ANADARKO PETROLEUM CORP
Form 10-Q
July 27, 2011
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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 June 30, 2011

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 June 30, 2011, is shown below:

Title of Class	Number of Shares Outstanding
Common Stock, par value $0.10 per share	497,809,244

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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	Three Months Ended June 30, **2011**	Three Months Ended June 30, 2010	Six Months Ended June 30, **2011**	Six Months Ended June 30, 2010
Revenues and Other				
Natural-gas sales	**$ 870**	$ 802	**$ 1,724**	$ 1,883
Oil and condensate sales	**2,236**	1,338	**4,043**	2,840
Natural-gas liquids sales	**370**	235	**703**	509
Gathering, processing, and marketing sales	**258**	188	**488**	461
Gains (losses) on divestitures and other, net	**(58)**	41	**(29)**	50
Total	**3,676**	2,604	**6,929**	5,743
Costs and Expenses				
Oil and gas operating	**236**	196	**468**	383
Oil and gas transportation and other	**207**	196	**416**	387
Exploration	**236**	198	**415**	353
Gathering, processing, and marketing	**205**	149	**376**	332
General and administrative	**291**	203	**526**	413
Depreciation, depletion, and amortization	**985**	902	**1,970**	1,883
Other taxes	**413**	268	**757**	569
Impairments	**102**	115	**104**	127
Total	**2,675**	2,227	**5,032**	4,447
Operating Income (Loss)	**1,001**	377	**1,897**	1,296
Other (Income) Expense				
Interest expense	**216**	200	**436**	424
(Gains) losses on commodity derivatives, net	**(343)**	(264)	**(87)**	(852)
(Gains) losses on other derivatives, net	**144**	406	**85**	435
Other (income) expense, net	**(18)**	14	**(42)**	23
Total	**(1)**	356	**392**	30
Income (Loss) Before Income Taxes	**1,002**	21	**1,505**	1,266
Income Tax Expense (Benefit)	**440**	49	**706**	566
Net Income (Loss)	**562**	(28)	**799**	700
Net Income Attributable to Noncontrolling Interests	**18**	12	**39**	24
Net Income (Loss) Attributable to Common Stockholders	**$ 544**	$ (40)	**$ 760**	$ 676

Per Common Share:

Net income (loss) attributable to common stockholders basic	**$ 1.09**	$ (0.08)	**$ 1.52**	$ 1.36
Net income (loss) attributable to common stockholders diluted	**$ 1.08**	$ (0.08)	**$ 1.51**	$ 1.35
Average Number of Common Shares Outstanding Basic	**498**	495	**497**	494
Average Number of Common Shares Outstanding Diluted	**500**	495	**499**	496
Dividends (per Common Share)	**$ 0.09**	$ 0.09	**$ 0.18**	$ 0.18

See accompanying Notes to Consolidated Financial Statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

millions	**June 30, 2011**	December 31, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 3,406**	$ 3,680
Accounts receivable, net of allowance:		
Customers	**1,264**	1,032
Others	**1,662**	1,391
Other current assets	**538**	572
Total	**6,870**	6,675
Properties and Equipment		
Cost	**57,155**	54,815
Less accumulated depreciation, depletion, and amortization	**18,812**	16,858
Net properties and equipment	**38,343**	37,957
Other Assets	**1,568**	1,616
Goodwill and Other Intangible Assets	**5,836**	5,311
Total Assets	**$ 52,617**	$ 51,559
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	**$ 2,286**	$ 2,726
Accrued expenses	**1,416**	1,097
Current portion of long-term debt	**425**	291
Total	**4,127**	4,114
Long-term Debt	**12,801**	12,722
Other Long-term Liabilities		
Deferred income taxes	**10,077**	9,861
Asset retirement obligations	**1,555**	1,529
Other	**1,709**	1,894
Total	**13,341**	13,284
Equity		
Stockholders equity		
Common stock, par value $0.10 per share (1.0 billion shares authorized, 515.3 million and 513.3 million shares issued as of June 30, 2011, and December 31, 2010, respectively)	**51**	51
Paid-in capital	**7,611**	7,496
Retained earnings	**15,119**	14,449
Treasury stock (17.5 million and 17.1 million shares as of June 30, 2011, and December 31, 2010, respectively)	**(793)**	(763)

Accumulated other comprehensive income (loss)		**(517)**		(549)
Total Stockholders Equity		**21,471**		20,684
Noncontrolling interests		**877**		755
Total Equity		**22,348**		21,439
Total Liabilities and Equity	**$**	**52,617**	$	51,559

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)**	**Non-controlling Interests**	**Total Equity**
Balance at December 31, 2010	$ 51	$ 7,496	$ 14,449	$ (763)	$ (549)	$ 755	$ 21,439
Net income (loss)			760			39	799
Common stock issued		115					115
Dividends common			(90)				(90)
Repurchase of common stock				(30)			(30)
Sale of subsidiary units						130	130
Contributions from (distributions to) noncontrolling interest owners and other, net						(47)	(47)
Reclassification of previously deferred derivative losses to net income					5		5
Adjustments for pension and other postretirement plans					27		27
Balance at June 30, 2011	**$ 51**	**$ 7,611**	**$ 15,119**	**$ (793)**	**$ (517)**	**$ 877**	**$ 22,348**

See accompanying Notes to Consolidated Financial Statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

millions	Three Months Ended June 30, **2011**	2010	Six Months Ended June 30, **2011**	2010
Net Income (Loss)	**$ 562**	$ (28)	**$ 799**	$ 700
Other Comprehensive Income (Loss), net of taxes				
Reclassification of previously deferred derivative losses to net income [(1)]	**3**	4	**5**	8
Adjustments for pension and other postretirement plans:				
Net gain (loss) incurred during period [(2)]		4		(21)
Prior service credit (cost) incurred during period [(3)]		(4)		(4)
Amortization of net actuarial loss and prior service cost to net periodic benefit cost [(4)]	**13**	11	**27**	22
Total adjustments for pension and other postretirement plans	**13**	11	**27**	(3)
Total	**16**	15	**32**	5
Comprehensive Income (Loss)	**578**	(13)	**831**	705
Comprehensive Income Attributable to Noncontrolling Interests	**18**	12	**39**	24
Comprehensive Income (Loss) Attributable to Common Stockholders	**$ 560**	$ (25)	**$ 792**	$ 681

(1) Net of income tax benefit (expense) of $(1) million and $(3) million for the three months ended June 30, 2011, and 2010, respectively, and $(3) million and $(5) million for the six months ended June 30, 2011, and 2010, respectively.

(2) Net of income tax benefit (expense) of zero and $(2) million for the three months ended June 30, 2011, and 2010, respectively, and zero and $12 million for the six months ended June 30, 2011, and 2010, respectively.

(3) Net of income tax benefit (expense) of zero and $2 million for the three months ended June 30, 2011, and 2010, respectively, and zero and $2 million for the six months ended June 30, 2011, and 2010, respectively.

(4) Net of income tax benefit (expense) of $(8) million and $(6) million for the three months ended June 30, 2011, and 2010, respectively, and $(16) million and $(12) million for the six months ended June 30, 2011, and 2010, respectively.

See accompanying Notes to Consolidated Financial Statements.

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ANADARKO PETROLEUM CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

millions	Six Months Ended June 30, 2011	2010
Cash Flows from Operating Activities		
Net income (loss)	$ **799**	$ 700
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion, and amortization	**1,970**	1,883
Deferred income taxes	**258**	(97)
Dry hole expense and impairments of unproved properties	**227**	244
Impairments	**104**	127
(Gains) losses on divestitures, net	**18**	(15)
Unrealized (gains) losses on derivatives, net	**75**	(240)
Other	**61**	206
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	**(535)**	5
Increase (decrease) in accounts payable and accrued expenses	**241**	(229)
Other items net	**(92)**	299
Net cash provided by (used in) operating activities	**3,126**	2,883
Cash Flows from Investing Activities		
Additions to properties and equipment and dry hole costs	**(2,799)**	(2,413)
Acquisition of midstream businesses	**(804)**	
Divestitures of properties and equipment and other assets	**55**	19
Other net	**(41)**	(78)
Net cash provided by (used in) investing activities	**(3,589)**	(2,472)
Cash Flows from Financing Activities		
Borrowings, net of issuance costs	**1,046**	947
Repayments of debt	**(859)**	(1,173)
Repayment of midstream subsidiary note payable to a related party		(250)
Increase (decrease) in accounts payable, banks	**(38)**	(93)
Dividends paid	**(90)**	(90)
Repurchase of common stock	**(30)**	(29)
Issuance of common stock, including tax benefit on stock option exercises	**49**	81
Sale of subsidiary units	**130**	97
Distributions to noncontrolling interest owners	**(37)**	(22)
Other financing activities	**4**	(7)
Net cash provided by (used in) financing activities	**175**	(539)
Effect of Exchange Rate Changes on Cash	**14**	(29)
Net Increase (Decrease) in Cash and Cash Equivalents	**(274)**	(157)
Cash and Cash Equivalents at Beginning of Period	**3,680**	3,531

Cash and Cash Equivalents at End of Period	**$**	**3,406**	$	3,374

See accompanying Notes to Consolidated Financial Statements.

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). In addition, the Company engages in the gathering, processing, and treating of natural gas, and the transporting of 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.

Basis of Presentation The information 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 June 30, 2011, and December 31, 2010, the Consolidated Statements of Income and Comprehensive Income for the three and six months ended June 30, 2011, and 2010, the Consolidated Statements of Cash Flows for the six months ended June 30, 2011, and 2010, and the Consolidated Statement of Equity for the six months ended June 30, 2011. Certain prior-period amounts have been reclassified to conform to the current-period presentation.

In preparing financial statements in accordance with accounting principles generally accepted in the United States, management makes informed judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. Management evaluates its estimates and related assumptions regularly, including those related to the value of properties and equipment; proved reserves; goodwill; intangible assets; asset retirement obligations; litigation reserves; environmental liabilities; pension assets, 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.

Recently Issued Accounting Standards Not Yet Adopted The Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) that further addresses fair-value-measurement accounting and related disclosure requirements. The ASU clarifies the FASB s intent regarding the application of existing fair-value measurement and disclosure requirements, changes the fair-value measurement requirements for certain financial instruments, and sets forth additional disclosure requirements for other fair-value measurements. The ASU is required to be adopted on a prospective basis by Anadarko beginning in 2012. The Company is currently evaluating the impact, if any, of the adoption of this ASU on its consolidated financial statements and related disclosures.

2. Deepwater Horizon Events

Background In April 2010, the Macondo well in the Gulf of Mexico, in which Anadarko holds a 25% non-operating leasehold interest, discovered hydrocarbon accumulations. During suspension operations, the well blew out, an explosion occurred on the *Deepwater Horizon* drilling rig, and the drilling rig sank, resulting in the release of hydrocarbons into the Gulf of Mexico. Eleven people lost their lives in the explosion and subsequent fire, and others sustained personal injuries. The Macondo well was permanently plugged on September 19, 2010. Response and cleanup efforts are being conducted by BP Exploration & Production Inc. (BP), the operator and 65% owner of the Macondo lease, and by other parties. Investigations by the federal government and other parties into the cause of the well blowout, explosion, and resulting oil spill, as well as other matters arising from or relating to these events, are ongoing.

Based on information provided by BP to the Company, BP has incurred costs of approximately $20.4 billion through June 30, 2011, related to spill response and containment, relief-well drilling, grants to certain Gulf Coast states for cleanup costs, local tourism promotion, other grants, monetary damage claims, and federal costs.

ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Deepwater Horizon Events (Continued)

BP has sought reimbursement from Anadarko for amounts BP has paid or committed to pay for spill-response efforts, grants, damage claims, and costs incurred by the federal government through provisions of the operating agreement (OA), which is the contract governing the relationship between BP and the non-operating OA parties to the lease for Mississippi Canyon Block 252 in which the Macondo well is located (Lease). BP has invoiced the Company an aggregate of $5.2 billion for what BP considers to be Anadarko s 25% proportionate share of actual costs through June 30, 2011. In addition, BP has invoiced Anadarko for anticipated near-term future costs related to the Deepwater Horizon events. Anadarko has withheld reimbursement to BP for Deepwater Horizon event-related invoices pending the completion of various ongoing investigations into and litigation regarding the cause of the well blowout, explosion, and subsequent release of hydrocarbons. Final determination of the root causes of the Deepwater Horizon events could materially impact the Company s potential obligations under the OA.

In April 2011, the Company received a Notice of Dispute (as defined in the OA) from BP requesting, among other things, payment of all amounts invoiced to the Company to date by BP related to the Deepwater Horizon events. Pursuant to dispute resolution procedures under the OA, each party appointed a management representative to meet with the other party s management representative in an attempt to resolve the dispute. In the event the dispute is not resolved within certain prescribed time periods, totaling approximately 190 days following issuance of the Notice of Dispute, any party may, but is not required to, initiate arbitration proceedings under the OA.

In May 2011, BP and the other non-operating OA party entered into a settlement, release and indemnity agreement. According to its press release, BP and the other non-operating OA party have agreed to a mutual release of claims against each other relating to the Deepwater Horizon events in exchange for a $1.1 billion payment to BP by the other non-operating OA party. BP has also agreed to indemnify the other non-operating OA party for compensatory claims arising from the Deepwater Horizon events, excluding civil, criminal or administrative fines and penalties, and certain other claims.

BP, Anadarko, and other parties, including parties that do not own an interest in the Lease, such as the drilling contractor, have received correspondence from the United States Coast Guard (USCG) referencing their identification as a responsible party or guarantor (RP) under the Oil Pollution Act of 1990 (OPA). The United States Department of Justice (DOJ) has also filed a civil lawsuit against such parties seeking, among other things, to confirm each party s identified RP status. Under OPA, RPs may be jointly and severally liable for costs of well control, spill response, and containment and removal of hydrocarbons, as well as other costs and damage claims related to the spill and spill cleanup. The USCG has directly invoiced the identified RPs for reimbursement of spill-related response costs incurred by the USCG and other federal and state agencies. The identified RPs each received identical invoices for total costs, without specification or stipulation of any allocation of costs among the identified RPs. To date, as operator, BP has paid all USCG invoices, thereby satisfying any joint and several obligation of the identified RPs to the USCG for these costs. BP has also made repeated public statements regarding its intention to continue to pay 100% of costs associated with cleanup efforts, claims, and reimbursements related to the Deepwater Horizon events.

The following analysis applies relevant accounting guidance to the Deepwater Horizon events to determine the Company s liability accrual as of June 30, 2011. The process for quantifying the Company s Deepwater Horizon event-related liability accrual involves the identification of all potential costs and the grouping of these costs in a manner that enables the Company to apply relevant accounting guidance to each cost based on the qualitative characteristics of such costs. This is appropriate because satisfaction of liability-recognition criteria varies depending on the type of costs being analyzed. For example, contingent contractual liabilities (such as those arising under the OA) and contingent environmental liabilities (such as those arising under OPA) are subject to substantially similar liability-recognition criteria; however, circumstances under which such criteria are considered satisfied are different.

After applying the relevant accounting guidance to the Company s Deepwater Horizon event-related contingent liabilities, the Company s aggregate liability accrual for these amounts is zero as of June 30, 2011. The zero liability accrual is not intended to represent an opinion of the Company that it will not incur any future liability related to the Deepwater Horizon events. Rather, the zero liability accrual is based on currently available facts and the application of accounting rules to this set of facts where the relevant accounting rules do not allow for loss recognition where a potential loss is not considered probable or cannot be reasonably estimated.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Deepwater Horizon Events (Continued)

In quantifying its potential Deepwater Horizon event-related liabilities, the Company has made certain assumptions regarding facts that are the subject of continuing investigations and litigation, the duration and extent of ongoing cleanup activities, and future damage claims. Thus, the Company s zero liability accrual for the Deepwater Horizon events as of June 30, 2011, is subject to change in the future, perhaps materially. Below is a discussion of the Company s current analysis, under applicable accounting guidance, of its potential liability for (i) amounts invoiced by BP under the OA, (ii) OPA-related environmental costs, and (iii) other contingent liabilities.

OA Contingent Liabilities OA contingent liabilities relate to Anadarko s potential responsibility for a 25% share of costs incurred by BP through June 30, 2011, for which BP has sought reimbursement from Anadarko under the OA. Accounting standards require the Company to accrue contingent liabilities arising under the terms of the OA if it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated.

With respect to the operator s duties and liabilities, the OA provides the following:

BP, as operator, owes duties to the non-operating parties (including Anadarko) to perform the drilling of the well in a good and workmanlike manner and to comply with all applicable laws and regulations;

BP, as operator, is not liable to non-operating parties for losses sustained or liabilities incurred, except for losses resulting from the operator s gross negligence or willful misconduct; and

liability for losses, damages, costs, expenses, or claims involving activities or operations shall be borne by each party in proportion to its participating interest, except that when liability results from the gross negligence or willful misconduct of a party, that party shall be solely responsible for liability resulting from its gross negligence or willful misconduct.

The Company believes publicly available evidence indicates that the blowout of the well, the explosion on the Deepwater Horizon drilling rig, and the subsequent release of hydrocarbons were preventable and the direct result of BP s decisions, omissions, and actions, and likely constitute gross negligence or willful misconduct by BP. BP has issued public statements indicating that it disagrees with this assessment. Under the terms of the OA, liabilities arising as a result of gross negligence or willful misconduct by BP are the sole responsibility of BP and are not chargeable to other OA parties, including Anadarko. In light of the foregoing, Anadarko does not consider OA contingent liabilities for Deepwater Horizon event-related costs invoiced by BP to the Company to satisfy the standard of probable required for loss recognition. Accordingly, as of June 30, 2011, pursuant to applicable accounting guidance, the Company has not recognized a liability in its Consolidated Balance Sheets for Deepwater Horizon event-related costs that have been invoiced by BP to Anadarko under the OA and that are, in part, the subject of BP s April 2011 Notice of Dispute.

In the future, the Company may recognize a liability for Deepwater Horizon event-related costs invoiced by BP under the OA if new information arising from the legal discovery or adjudication process, hearings, other investigations, expert analysis, or testing alters the Company s current assessment as to the likelihood of the Company incurring a liability for its existing OA contingent liabilities. In addition, BP, as the operator, may have enforceable indemnity obligations to certain of its contractors, for which BP may be able to obtain reimbursement from the Company under the OA for the Company s share of any such costs incurred by BP, notwithstanding BP s own gross negligence. The Company currently is not positioned to assess the validity of BP s ostensible indemnity obligations to its contractors, nor is the Company knowledgeable as to whether BP has incurred actual costs as a result of these indemnity provisions. As a result, the Company currently does not consider any loss attributable to potential indemnity obligations to be probable, and is furthermore unable to reasonably estimate the amount of any such potential loss.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Deepwater Horizon Events (Continued)

OPA-Related Environmental Costs Under OPA, Anadarko may be jointly and severally liable with all RPs for OPA-related environmental costs associated with the Deepwater Horizon events. Anadarko s treatment by the USCG as an identified RP arises as a result of Anadarko s status as a co-lessee in the Lease.

Applicable accounting guidance requires the Company to accrue an environmental liability if it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Under accounting guidance applicable to environmental liabilities, a liability is presumed probable if the entity is both identified as an RP and associated with the environmental event. The Company s co-lessee status in the Lease and the subsequent identification and treatment of the Company as an RP satisfies these standards and therefore establishes the presumption that the Company s potential environmental liabilities related to the Deepwater Horizon events are probable. Given that such liabilities are probable, applicable accounting guidance requires the Company to (i) estimate, on a gross basis, a range of total potential OPA-related environmental costs for the Deepwater Horizon events, and (ii) separately assess and estimate the Company s allocable share of the gross estimated costs.

OPA-related environmental costs that have been paid by BP and subsequently invoiced to Anadarko under the OA are accounted for as OA contingent liabilities (discussed above) rather than OPA-related environmental costs (discussed herein). Payment of OPA-related environmental costs by BP satisfies these liabilities for all identified RPs, including Anadarko, and has resulted in BP seeking reimbursement from Anadarko for these costs through the OA, thereby creating OA contingent liabilities. The Company assumes that all OPA-related environmental costs incurred by BP and reported to the Company have been paid by BP, thereby satisfying those joint and several OPA-related environmental costs for all identified RPs.

Gross OPA-Related Environmental Cost Estimate The Company estimates the range of gross OPA-related environmental costs for all identified RPs to be $4.0 billion to $5.0 billion, excluding (i) $20.4 billion of costs BP has incurred as of June 30, 2011, which are considered and analyzed as OA contingent liabilities, and (ii) amounts the Company currently cannot reasonably estimate, which include OPA damage claims that may be filed subsequent to the third quarter of 2011, potential costs associated with penalties and fines, civil litigation damages, and costs that have not yet been committed by BP for natural resource damage (NRD) assessments and NRD claims. The costs that the Company currently cannot reasonably estimate may be significant.

Anadarko s gross OPA-related environmental cost estimate is comprised of spill-response costs and OPA damage claims. This cost estimate is based on cost information received from BP, certain assumptions discussed below, and publicly available information from the Gulf Coast Claims Facility (GCCF). The GCCF is a claims facility that was established in June 2010, as part of an agreement between the federal government and BP, to assist claimants in the submission and resolution of claims for costs and damages incurred as a result of the Deepwater Horizon events. As a non-operator, the Company is limited to formulating its estimates of spill-response costs and OPA damages based on information provided by BP, publicly available information, and management s assumptions regarding a number of variables associated with the Deepwater Horizon events that remain uncertain or unknown. Although the Macondo well has been permanently plugged, the scope and extent of damages and cleanup activities continue to evolve, resulting in significant uncertainty as to the spill s ultimate impacts and associated costs. Accordingly, the Company believes that actual gross OPA-related environmental costs may vary, perhaps materially, from the Company s estimate.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. Deepwater Horizon Events (Continued)

Spill-Response Costs and Assumptions Estimated spill-response costs are based on cost information received from BP, which was used to estimate activity-based cost run-rates for spill-response activities, which, in turn, were projected forward according to the Company s estimates of the potential duration and extent of the spill response and cleanup.

The Company s current cost estimate is based on the following assumptions:

- activities (including required resources) related to the operation, demobilization, and decontamination of offshore well-site equipment are substantially complete; and

- at a minimum, costs will continue through the end of the third quarter of 2011, and end prior to the end of the fourth quarter of 2011, for the following activities:

  - shallow-water marine cleanup;

  - demobilization and decontamination of vessels deployed in open-water cleanup;

  - shoreline cleanup; and

  - federal, state, and local spill mitigation and coordination.

The above costs may continue for periods longer than those assumed by the Company for purposes of formulating its cost estimate. The scope and extent of the above costs continue to evolve over time, which adversely impacts the Company s ability to reasonably estimate certain costs that may continue beyond the above-stated periods. The Company will continue to monitor and estimate costs as the scope and extent of required activities become more certain.

OPA Damage Claims OPA damages (other than NRD, discussed below) include costs associated with increased public-service expenses, damages to real or personal property, damages to subsistence users of natural resources, lost revenues, lost profits, and diminished earnings capacity. These damages are assessed pursuant to OPA and are limited, in general, to $75 million. However, the $75 million limit has not been applied for purposes of formulating the Company s cost-range estimate and may not be applicable under OPA where there is a finding of gross negligence, willful misconduct, or a violation of an applicable federal safety, construction, or operating regulation by an RP, an agent or employee of an RP, or a person acting pursuant to a contractual relationship with an RP.

The Company s cost estimate includes potential OPA damage claims and costs to administer those claims based on data received from BP and publicly available information from the GCCF. This claims information has been used to formulate estimates of the number of claims to be paid and the average per-claim payout projected for claims filed through the end of the third quarter of 2011. In addition, the Company s cost estimate includes claims administration costs projected through August 2013, the date the GCCF is expected to cease operations.

The Company believes that new claims will continue to be filed beyond the end of the third quarter of 2011; however, the Company is currently unable to reasonably estimate the number and magnitude of such claims. The Company lacks visibility into, among other things, the processes associated with OPA damage claim approvals and claims administration, which significantly hinders the Company s ability to formulate a long-term estimate of the amount of potential OPA damage claims. Accordingly, the Company s cost estimate does not include amounts attributable to OPA damage claims that could be made subsequent to the end of the third quarter of 2011.

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(Unaudited)

2. Deepwater Horizon Events (Continued)

Allocable Share of Gross OPA-Related Environmental Costs As discussed above, under applicable accounting guidance, the Company is required to estimate its allocable share of gross OPA-related environmental costs based on the Company s estimate of the allocation method and percentage that may ultimately apply. No agreed-upon or stipulated allocation of gross OPA-related environmental costs currently exists. As a result, the Company considered the following factors for purposes of estimating a range of its allocable share of these costs:

BP s payment to date of Deepwater Horizon event-related costs To date, BP has paid all Deepwater Horizon event-related costs and has repeatedly stated publicly and in congressional testimony that it will continue to pay all of these costs. The liability of all RPs for amounts payable under OPA is satisfied as BP funds these amounts. Accordingly, Anadarko s minimum allocable share of gross OPA-related environmental costs is zero where BP continues to fund 100% of OPA-related environmental costs. Furthermore, the Company believes that in order for BP to obtain reimbursement from Anadarko under the OA for OPA-related environmental costs paid by BP, BP must establish that it is entitled to reimbursement under the terms of the OA. As discussed above, the Company does not consider BP to be entitled to cost reimbursement under the OA.

Anadarko s OA sharing percentage If BP ceases paying any portion of the Deepwater Horizon event-related costs, the federal government could seek payment from all potential RPs under the joint and several liability provisions of OPA. Under this scenario, the Company estimates its maximum allocation of gross OPA-related environmental costs could be 25%, which is equivalent to Anadarko s OA sharing percentage. The Company does not consider an allocable percentage in excess of 25% to be reasonable based on BP s public statements that it intends to continue to honor its commitments in the Gulf of Mexico, the Company s assessment of BP s ability to continue funding all OPA-related environmental costs, and BP s agreement to indemnify the other non-operating OA party for its share of potential costs. This estimate of a maximum allocation percentage assumes no allocation of gross OPA-related environmental costs to RPs that are not party to the OA (non-OA RPs).

Allocation to non-OA RPs In addition to the parties to the OA identified as RPs (including the Company), two non-OA RPs have been identified by the federal government. The allocation of costs to all potential RPs, including non-OA RPs, would likely reduce Anadarko s potential allocable share of gross OPA-related environmental costs to an amount less than Anadarko s 25% OA sharing percentage.

Based on the above, the Company has concluded that a range of 0-25% is appropriate as an estimate of its potential allocable share of gross OPA-related environmental costs. At June 30, 2011, the Company considers zero to be the most likely allocable percentage within the 0-25% range for allocation of gross OPA-related environmental costs and, consistent with applicable accounting guidance, continues to have a liability accrual of zero. The Company s assessment as to the most likely allocation percentage is based on BP s continued funding of 100% of OPA-related environmental costs and BP s repeated public commentary regarding its ability and intent to continue to honor its Deepwater Horizon-related commitments. BP s funding and public commentary has continued subsequent to the release of BP s own investigation report as well as the National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling s final report, which the Company considers significant in concluding that zero is the most likely allocation percentage within the 0-25% range.

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2. Deepwater Horizon Events (Continued)

Other Contingencies

Penalties and Fines These costs include amounts that may be assessed as a result of potential civil and/or criminal penalties under various federal, state, and/or local statutes and/or regulations as a result of the Deepwater Horizon events, including, for example, the Clean Water Act (CWA), the Outer Continental Shelf Lands Act, the Migratory Bird Treaty Act, and possibly other federal, state, and local laws. The foregoing does not represent an exhaustive list of statutes and regulations that potentially could trigger a penalty or fine assessment against BP or the Company. Currently, the Company cannot reasonably estimate the amount of any federal, state, or local penalties or fines that could be assessed or the extent to which such penalties or fines could be material to the Company s financial statements.

To date, no penalties or fines have been assessed against the Company or, to the Company s knowledge, any other party. However, on December 15, 2010, the DOJ, on behalf of the United States, filed a civil lawsuit in the United States District Court in New Orleans, Louisiana (Louisiana District Court) against several parties, including Anadarko Petroleum Corporation and Anadarko E&P Company LP (AE&P), a subsidiary of Anadarko, seeking (i) an assessment of civil penalties under the CWA in an amount to be determined by the Louisiana District Court, and (ii) a declaratory judgment that such parties are jointly and severally liable without limitation under OPA for all removal costs and damages resulting from the Deepwater Horizon events. In the lawsuit, the DOJ states that civil penalties under the CWA may be assessed in an amount up to $1,100 per barrel of oil discharged or, in cases involving gross negligence or willful misconduct, in an amount up to $4,300 per barrel of oil discharged. Based on the allegations in the DOJ complaint, the United States government is seeking a declaration of liability and separate assessments against both Anadarko Petroleum Corporation and AE&P. The DOJ apparently seeks relief against AE&P solely based on a temporary interest that AE&P held at one time in the Lease. In April 2011, the Company moved to dismiss AE&P from the DOJ lawsuit because the effective date of AE&P s transfer of its interest in the Lease to Anadarko pre-dated the Deepwater Horizon events.

While Anadarko was named in the DOJ civil lawsuit, its status as a defendant does not mean that Anadarko will be assessed a penalty in that action. CWA penalties, in practice, are generally assessed on a party-specific basis and take into account several factors such as the party s degree of fault. The Company considers BP s actions, as well as the Company s lack of direct involvement in the operation of the drilling rig or the spill, significant for purposes of concluding that potential losses from CWA penalty assessments are not probable. Neither the DOJ civil lawsuit nor the potential for BP to be found grossly negligent alters the Company s assessment of its exposure to potential penalties under the CWA. Accordingly, the Company has not recorded a liability for potential CWA penalties at June 30, 2011.

In addition to determining that any potential liability for CWA penalties is not probable, the Company currently cannot estimate the amount of any such penalty. Over the course of the spill, there have been several widely varying estimates of the ultimate spill volume by various groups. On August 2, 2010, the federal government published its spill-volume estimate of 4.9 million barrels, which was based on several assumptions and acknowledges variability of the flow rate over time, inherent imprecision in the federal government s ability to accurately estimate the flow rate, and uncertainty in evaporation and dispersion rates. In December 2010, BP stated publicly its intent to challenge the federal government s spill-volume estimate. The DOJ complaint does not reference or estimate a spill volume.

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(Unaudited)

2. Deepwater Horizon Events (Continued)

In addition to spill-volume variability, there is significant uncertainty as to the Company s ultimate liability for potential CWA penalties, if any, as previous CWA penalty settlements vary greatly, have not been based solely on a simple per-barrel penalty assessment, and have often been influenced by some or all of the following subjective factors included in the CWA:

- the degree of culpability involved;
- the seriousness of the violation;
- the economic benefit to the violator;
- any other penalties assessed for the same incident;
- the history of prior violations; and
- any mitigation efforts undertaken and the success of those efforts.

Based on the above factors, the significant uncertainty regarding the actual spill volume, and historic resolution through settlement, the Company currently is unable to reasonably estimate any potential CWA penalties.

Natural Resource Damages (NRD) This category includes costs to assess damages to natural resources resulting from the spill and/or spill-cleanup activities as well as future damage claims that may be made by federal and/or state natural resource trustee agencies at the completion of injury assessments and restoration planning. Natural resources generally include land, fish, water, air, wildlife, or other such resources belonging to, managed by, held in trust by, or otherwise controlled by, the federal, state, or local government.

The NRD-assessment process is led by government agencies that act as trustees of natural resources on behalf of the public. Government agencies involved in the process include the Department of Commerce, the Department of the Interior, and the Department of Defense. These governmental departments, along with the five affected states, Alabama, Florida, Louisiana, Mississippi, and Texas, are referred to as the Co-Trustees. The Co-Trustees continue to conduct injury assessment and restoration planning. The assessment phase will continue as long as spill-cleanup activities are ongoing, and may extend for an unknown period of time subsequent to the completion date of spill-cleanup activities. Restoration planning is ongoing and will be completed subsequent to the completion of the injury assessment.

In October 2010, the Co-Trustees notified the identified RPs that certain emergency restoration actions were to commence. BP is working cooperatively with the Co-Trustees and has provided the Company with documentation of expenses associated with pre-funding the Co-Trustees NRD assessment activities. NRD assessment costs, such as these, may change significantly as injury assessment and restoration planning continues. Thus, the Company is unable to project total NRD assessment costs at this time.

The DOJ civil lawsuit filed against BP, the Company, and others seeks unspecified damages for injury to federal natural resources. Not all of the Co-Trustees were a party to this lawsuit; however, during the second quarter of 2011, the states of Alabama and Louisiana each filed NRD-related claims against the Company in the Louisiana District Court. The Company filed a motion to dismiss all of the claims in both of these complaints in June 2011. At this time, the Company is unable to reasonably estimate the magnitude of any NRD claim until assessment and restoration planning is complete, which may take several years, or until additional facts or information are revealed during legal discovery.

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(Unaudited)

2. Deepwater Horizon Events (Continued)

Civil Litigation Damage Claims Numerous civil lawsuits have been filed against BP and other parties, including the Company, by, among others, fishing, boating, and shrimping enterprises and industry groups; restaurants; commercial and residential property owners; certain rig workers or their families; the State of Alabama and several of its political subdivisions; the DOJ; environmental non-governmental organizations; the State of Louisiana and certain of its political subdivisions; and certain Mexican states. Many of the lawsuits filed assert various claims of negligence, gross negligence, and violations of several federal and state laws and regulations, including, among others, OPA; the Comprehensive Environmental Response, Compensation, and Liability Act; the Clean Air Act; the CWA; and the Endangered Species Act; or challenge existing permits for operations in the Gulf of Mexico. Generally, the plaintiffs are seeking actual damages, punitive damages, declaratory judgment, and/or injunctive relief.

In August 2010, the United States Judicial Panel on Multidistrict Litigation created Multidistrict Litigation No. 2179 (MDL) to administer essentially all pretrial matters for litigation filed in federal court involving Deepwater Horizon event-related claims. Federal Judge Carl Barbier presides over this MDL in the Louisiana District Court. The Louisiana District Court has issued a number of case management orders that establish a schedule for procedural matters, discovery, and trial of certain of the MDL cases. The parties to the MDL are actively engaged in discovery. In May 2011, Judge Barbier heard oral arguments on the numerous motions to dismiss filed by the multiple defendants named in this litigation, but has not issued a ruling on the Master Complaints that name the Company as a defendant, except in July 2011 to dismiss Racketeer Influenced and Corrupt Organizations Act (RICO) claims alleged by the plaintiffs.

The Louisiana District Court has scheduled a February 2012 trial in Transocean s Limitation of Liability case in the MDL to determine the liability issues and the liability allocation among the parties involved in the Deepwater Horizon events. In April 2011, the Company filed its answer in this Limitation of Liability case in the MDL proceeding and cross-claimed against affiliates of BP and Transocean Ltd. (Transocean), Halliburton Energy Services, Inc. (Halliburton), Cameron International Corporation (Cameron), and other third-party defendants. Transocean, Halliburton, and Cameron subsequently filed cross-claims against the Company, and BP filed a motion to stay the litigation in the MDL between BP and the non-operating OA parties. In the motion to stay, BP argues that the cross-claims asserted against BP by the Company and the other non-operating OA party are covered by the dispute resolution procedures under the OA and should be stayed. In May 2011, BP and the other non-operating OA party entered into a settlement, release and indemnity agreement. In June 2011, Judge Barbier issued an order holding that BP and the Company had agreed in the OA to submit disputes among them to arbitration, but requested that the parties submit further briefing on whether BP had waived arbitration by its conduct in the MDL. In July 2011, BP and the Company submitted their briefs and the court ordered that all litigation between BP and the Company is stayed pending arbitration.

Lawsuits seeking to place limitations on the oil and gas industry s operations in the Gulf of Mexico, including those of the Company, have also been filed outside of the MDL by non-governmental organizations against various governmental agencies. These cases are filed in the Louisiana District Court, the United States District Courts for the Southern District of Alabama and the District of Columbia, and in the United States Court of Appeals for the Fifth Circuit.

Two separate class action complaints were filed in June and August 2010, in the United States District Court for the Southern District of New York (New York District Court) on behalf of purported purchasers of the Company s stock between June 12, 2009, and June 9, 2010, against Anadarko and certain of its officers. The complaints allege causes of action arising pursuant to the Securities Exchange Act of 1934 for purported misstatements and omissions regarding, among other things, the Company s liability related to the Deepwater Horizon events. The plaintiffs seek an unspecified amount of compensatory damages, including interest thereon, as well as litigation fees and costs. In November 2010, the New York District Court consolidated the two cases and appointed The Pension Trust Fund for Operating Engineers and Employees Retirement System of the Government of the Virgin Islands (Virgin Islands Group) to act as Lead Plaintiff. In January 2011, the Lead Plaintiff filed its Consolidated Amended Complaint. Prior to filing its Consolidated Amended Complaint, the Lead Plaintiff requested leave from the New York District Court to transfer this lawsuit to the United States District Court for the Southern District of Texas. The Company opposes the Lead Plaintiff s request to transfer the case to the District Court for the Southern District of Texas. The parties have submitted briefs to the New

York District Court concerning the transfer of venue issue. In March 2011, the Company moved to dismiss the Consolidated Amended Complaint of the Lead Plaintiff, and in April 2011, the Lead Plaintiff filed its opposition to the motion to dismiss.

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2. Deepwater Horizon Events (Continued)

Also in June 2010, a shareholder derivative petition was filed in the 152nd Judicial District Court of Harris County, Texas (Harris County District Court), by a shareholder of the Company against Anadarko (as a nominal defendant), certain of its officers, and current and certain former directors. The petition alleged breaches of fiduciary duties, unjust enrichment, and waste of corporate assets in connection with the Deepwater Horizon events. The plaintiffs sought certain changes to the Company s governance and internal procedures, disgorgement of profits, and reimbursement of litigation fees and costs. In November 2010, the Harris County District Court granted Anadarko s Motion to Dismiss for Lack of Jurisdiction and Special Exceptions, and granted the plaintiffs 120 days to file an Amended Petition. In March 2011, the plaintiffs filed an Amended Petition. The Company filed Special Exceptions and a Motion to Dismiss the Amended Petition in April 2011. In June 2011, the Harris County District Court heard oral arguments on these matters and granted the motion to dismiss. The time for the plaintiffs to appeal has expired.

In September 2010, a purported shareholder made a demand of the Company s Board of Directors (Board) to investigate allegations of breaches of duty by members of management. The Board duly considered the demand, and in January 2011 determined that it would not be in the best interest of the Company to pursue the alleged issues in the demand letter.

The Company currently cannot assess the probability of losses, or reasonably estimate a range of any potential losses related to ongoing proceedings. The Company intends to vigorously defend itself, its officers, and directors in all proceedings.

Liability Outlook As discussed above, the Company s aggregate Deepwater Horizon event-related liability accrual of zero as of June 30, 2011, is not intended to represent an opinion of the Company that it will not incur any future liability related to the Deepwater Horizon events. The Company s liability assessment is based on the application of relevant accounting guidance to the Company s understanding of currently available facts surrounding the Deepwater Horizon events. As more facts become known, it is reasonably possible that the Company may be required to recognize a liability related to the Deepwater Horizon events, and that the liability could be material to the Company s consolidated financial position, results of operations, or cash flows.

The Company will continue to monitor the MDL and other legal proceedings discussed above as well as federal investigations related to the Deepwater Horizon events, including investigations by The Deepwater Horizon Joint Investigation Team, and the United States Chemical Safety Board. The Company cannot predict the nature of evidence that may be discovered during the course of legal proceedings and investigations, the timing of discovery, or the timing of completion of any legal proceedings or investigations. The Company continues to evaluate its liability assessment based on the accumulation of evidence obtained and expected to be obtained through continued discovery, expert testimony and opinion, and technical analysis.

Additionally, if BP discontinues payment or is otherwise unable to satisfy its obligations, the Company could be required to recognize a liability for OPA-related environmental costs. Similarly, if other identified RPs do not satisfy their obligations under OPA, the Company could incur additional liability. If Anadarko is required to recognize and pay additional liabilities, the Company could pursue remedies under the OA to recover costs from BP or the other party to the OA. In addition, the Company could pursue recovery or contribution from other parties or non-OA RPs.

Insurance Recoveries The Company carries insurance to protect against potential financial losses. At the time of the Deepwater Horizon events, the Company s insurance coverage applied to gross covered costs up to a level of approximately $710 million, less up to $60 million of deductibles. Based on Anadarko s 25% non-operated leasehold interest in the Lease, the Company estimates its potential net insurance coverage could total $178 million, less deductibles of $15 million. The Company has not recognized a receivable for any potential recoveries in its Consolidated Balance Sheets. At this time, recovery of these amounts is not considered probable because the Company has not yet filed a claim, nor has the Company incurred a probable loss under the OA or an insurable loss for unpaid liabilities. If the Company s current legal assessment changes such that the Company becomes liable under the OA for Deepwater Horizon event-related costs and funds such costs, the Company expects to recover the first $163 million of insured costs under its existing insurance policy. The Company also carries directors and officers insurance to cover certain risks associated with certain of the above-described legal proceedings.

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ANADARKO PETROLEUM CORPORATION

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(Unaudited)

2. Deepwater Horizon Events (Continued)

In March 2011, the Company was granted leave by the Louisiana District Court to intervene in a declaratory judgment lawsuit brought by excess insurers for Transocean in a lawsuit now pending in the MDL. The Company contends that it is an additional insured party under the Transocean insurance policies and, as such, is a proper party to the lawsuit and is entitled to participate in any legal proceedings in which the liability of insurers is determined for costs and damages arising from the blowout, explosion, and fire related to the Deepwater Horizon events.

3. Acquisitions

In May 2011, Anadarko increased its ownership interest in a natural-gas processing plant (Wattenberg Plant), located in northeast Colorado, by acquiring an additional 93% interest for $576 million. Anadarko operates and now owns a 100% interest in the Wattenberg Plant.

In February 2011, Western Gas Partners, LP (WES), a consolidated subsidiary of the Company, acquired a natural-gas processing plant and related gathering systems, located in northeast Colorado, for $304 million (Platte Valley).

These acquisitions, along with future expansion plans, align Anadarko s natural-gas processing capacity with the Company s anticipated production growth in the Rocky Mountains Region (Rockies). In addition, these acquisitions position the Company to improve field recoveries and realize operational cost efficiencies.

The Wattenberg Plant and Platte Valley acquisitions constitute business combinations and were accounted for using the acquisition method with the assets acquired and liabilities assumed recognized at fair value at the acquisition dates. The following summarizes the preliminary fair value of assets acquired and liabilities assumed at the acquisition dates:

millions		
Properties and equipment	$	**298**
Intangible assets		**167**
Deferred income taxes		**31**
Other assets		**4**
Other liabilities		**(21)**
Goodwill		**362**
Total assets acquired and liabilities assumed		**841**
Less: Fair value of Anadarko s pre-acquisition 7% equity interest in the Wattenberg Plant		**37**
Acquisition of midstream businesses		**804**
Loss on Anadarko s preexisting contracts with the previous Wattenberg Plant owner		**76**
Total consideration paid	$	**880**

All fair-value measurements of assets acquired and liabilities assumed are based on inputs that are not observable in the market and thus represent Level 3 inputs. The fair value of acquired properties and equipment is based on market and cost approaches. Intangible assets consist of customer contracts, the fair value of which was determined using an income approach. Deferred tax assets represent the tax effects of differences in the tax basis and acquisition-date fair values of assets acquired and liabilities assumed. Liabilities assumed include asset retirement obligations existing at the date of acquisition, and were valued consistent with the Company s policy for estimating its asset retirement obligations.

ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Acquisitions (Continued)

Assets acquired and liabilities assumed are included within the midstream reporting segment, except for $362 million of goodwill recognized in connection with the Wattenberg Plant acquisition and the deferred tax asset arising from $469 million of goodwill that is amortizable for tax purposes. The Wattenberg Plant acquisition-related goodwill and related deferred tax asset are reported within the oil and gas exploration and production reporting segment based on the increase in value to that segment. The increase in value is derived from improved NGLs volume retention from equity production and the alignment of Company-controlled natural-gas processing capacity with future production growth plans in the Rockies. Goodwill is not subject to amortization, but will be subject to annual impairment testing (or more frequent testing as circumstances dictate). At June 30, 2011, the Company had $5.6 billion of goodwill allocated to its four reporting units: $5.5 billion to oil and gas exploration and production; $79 million to gathering and processing; $55 million to WES gathering and processing; and $5 million to transportation.

Prior to the Wattenberg Plant acquisition, the Company was party to natural-gas processing contracts with the previous Wattenberg Plant owner. As a result of the acquisition, these preexisting contracts were terminated, causing the Company to recognize a $76 million loss, which is included in gains (losses) on divestitures and other, net in the Consolidated Statements of Income for the three and six months ended June 30, 2011. This loss represents the aggregate amount by which the contracts were unfavorable as compared to current market transactions for the same or similar services.

The Company also recognized a gain of $21 million from the acquisition-date fair-value remeasurement of its pre-acquisition 7% equity interest in the Wattenberg Plant. The gain is included in gains (losses) on divestitures and other, net in the Consolidated Statements of Income for the three and six months ended June 30, 2011.

Results of operations attributable to the Wattenberg Plant and Platte Valley acquisitions are included in the Company s Consolidated Statements of Income from the dates acquired. The amounts of revenue and earnings included in the Company s Consolidated Statements of Income for the three and six months ended June 30, 2011, and the amounts of revenue and earnings that would have been recognized had the acquisitions occurred on January 1, 2010, are not material.

4. Inventories

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

millions	**June 30, 2011**	December 31, 2010
Crude oil	**$ 93**	$ 126
Natural gas	**20**	64
NGLs	**58**	61
Total	**$ 171**	$ 251

5. Properties and Equipment

Suspended Exploratory Drilling Costs The Company s capitalized suspended well costs at June 30, 2011, and December 31, 2010, were $1.2 billion and $935 million, respectively. The increase in suspended exploratory drilling costs during 2011 primarily relates to the capitalization of costs associated with successful exploration drilling in Mozambique, Ghana, Brazil, and the Niobrara area in the Rockies. For the six months ended June 30, 2011, $38 million of exploratory well costs previously capitalized as suspended well costs for greater than one year were charged to dry hole expense and $66 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 assessing whether reserves can be attributed to these areas. If additional information becomes available that raises substantial doubt regarding the economic or operational viability of any of these projects, the associated costs will be expensed at that time.

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(Unaudited)

5. Properties and Equipment (Continued)

Impairments Impairment expense for the three and six months ended June 30, 2011, was $102 million and $104 million, respectively, including $100 million recognized in the second quarter of 2011 related to United States onshore oil and gas exploration and production operating segment properties, based on the change in projected cash flows due to the Company s intent to divest of the properties. These assets were impaired to fair value, estimated using Level 3 fair-value inputs.

Impairment expense for the three and six months ended June 30, 2010, was $115 million and $127 million, respectively, including $114 million recognized in the second quarter of 2010 related to a production platform included in the oil and gas exploration and production operating segment that remains idle with no identifiable plans for use, and for which a limited market currently exists. The platform was impaired to fair value, estimated using Level 3 fair-value inputs.

6. Noncontrolling Interests

At June 30, 2011, noncontrolling interests on the Consolidated Balance Sheet includes approximately $146 million, net of tax, related to the effects of changes in the Company s ownership interest in WES. This amount will be transferred to paid-in capital in the third quarter of 2011 when the WES subordinated limited partner units convert to common units. At June 30, 2011, Anadarko s ownership interest in WES consists of a 44.3% limited partner interest (common and subordinated units), a 2% general partner interest, and incentive distribution rights.

7. Derivative Instruments

Objective and Strategy The Company uses derivative instruments to manage its exposure to cash-flow variability from commodity-price and interest-rate risks.

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

Interest-rate swaps are used to fix or float interest rates on existing or anticipated indebtedness. The purpose of these instruments is to manage 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. 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 as the transactions to which the derivatives relate are recognized in earnings. Accumulated other comprehensive loss balances of $117 million ($74 million after tax) and $125 million ($79 million after tax) at June 30, 2011, and December 31, 2010, respectively, relate to interest-rate derivatives that were previously subject to hedge accounting.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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7. Derivative Instruments (Continued)

Oil and Natural-Gas Production/Processing Derivative Activities Below is a summary of the Company s derivative instruments at June 30, 2011, related to its oil and natural-gas production/processing activities. The natural-gas prices listed below are New York Mercantile Exchange (NYMEX) Henry Hub prices. The crude-oil prices listed below are NYMEX Cushing.

	2011	2012	2013
Natural Gas			
Three-Way Collars (thousand MMBtu/d)	480	500	450
Average price per MMBtu			
Ceiling sold price (call)	$ 8.29	$ 9.03	$ 6.57
Floor purchased price (put)	$ 6.50	$ 6.50	$ 5.00
Floor sold price (put)	$ 5.00	$ 5.00	$ 4.00
Fixed-Price Contracts (thousand MMBtu/d)	90		
Average price per MMBtu	$ 6.17	$	$
Basis Swaps (thousand MMBtu/d)	45		
Average price per MMBtu	$ (1.74)	$	$

MMBtu million British thermal units
MMBtu/d million British thermal units per day

	2011	2012
Crude Oil		
Three-Way Collars (MBbls/d)	126	2
Average price per barrel		
Ceiling sold price (call)	$ 99.95	$ 92.50
Floor purchased price (put)	$ 79.29	$ 50.00
Floor sold price (put)	$ 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 (e.g., 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 related derivative transactions used to manage commodity-price risk. At June 30, 2011, and December 31, 2010, the Company had outstanding fixed-price physical transactions related to natural gas for 31 billion cubic feet (Bcf) and 32 Bcf, respectively, offset by derivative transactions for 23 Bcf and 28 Bcf, respectively, for net positions of 8 Bcf and 4 Bcf, respectively.

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ANADARKO PETROLEUM CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

7. Derivative Instruments (Continued)

Interest-Rate Derivatives In 2008 and 2009, Anadarko entered into interest-rate swap agreements to mitigate the risk of rising interest rates on up to $3.0 billion of debt, originally 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 London Interbank Offer Rate (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. In March 2011, WES entered into a five-year, forward starting interest-rate swap agreement with a notional principal amount of $150 million to mitigate the risk of rising interest rates prior to the issuance of the 5.375% Senior Notes due in 2021. In May 2011, WES terminated the swap at a cost of $1.9 million.

A summary of the swaps outstanding at June 30, 2011, including the outstanding notional principal amounts and the associated reference periods, is presented below.

millions except percentages	**Reference Period**		
	Start	**End**	**Weighted-Average**
Notional Principal Amount:			**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 %

Effect of Derivative Instruments Balance Sheet The fair value of the Company s derivative instruments is presented below.

millions	**Balance Sheet**	**Gross Derivative Assets**		**Gross Derivative Liabilities**	
Derivatives	**Classification**	**June 30, 2011**	December 31, 2010	**June 30, 2011**	December 31, 2010
Commodity					
	Other Current Assets	**$ 361**	$ 444	**$ (138)**	$ (274)
	Other Assets	**147**	242	**(4)**	(56)
	Accrued Expenses	**78**	89	**(116)**	(131)
	Other Liabilities	**6**	26	**(13)**	(28)
		592	801	**(271)**	(489)
Interest Rate and Other					