ANADARKO PETROLEUM CORP
Form 10-Q
May 04, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2010

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the transition period from to

Commission File No. 1-8968

ANADARKO PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**76-0146568**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1201 Lake Robbins Drive, The Woodlands, Texas 77380-1046

(Address of principal executive offices)

Registrant s telephone number, including area code **(832) 636-1000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the Company s common stock as of March 31, 2010 is shown below:

Title of Class	**Number of Shares Outstanding**
Common Stock, par value $0.10 per share	494,744,305

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

millions except per-share amounts	Quarter Ended March 31, 2010	Quarter Ended March 31, 2009
Revenues and Other		
Gas sales	**$ 1,081**	$ 871
Oil and condensate sales	**1,502**	636
Natural-gas liquids sales	**274**	83
Gathering, processing and marketing sales	**273**	161
Gains (losses) on divestitures and other, net	**9**	45
Total	**3,139**	1,796
Costs and Expenses		
Oil and gas operating	**187**	241
Oil and gas transportation and other	**191**	174
Exploration	**155**	301
Gathering, processing and marketing	**183**	135
General and administrative	**210**	209
Depreciation, depletion and amortization	**981**	806
Other taxes	**301**	150
Impairments	**12**	51
Total	**2,220**	2,067
Operating Income (Loss)	**919**	(271)
Other (Income) Expense		
Interest expense	**224**	182
(Gains) losses on commodity derivatives, net	**(588)**	201
(Gains) losses on other derivatives, net	**29**	(98)
Other (income) expense, net	**9**	(11)
Total	**(326)**	274
Income (Loss) Before Income Taxes	**1,245**	(545)
Income Tax Expense (Benefit)	**517**	(214)
Net Income (Loss)	**728**	(331)
Net Income Attributable to Noncontrolling Interests	**12**	7
Net Income (Loss) Attributable to Common Stockholders	**$ 716**	$ (338)
Per Common Share:		
Net income (loss) attributable to common stockholders basic	**$ 1.44**	$ (0.73)
Net income (loss) attributable to common stockholders diluted	**$ 1.43**	$ (0.73)
Average Number of Common Shares Outstanding Basic	**493**	460

Average Number of Common Shares Outstanding Diluted	**496**	460
Dividends (per Common Share)	**$ 0.09**	$ 0.09

See accompanying notes to consolidated financial statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

millions	**March 31, 2010**	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 3,692**	$ 3,531
Accounts receivable, net of allowance:		
Customers	**1,097**	1,019
Others	**1,002**	1,033
Other current assets	**611**	500
Total	**6,402**	6,083
Properties and Equipment		
Cost	**51,422**	50,344
Less accumulated depreciation, depletion and amortization	**14,069**	13,140
Net properties and equipment	**37,353**	37,204
Other Assets	**1,640**	1,514
Goodwill and Other Intangible Assets	**5,313**	5,322
Total Assets	**$ 50,708**	$ 50,123
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	**$ 2,449**	$ 2,876
Accrued expenses	**972**	948
Current debt	**478**	
Total	**3,899**	3,824
Long-term Debt	**11,110**	11,149
Midstream Subsidiary Note Payable to a Related Party	**1,349**	1,599
Other Long-term Liabilities		
Deferred income taxes	**9,952**	9,925
Other	**3,273**	3,211
Total	**13,225**	13,136
Equity		
Stockholders Equity		
Common stock, par value $0.10 per share (1.0 billion shares authorized, 507.6 million and 505.0 million shares issued as of March 31, 2010, and December 31, 2009, respectively)	**51**	50
Paid-in capital	**7,348**	7,243
Retained earnings	**14,539**	13,868
Treasury stock (12.8 million and 12.4 million shares as of March 31, 2010, and December 31, 2009, respectively)	**(749)**	(721)

Accumulated other comprehensive income (loss)		**(522)**		(512)
Total Stockholders Equity		**20,667**		19,928
Noncontrolling Interests		**458**		487
Total Equity		**21,125**		20,415
Commitments and Contingencies (Note 8)				
Total Liabilities and Equity	**$**	**50,708**	$	50,123

See accompanying notes to consolidated financial statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENT OF EQUITY

(Unaudited)

	Total Stockholders Equity							
millions	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity	Noncontrolling Interests	Total Equity
Balance at December 31, 2009	$ 50	$ 7,243	$ 13,868	$ (721)	$ (512)	$ 19,928	$ 487	$ 20,415
Net income (loss)			**716**			**716**	**12**	**728**
Common stock issued	**1**	**105**				**106**		**106**
Dividends			**(45)**			**(45)**		**(45)**
Repurchase of common stock				**(28)**		**(28)**		**(28)**
Distributions to noncontrolling interest owners and other, net							**(41)**	**(41)**
Previously deferred losses on derivative instruments					**4**	**4**		**4**
Pension and other postretirement plans adjustments					**(14)**	**(14)**		**(14)**
Balance at March 31, 2010	**$ 51**	**$ 7,348**	**$ 14,539**	**$ (749)**	**$ (522)**	**$ 20,667**	**$ 458**	**$ 21,125**

See accompanying notes to consolidated financial statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Quarter Ended March 31,	
millions	**2010**	2009
Net Income (Loss)	**$ 728**	$ (331)
Other Comprehensive Income (Loss), net of taxes		
Previously deferred losses on derivative instruments[1]	**4**	6
Pension and other postretirement plans adjustments:		
Net gain (loss) incurred during period[2]	**(25)**	
Amortization of net actuarial loss to net periodic benefit cost[3]	**11**	8
Total	**(10)**	14
Comprehensive Income (Loss)	**718**	(317)
Comprehensive Income Attributable to Noncontrolling Interests	**12**	7
Comprehensive Income (Loss) Attributable to Common Stockholders	**$ 706**	$ (324)

[1] Net of income tax benefit (expense) of $(2) million and $(3) million for the quarters ended March 31, 2010 and 2009, respectively.
[2] Net of income tax benefit (expense) of $14 million and $0 million for the quarters ended March 31, 2010 and 2009, respectively.
[3] Net of income tax benefit (expense) of $(6) million and $(5) million for the quarters ended March 31, 2010 and 2009, respectively.

See accompanying notes to consolidated financial statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

millions	**Quarter Ended March 31, 2010**	2009
Cash Flow from Operating Activities		
Net income (loss)	**$ 728**	$ (331)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	**981**	806
Deferred income taxes	**154**	(299)
Dry hole expense and impairments of unproved properties	**113**	228
Impairments	**12**	51
(Gains) losses on divestitures, net	**(13)**	(10)
Unrealized (gains) losses on derivatives	**(545)**	240
Other non-cash items	**100**	47
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	**(27)**	256
Increase (decrease) in accounts payable and accrued expenses	**(281)**	(589)
Other items net	**95**	134
Net cash provided by (used in) operating activities	**1,317**	533
Cash Flow from Investing Activities		
Additions to properties and equipment and dry hole costs	**(1,178)**	(1,133)
Divestitures of properties and equipment and other assets	**8**	5
Other net	**(11)**	(7)
Net cash provided by (used in) investing activities	**(1,181)**	(1,135)
Cash Flow from Financing Activities		
Borrowings, net of issuance costs	**947**	1,088
Retirements of debt	**(562)**	(451)
Repayment of midstream subsidiary note payable to a related party	**(250)**	
Increase (decrease) in accounts payable, banks	**(82)**	(174)
Dividends paid	**(45)**	(42)
Repurchase of common stock	**(28)**	(8)
Issuance of common stock, including tax benefit on stock option exercises	**67**	
Distributions to noncontrolling interest owners	**(11)**	(6)
Net cash provided by (used in) financing activities	**36**	407
Effect of Exchange Rate Changes on Cash	**(11)**	
Net Increase (Decrease) in Cash and Cash Equivalents	**161**	(195)
Cash and Cash Equivalents at Beginning of Period	**3,531**	2,360
Cash and Cash Equivalents at End of Period	**$ 3,692**	$ 2,165

See accompanying notes to consolidated financial statements.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

General Anadarko Petroleum Corporation is engaged in the exploration, development, production and marketing of natural gas, crude oil, condensate and natural gas liquids (NGLs). The Company also engages in the gathering, processing and treating of natural gas, and transporting natural gas, crude oil and NGLs. The Company also participates in the hard minerals business through its ownership of non-operated joint ventures and royalty arrangements. The terms Anadarko and Company refer to Anadarko Petroleum Corporation and its consolidated subsidiaries.

The accompanying financial statements and notes should be read in conjunction with the Company s 2009 Annual Report on Form 10-K.

Basis of Presentation The information, as furnished herein, reflects all normal recurring adjustments that are, in the opinion of management, necessary for the fair presentation of the Company s Consolidated Balance Sheets as of March 31, 2010, and December 31, 2009, the Consolidated Statements of Income, Comprehensive Income and Cash Flows for the quarters ended March 31, 2010, and 2009, and the Consolidated Statement of Equity for the quarter ended March 31, 2010. Certain prior-period amounts have been reclassified to conform to the current-period presentation.

In the fourth quarter of 2009, the Company changed the manner in which gains and losses on commodity derivatives, used to economically hedge production, are presented within the Consolidated Statements of Income to provide enhanced transparency into asset operating performance. Previously, all realized and unrealized gains and losses on commodity derivatives were reported in gas sales, oil and condensate sales or NGLs sales. Gains and losses on commodity derivatives are now presented as a separate line item on the Consolidated Statements of Income. Prior periods have been reclassified to conform to this presentation. See Note 5 for disclosures regarding derivative instruments.

In preparing financial statements in accordance with accounting principles generally accepted in the United States, management makes informed judgments and estimates that affect both the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the periods reported. Management reviews its estimates periodically, including those related to the carrying value of properties and equipment, proved reserves, goodwill, intangible assets, asset retirement obligations, litigation reserves, environmental liabilities, pension liabilities and costs, income taxes and fair values. Changes in facts and circumstances or additional information may result in revised estimates and actual results may differ from these estimates.

Changes in Accounting Principles Effective January 1, 2010, the Company adopted revised oil and gas reserve estimation standards. These standards allow the use of reliable technology in determining estimates of proved reserve quantities and require the use of a 12-month first-day-of-the-month average price to estimate proved reserves. Adoption of these new standards did not have a material impact on depreciation, depletion and amortization expense.

The Company adopted amendments to consolidation guidance applicable to variable interest entities, effective January 1, 2010. The revised guidance did not have an impact on the Company s consolidated financial statements, but did result in expanded disclosures related to the Company s maximum exposure to loss and conclusions regarding control and consolidation. See Note 4.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Inventories

The major classes of inventories, included in other current assets, are as follows:

millions	**March 31, 2010**	December 31, 2009
Crude oil and NGLs	**$ 112**	$ 142
Natural gas	**37**	94
Total	**$ 149**	$ 236

3. Properties and Equipment

Suspended Exploratory Drilling Costs The Company s capitalized suspended well costs at March 31, 2010, and December 31, 2009, were $734 million and $579 million, respectively. The increase primarily relates to capitalization of additional costs associated with successful exploration drilling activities in Brazil and the Gulf of Mexico. For the quarter ended March 31, 2010, $2 million of exploratory well costs, previously capitalized as suspended well costs for greater than one year, were charged to dry hole expense. In addition, during the quarter ended March 31, 2010, $43 million of capitalized suspended well costs were reclassified to proved properties.

Management believes projects with suspended exploratory drilling costs exhibit sufficient quantities of hydrocarbons to justify potential development and is actively pursuing efforts to assess whether reserves can be attributed to these areas. If additional information becomes available that raises substantial doubt as to the economic or operational viability of any of these projects, the associated costs will be expensed at that time.

4. Investments

Noncontrolling Mandatorily Redeemable Interests In 2007, Anadarko contributed certain of its oil and gas properties and gathering and processing assets with an aggregate fair value of $2.9 billion at the time of the contribution to newly formed unconsolidated entities in exchange for noncontrolling mandatorily redeemable interests in those entities. Subsequent to their formation, the investee entities loaned Anadarko an aggregate of $2.9 billion. The Company accounts for its investment in these entities under the equity method of accounting. At March 31, 2010, the carrying amount of these investments was $2.8 billion, while the carrying amount of notes payable to affiliates was $2.9 billion. Anadarko has legal right of setoff and intends to net-settle its obligations under each of the notes payable to the investees with the distributable value of its interest in the corresponding investee. Accordingly, the investments and the obligations are presented net on the consolidated balance sheets with the excess of the notes payable to affiliates over the aggregate investment carrying amount reported in other long-term liabilities other for all periods presented. Other (income) expense, net for the quarters ended March 31, 2010 and 2009, includes interest expense on the notes payable to the investee entities of $9 million and $20 million, respectively. Other (income) expense, net also includes equity in earnings from Anadarko s investments in the investee entities of $(9) million for the quarters ended March 31, 2010 and 2009.

Investment Associated with Midstream Subsidiary Note In December 2007, Anadarko, and an entity formed by a group of unrelated third-party investors (the Investor), formed Trinity Associates LLC (Trinity), a variable interest entity. Trinity was initially capitalized with a $100 million cash contribution by Anadarko in exchange for Class A member and managing member interests in Trinity, and a $2.2 billion cash contribution by the Investor in exchange for a Class B member cumulative preferred interest. Trinity invested $100 million in a U.S. Government securities money market fund (the Fund) and loaned $2.2 billion to a wholly owned midstream subsidiary of Anadarko (Midstream Holding).

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Investments (Continued)

Trinity s assets consist of $100 million invested in the Fund and the $1.3 billion note receivable from Midstream Holding. Trinity s earnings, which consist primarily of interest income from the note receivable and the Fund, are allocated first to the Investor s Class B member interest, until its cumulative preferred return is satisfied, with the remaining earnings allocated to Anadarko s Class A member interest. These earnings-allocation provisions generally result in Anadarko receiving a minor share of Trinity s total earnings, consistent with the relative sizes of Anadarko s Class A and the Investor s Class B member capital account balances. Should Trinity incur a loss, Anadarko would absorb first-dollar losses of Trinity, until its Class A member capital account in Trinity is reduced to zero.

Through its Class A member and managing member interests, Anadarko has significant influence over Trinity; therefore, Anadarko accounts for its investment in Trinity under the equity method of accounting. As of March 31, 2010, the carrying amount of Anadarko s investment in Trinity, reported in other assets, and the Company s maximum exposure to loss were each $100 million. Anadarko does not hold a controlling financial interest in Trinity because it does not have the power, without the Investor s consent, to direct activities that are significant to Trinity s economic performance. Further, Anadarko s right to allocated Trinity earnings and its obligation to absorb first-dollar losses of Trinity, if any, do not have the potential to be significant relative to the total potential earnings and losses of Trinity.

Note Payable The principal balance owed by Midstream Holding to Trinity is described in the accompanying consolidated balance sheets as Midstream Subsidiary Note Payable to a Related Party (the Loan). The Loan has an initial maturity date of December 27, 2012, subject to renewals for additional five-year periods on market terms at the time of renewal, as approved by the Investor and Anadarko. Interest on the Loan is based on the three-month London Interbank Offered Rate (LIBOR) plus a margin. The rate in effect during the first quarter of 2010 was 1.37%. Following a sale or transfer of assets to third parties or other entities within Anadarko, Midstream Holding and/or its subsidiaries is required to repay a portion of the Loan principal. Midstream Holding may otherwise repay the Loan in whole or in part at any time prior to maturity. See Note 6 for information on repayments of the Loan during the quarter ended March 31, 2010. Midstream Holding s obligation for principal and interest payments is guaranteed by Anadarko Petroleum Corporation. If Anadarko s senior unsecured credit rating falls below BB- by Standard and Poor s (S&P) or Ba3 by Moody s Investors Service (Moody s), maturity of the Loan could be accelerated.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Derivative Instruments

Objective & Strategy The Company is exposed to commodity price and interest-rate risk, and management considers it prudent to periodically enter into derivative instruments in order to manage the Company s exposure to cash flow variability resulting from these risks.

Futures, swaps and options are used to manage the Company s exposure to commodity price risk inherent in the Company s oil and gas production and gas-processing operations (Oil and Gas Production/Processing Derivative Activities). Futures contracts and commodity swap agreements are used to fix the price of expected future oil and gas sales at major industry trading locations, such as Henry Hub, Louisiana for gas and Cushing, Oklahoma for oil. Basis swaps are used to fix or float the price differential between the product price at one market location versus another. Options are used to establish a floor and a ceiling price (collar) for expected future oil and gas sales. Derivative instruments are also used to manage commodity price risk inherent in customer pricing requirements and to fix margins on the future sale of natural gas and NGLs from the Company s leased storage facilities (Marketing and Trading Derivative Activities).

The Company may also enter into physical-delivery sales contracts to manage cash flow variability. These contracts call for the receipt or delivery of physical product at a specified location and price, which may be fixed or market-based.

Interest-rate swaps are used to fix or float interest rates on existing or anticipated indebtedness. The purpose of these instruments is to mitigate the Company s existing or anticipated exposure to unfavorable interest-rate changes.

The Company does not apply hedge accounting to any of its derivative instruments. The application of hedge accounting was discontinued by the Company for periods beginning on or after January 1, 2007. As a result, both realized and unrealized gains and losses associated with derivative instruments are recognized in earnings. Net derivative losses attributable to derivatives previously subject to hedge accounting reside in accumulated other comprehensive income (loss) and are reclassified to earnings in future periods as the economic transactions to which the derivatives relate are recorded in earnings.

The accumulated other comprehensive loss balances related to commodity derivatives at March 31, 2010, and December 31, 2009, were $8 million ($5 million after tax) and $10 million ($7 million after tax), respectively. The accumulated other comprehensive loss balances related to interest-rate derivatives at March 31, 2010, and December 31, 2009, were $137 million ($87 million after tax) and $141 million ($89 million after tax), respectively.

ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Derivative Instruments (Continued)

Oil and Gas Production/Processing Derivative Activities Below is a summary of the Company s derivative instruments related to its oil and gas production as of March 31, 2010. The natural-gas prices listed below are New York Mercantile Exchange (NYMEX) Henry Hub prices. The crude-oil prices listed below reflect a combination of NYMEX Cushing and London Brent Dated prices.

	2010	2011	2012
Natural Gas			
Three-Way Collars (thousand MMBtu/d)	1,630	480	500
Average price per MMBtu			
Ceiling sold price (call)	$ 8.23	$ 8.29	$ 9.03
Floor purchased price (put)	$ 5.59	$ 6.50	$ 6.50
Floor sold price (put)	$ 4.22	$ 5.00	$ 5.00
Fixed-Price Contracts (thousand MMBtu/d)	90	90	
Average price per MMBtu	$ 6.10	$ 6.17	$
Basis Swaps (thousand MMBtu/d)	620	45	
Average price per MMBtu	$ (0.98)	$ (1.74)	$

MMBtu million British thermal units

MMBtu/d million British thermal units per day

	2010	2011	2012
Crude Oil			
Three-Way Collars (MBbls/d)	129	126	2
Average price per barrel			
Ceiling sold price (call)	$ 90.73	$ 99.95	$ 92.50
Floor purchased price (put)	$ 64.34	$ 79.29	$ 50.00
Floor sold price (put)	$ 49.34	$ 64.29	$ 35.00

MBbls/d thousand barrels per day

A three-way collar is a combination of three options: a sold call, a purchased put and a sold put. The sold call establishes the maximum price that the Company will receive for the contracted commodity volumes. The purchased put establishes the minimum price that the Company will receive for the contracted volumes unless the market price for the commodity falls below the sold put strike price, at which point the minimum price equals the reference price (*i.e.*, NYMEX) plus the excess of the purchased put strike price over the sold put strike price.

Marketing and Trading Derivative Activities In addition to the positions in the above tables, the Company also engages in marketing and trading activities, which include physical product sales and derivative transactions entered into to reduce commodity price risk associated with certain physical product sales. At March 31, 2010, and December 31, 2009, the Company had outstanding physical transactions related to natural gas for 40 billion cubic feet (Bcf) and 46 Bcf, respectively, offset by derivative transactions for 28 Bcf and 17 Bcf, respectively, for net positions of 12 Bcf and 29 Bcf, respectively.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Derivative Instruments (Continued)

Interest-Rate Derivatives Anadarko entered into interest-rate swap agreements to mitigate the risk of rising interest rates on $3.0 billion of debt expected to be refinanced in 2011 and 2012, over a reference term of either 10 years or 30 years. The Company locked in a fixed interest rate in exchange for a floating interest rate indexed to the three-month LIBOR. The swap instruments include a provision that requires both the termination of the swaps and cash settlement in full at the start of the reference period.

Unrealized (gains) losses of $27 million and $(110) million on these swap agreements are reported in (gains) losses on other derivatives, net for the quarters ended March 31, 2010 and 2009, respectively. A summary of the swaps outstanding as of March 31, 2010, including the outstanding notional principal amounts and the associated reference periods, is shown in the table below.

millions except percentages	Reference Period		Weighted-Average
Notional Principal Amount:	**Start**	**End**	**Interest Rate**
$ 750	October 2011	October 2021	4.72%
$ 1,250	October 2011	October 2041	4.83%
$ 250	October 2012	October 2022	4.91%
$ 750	October 2012	October 2042	4.80%

During the first quarter of 2009, Anadarko issued fixed-rate senior notes in the aggregate principal amount of $1.1 billion. In advance of certain of these debt issuances, Anadarko entered into derivative financial instruments, effectively hedging the U.S. Treasury portion of the coupon rate on a portion of this debt. These derivative instruments were settled concurrently with the associated debt issuances, resulting in a realized loss of $13 million for the quarter ended March 31, 2009, reflected in (gains) losses on other derivatives, net.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Derivative Instruments (Continued)

Effect of Derivative Instruments Balance Sheet The fair value of all derivative instruments not designated as hedging instruments (including physical-delivery sales contracts) is included in the table below.

millions	**Balance Sheet**	**Gross Derivative Assets**		**Gross Derivative Liabilities**	
Derivatives	**Classification**	**March 31, 2010**	December 31, 2009	**March 31, 2010**	December 31, 2009
Commodity					
	Other Current Assets	**$ 597**	$ 140	**$ (233)**	$ (63)
	Other Assets	**276**	82	**(74)**	(6)
	Accrued Expenses	**159**	195	**(223)**	(417)
	Other Liabilities	**20**	25	**(41)**	(52)
		1,052	442	**(571)**	(538)
Interest Rate and Other					
	Other Assets	**45**	53		
	Accrued Expenses			**(1)**	
	Other Liabilities			**(23)**	(3)
		45	53	**(24)**	(3)
Total Derivatives		**$ 1,097**	$ 495	**$ (595)**	$ (541)

Effect of Derivative Instruments Statement of Income The unrealized and realized gain or loss amounts and classification related to derivative instruments not designated as hedging instruments are as follows:

millions		**(Gain) Loss Quarter Ended March 31, 2010**		
Derivatives	**Classification of (Gain) Loss Recognized**	**Realized**	**Unrealized**	**Total**
Commodity	Gathering, Processing and Marketing Sales*	$	$ (7)	$ (7)
	(Gains) Losses on Commodity Derivatives, net	(21)	(567)	(588)
Interest Rate and Other	(Gains) Losses on Other Derivatives, net		29	29
Derivative (Gain) Loss, Net		$ (21)	$ (545)	$ (566)

* Represents the effect of marketing and trading derivative activities.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Derivative Instruments (Continued)

millions		(Gain) Loss Quarter Ended March 31, 2009		
Derivatives	**Classification of (Gain) Loss Recognized**	**Realized**	**Unrealized**	**Total**
Commodity	Gathering, Processing and Marketing Sales*	$ (22)	$ 29	$ 7
	(Gains) Losses on Commodity Derivatives, net	(123)	324	201
Interest Rate	(Gains) Losses on Other Derivatives, net	15	(113)	(98)
Derivative (Gain) Loss, Net		$ (130)	$ 240	$ 110

* Represents the effect of marketing and trading derivative activities.

Credit-Risk Considerations The financial integrity of exchange-traded contracts are assured by NYMEX or the Intercontinental Exchange through their systems of financial safeguards and transaction guarantees and are subject to nominal credit risk. Over-the-counter traded swaps, options and futures contracts expose the Company to counterparty credit risk. The Company monitors the creditworthiness of its counterparties, establishes credit limits according to the Company s credit policies and guidelines, and assesses the impact, if any, of a counterparty s creditworthiness on fair value. The Company has the ability to require cash collateral or letters of credit to mitigate credit-risk exposure. The Company also routinely exercises its contractual right to net realized gains against realized losses when settling with its counterparties.

Included in the Company s $1.1 billion gross derivative asset balance at March 31, 2010, is $829 million attributable to open positions with financial institutions. The Company has netting and setoff agreements with each of these counterparties, which permit the net settlement of gross derivative assets against gross derivative liabilities. As of March 31, 2010, $427 million of the Company s $595 million gross derivative liability balance is permitted to offset the gross derivative asset balance with financial institutions. The table below includes the financial impact of the Company s total netting arrangements.

Certain of the Company s derivative instruments contain provisions requiring either full or partial collateralization of the Company s obligations, or the immediate settlement of all such obligations in the event of a downgrade in the Company s credit rating to a level below investment grade from major credit rating agencies. The aggregate fair value of all derivative instruments with credit-risk-related contingent features, for which a net liability position existed on March 31, 2010, was $50 million. This amount represents the amount that the Company would have to either collateralize or cash settle in the event the Company s credit rating was downgraded to a level below investment grade and the credit-risk-related features of such instruments were exercised.

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5. Derivative Instruments (Continued)

Fair Value Fair value of futures contracts is based on inputs that represent quoted prices in active markets for identical assets or liabilities, resulting in Level 1 categorization of such measurements. Valuations of physical-delivery purchase and sale agreements, over-the-counter financial swaps, and commodity option collars are based on similar transactions observable in active markets and industry-standard models that primarily rely on market-observable inputs. Anadarko uses the Black-Scholes model for option valuations. Inputs used in the Company s derivative valuations include market-price curves, contract term and prices, and, for option valuations, implied market volatility and discount factors. Because substantially all of the assumptions and inputs for industry-standard models are observable in active markets throughout the full term of the instruments, the Company categorizes each of these measurements as Level 2.

The following table sets forth, by level within the fair-value hierarchy, the fair value of the Company s derivative financial assets and liabilities.

March 31, 2010

millions	**Level 1**	**Level 2**	**Level 3**	**Netting and Collateral** [1]	**Total**
Assets:					
Commodity derivatives	$ 4	$ 1,048	$	$ (486)	$ 566
Interest-rate and other derivatives		45			45
Total	$ 4	$ 1,093	$	$ (486)	$ 611
Liabilities:					
Commodity derivatives	$ (6)	$ (565)	$	$ 495	$ (76)
Interest-rate and other derivatives		(24)			(24)
Total	$ (6)	$ (589)	$	$ 495	$ (100)

[1] Represents the impact of netting assets, liabilities and collateral with counterparties where the right of setoff exists. Cash collateral held by counterparties from Anadarko was $24 million at March 31, 2010. Anadarko held $3 million of cash collateral from counterparties at March 31, 2010.

December 31, 2009

millions	**Level 1**	**Level 2**	**Level 3**	**Netting and Collateral** [1]	**Total**
Assets:					
Commodity derivatives	$ 4	$ 438	$	$ (289)	$ 153
Interest-rate derivatives		53			53
Total	$ 4	$ 491	$	$ (289)	$ 206

Liabilities:					
Commodity derivatives	$ (6)	$ (532)	$	$ 333	$ (205)
Interest-rate derivatives		(3)			(3)
Total	$ (6)	$ (535)	$	$ 333	$ (208)

(1) Represents the impact of netting assets, liabilities and collateral with counterparties where the right of setoff exists. Cash collateral held by counterparties from Anadarko was $105 million at December 31, 2009. Anadarko held no cash collateral from counterparties at December 31, 2009.

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6. Debt and Interest Expense

Debt The following table presents the outstanding debt of the Company as of March 31, 2010, and December 31, 2009. See Note 4 for disclosure regarding Anadarko s notes payable related to its ownership of certain noncontrolling mandatorily redeemable interests that do not affect the Company s reported debt balance or consolidated interest expense.

	March 31, 2010			December 31, 2009		
millions	**Principal**	**Carrying Value**	**Fair Value**	Principal	Carrying Value	Fair Value
Current and long-term notes and debentures	**$ 13,131**	**$ 11,378**	**$ 12,342**	$ 12,909	$ 11,149	$ 12,133
Midstream subsidiary note payable to a related party	**1,349**	**1,349**	**1,349**	1,599	1,599	1,599
WES* credit facility borrowing	**210**	**210**	**210**			
Total debt	**$ 14,690**	**$ 12,937**	**$ 13,901**	$ 14,508	$ 12,748	$ 13,732

* Western Gas Partners, LP (WES), a consolidated subsidiary of Anadarko

The following table presents the debt activity of the Company for the quarter ended March 31, 2010.

millions	**Activity**	**Principal**	**Carrying Value**	**Description**
Balance as of December 31, 2009		$ 14,508	$ 12,748	
	Issuance	**750**	**745**	6.200% Senior Notes due 2040
	WES borrowing	**210**	**210**	WES credit facility borrowing
	Retirements	**(528)**	**(522)**	Tender-offer repurchases
	Repayments	**(250)**	**(250)**	Midstream subsidiary note repayment
	Other, net		**6**	Accretion and discount amortization
Balance as of March 31, 2010		**$ 14,690**	**$ 12,937**	

In March 2010, Anadarko commenced a cash tender offer for up to $1.0 billion aggregate principal amount of specified series of its outstanding debt. Pursuant to the tender-offer terms, the Company repurchased $528 million and $472 million principal amount of debt in March 2010 and April 2010, respectively, as summarized in the following table.

millions			**Principal Amount**	
Description	**Month of Repurchase**	**Early-Tender Premium**	**Repurchased**	**Remaining Outstanding Balance**
6.750% Notes due 2011	March 2010	$ 34	$ 528	$ 422

6.875% Notes due 2011	April 2010	32	390	285
6.125% Notes due 2012	April 2010	3	38	132
5.000% Notes due 2012	April 2010	2	44	38
		$ 71	$ 1,000	$ 877

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6. Debt and Interest Expense (Continued)

At March 31, 2010, Anadarko was in compliance with the covenants contained in its $1.3 billion committed revolving credit agreement (RCA), available through March 2013, and the full amount of the RCA was available for borrowing.

At March 31, 2010, WES was in compliance with its $350 million senior unsecured revolving credit facility (RCF). Outstanding borrowings under the RCF, at an annual interest rate of 2.62%, were $210 million at March 31, 2010.

Interest Expense The following table summarizes the amounts included in interest expense.

millions	**Quarter Ended March 31, 2010**	**Quarter Ended March 31, 2009**
Gross interest expense		
Current debt, long-term debt and other	**$ 202**	$ 187
Midstream subsidiary note payable to a related party	**7**	12
(Gain) loss on early retirements of debt	**40**	(1)
Capitalized interest	**(25)**	(16)
Net interest expense	**$ 224**	$ 182

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7. Stockholders Equity

Common Stock The reconciliation between basic and diluted earnings per share (EPS) from income attributable to common stockholders is as follows:

millions except per-share amounts	Quarter Ended March 31, **2010**	2009
Income (loss):		
Income (loss) attributable to common stockholders	**$ 716**	$ (338)
Less: Distributions on participating securities		
Less: Undistributed income allocated to participating securities	**5**	
Basic	**$ 711**	$ (338)
Diluted	**$ 711**	$ (338)
Shares:		
Basic		
Weighted-average common shares outstanding	**493**	460
Dilutive effect of stock options and performance-based stock awards	**3**	
Diluted	**496**	460
Income (loss) per common share:		
Basic	**$ 1.44**	$ (0.73)
Diluted	**$ 1.43**	$ (0.73)

For the quarters ended March 31, 2010 and 2009, 5 million and 13 million average shares, respectively, of common stock were excluded from the diluted EPS calculation because the inclusion of these shares would have had an anti-dilutive effect. For all periods presented, quarterly dividends of nine cents per share were paid to holders of common stock.

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8. Commitments and Contingencies

General Litigation charges and adjustments of $4 million and $13 million increased earnings during the first quarter of 2010 and 2009, respectively. The Company is a defendant in a number of lawsuits and is involved in governmental proceedings, including, but not limited to, royalty claims, contract claims and environmental claims. The Company has also been named as a defendant in various personal injury claims, including claims by employees of third-party contractors alleging exposure to asbestos, silica and benzene while working at refineries (previously owned by predecessors of acquired companies) located in Texas, California and Oklahoma. While the ultimate outcome and impact on the Company cannot be predicted with certainty, management believes that the resolution of these proceedings will not have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

Litigation The Company is subject to various claims by its royalty owners in the regular course of business as an oil and gas producer, including disputes regarding measurement, post-production costs and expenses and royalty valuations. The Company was named as a defendant in a case styled *U.S. of America ex rel. Harold E. Wright v. AGIP Company, et al.* filed in September 2000 in the U.S. District Court for the Eastern District of Texas, Lufkin Division. Kerr-McGee Corporation (Kerr-McGee) was also named as a defendant in this legal proceeding. This lawsuit generally alleges that the Company, including Kerr-McGee, and other industry defendants knowingly undervalued natural gas in connection with royalty payments on production from federal and Indian lands. Based on the Company s present understanding of these various governmental and False Claims Act proceedings, the Company believes that it has substantial defenses to these claims and is vigorously asserting such defenses. However, if the Company is found to have violated the False Claims Act, the Company could be subject to a variety of damages, including treble damages and substantial monetary fines. The discovery process is ongoing. The claims against the Company have yet to be set for trial. The Company is currently in settlement discussions with the U.S. Government to resolve this litigation against Anadarko and Kerr-McGee, as well as any related administrative actions. Management has accrued a liability for the estimated settlement amount. The Company believes that an additional loss, in excess of the amount accrued, is unlikely to have a material adverse effect on Anadarko s consolidated financial position, results of operations or cash flows.

Deepwater Royalty Relief Act In 1995, the United States Congress passed the Deepwater Royalty Relief Act (DWRRA) to stimulate exploration and production of oil and natural gas by providing relief from the obligation to pay royalties on certain federal leases located in the deep waters of the Gulf of Mexico. The Company currently owns interests in several deepwater Gulf of Mexico leases. After the passage of the DWRRA, the Minerals Management Service (MMS), an agency of the Department of the Interior (DOI), inserted price thresholds into leases issued in 1996, 1997 and 2000 that effectively eliminated the DWRRA royalty relief if these price thresholds were exceeded.