrate its commercial viability using current technology or technology under development. Given that discovered PIIP by definition requires recoverability in order to be further classified as reserves or contingent resources, such amounts must be disclosed as unrecoverable, although issuers are certainly permitted to disclose the recovery projects on which they are engaged and which might ultimately lead to classification as contingent resources or reserves (accompanied by appropriate positive and negative factors). Appropriate cautionary language about the status of the recovery project and the certainty of commercial viability must also be provided.

8. Criteria for classification of unconventional hydrocarbons as discovered PIIP

The Staff Notice also provides guidance for disclosure of discovered PIIP in relation to unconventional hydrocarbons, noting that while the typical criteria for classification as discovered PIIP include that such volumes are derived from a “known accumulation”, in the case of unconventional hydrocarbons, flow testing is not applicable. Reliance on log and core data and analogues to geologically comparable known accumulations represent the only viable alternative. In particular:

- > *Temporary flow by stimulation* – Any volumes would be categorized, absent further evidence, as unrecoverable resources.
- > *Log data and laboratory tests of cores* – While log data alone would not satisfy the “known accumulation” requirement, together with laboratory results providing convincing evidence of significant moveable oil, enough support would exist to meet the requirement and thereby the assignment of discovered PIIP to the area around the well from which the core was taken. Any volumes would be categorized, absent further evidence, as unrecoverable resources.
- > *Analogous known accumulations* – The analog is a replacement for the flow test, provided that all aspects of the geology are comparable and that flow is anticipated to occur in a similar fashion using the same recovery process.

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¹ The term “stand-alone possible reserves” refers to possible reserves that are attributable to a property but to which no proved or probable reserves are attributable.

² See CSA Staff Notice 51-321 – Questions and answers concerning resources and possible reserves National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities published November 17, 2006.

³ High estimate is, in relation to reserves, the aggregation of proved, probable and possible reserves. High estimate is, in relation to resources, an optimistic estimate of the quantity that will actually be recovered, it being unlikely that actual remaining quantities recovered will exceed that estimate. On a probabilistic basis, there is at least a 10% probability that the quantities actually recovered will equal or exceed the High estimate.

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