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7. Financial Instruments

We use commodity-based and financial derivative contracts to manage exposures to commodity price and interest rate fluctuations. We do not hold or issue derivative financial instruments for speculative or trading purposes. We also may enter gas physical delivery contracts to effectively provide gas price hedges. Because these contracts are not expected to be net cash settled, they are considered normal sales contracts. Therefore, these contracts are not recorded in the financial statements.

Commodity Price Hedging Instruments

We periodically enter into futures contracts, energy swaps, collars and basis swaps to hedge our exposure to price fluctuations on natural gas, crude oil and natural gas liquids sales. When actual commodity prices exceed the fixed price provided by these contracts, we pay this excess to the counterparty, and when actual commodity prices are below the contractually provided fixed price, we receive this difference from the counterparty. See Note 8.

The fair value of our derivative contracts consists of the following:

	<u>Fair Value of Derivative Instruments</u>			
	<u>Asset</u>		<u>Liability</u>	
	<u>Derivatives</u>		<u>Derivatives</u>	
	<u>December 31,</u>		<u>December 31,</u>	
<i>(in millions)</i>	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Derivatives designated as hedging instruments:				
Natural gas futures and basis swaps	\$ 836	\$ 1,917	\$ (52)	\$ (17)
Crude oil futures and differential swaps	442	1,772	(105)	(12)
Total derivatives designated as hedging instruments	1,278	3,689	(157)	(29)
Derivatives not designated as hedging instruments:				
Natural gas futures and basis swaps	12	9	(8)	(6)
Crude oil futures and differential swaps	—	60	(8)	—
Total derivatives not designated as hedging instruments	12	69	(16)	(6)
Total derivatives	\$1,290	\$3,758	\$(173)	\$(35)

The effects of our cash flow hedges on accumulated other comprehensive income (loss) on the consolidated balance sheets are summarized below.

	<u>Year Ended December 31</u>					
	<u>Change in</u>			<u>Realized (Gain) Loss</u>		
	<u>Hedge Derivative</u>			<u>Reclassified from</u>		
	<u>Fair Value</u>			<u>OCI into Revenue (a)</u>		
<i>(in millions)</i>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Natural gas futures and basis swaps	\$1,641	\$1,761	\$ 255	\$(2,955)	\$161	\$(677)
Crude oil futures and differential swaps	(428)	2,088	(359)	(1,224)	114	(24)
Natural gas liquids futures	—	3	(22)	—	19	—
Total	\$1,213	\$3,852	\$(126)	\$(4,179)	\$294	\$(701)

(a) For realized gains upon contract settlements, the reduction to comprehensive income is offset by contract settlements generally recorded as increases to gas, natural gas liquids or oil revenue. For realized losses upon contract settlements, the increase to other comprehensive income is offset by contract settlements generally recorded as reductions to gas, natural gas liquids or oil revenue.

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The effects of our non-hedge derivatives and the ineffective portion of our hedge derivatives on the consolidated income statements are summarized below.

<i>(in millions)</i>	Year Ended December 31								
	(Gain) Loss Recognized in Income (Non-Hedge)			(Gain) Loss Recognized in Income (Ineffective Portion)			Derivative Fair Value (Gain) Loss		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
Natural gas futures and basis swaps	\$ 32	\$ (6)	\$—	\$ (47)	\$ 2	\$ (22)	\$ (15)	\$ (4)	\$ (22)
Crude oil futures and differential swaps	17	(78)	—	22	(2)	11	39	(80)	11
Natural gas liquids futures	—	—	—	—	(1)	—	—	(1)	—
Total	\$ 49	\$ (84)	\$—	\$ (25)	\$ (1)	\$ (11)	\$ 24	\$ (85)	\$ (11)

Derivative Fair Value (Gain) Loss

Derivative fair value (gain) loss comprises the following realized and unrealized components related to non-hedge derivatives and the ineffective portion of hedge derivatives:

<i>(in millions)</i>	2009	2008	2007
Net cash received from counterparties	\$(106)	\$(13)	\$(54)
Non-cash change in derivative fair value	130	(72)	43
Derivative fair value (gain) loss	\$ 24	\$(85)	\$(11)

Fair Value of Financial Instruments

Because of their short-term maturity, the fair value of cash and cash equivalents, accounts receivable and accounts payable approximates their carrying values at December 31, 2009 and 2008. The following are estimated fair values and carrying values of our other financial instruments at each of these dates:

<i>(in millions)</i>	Asset (Liability)			
	December 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Net derivative asset	\$ 1,117	\$ 1,117	\$ 3,723	\$ 3,723
Total debt	\$(10,487)	\$(11,526)	\$(11,959)	\$(11,421)

The fair value of our debt is based upon current market quotes and is the estimated amount required to purchase our debt on the open market. The estimated value does not include any redemption premium.

Fair Value Measurements

Fair value is defined as the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, use of unobservable prices or inputs are used to estimate the current fair value, often using an internal valuation model. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the item being valued.

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Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities are as follows:

Level I—Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level II—Inputs (other than quoted prices included in Level I) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level III—Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The fair value of our derivative contracts are measured using Level II inputs, and are determined by either market prices on an active market for similar assets or by prices quoted by a broker or other market-corroborated prices. Counterparty credit risk is considered when determining the fair value of our derivative contracts. While our counterparties are generally A- or better rated companies, the fair value of our derivative contracts have been adjusted to account for the risk of nonperformance by the counterparty.

Our asset retirement obligation is measured using primarily Level III inputs. The significant unobservable inputs to this fair value measurement include estimates of plugging, abandonment and remediation costs, inflation rate and well life. The inputs are calculated based on historical data as well as current estimated costs. See Note 5 for a rollforward of the asset retirement obligation.

The following table summarizes our fair value measurements and the level within the fair value hierarchy in which the fair value measurements fall.

	Fair Value Measurements			
	December 31, 2009		December 31, 2008	
	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in millions)				
Net derivative asset	\$ 1,117	\$ —	\$ 3,723	\$ —
Asset retirement obligation	\$ —	\$ (812)	\$ —	\$ (759)

Concentrations of Credit Risk

Cash equivalents are high-grade, short-term securities, placed with highly rated financial institutions. Most of our receivables are from a diverse group of companies including major energy companies, pipeline companies, local distribution companies, financial institutions and end-users in various industries. We currently have greater concentrations of credit with several A- or better rated companies. Letters of credit or other appropriate security are obtained as considered necessary to limit risk of loss. Financial and commodity-based swap contracts expose us to the credit risk of nonperformance by the counterparty to the contracts. This exposure is diversified among major investment grade financial institutions, and we have master netting agreements with most counterparties that provide for offsetting payables against receivables from separate derivative contracts. None of our derivative contracts contain credit-risk related contingent features that would require collateralization based on any triggering events. In September 2008, the parent company of one of our counterparties, Lehman Brothers Holdings Inc., filed for bankruptcy, and we recognized a \$38 million loss (\$24 million after-tax) in derivative fair value (gain) loss in the income statement.