Darley, John J SIEP-EPT

From: Coopman, Frank F SIEP-EPF
Sent: 02 December 2003 07:54
To: Bell, John J SIEP-EPS; Bichsel, Matthias M SIEP-EPX; Darley, John J SIEP-EPT
Cc: Pay, John JR SIEP-EPS-P
Subject: proved reserves

Please find attached our draft note which is now with Walter. No comments as yet.
My functional boss is not happy.

Script for Walter on the prove...

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Script for Walter on the proved reserves position

Facts

1. Recent (October –November) audit reports and completion of reserves studies concerning the proved reserves positions as per year end 2002 for SPDC and PDO Oman tell us that the 31/12/02 proved reserves for those companies were overstated by approximately 1.3 bln boe.

2. Correspondence with the SEC in 2003 (last letter received in September) on the topic of the LKH issue leaves us with the message from the SEC to de-book the volumes below the Lowest Known Hydrocarbon logged. These volumes are estimated to be approximately 300 mln boe.

3. The proved reserves bookings as filed in the 2002 20F included a number of items which, while in compliance with our own guidelines at that time, were possibly at odds with the strictest possible interpretation of the SEC guidelines. It was decided to leave them as, in aggregate, they were regarded as immaterial in relation to our total proved reserves position. The largest single position was Gorgon (557 mln boe). All others added up to less than 200 mln boe.

Consistency with previous presentations

The position described above is consistent with an October presentation to the GAC and a related NFI to CMD. What is new are the items under point 1 above, which became known only very recently.

Materiality

With the SPDC and PDO Oman volumes, the total volume not in compliance with SEC guidelines in the proved reserves filing in the 20F as per 31/12/02 has become significant (2.1 bln boe or 11% of the Group's total proved reserves).

The materiality test is whether the total change in reported reserves would be viewed by a reasonable investor as having significantly altered the total investment information available. Applying that parameter, the absolute quantity and the percentage is material.

If a de-booking or restatement was considered, the financial impact thereof is very limited (approximately 40 mln dollars after tax in 2003) and not material in Group (or EP) terms. This is because virtually all volumes to be adjusted are registered as proved undeveloped reserves – this category only rarely drives DD&A.

There is no effect on existing or past reserve addition bonus schemes (in Oman and Nigeria).

Completeness

If we were to de-book /restate points 1 – 3 above, would we then be in full compliance with the SEC guidelines?

There is a possible issue around our Kashagan reserves (380 mln boe). Total is being challenged right now by the SEC to de-book on the grounds of the absence of a government approved development plan.

Both PDO Oman and SPDC will have to further mature field development plans in 2004 to be fully compliant and avoid further adjustments.

Fuel and Flare

All major competitors include fuel and incidental flare in proved gas reserves, with the exception of BP who report on the same "as sold" basis as Shell.

Including fuel and flare would result in approximately 300 mln boe additional reserves as reported at 31.12.2002. However, implementation is not as straightforward as it would at first appear. Inclusion of fuel and flare requires a corresponding Opex charge to be made (at fair market value of the gas consumed), offset by a revenue entry. Consequently, including fuel and flare in any restatement of historically disclosed reserves would also require changes to several financial report line items. Whilst feasible, this would be a major undertaking requiring dedicated study work on the part of every operating company that disclosed production in recent years.

Therefore, it is recommended not to include fuel and flare in the restatement.

Legal Consequences and Required Steps

If and from the time onwards that it is accepted or acknowledged by the management of the issuers (Royal Dutch and STT) that, when applying the SEC rules, the 2002 proved reserves as reported in the Form 20-F are materially wrong, the issuers are under a legal obligation to disclose that information to all investors at the same time and without delay. Not to disclose it would constitute a violation of US securities law and the multiple listing requirements. It would also increase any potential exposure to liability within and outside the US. Note that the reserves information also appears in the non 20-F Annual Reports.

Disclosure cannot await the next Form 20-F 2003 appearing in April 2004. With respect to the 2002 Form 20-F there are two possible approaches to address the previously reported reserves: (i) a stock exchange release stating the key issues on reserves restatement followed by a filing of a restated 2002 Form 20-F as soon as possible thereafter or (ii) the same stock exchange release with the added message that the changes will be reflected in the 2003 Form 20-F and no filing of a restated 2002 Form 20-F. The preference is for the more robust approach in i) as the SEC is likely to request for a restated 2002 Form 20-F and the reliance by investors on an uncorrected 2002 Form 20-F remains an issue.

A significant number of additional measures will be required around a restatement of the 2002 Form 20-F and the previous dissemination of incorrect proved reserves data on Group websites and in other publications. Sox 302 re-certification, Form 6 K filing, consultation with external auditors, communication with the SEC, briefing for analysts etc.

IR issues

The announcement of restating or de-booking the reserves will be a significant negative IR event. We will point out that we did not lose any significant hydrocarbon volumes, as this is basically a re-classification. Our expectation estimate of the total volume of resources will be largely unaffected. Our own strict rules and governance triggered this adjustment. The LKH issue remains controversial in the industry (but rules are rules, etc). The Gorgon development decision is getting closer, as the recent bi –lateral declaration of intent demonstrated.

Frank Coopman
John Pay

1 December 2003