APPLIED INDUSTRIAL TECHNOLOGIES INC
Form 10-K
August 20, 2008

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2008, or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-2299

APPLIED INDUSTRIAL TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Ohio	34-0117420
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1 Applied Plaza, Cleveland, Ohio 44115
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: (216) 426-4000.
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, without par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. þ Yes o No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. o Yes þ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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. þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter (December 31, 2007): $1,194,695,302.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

Class	Outstanding at August 11, 2008
Common Stock, without par value	42,321,628

DOCUMENTS INCORPORATED BY REFERENCE

Listed hereunder are the documents, portions of which are incorporated by reference, and the Parts of this Form 10-K into which such portions are incorporated:

(1) Applied Industrial Technologies, Inc. annual report to shareholders for the fiscal year ended June 30, 2008, portions of which are incorporated by reference into Parts I, II and IV of this Form 10-K, and

(2) Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, portions of which are incorporated by reference into Parts II, III, and IV of this Form 10-K.

TABLE OF CONTENTS

Table of Contents

CAUTIONARY STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT

This report, including the documents incorporated by reference, contains statements that are forward-looking, based on management s current expectations about the future. Forward-looking statements are often identified by qualifiers such as guidance, expect, expectation, believe, plan, intend, will, should, could, a may, and similar expressions. Similarly, descriptions of our objectives, strategies, plans, or goals are also forward-looking statements. These statements may discuss, among other things, expected growth, future sales, future cash flows, future capital expenditures, future performance, and the anticipation and expectations of Applied and its management as to future occurrences and trends. Applied intends that the forward-looking statements be subject to the safe harbors established in the Private Securities Litigation Reform Act of 1995 and by the Securities and Exchange Commission in its rules, regulations, and releases.

Readers are cautioned not to place undue reliance on any forward-looking statements. All forward-looking statements are based on current expectations regarding important risk factors, many of which are outside Applied s control. Accordingly, actual results may differ materially from those expressed in the forward-looking statements. The making of those statements should not be regarded as a representation by Applied or any other person that the results expressed in the statements will be achieved. In addition, Applied assumes no obligation publicly to update or revise any forward-looking statements, whether because of new information or events, or otherwise, except as may be required by law.

Applied believes its primary risk factors include, but are not limited to, those identified in Risk Factors at Part I, Item 1A, and in Narrative Description of Business, at Part I, Item 1, section (c), in this annual report on Form 10-K, as well as in Management s Discussion and Analysis in Applied s 2008 annual report to shareholders. PLEASE READ THOSE DISCLOSURES CAREFULLY.

Table of Contents

PART I.

ITEM 1. BUSINESS.

In this annual report on Form 10-K, Applied refers to Applied Industrial Technologies, Inc., an Ohio corporation. References to we, us, our, and the company refer to Applied and its subsidiaries.

The company is one of North America s leading industrial product distributors. In addition, we provide fluid power, mechanical, and rubber shop services. We offer technical application support for our products and provide creative solutions to help customers minimize downtime and reduce overall procurement costs. Although we do not generally manufacture the products we sell, we do assemble and repair various products and systems. Our customers are primarily North American companies, who use our products to maintain and to repair their machinery and equipment. We also sell for original equipment manufacturing uses.

Applied and its predecessor companies have engaged in this business since 1923, when The Ohio Ball Bearing Company was formed. Applied reincorporated in Ohio in 1988.

Applied s Internet address is *www.applied.com*. The following documents are available free of charge at the investor relations area of our website:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, together with Section 16 insider beneficial stock ownership reports, all as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission
- Our Code of Business Ethics
- Our Board of Directors Governance Principles and Practices
- Our Director Independence Standards
- Charters for the Audit, Corporate Governance, and Executive Organization & Compensation Committees of our Board of Directors

The information on our website is not incorporated into this annual report on Form 10-K. The documents referenced above are also available in print to any shareholder who sends a written request to our Vice President-Chief Financial Officer & Treasurer at 1 Applied Plaza, Cleveland, Ohio 44115.

(a) General Development of Business.

Information regarding developments in our business can be found in our 2008 annual report to shareholders under the caption Management s Discussion and Analysis on pages 10 15. This information is incorporated here by reference.

Table of Contents

(b) Financial Information about Segments.

We have identified two reportable segments, service center-based distribution and fluid power businesses.

The service center-based distribution segment provides customers with a wide range of industrial products through a network of service centers stretching across North America. The fluid power businesses segment consists of specialized regional companies that distribute fluid power components and operate shops to assemble fluid power systems and perform equipment repair. The fluid power businesses primarily sell products and services directly to customers rather than through the service centers. Both segments offer technical support and provide creative solutions to help customers minimize their production downtime, improve machine performance, and reduce overall procurement and maintenance costs.

Segment financial information can be found in the 2008 annual report to shareholders in note 11 to the consolidated financial statements on pages 31 32. That information is incorporated here by reference.

(c) Narrative Description of Business.

Overview. Our field operating structure is built on two platforms service center-based distribution and fluid power businesses:

Service Center-Based Distribution. We distribute a wide range of industrial products through service centers in 48 states, Puerto Rico, five Canadian provinces, and 13 Mexican states. Customers primarily purchase our products for scheduled maintenance of their machinery and equipment and for emergency repairs. In addition, we operate regional fabricated rubber shops, which modify and repair conveyor belts and make hose assemblies in accordance with customer requirements, and rubber service field crews, which install and repair belts and rubber linings at customer locations. The service center-based distribution business accounts for a substantial majority of our field operations and sales dollars. The business operates in the U.S. using the Applied Industrial Technologies trade name. We also are known as Bearing & Transmission and Groupe GLM in Canada, Applied México and Suministros Industriales Enol in Mexico, and Rafael Benitez Carrillo in Puerto Rico.

Fluid Power Businesses. Our specialized fluid power businesses primarily market products and services directly to customers within the businesses geographic regions. In the U.S., the businesses also market products and services through our service center network. In addition to distributing fluid power components, the businesses assemble fluid power systems, perform equipment repair, and offer technical advice to customers. Customers include firms purchasing for maintenance, repair, and operations needs, as well as for original equipment manufacturing applications. Our fluid power businesses operate in various geographic areas of the U.S., Canada, and Mexico under the following names:

Fluid Power Business	Geographic Area
A&H Fluid Technologies	Southeast
Air Draulics Engineering	Mississippi Valley
Air-Hydraulic Systems	Upper Midwest
Applied Engineered Systems	Midwest
Atelier P.V. Hydraulique	Quebec, Canada
Dees Fluid Power	Mid-Atlantic and Northeast
Elect-Air	West Coast
Engineered Sales	Midwest
ESI Power Hydraulics	Midwest
HyPower	Western Canada
Kent Fluid Power	West Coast
Pro-Hydraulique	Quebec, Canada
Spencer Fluid Power	Northwest and West
Vycmex	Mexico

5

Table of Contents

Products. We are one of North America s leading distributors of bearings, power transmission components, fluid power components and systems, industrial rubber products, linear components, tools, safety products, general maintenance products, and a variety of mill supply products. Fluid power products include hydraulic, pneumatic, lubrication, and filtration components and systems.

These products are generally supplied to us by manufacturers whom we serve as a non-exclusive distributor. The suppliers also may provide us product training, as well as sales and marketing support. Authorizations to represent particular suppliers and product lines may vary by geographic region, particularly for our fluid power businesses. We believe our supplier relationships are generally good, and many have existed for decades. The disruption of relationships with certain suppliers, or the disruption of their operations, could adversely affect our business.

Our product suppliers generally confine their direct sales activities to large-volume transactions, mainly with original equipment manufacturers. The suppliers generally do not sell maintenance and repair products directly to the customer, but instead refer the customer to us or another distributor. There is no assurance that this practice will continue and its discontinuance could adversely affect our business.

Net sales by product category for the most recent three fiscal years is detailed in the 2008 annual report to shareholders in note 11 to the consolidated financial statements on page 32. That information is incorporated here by reference.

Services. Our associates advise and assist customers in selecting and applying products, and in managing inventory. We consider this advice and assistance to be an integral part of our sales efforts. Beyond traditional parts distribution services, we offer product and process solutions involving multiple technologies. These solutions help customers minimize production downtime, improve machine performance, and reduce overall procurement and maintenance costs. By providing high levels of service, product and industry expertise, and technical support, while at the same time offering competitive pricing, we believe we develop stronger, longer-lasting, and more profitable customer relationships.

Table of Contents

Our service center sales associates include customer sales and service representatives and account managers, as well as product and industry specialists. Customer sales and service representatives receive, process, and expedite customer orders, provide product information, and assist account managers in serving customers. Account managers make on-site calls to current and potential customers to provide product information, identify customer requirements, make recommendations, and assist in implementing equipment maintenance and storeroom management programs, including our automated storeroom replenishment system, AppliedSTORE®. Account managers also measure and document the value of the cost savings and increased productivity we help generate. Product and industry specialists assist with applications in their areas of expertise.

We maintain product inventory levels at each service center tailored to the local market. These inventories consist of standard items as well as other items specific to local customers demand. Seven distribution centers replenish service center inventories and also may ship products directly to customers. Having product in stock helps us satisfy customers immediate needs.

Timely delivery of products is an integral part of our service, particularly when customers require products for emergency repairs. Service centers and distribution centers use the most effective method of transportation available to meet customer needs. These methods include our own delivery vehicles, dedicated third-party transportation providers, as well as surface and air common carrier and courier services. Customers can also pick up items at our service centers.

Our information systems enhance our ability to serve customers. While we have long transacted with customers through electronic data interchange (EDI), customers can also turn to our website at *www.applied.com* to search for products in a comprehensive electronic catalog, research product attributes, view prices, check inventory levels, place orders, and track order status. We also interface with certain customers technology platforms and plant maintenance systems.

In addition to our electronic capabilities, we serve customers with our paper catalog. In June 2008, we issued our newest catalog, a comprehensive resource for 41,000 widely used products, including more than 20,000 bearing and power transmission parts and 9,000 fluid power products. Products from the catalog are also available for purchase at *www.applied.com*.

We supplement the service center product offering with our MaintenancePro® fee-based technical training seminars. These courses provide customer personnel with information on maintenance, troubleshooting, component application, and failure analysis in the areas of hydraulics and pneumatics, lubrication, bearings, and power transmission.

In addition to distributing products, we offer shop services in select geographic areas. Our fabricated rubber shops modify and repair conveyor belts and provide hose assemblies (also available at select service centers and distribution centers) in accordance with customer requirements. Field crews install and repair belts and rubber lining, primarily at customer locations. Among the other services we offer, either performed by us directly or by third party providers, are the rebuilding or assembly of speed reducers, pumps, valves, cylinders, and electric and hydraulic motors, and custom machining.

Table of Contents

Our specialized fluid power businesses generally operate independently of the service centers, but as product distributors, share the same focus on customer service. Product and application recommendations, inventory availability, and delivery speed are all critical to the businesses success.

The fluid power businesses distinguish themselves from most component distributors by offering engineering, design, system fabrication, installation, and repair services. These services can represent a significant portion of the overall value provided to customers. Each business has account managers with extensive technical knowledge, who handle sophisticated projects, including original equipment manufacturing applications. The businesses also provide technical support to our service centers and their customers.

Markets. We purchase from over 2,000 product manufacturers and resell the products to thousands of customers in a wide variety of industries, including agriculture and food processing, automotive, chemical processing, forest products, industrial machinery and equipment, mining, primary metals, transportation, and utilities, as well as to government agencies. Customers range from the largest concerns in North America, with whom we may have multiple-location relationships, to the smallest. We are not significantly dependent on a single customer or group of customers, the loss of which would have a material adverse effect on our business as a whole, and no single customer accounts for more than 4% of our net sales.

Competition. We consider our business to be highly competitive. In addition, our markets present few economic or technological barriers to entry, contributing to a high fragmentation of market share in our industry. Longstanding supplier and customer relationships, geographic coverage, name recognition, and our associates knowledge and experience do, however, support our competitive position. Competition is based generally on breadth and quality of product and service offerings, product availability, price, ease of product selection and ordering, catalogs, online capability, and having a local presence. In the fluid power businesses, product manufacturer authorizations are often more selective and can be a more significant competitive factor.

Our principal competitors are other bearing, power transmission, industrial rubber, fluid power, linear motion, and general maintenance and safety product distributors, and, to a lesser extent, mill supply and catalog companies. These competitors include local, regional, national, and multinational operations. We also compete with original equipment manufacturers and their distributors in the sale of maintenance and replacement components. Some competitors have greater financial resources than we do. The identity and number of our competitors vary throughout the geographic and product markets we serve.

Although we are one of the leading distributors in North America for the major product categories we carry, our market share for those products in any given geographic area may be relatively small compared to the portion of the market served by original equipment manufacturers and other distributors.

Backlog Orders and Seasonality. Because of our product resources and distribution network, we do not have a substantial backlog of orders, nor are backlog orders material at any given time to our business as a whole, although they are a more important factor for our fluid power businesses. Our business has exhibited minor seasonality in particular, sales per day during the first half of our fiscal year have tended to be slightly lower compared with the second half due, in part, to the impact of customer plant shutdowns and holidays.

Patents, Trademarks, and Licenses. Customer recognition of our service marks and trade names, including Applied Industrial Technologies®, Applied®, and AIT®, is an important contributing factor to our sales. Patents and licenses are not of material importance to our business.

Raw Materials and General Business Conditions. Our operations are dependent on general industrial and economic conditions. We would be adversely affected by the unavailability of raw materials to our suppliers, prolonged labor disputes experienced by suppliers or customers, or by any recession or depression that has an adverse effect on North American industrial activity generally or on key customer industries.

Number of Employees. At July 31, 2008, we had 4,805 employees.

Working Capital. Our working capital position is discussed in Management s Discussion and Analysis in the 2008 annual report to shareholders on pages 11 13.

We require substantial working capital related to accounts receivable and inventories. Significant amounts of inventory are carried to meet customers delivery requirements. We generally require payments for sales on account within 30 days. Returns are not considered to have a material effect on our working capital requirements. We believe these practices are generally consistent among companies in our industry.

Environmental Laws. We believe that compliance with laws regulating the discharge of materials into the environment or otherwise relating to environmental protection will not have a material adverse effect on our capital expenditures, earnings, or competitive position.

(d) Financial Information about Geographic Areas.

We believe our U.S. operations export sales during the fiscal year ended June 30, 2008, and prior fiscal years, were less than 2% of net sales. Export sales were not concentrated in a specific geographic area.

Additional information regarding our foreign operations, including information about revenues and long-lived assets, is included in the 2008 annual report to shareholders in note 11 to the consolidated financial statements on page 32 and in Quantitative and Qualitative Disclosures About Market Risk on page 15. That information is incorporated here by reference.

ITEM 1A. RISK FACTORS.

In addition to other information set forth in this report, you should carefully consider the following factors that could materially affect our business, financial condition, or results of operations. The risks described below are not the only risks facing our company. Additional risks not currently known to us, risks that could apply to any issuer, or risks that we currently deem immaterial, may also impact our business and operations.

RISKS RELATED TO OUR BUSINESS

Loss of key supplier authorizations, lack of product availability, or changes in supplier distribution programs could adversely affect our sales and earnings. Our business depends on maintaining an immediately available supply of various products to meet customer demand. Of our overall dollar volume of product purchases in fiscal 2008, almost half was purchased from our top 10 suppliers. Many of our relationships with key product suppliers are longstanding, but are terminable by either party. The loss of key supplier authorizations, or a substantial decrease in the availability of their products, could have a material adverse effect on our business. Supply interruptions could arise from shortages of raw materials, labor disputes or weather conditions affecting suppliers production, transportation disruptions, or other reasons beyond our control. Furthermore, we cannot be certain that particular products will be available to us, or available in quantities sufficient to meet customer demand. Limitations on our access to products could put us at a competitive disadvantage.

In addition, as a distributor, we face the risk of key product suppliers changing their relationships with distributors generally, or Applied in particular, in a manner that adversely impacts us. For example, key suppliers could change any of the following: the prices we must pay for their products relative to other distributors or relative to competing products; the geographic or product line breadth of distributor authorizations; supplier support programs; or product purchase or stocking expectations.

An increase in competition could decrease sales or earnings. We operate in a highly competitive industry. Our competitors include local, regional, national, and multinational distributors of industrial machinery parts, equipment, and supplies. Competition is largely focused in the local service area and is generally based on product line breadth, product availability, service capabilities, and price. Some existing competitors have, and new market entrants may have, greater financial resources than we do. If existing or future competitors seek to gain or to retain market share by reducing prices, we may need to lower our prices for products or services, thereby adversely affecting financial results.

Table of Contents

Increases in product and energy costs could reduce our profitability. Cost increases in commodity materials, such as steel, and energy have led product manufacturers to increase the prices of products we distribute. In addition, a portion of our own distribution costs is comprised of fuel for our sales and delivery vehicles, freight, and utility expenses for our facilities. All of these costs have increased significantly in recent years. Our ability to pass on increases in our costs depends on market conditions. Raising our prices could result in decreased sales volume, which could significantly reduce our profitability.

A disruption of our information systems could increase expenses, decrease sales, or otherwise reduce earnings. Our ability to transact business has become increasingly reliant on our information systems. We depend on information systems to process customer orders, manage inventory and accounts receivable collections, purchase products, ship products to customers on a timely basis, maintain cost-effective operations, and provide superior service to customers. A serious, prolonged disruption of our information systems could materially impair fundamental business processes.

Our business depends on our ability to retain and to attract qualified sales and customer service personnel. There are significant costs associated with hiring and training sales and customer service professionals. We greatly benefit from having employees who are familiar with the products we sell and their applications, as well as with our customer and supplier relationships. We could be adversely affected by a shortage of available skilled workers or the loss of a significant number of our sales or customer service professionals, including through retirement as the workforce ages.

Future acquisitions are a key component of our anticipated growth. We may not be able to identify or to complete future acquisitions, to integrate them effectively into our operations, or to realize their anticipated benefits. Many industries we serve are mature. As a result, our growth in recent years has resulted substantially from the acquisition of other businesses. While we wish to continue to acquire businesses, we may not be able to identify and to negotiate suitable acquisitions, to obtain financing for them on satisfactory terms, or otherwise to complete acquisitions. In addition, existing or future competitors, including financial buyers, may increasingly seek to compete with us for acquisitions, which could have the effect of increasing the price and reducing the number of suitable opportunities. We seek acquisition opportunities that complement and expand our operations. However, substantial costs, delays, or other difficulties related to integrating acquisitions into our operations could adversely affect our business or financial results. We could face significant challenges in consolidating functions and integrating procedures, information technology, personnel, and operations in a timely and efficient manner.

Further, even if we successfully integrate the acquisitions with our operations, we may not be able to realize the cost savings, sales increases, or other benefits that we anticipate from these acquisitions, either as to amount or in the time frame we expect. Our ability to realize anticipated benefits may be affected by a number of factors, including the following: our ability to reduce duplicative expenses and inventory effectively, and to consolidate facilities; the incurrence of significant integration costs or charges in order to achieve those benefits; and our ability to retain key product supplier authorizations and customer relationships. In addition, future acquisitions could place significant demand on administrative, operational, and financial resources.

An interruption of operations at our headquarters or distribution centers could adversely impact our business. Our business depends on maintaining operations at our headquarters and distribution centers. A serious, prolonged interruption due to power outage, telecommunications outage, terrorist attack, earthquake, hurricane, fire, flood or other natural disaster, or other interruption could have a material adverse effect on our business and financial results.

Our growth outside the United States increases our exposure to global economic and political conditions. Our foreign operations contributed 12.0% of our sales in 2008. If we continue to grow outside the U.S., the risks associated with exposure to more volatile economic conditions, political instability, cultural and legal differences in conducting business, and currency fluctuations will increase.

We are subject to litigation risk due to the nature of our business, which may have a material adverse effect on our business. From time to time, we are involved in lawsuits or other legal proceedings that arise from business transactions. These may, for example, relate to product liability claims, commercial disputes, or employment matters. In addition, we could face claims over other matters, such as claims arising from our status as a government contractor or corporate or securities law matters. The defense and ultimate outcome of lawsuits or other legal proceedings may result in higher operating expenses, which could have a material adverse effect on our business, financial condition, or results of operations.

RISKS RELATED TO OUR INDUSTRY

Our business depends heavily on the operating levels of our customers and the economic factors that affect them. Some of the primary markets for the products and services we sell are subject to cyclical fluctuations that affect demand for goods that our customers produce. Consequently, the demand for our services and products has been and will continue to be influenced by most of the same economic factors that affect the demand for and production of customers goods. When customers or prospective customers reduce production levels in response to lower demand for their products, they have less need for our products and services. Also, during periods of economic slowdown, our credit losses could increase. In addition, because some customers are moving operations overseas in order to reduce manufacturing costs, our ability to continue to serve those customers may be impaired and the size of our overall market opportunity in North America may be diminished.

Table of Contents

Consolidation occurring in our customers and suppliers industries could adversely affect our business and financial results. In recent years, we have witnessed increased consolidation among our product suppliers and customers. As customer industries consolidate, a greater proportion of our sales could be derived from larger, national contracts, which could adversely impact the amount and volatility of our earnings. In addition, consolidation increases the risk of larger customers seeking to purchase industrial products directly from manufacturers rather than through distributors. Similarly, continued consolidation among our suppliers could reduce our ability to negotiate favorable pricing and other commercial terms for our inventory purchases.

OTHER RISKS

In addition to the risks identified above, other risks we face include, but are not limited to, the following:

- changes in customer preferences for products and services of the nature, brands, quality, or cost sold by Applied;
- changes in the market prices for products and services relative to the cost of providing them;
- changes in customer procurement policies and practices;
- changes in product manufacturer sales policies and practices;
- changes in operating expenses;
- the variability and timing of new business opportunities including acquisitions, alliances, customer relationships, and supplier authorizations;
- the incurrence of debt and contingent liabilities in connection with acquisitions;
- our ability to access capital markets as needed;
- volatility of our stock price and the resulting impact on our consolidated financial statements;
- changes in accounting policies and practices;
- organizational changes within the company; and
- adverse regulation and legislation.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

Table of Contents

ITEM 2. PROPERTIES.

We believe that having a local presence is important to serving our customers, so we maintain service centers and other operations in local markets throughout North America. At June 30, 2008, we owned real properties at 144 locations and leased 295 locations. Certain properties house more than one operation.

The following were our principal owned real properties (each of which has more than 30,000 square feet of floor space) at June 30, 2008:

Location of Principal Owned Real Property	Type of Facility
Atlanta, Georgia	Distribution center and service center
Florence, Kentucky	Distribution center
Carlisle, Pennsylvania	Distribution center
Fort Worth, Texas	Distribution center and rubber shop

Our principal leased real properties (each of which has more than 30,000 square feet of floor space) at June 30, 2008 were:

Location of Principal Leased Real Property	Type of Facility
Cleveland, Ohio	Corporate headquarters
Fontana, California	Distribution center, rubber shop, fluid power shop, and service center
Denver, Colorado	Rubber shop and service center
Billings, Montana	Fluid power shop
Portland, Oregon	Distribution center
Kent, Washington	Offices and fluid power shop
Longview, Washington	Rubber shop and the fluid power shop
Appleton, Wisconsin	Offices, service center, and rubber shop
Winnipeg, Manitoba	Distribution center and service center

The properties in Billings and Kent are used in our fluid power businesses segment. The Fontana and Longview properties are used in operations both in the service center-based distribution segment and the fluid power businesses segment. The remaining properties are used in the service center-based distribution segment.

We consider our properties generally sufficient to meet our requirements for office space and inventory stocking. A service center s size is primarily influenced by the amount of inventory the service center requires to meet customers needs. We use all of our owned and leased properties except for certain properties which in the aggregate are not material and are either for sale, lease, or sublease to third parties due to a relocation or closing. We also may lease or sublease to others unused portions of buildings.

Table of Contents

In recent years, when opening new operations, we have tended to lease rather than purchase real property. We do not consider any of our service center, distribution center, or shop properties to be material, because we believe that, if it becomes necessary or desirable to relocate an operation, other suitable property could be found.

Additional information regarding our properties is included in the 2008 annual report to shareholders in note 10 to the consolidated financial statements on page 31. That information is incorporated here by reference.

ITEM 3. LEGAL PROCEEDINGS.

Applied and/or one of its subsidiaries is a party to pending legal proceedings with respect to product liability, commercial, and other matters. Although it is not possible to predict the outcome of these proceedings or the range of possible loss, we believe, based on circumstances currently known, that the likelihood is remote that the ultimate resolution of any of these proceedings will have, either individually or in the aggregate, a material adverse effect on Applied s consolidated financial position, results of operations, or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of Applied s security holders during the last quarter of fiscal 2008.

Table of Contents

EXECUTIVE OFFICERS OF THE REGISTRANT.

Applied s executive officers are elected by the Board of Directors for a term of one year, or until their successors are chosen and qualified, at the Board s organizational meeting held following the annual meeting of shareholders. The following is a list of the executive officers and a description of their business experience during the past five years. Except as otherwise stated, the positions and offices indicated are with Applied, and the persons were elected to their current positions on October 23, 2007:

Name	Positions and Experience	Age
David L. Pugh	Chairman & Chief Executive Officer, and a member of Board of Directors	59
Benjamin J. Mondics	President & Chief Operating Officer effective January 2008; previously served as Executive Vice President & Chief Operating Officer (from February 2007 to December 2007) and Vice President-Midwest Area (prior to February 2007)	50
Thomas E. Armold	Vice President-Marketing and Strategic Accounts (since January 2008); previously served as Vice President-Product Management and Marketing (from January 2004 to December 2007) and Vice President-Central States Area (prior to January 2004)	53
Todd A. Barlett	Vice President-Acquisitions and Global Business Development (since July 2004); previously served as Vice President-Global Business Development	53
Fred D. Bauer	Vice President-General Counsel & Secretary	42
Michael L. Coticchia	Vice President-Chief Administrative Officer and Government Business (since July 2006); previously served as Vice President-Human Resources and Administration	45
Mark O. Eisele	Vice President-Chief Financial Officer & Treasurer (since January 2004); previously served as Vice President & Controller	51
James T. Hopper	Vice President-Chief Information Officer	64
Jeffrey A. Ramras	Vice President-Supply Chain Management (since January 2008); previously served as Vice President-Marketing and Supply Chain Management	53
Richard C. Shaw	Vice President-Communications and Learning	59

PART II.

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Applied s common stock, without par value, is listed for trading on the New York Stock Exchange with the ticker symbol AIT. Information concerning the principal market for Applied s common stock, the quarterly stock prices and dividends for the fiscal years ended June 30, 2008, 2007, and 2006 and the number of shareholders of record as of August 11, 2008 is set forth in the 2008 annual report to shareholders on page 37, under the caption Quarterly Operating Results and Market Data, and that information is incorporated here by reference.

The following table summarizes Applied s repurchases of its common stock in the quarter ended June 30, 2008.

Period	(a) Total Number of Shares (1)	(b) Average Price Paid per Share ($)	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
April 1, 2008 to April 30, 2008	0		0	1,065,100
May 1, 2008 to May 31, 2008	0		0	1,065,100
June 1, 2008 to June 30, 2008	0		0	1,065,100
Total	0		0	1,065,100

(1) During the quarter ended June 30, 2008, Applied purchased 17,309 shares in connection with an employee deferred compensation program. This purchase is not counted in the Board of Directors authorization in note (2).

(2) On January 23, 2008, the Board of Directors

authorized the purchase of up to 1.5 million shares of Applied s common stock. We publicly announced the authorization that day. Purchases may be made in the open market or in privately negotiated transactions. This authorization is in effect until all shares are purchased or the authorization is revoked or amended by the Board of Directors.

ITEM 6. SELECTED FINANCIAL DATA.

The summary of selected financial data for the last five years is set forth in the 2008 annual report to shareholders in the table on pages 38 39 under the caption 10 Year Summary. That information is incorporated here by reference.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Management s Discussion and Analysis is set forth in the 2008 annual report to shareholders on pages 10 15 and is incorporated here by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The disclosures about market risk required by this item are set forth in Applied s 2008 annual report to shareholders on page 15, which information is incorporated here by reference. For more information relating to borrowing and interest rates, see the Liquidity and Capital Resources section of Management s Discussion and Analysis and notes 5 and 6 to the consolidated financial statements in Applied s 2008 annual report to shareholders on pages 11 12, and 24. That information is also incorporated here by reference. In addition, see Risk Factors at pages 12 - 13, above, for additional risk factors relating to our business.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The following consolidated financial statements and supplementary data of Applied and its subsidiaries and the reports of the independent registered public accounting firm listed below, which are included in the 2008 annual report to shareholders at the pages indicated, are incorporated here by reference and filed with this report:

Caption	Page No.
Financial Statements:	
Statements of Consolidated Income for the Years Ended June 30, 2008, 2007, and 2006	16
Consolidated Balance Sheets June 30, 2008 and 2007	17
Statements of Consolidated Cash Flows for the Years Ended June 30, 2008, 2007, and 2006	18
Statements of Consolidated Shareholders Equity for the Years Ended June 30, 2008, 2007, and 2006	19
Notes to Consolidated Financial Statements for the Years Ended June 30, 2008, 2007, and 2006	20 - 33
Reports of Independent Registered Public Accounting Firm	34, 36
Supplementary Data:	
Quarterly Operating Results & Market Data	37

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Applied s management, under the supervision and with the participation of the chief executive officer and the chief financial officer, has evaluated the effectiveness of Applied s disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on that evaluation, management has concluded that the disclosure controls and procedures are effective.

Management s annual report on Applied s internal control over financial reporting and the attestation report of the independent registered public accounting firm are set forth in the 2008 annual report to shareholders on pages 35 36 and are incorporated here by reference.

Management has not identified any change in internal control over financial reporting occurring during the fourth quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION.

Not applicable.

Table of Contents

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information required by this Item as to Applied s directors is incorporated by reference to Applied s proxy statement relating to the annual meeting of shareholders to be held October 21, 2008, under the caption Item 1 Election of Directors. The information required by this Item as to Applied s executive officers has been furnished in this Report on pages 15 16 in Part I, after Item 4, under the caption Executive Officers of the Registrant.

The information required by this Item regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to Applied s proxy statement, under the caption Section 16(a) Beneficial Ownership Reporting Compliance.

Applied has a code of ethics, named the Code of Business Ethics, that applies to our employees, including our chief executive officer, chief operating officer, chief financial officer, and corporate controller. The Code of Business Ethics is posted at the investor relations area of our *www.applied.com* website.

Information regarding the composition of Applied s audit committee and the identification of audit committee financial expert(s) serving on the audit committee is incorporated by reference to Applied s proxy statement, under the caption Corporate Governance.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this Item is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, under the captions Director Compensation, Executive Compensation and Compensation Committee Report.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Applied s shareholders have approved the following equity compensation plans: the 1997 Long-Term Performance Plan, the 2007 Long-Term Performance Plan, the Deferred Compensation Plan, and the Deferred Compensation Plan for Non-Employee Directors. All of these plans are currently in effect.

Table of Contents

The following table shows information regarding the number of shares of Applied common stock that may be issued pursuant to equity compensation plans or arrangements of Applied as of June 30, 2008.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by security holders	2,195,340	$ 15.17	*
Equity compensation plans not approved by security holders	0		0
Total	2,195,340	$ 15.17	*

* The 2007 Long-Term Performance Plan was adopted in October 2007 to replace the 1997 Long-Term Performance Plan, under which previously awarded stock options and stock appreciation rights remain outstanding. The aggregate number of shares that remained available for awards under the 2007 Long-Term Performance Plan at June 30, 2008, was

1,962,970. The number of shares issuable under the Deferred Compensation Plan for Non-Employee Directors and the Deferred Compensation Plan depends on the dollar amount of participant contributions deemed invested in Applied common stock.

Information concerning the security ownership of certain beneficial owners and management is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, under the caption Beneficial Ownership of Certain Applied Shareholders and Management.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this Item is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, under the caption Corporate Governance.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this Item is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, under the caption Item 2 Ratification of Auditors.

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a)1. Financial Statements.

The following consolidated financial statements, notes thereto, the reports of independent registered public accounting firm, and supplemental data are included in the 2008 annual report to shareholders on pages 16 34 and 36 37, and are incorporated by reference in Item 8 of this report.

Caption

Statements of Consolidated Income
for the Years Ended June 30, 2008, 2007, and 2006

Consolidated Balance Sheets
June 30, 2008 and 2007

Statements of Consolidated Cash Flows
for the Years Ended June 30, 2008, 2007, and 2006

Statements of Consolidated Shareholders Equity
for the Years Ended June 30, 2008, 2007, and 2006

Notes to Consolidated Financial Statements
for the Years Ended June 30, 2008, 2007, and 2006

Reports of Independent Registered Public Accounting Firm

Supplementary Data:
Quarterly Operating Results & Market Data

(a)2. Financial Statement Schedule.

The following report and schedule are included in this Part IV, and are found in this report at the pages indicated:

Caption	Page No.
Report of Independent Registered Public Accounting Firm	28
Schedule II Valuation and Qualifying Accounts	29

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission have been omitted because they are not required under the related instructions, are not applicable, or the required information is included in the consolidated financial statements and notes thereto.

(a)3. Exhibits.

* Asterisk indicates an executive compensation plan or arrangement.

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation of Applied Industrial Technologies, Inc., as amended on October 25, 2005 (filed as Exhibit 3(a) to the Company s Form 10-Q for the quarter ended December 31, 2005, SEC File No. 1-2299, and incorporated here by reference).
3.2	Code of Regulations of Applied Industrial Technologies, Inc., as amended on October 19, 1999 (filed as Exhibit 3(b) to Applied s Form 10-Q for the quarter ended September 30, 1999, SEC File No. 1-2299, and incorporated here by reference).
4.1	Certificate of Merger of Bearings, Inc. (Ohio) and Bearings, Inc. (Delaware) filed with the Ohio Secretary of State on October 18, 1988, including an Agreement and Plan of Reorganization dated September 6, 1988 (filed as Exhibit 4(a) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
4.2	Private Shelf Agreement dated as of November 27, 1996, as amended on January 30, 1998, between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(f) to Applied s Form 10-Q for the quarter ended March 31, 1998, SEC File No. 1-2299, and incorporated here by reference).
4.3	Amendment dated October 24, 2000 to November 27, 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(e) to Applied s Form 10-Q for the quarter ended September 30, 2000, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

Exhibit No.	Description
4.4	Amendment dated November 14, 2003 to 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(d) to Applied s Form 10-Q for the quarter ended December 31, 2003, SEC File No. 1-2299, and incorporated here by reference).
4.5	Amendment dated February 25, 2004 to 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(e) to Applied s Form 10-Q for the quarter ended March 31, 2004, SEC File No. 1-2299, and incorporated here by reference).
4.6	Amendment dated March 30, 2007 to 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(f) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
4.7	Credit Agreement dated as of June 3, 2005, among Applied, KeyBank National Association as Agent, and various financial institutions (filed as Exhibit 4 to Applied s Form 8-K dated June 9, 2005, SEC File No. 1-2299, and incorporated here by reference).
4.8	First Amendment Agreement dated as of June 6, 2007, among Applied, KeyBank National Association as Agent, and various financial institutions, amending June 3, 2005 Credit Agreement (filed as Exhibit 4 to Applied s Form 8-K dated June 11, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.1	Form of Change in Control Agreement between Applied and each of its executive officers (filed as Exhibit 99.1 to Applied s Form 8-K dated April 25, 2008, SEC File No. 1-2299, and incorporated here by reference).
*10.2	A written description of Applied s director compensation program is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008 under the caption Director Compensation.
*10.3	Applied Deferred Compensation Plan for Non-Employee Directors (September 1, 2003 Restatement) (filed as Exhibit 10(c) to Applied s Form 10-K for the year ended June 30, 2003, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

Exhibit No.	Description
*10.4	A written description of Applied s Life and Accidental Death and Dismemberment Insurance for executive officers (filed as Exhibit 10(d) to Applied s Form 10-K for the year ended June 30, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.5	A written description of Applied s Long-Term Disability Insurance for executive officers (filed as Exhibit 10(c) to Applied s Form 10-Q for the quarter ended December 31, 1997, SEC File No. 1-2299, and incorporated here by reference).
*10.6	Form of Director and Officer Indemnification Agreement entered into between Applied and each of its directors and executive officers (filed as Exhibit 10(g) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
*10.7	Applied Supplemental Executive Retirement Benefits Plan (January 1, 2002 Restatement), the terms of which govern benefits vested as of December 31, 2004, for two current executive officers, J. T. Hopper and R. C. Shaw, and certain former executive officers (filed as Exhibit 10 to Applied s Form 10-Q for the quarter ended March 31, 2002, SEC File No. 1-2299, and incorporated here by reference).
*10.8	First Amendment to Supplemental Executive Retirement Benefits Plan (January 1, 2002 Restatement) (filed as Exhibit 10 to Applied s Form 10-Q for the quarter ended September 30, 2004, SEC File No. 1-2299, and incorporated here by reference).
*10.9	Supplemental Executive Retirement Benefits Plan (Post-2004 Terms), the terms of which govern benefits vested after December 31, 2004, for nine current executive officers (filed as Exhibit 10(c) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.10	Applied Deferred Compensation Plan (2005 Restatement) (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.11	1997 Long-Term Performance Plan, as amended April 19, 2007 (filed as Exhibit 10(k) to Applied s Form 10-K for the year ended June 30, 2007, SEC File No. 1-2299, and incorporated here by reference).

Exhibit No.	Description
*10.12	2007 Long-Term Performance Plan (filed as Exhibit 10 to the Company s Form 8-K dated October 23, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.13	Applied Supplemental Defined Contribution Plan (January 1, 1997 Restatement) (filed as Exhibit 10(m) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
*10.14	First Amendment to Applied Supplemental Defined Contribution Plan effective as of October 1, 2000 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended September 30, 2000, SEC File No. 1-2299, and incorporated here by reference).
*10.15	Second Amendment to Applied Supplemental Defined Contribution Plan effective as of January 16, 2001 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 2001, SEC File No. 1-2299, and incorporated here by reference).
*10.16	Form of Non-Statutory Stock Option Award Terms and Conditions (Directors) (filed as Exhibit 10 to Applied s Form 8-K dated November 30, 2005, SEC File No. 1-2299, and incorporated here by reference).
*10.17	Restricted Stock Award Terms (Directors) (filed as Exhibit 10(b) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.18	Stock Appreciation Rights Award Terms and Conditions (Officers) (filed as Exhibit 10(b) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.19	Performance Grant Terms and Conditions (filed as Exhibit 10 to the Company s Form 10-Q for the quarter ended September 30, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.20	2008 Management Incentive Plan General Terms (filed as Exhibit 10(a) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

Exhibit No.	Description
*10.21	Non-qualified Deferred Compensation Agreement between Applied and J. Michael Moore effective as of December 31, 1997 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 1998, SEC File No. 1-2299, and incorporated here by reference).
10.22	Lease dated as of March 1, 1996 between Applied and the Cleveland-Cuyahoga County Port Authority (filed as Exhibit 10(n) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
10.23	Asset Purchase Agreement made as of July 14, 2008, by and among Applied, Fluid Power Resource, LLC (FPR), and certain FPR subsidiaries (filed as Exhibit 2.1 to Applied s Form 8-K dated July 16, 2008, SEC File No. 1-2299, and incorporated here by reference).
13	Applied s 2008 annual report to shareholders (not deemed filed as part of this Form 10-K except for those portions that are expressly incorporated by reference).
21	Applied s subsidiaries at June 30, 2008.
23	Consent of Independent Registered Public Accounting Firm.
24	Powers of attorney.
31	Rule 13a-14(a)/15d-14(a) certifications.
32	Section 1350 certifications.

Applied will furnish a copy of any exhibit described above and not contained herein upon payment of a specified reasonable fee, which shall be limited to Applied s reasonable expenses in furnishing the exhibit.

Certain long-term debt instruments have not been filed as exhibits because the total amount of securities authorized under any one of the instruments does not exceed 10 percent of the total assets of Applied and its subsidiaries on a consolidated basis. Applied agrees to furnish to the Securities and Exchange Commission, upon request, a copy of each such instrument.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Applied Industrial Technologies, Inc.

We have audited the consolidated financial statements of Applied Industrial Technologies, Inc. and subsidiaries (the Company) as of June 30, 2008 and 2007, and for each of the three years in the period ended June 30, 2008, and the Company s internal control over financial reporting as of June 30, 2008, and have issued our reports thereon dated August 15, 2008; such consolidated financial statements and reports are included in your 2008 Annual Report to Shareholders and are incorporated herein by reference. Our report relating to the consolidated financial statements of the Company includes an explanatory paragraph concerning the adoption of new accounting standards in 2007 and 2008. Our audits also included the consolidated financial statement schedule of the Company listed in Item 15. This consolidated financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche LLP

Cleveland, Ohio

August 15, 2008

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. & SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED JUNE 30, 2008, 2007 AND 2006
(in thousands)

COLUMN A	COLUMN B	COLUMN C		COLUMN D	COLUMN E
DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	ADDITIONS CHARGED TO COSTS AND EXPENSES	ADDITIONS (DEDUCTIONS) CHARGED TO OTHER ACCOUNTS	DEDUCTIONS FROM RESERVE	BALANCE AT END OF PERIOD
YEAR ENDED JUNE 30 2008:					
Reserve deducted from assets to which it applies accounts receivable allowances	$ 6,134	$ 2,595	$ 80(B)	$ 2,690(A)	$ 6,119
YEAR ENDED JUNE 30 2007:					
Reserve deducted from assets to which it applies accounts receivable allowances	$ 6,000	$ 1,462	$ (30)(B)	$ 1,298(A)	$ 6,134
YEAR ENDED JUNE 30 2006:					
Reserve deducted from assets to which it applies accounts receivable allowances	$ 6,500	$ 1,953	$ (510)(B)	$ 1,943(A)	$ 6,000

(A) Amounts represent uncollectible accounts charged off.

(B) Amounts represent reserves for the return of merchandise by customers.

SCHEDULE II

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

APPLIED INDUSTRIAL TECHNOLOGIES, INC.

/s/ David L. Pugh	/s/ Benjamin J. Mondics
David L. Pugh, Chairman & Chief Executive Officer	Benjamin J. Mondics, President & Chief Operating Officer
/s/ Mark O. Eisele	/s/ Daniel T. Brezovec
Mark O. Eisele Vice President-Chief Financial Officer & Treasurer	Daniel T. Brezovec Corporate Controller (Principal Accounting Officer)

Date: August 20, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

*	*
William G. Bares, Director	Thomas A. Commes, Director
*	*
Peter A. Dorsman, Director	L. Thomas Hiltz, Director
*	*
Edith Kelly-Green, Director	John F. Meier, Director
*	/s/ David L. Pugh
J. Michael Moore, Director	David L. Pugh, Chairman & Chief Executive Officer and Director
*	*
Dr. Jerry Sue Thornton, Director	Peter C. Wallace, Director
*	
Stephen E. Yates, Director	

/s/ Fred D. Bauer

Fred D. Bauer, as attorney in fact
for persons indicated by *
Date: August 20, 2008

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC.
EXHIBIT INDEX
TO FORM 10-K FOR THE YEAR ENDED JUNE 30, 2008

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation of Applied Industrial Technologies, Inc., as amended on October 25, 2005 (filed as Exhibit 3(a) to the Company s Form 10-Q for the quarter ended December 31, 2005, SEC File No. 1-2299, and incorporated here by reference).
3.2	Code of Regulations of Applied Industrial Technologies, Inc., as amended on October 19, 1999 (filed as Exhibit 3(b) to Applied s Form 10-Q for the quarter ended September 30, 1999, SEC File No. 1-2299, and incorporated here by reference).
4.1	Certificate of Merger of Bearings, Inc. (Ohio) and Bearings, Inc. (Delaware) filed with the Ohio Secretary of State on October 18, 1988, including an Agreement and Plan of Reorganization dated September 6, 1988 (filed as Exhibit 4(a) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
4.2	Private Shelf Agreement dated as of November 27, 1996, as amended on January 30, 1998, between Applied and The Prudential Insurance Company of America (filed as Exhibit 4(f) to Applied s Form 10-Q for the quarter ended March 31, 1998, SEC File No. 1-2299, and incorporated here by reference).
4.3	Amendment dated October 24, 2000 to November 27, 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(e) to Applied s Form 10-Q for the quarter ended September 30, 2000, SEC File No. 1-2299, and incorporated here by reference).
4.4	Amendment dated November 14, 2003 to 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(d) to Applied s Form 10-Q for the quarter ended December 31, 2003, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

Exhibit No.	Description
4.5	Amendment dated February 25, 2004 to 1996 Private Shelf Agreement between Applied and the and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(e) to Applied s Form 10-Q for the quarter ended March 31, 2004, SEC File No. 1-2299, and incorporated here by reference).
4.6	Amendment dated March 30, 2007 to 1996 Private Shelf Agreement between Applied and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America) (filed as Exhibit 4(f) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
4.7	Credit Agreement dated as of June 3, 2005, among Applied, KeyBank National Association as Agent, and various financial institutions (filed as Exhibit 4 to Applied s Form 8-K dated June 9, 2005, SEC File No. 1-2299, and incorporated here by reference).
4.8	First Amendment Agreement dated as of June 6, 2007, among Applied, KeyBank National Association as Agent, and various financial institutions, amending June 3, 2005 Credit Agreement (filed as Exhibit 4 to Applied s Form 8-K dated June 11, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.1	Form of Change in Control Agreement between Applied and each of its executive officers (filed as Exhibit 99.1 to Applied s Form 8-K dated April 25, 2008, SEC File No. 1-2299, and incorporated here by reference).
*10.2	A written description of Applied s director compensation program is incorporated by reference to Applied s proxy statement for the annual meeting of shareholders to be held October 21, 2008, under the caption Director Compensation.
*10.3	Applied Deferred Compensation Plan for Non-Employee Directors (September 1, 2003 Restatement) (filed as Exhibit 10(c) to Applied s Form 10-K for the year ended June 30, 2003, SEC File No. 1-2299, and incorporated here by reference).
*10.4	A written description of Applied s Life and Accidental Death and Dismemberment Insurance for executive officers (filed as Exhibit 10(d) to Applied s Form 10-K for the year ended June 30, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.5	A written description of Applied s Long-Term Disability Insurance for executive officers (filed as Exhibit 10(c) to Applied s Form 10-Q for the quarter ended December 31, 1997, SEC File No. 1-2299, and incorporated

here by reference).

Table of Contents

Exhibit No.	Description
*10.6	Form of Director and Officer Indemnification Agreement entered into between Applied and each of its directors and executive officers (filed as Exhibit 10(g) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
*10.7	Applied Supplemental Executive Retirement Benefits Plan (January 1, 2002 Restatement), the terms of which govern benefits vested as of December 31, 2004, for two current executive officers, J. T. Hopper and R. C. Shaw, and certain former executive officers (filed as Exhibit 10 to Applied s Form 10-Q for the quarter ended March 31, 2002, SEC File No. 1-2299, and incorporated here by reference).
*10.8	First Amendment to Supplemental Executive Retirement Benefits Plan (January 1, 2002 Restatement) (filed as Exhibit 10 to Applied s Form 10-Q for the quarter ended September 30, 2004, SEC File No. 1-2299, and incorporated here by reference).
*10.9	Supplemental Executive Retirement Benefits Plan (Post-2004 Terms), the terms of which govern benefits vested after December 31, 2004, for nine current executive officers (filed as Exhibit 10(c) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.10	Applied Deferred Compensation Plan (2005 Restatement) (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.11	1997 Long-Term Performance Plan, as amended April 19, 2007 (filed as Exhibit 10(k) to Applied s Form 10-K for the year ended June 30, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.12	2007 Long-Term Performance Plan (filed as Exhibit 10 to the Applied s Form 8-K dated October 23, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.13	Applied Supplemental Defined Contribution Plan (January 1, 1997 Restatement) (filed as Exhibit 10(m) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
*10.14	First Amendment to Applied Supplemental Defined Contribution Plan effective as of October 1, 2000 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended September 30, 2000, SEC File No. 1-2299, and incorporated here by reference).

Exhibit No.	Description
*10.15	Second Amendment to Applied Supplemental Defined Contribution Plan effective as of January 16, 2001 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 2001, SEC File No. 1-2299, and incorporated here by reference).
*10.16	Form of Non-Statutory Stock Option Award Terms and Conditions (Directors) (filed as Exhibit 10 to Applied s Form 8-K dated November 30, 2006, SEC File No. 1-2299, and incorporated here by reference).
*10.17	Restricted Stock Award Terms (Directors) (filed as Exhibit 10(b) to Applied s Form 10-Q for the quarter ended March 31, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.18	Stock Appreciation Rights Award Terms and Conditions (Officers) (filed as Exhibit 10(b) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.19	Performance Grant Terms and Conditions (filed as Exhibit 10 to Applied s Form 10-Q for the quarter ended September 30, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.20	2008 Management Incentive Plan General Terms (filed as Exhibit 10(a) to Applied s Form 8-K dated August 9, 2007, SEC File No. 1-2299, and incorporated here by reference).
*10.21	Non-qualified Deferred Compensation Agreement between Applied and J. Michael Moore effective as of December 31, 1997 (filed as Exhibit 10(a) to Applied s Form 10-Q for the quarter ended March 31, 1998, SEC File No. 1-2299, and incorporated here by reference).
10.22	Lease dated as of March 1, 1996 between Applied and the Cleveland-Cuyahoga County Port Authority (filed as Exhibit 10(n) to Applied s Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
10.23	Asset Purchase Agreement made as of July 14, 2008, by and among Applied, Fluid Power Resource, LLC (FPR), and certain FPR subsidiaries (filed as Exhibit 2.1 to Applied s Form 8-K dated July 16, 2008, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

Exhibit No.	Description	
13	Applied s 2008 annual report to shareholders (not deemed filed as part of this Form 10-K except for those portions that are expressly incorporated by reference).	Attached
21	Applied s subsidiaries at June 30, 2008.	Attached
23	Consent of Independent Registered Public Accounting Firm.	Attached
24	Powers of attorney.	Attached
31	Rule 13a-14(a)/15d-14(a) certifications.	Attached
32	Section 1350 certifications.	Attached

35

t none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;background-color: #CCEEFF;padding:0pt;">

Variable Rate Payments (1) (in millions)

$

–

$

–

$

–

$

1,518

(2)

$

–

$

–

$

1,518

Weighted Average Interest Rate

–

%

–

%

–

%

3.22

%

–

%

–

%

3.22

%

(1) Excludes unamortized debt issuance costs and debt discounts.

(2) The maturity date will accelerate to October 2019 if, by that date, we have not amended, redeemed or refinanced at least $765 million of our 2020 Senior Notes.

Commodities Risk

We use over-the-counter fixed price swap agreements and options to protect sales of our production against the inherent risks of adverse price fluctuations or locational pricing differences between a published index and the NYMEX futures market. These swaps and options include transactions in which one party will pay a fixed price (or variable price) for a notional quantity in exchange for receiving a variable price (or fixed price) based on a published index (referred to as price swaps) and transactions in which parties agree to pay a price based on two different indices (referred to as basis swaps).

The primary market risks relating to our derivative contracts are the volatility in market prices and basis differentials for natural gas. However, the market price risk is offset by the gain or loss recognized upon the related sale or purchase of the natural gas that is financially protected. Credit risk relates to the risk of loss as a result of non-performance by our counterparties. The counterparties are primarily major banks and integrated energy companies that management believes present minimal credit risks. The credit quality of each counterparty and the level of financial exposure we have to each counterparty are closely monitored to limit our credit risk exposure. Additionally, we perform both quantitative and qualitative assessments of these counterparties based on their credit ratings and credit default swap rates where applicable. We have not incurred any counterparty losses related to non-performance and do not anticipate any losses given the information we have currently. However, we cannot be certain that we will not experience such losses in the future. We refer you to Note 4 of the consolidated financial statements included in this Annual Report for additional details about our derivative instruments.

Table of Contents

Index to Financial Statements

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Index to Financial Statements

Management's Report on Internal Control Over Financial Reporting

It is the responsibility of the management of Southwestern Energy Company to establish and maintain adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016, utilizing the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control—Integrated Framework (2013).

Based on this evaluation, management has concluded the Company's internal control over financial reporting was effective as of December 31, 2016.

The effectiveness of our internal control over financial reporting as of December 31, 2016 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in its report which appears herein.

69

Table of Contents

Index to Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Southwestern Energy Company

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Southwestern Energy Company and its subsidiaries at December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/PRICEWATERHOUSECOOPERS LLP

Houston, TX

February 23, 2017

70

Table of Contents

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the years ended December 31,		
	2016	2015	2014
	(in millions, except share/per share amounts)		
Operating Revenues:			
Gas sales	$ 1,273	$ 1,946	$ 2,827
Oil sales	69	76	19
NGL sales	92	73	3
Marketing	864	863	996
Gas gathering	138	175	193
	2,436	3,133	4,038
Operating Costs and Expenses:			
Marketing purchases	864	852	980
Operating expenses	592	689	427
General and administrative expenses	247	246	221
Restructuring charges	78	–	–
Depreciation, depletion and amortization	436	1,091	942
Impairment of natural gas and oil properties	2,321	6,950	–
Gain on sale of assets, net	–	(283)	–
Taxes, other than income taxes	93	110	95
	4,631	9,655	2,665
Operating Income (Loss)	(2,195)	(6,522)	1,373
Interest Expense:			
Interest on debt	226	200	101
Other interest charges	14	60	13
Interest capitalized	(152)	(204)	(55)
	88	56	59
Gain (Loss) on Derivatives	(339)	47	139
Loss on Early Extinguishment of Debt	(51)	–	–
Other Income (Loss), Net	1	(30)	(4)
Income (Loss) Before Income Taxes	(2,672)	(6,561)	1,449
Provision (Benefit) for Income Taxes:			
Current	(7)	(2)	21
Deferred	(22)	(2,003)	504
	(29)	(2,005)	525
Net Income (Loss)	$ (2,643)	$ (4,556)	$ 924
Mandatory convertible preferred stock dividend	108	106	–

Net Income (Loss) Attributable to Common Stock	$ (2,751)	$ (4,662)	$ 924
Earnings (Loss) Per Common Share:			
Basic	$ (6.32)	$ (12.25)	$ 2.63
Diluted	$ (6.32)	$ (12.25)	$ 2.62
Weighted Average Common Shares Outstanding:			
Basic	435,337,402	380,521,039	351,446,747
Diluted	435,337,402	380,521,039	352,410,683

The accompanying notes are an integral part of these consolidated financial statements.

71

Table of Contents

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	For the years ended December 31,		
	2016	2015	2014
	(in millions)		
Net income (loss)	$ (2,643)	$ (4,556)	$ 924
Change in derivatives:			
Settlements (1)	–	(128)	16
Ineffectiveness	–	1	–
Change in fair value of derivative instruments (2)	–	29	73
Total change in derivatives	–	(98)	89
Change in value of pension and other postretirement liabilities:			
Amortization of prior service cost and net loss included in net periodic pension cost (3)	13	2	–
Net gain (loss) incurred in period (4)	(7)	(3)	(15)
Total change in value of pension and postretirement liabilities	6	(1)	(15)
Change in currency translation adjustment	3	(11)	(8)
Comprehensive income (loss)	$ (2,634)	$ (4,666)	$ 990

(1) Net of ($81) million and $10 million in taxes for the years ended December 31, 2015 and 2014, respectively.

(2) Net of $16 million and $49 million in taxes for the years ended December 31, 2015 and 2014, respectively.

(3) Net of $8 million in taxes for the year ended December 31, 2016.

(4) Net of ($4) million and ($10) million in taxes for the years ended December 31, 2016 and 2014, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2016	December 31, 2015
ASSETS	(in millions)	
Current assets:		
Cash and cash equivalents	$ 1,423	$ 15
Accounts receivable, net	363	327
Derivative assets	51	3
Other current assets	35	48
Total current assets	1,872	393
Natural gas and oil properties, using the full cost method, including $2,105 million as of December 31, 2016 and $3,727 million as of December 31, 2015 excluded from amortization	22,653	22,478
Gathering systems	1,299	1,280
Other	537	606
Less: Accumulated depreciation, depletion and amortization	(19,534)	(16,821)
Total property and equipment, net	4,955	7,543
Other long-term assets	249	150
TOTAL ASSETS	$ 7,076	$ 8,086
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	$ 41	$ 1
Accounts payable	473	513
Taxes payable	59	64
Interest payable	74	75
Dividends payable	27	27
Derivative liabilities	355	3
Other current liabilities	35	24
Total current liabilities	1,064	707
Long-term debt	4,612	4,704
Pension and other postretirement liabilities	49	50
Other long-term liabilities	434	343
Total long-term liabilities	5,095	5,097
Commitments and contingencies (see Note 8)		
Equity:		
Common stock, $0.01 par value; 1,250,000,000 shares authorized; issued 495,248,369 shares as of December 31, 2016 (does not include 2,751,410 shares issued on January 17, 2017 on account of a dividend declared on December 12, 2016) and 390,138,549 as of December 31, 2015	5	4

Preferred stock, $0.01 par value, 10,000,000 shares authorized, 6.25% Series B Mandatory Convertible, $1,000 per share liquidation preference, 1,725,000 shares issued and outstanding as of December 31, 2016 and 2015, conversion in January 2018	–	–
Additional paid-in capital	4,677	3,409
Accumulated deficit	(3,725)	(1,082)
Accumulated other comprehensive loss	(39)	(48)
Common stock in treasury, 31,269 and 47,149 shares as of December 31, 2016 and 2015, respectively	(1)	(1)
Total equity	917	2,282
TOTAL LIABILITIES AND EQUITY	$ 7,076	$ 8,086

The accompanying notes are an integral part of these consolidated financial statements.

73

Table of Contents

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the twelve months ended December 31,		
	2016	2015	2014
	(in millions)		
Cash Flows From Operating Activities:			
Net income (loss)	$ (2,643)	$ (4,556)	$ 924
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation, depletion and amortization	436	1,092	942
Impairment of natural gas and oil properties	2,321	6,950	–
Amortization of debt issuance costs	14	53	10
Deferred income taxes	(22)	(2,003)	504
(Gain) loss on derivatives, net of settlement	373	155	(130)
Stock-based compensation	29	26	18
Gain on sale of assets, net	–	(283)	–
Restructuring charges	30	–	–
Loss on early extinguishment of debt	51	–	
Other	8	34	2
Change in assets and liabilities:			
Accounts receivable	(30)	203	(66)
Accounts payable	(69)	(78)	84
Taxes payable	(5)	(28)	24
Interest payable	–	9	–
Other assets and liabilities	5	6	23
Net cash provided by operating activities	498	1,580	2,335
Cash Flows From Investing Activities:			
Capital investments	(593)	(1,798)	(2,043)
Acquisitions	–	(579)	(5,298)
Proceeds from sale of property and equipment	430	729	43
Other	1	10	10
Net cash used in investing activities	(162)	(1,638)	(7,288)
Cash Flows From Financing Activities:			
Payments on current portion of long-term debt	(1)	(1)	(1)
Payments on long-term debt	(1,175)	(500)	–

Payments on short-term debt	–	(4,500)	–
Payments on revolving credit facility	(3,268)	(3,024)	(5,179)
Borrowings under revolving credit facility	3,152	2,840	5,196
Payments on commercial paper	(242)	(7,988)	–
Borrowings under commercial paper	242	7,988	–
Change in bank drafts outstanding	(20)	12	11
Proceeds from issuance of long-term debt	1,191	2,950	500
Proceeds from issuance of short-term debt	–	–	4,500
Debt issuance costs	(17)	(20)	(56)
Proceeds from exercise of common stock options	–	–	12
Proceeds from issuance of common stock	1,247	669	–
Proceeds from issuance of mandatory convertible preferred stock	–	1,673	–
Preferred stock dividend	(27)	(79)	–
Cash paid for tax withholding	(9)	–	–
Other	(1)	–	–
Net cash provided by financing activities	1,072	20	4,983
Increase (decrease) in cash and cash equivalents	1,408	(38)	30
Cash and cash equivalents at beginning of year	15	53	23
Cash and cash equivalents at end of year	$ 1,423	$ 15	$ 53

The accompanying notes are an integral part of these consolidated financial statements.

74

Table of Contents

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Common Stock		Preferred Stock	Additional	Retained Earnings	Accumulated Other	Common Stock in	
	Shares		Shares	Paid-In	(Accumulated	Comprehensive Income		
	Issued	Amount	Issued	Capital	Deficit)	(Loss)	Treasury	Total
	(in millions, except share amounts)							
Balance at December 31, 2013	352,938,584	$ 4	–	$ 969	$ 2,653	$ (4)	$ –	$ 3,622
Comprehensive income:								
Net income	–	–	–	–	924	–	–	924
Other comprehensive income	–	–	–	–	–	66	–	66
Total comprehensive income	–	–	–	–	–	–	–	990
Stock-based compensation	–	–	–	38	–	–	–	38
Exercise of stock options	402,190	–	–	12	–	–	–	12
Issuance of restricted stock	1,299,367	–	–	–	–	–	–	–
Cancellation of restricted stock	(140,703)	–	–	–	–	–	–	–
Tax withholding – stock compensation	(12,133)	–	–	–	–	–	–	–
Issuance of stock awards	1,687	–	–	–	–	–	–	–
Balance at December 31, 2014	354,488,992	$ 4	–	$ 1,019	$ 3,577	$ 62	$ –	$ 4,662
Comprehensive loss:								
Net loss	–	–	–	–	(4,556)	–	–	(4,556)
	–	–	–	–	–	(110)	–	(110)

Other comprehensive loss								
Total comprehensive loss	–	–	–	–	–	–	–	(4,666)
Stock-based compensation	–	–	–	48	–	–	–	48
Preferred stock dividend	–	–	–	–	(106)	–	–	(106)
Issuance of common stock	30,000,000	–	–	669	–	–	–	669
Issuance of preferred stock	–	–	1,725,000	1,673	–	–	–	1,673
Issuance of restricted stock	5,821,125	–	–	–	–	–	–	–
Cancellation of restricted stock	(103,162)	–	–	–	–	–	–	–
Treasury stock – non-qualified plan	–	–	–	–	–	–	(1)	(1)
Tax withholding – stock compensation	(73,869)	–	–	–	–	–	–	–
Issuance of stock awards	5,463	–	–	–	–	–	–	–
Non-controlling interest	–	–	–	–	3	–	–	3
Balance at December 31, 2015	390,138,549	$ 4	1,725,000	$ 3,409	$ (1,082)	$ (48)	$ (1)	$ 2,282
Comprehensive loss:								
Net loss	–	–	–	–	(2,643)	–	–	(2,643)
Other comprehensive income	–	–	–	–	–	9	–	9
Total comprehensive loss	–	–	–	–	–	–	–	(2,634)
Stock-based compensation	–	–	–	58	–	–	–	58
Preferred stock dividend (1)	7,166,389	–	–	(27)	–	–	–	(27)
Exercise of stock options	44,880	–	–	–	–	–	–	–
Issuance of common stock	98,900,000	1	–	1,246	–	–	–	1,247
Issuance of restricted stock	87,472	–	–	–	–	–	–	–
Cancellation of restricted stock	(165,483)	–	–	–	–	–	–	–
Tax withholding – stock compensation	(929,252)	–	–	(9)	–	–	–	(9)
Issuance of stock awards	5,814	–	–	–	–	–	–	–
Balance at December 31, 2016	495,248,369	$ 5	1,725,000	$ 4,677	$ (3,725)	$ (39)	$ (1)	$ 917

(1) Does not include 2,751,410 shares issued on January 17, 2017 and distributed to holders of the Company's mandatory convertible preferred stock.

The accompanying notes are an integral part of these consolidated financial statements.

Index to Financial Statements

SOUTHWESTERN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Southwestern Energy Company (including its subsidiaries, collectively "Southwestern" or the "Company") is an independent energy company engaged in natural gas, oil and NGL exploration, development and production ("E&P"). The Company is also focused on creating and capturing additional value through its natural gas gathering and marketing businesses ("Midstream Services"). Southwestern conducts most of its businesses through subsidiaries and operates principally in two segments: E&P and Midstream Services.

Exploration and Production. Southwestern's primary business is the exploration for and production of natural gas, oil and NGLs, with current operations principally focused on the development of unconventional natural gas reservoirs located in Pennsylvania, West Virginia and Arkansas. The Company's operations in northeast Pennsylvania, herein referred to as "Northeast Appalachia," are primarily focused on the unconventional natural gas reservoir known as the Marcellus Shale. Operations in West Virginia and southwest Pennsylvania, herein referred to as "Southwest Appalachia," are focused on the Marcellus Shale, the Utica and the Upper Devonian unconventional natural gas and oil reservoirs. Collectively, Southwestern refers to its properties located in Pennsylvania and West Virginia as the "Appalachian Basin." The Company's operations in Arkansas are primarily focused on an unconventional natural gas reservoir known as the Fayetteville Shale. Southwestern has activities ongoing in Colorado and Louisiana, along with other areas in which it is currently assessing new development opportunities. The Company also has drilling rigs located in Pennsylvania, West Virginia and Arkansas and provides oilfield products and services, principally serving its E&P operations.

Midstream Services. Through the Company's affiliated midstream subsidiaries, Southwestern engages in natural gas gathering activities in Arkansas and Louisiana. These activities primarily support the Company's E&P operations and generate revenue from fees associated with the gathering of natural gas. Southwestern's marketing activities capture opportunities that arise through the marketing and transportation of the natural gas, oil and NGLs produced in its E&P operations.

Basis of Presentation

The consolidated financial statements included in this Annual Report present the Company's financial position, results of operations and cash flows for the periods presented in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements, and the amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company evaluates subsequent events through the date the financial statements are issued. Certain reclassifications have been made to the prior year financial statements to conform to the 2016 presentation. The effects of the reclassifications were not material to the Company's consolidated financial statements. See Note 1 – New Accounting Standards Implemented in this Report for additional information regarding the reclassifications.

Principles of Consolidation

The consolidated financial statements include the accounts of Southwestern and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

In 2015, the Company purchased an 86% ownership in a limited partnership which owns and operates a gathering system in Northeast Appalachia as part of the WPX Property Acquisition (as defined and discussed in Note 3). Because the Company owns a controlling interest in the partnership, the operating and financial results are consolidated with the Company's E&P segment results. The investor's share of the partnership activity is reported in retained earnings in the consolidated financial statements. Net income attributable to noncontrolling interest for the years ended December 31, 2016 and 2015 was insignificant.

Revenue Recognition

Natural gas and liquid sales. Natural gas and liquid sales are recognized when the products are sold to a purchaser at a fixed or determinable price, delivery has occurred, title has transferred and collectability of the revenue is reasonably assured. The Company uses the entitlement method that requires revenue recognition for the Company's net revenue interest of sales

76

Table of Contents

Index to Financial Statements

from its properties. Accordingly, natural gas and liquid sales are not recognized for deliveries in excess of the Company's net revenue interest, while natural gas and liquid sales are recognized for any under-delivered volumes. Production imbalances are generally recorded at estimated sales prices of the anticipated future settlements of the imbalances. The Company had no significant production imbalances at December 31, 2016 or 2015.

Marketing. The Company generally markets its natural gas and liquids, as well as some products produced by third parties, to marketers, local distribution companies and end-users, pursuant to a variety of contracts. Marketing revenues are recognized when delivery has occurred, title has transferred, the price is fixed or determinable and collectability of the revenue is reasonably assured.

Gas gathering. In certain areas, the Company gathers its natural gas as well as some natural gas produced by third parties pursuant to a variety of contracts. Gas gathering revenues are recognized when the service is performed, the price is fixed or determinable and collectability of the revenue is reasonably assured.

Cash and Cash Equivalents

Cash and cash equivalents are defined by the Company as short-term, highly liquid investments that have an original maturity of three months or less and deposits in money market mutual funds that are readily convertible into cash. Management considers cash and cash equivalents to have minimal credit and market risk as the Company monitors the credit status of the financial institutions holding its cash and marketable securities. The following table presents a summary of cash and cash equivalents as of December 31, 2016 and December 31, 2015:

	For the years ended December 31,	
	2016	2015
	(in millions)	
Cash	$ 254	$ 15
Marketable Securities (1)	1,169	–
Total	$ 1,423	$ 15

(1) Consists of government stable value money market funds.

Certain of the Company's cash accounts are zero-balance controlled disbursement accounts. The Company presents the outstanding checks written against these zero-balance accounts as a component of accounts payable in the accompanying consolidated balance sheets. Outstanding checks included as a component of accounts payable totaled $8 million and $29 million as of December 31, 2016 and 2015, respectively.

Property, Depreciation, Depletion and Amortization

Natural Gas and Oil Properties. The Company utilizes the full cost method of accounting for costs related to the exploration, development and acquisition of natural gas and oil properties. Under this method, all such costs (productive and nonproductive), including salaries, benefits and other internal costs directly attributable to these activities are capitalized on a country-by-country basis and amortized over the estimated lives of the properties using the units-of-production method. These capitalized costs are subject to a ceiling test that limits such pooled costs, net of applicable deferred taxes, to the aggregate of the present value of future net revenues attributable to proved natural gas, oil and NGL reserves discounted at 10% (standardized measure). Any costs in excess of the ceiling are written off as a non-cash expense. The expense may not be reversed in future periods, even though higher natural gas, oil and NGL prices may subsequently increase the ceiling. Companies using the full cost method are required to use the average quoted price from the first day of each month from the previous 12 months, including the impact of derivatives designated for hedge accounting, to calculate the ceiling value of their reserves. Decreases in market prices as well as changes in production rates, levels of reserves, evaluation of costs excluded from amortization, future development costs and production costs could result in future ceiling test impairments.

Costs associated with unevaluated properties are excluded from the amortization base until the properties are evaluated or impairment is indicated. The costs associated with unevaluated leasehold acreage and related seismic data, wells currently drilling and related capitalized interest are initially excluded from the amortization base. Leasehold costs are either transferred to the amortization base with the costs of drilling a well on the lease or are assessed at least annually for possible impairment or reduction in value. The Company's decision to withhold costs from amortization and the timing of the transfer of those costs into the amortization base involves a significant amount of judgment and may be subject to changes over time based on several factors, including drilling plans, availability of capital, project economics and drilling results from adjacent acreage. At December 31, 2016, the Company had a total of $2,105 million of costs excluded from the amortization base,

77

Table of Contents

Index to Financial Statements

all of which related to its properties in the United States. Inclusion of some or all of these costs in the Company's United States properties in the future, without adding any associated reserves, could result in additional ceiling test impairments.

In the first, second, and third quarters of 2016, the Company's net book value of its United States and Canada natural gas and oil properties exceeded the ceiling by approximately $641 million (net of tax) at March 31, 2016, $297 million (net of tax) at June 30, 2016 and $506 million (net of tax) at September 30, 2016, resulting in non-cash ceiling test impairments in each of those quarters. Using the average quoted price from the first day of each month from the previous 12 months for Henry Hub natural gas of $2.48 per MMBtu, West Texas Intermediate oil of $39.25 per barrel and NGLs of $6.74 per barrel, adjusted for market differentials, the Company's net book value of its United States natural gas and oil properties did not exceed the ceiling amount and did not result in a ceiling test impairment at December 31, 2016. The Company had no derivative positions that were designated for hedge accounting as of December 31, 2016.

In the second and third quarters of 2015, the net book value of the Company's United States natural gas and oil properties exceeded the ceiling by $944 million (net of tax) at June 30, 2015 and $1,746 million (net of tax) at September 30, 2015 and resulted in non-cash ceiling test impairments. Cash flow hedges of natural gas production in place increased the ceiling amount by approximately $60 million and $40 million as of June 30, 2015 and September 30, 2015, respectively. Using the average quoted price from the first day of each month from the previous 12 months for Henry Hub natural gas of $2.59 per MMBtu, West Texas Intermediate oil of $46.79 per barrel and NGLs of $6.82 per barrel, adjusted for market differentials, the Company's net book value of its United States natural gas and oil properties exceeded the ceiling by $1,586 million (net of tax) at December 31, 2015 and resulted in a non-cash ceiling test impairment. The Company had no derivative positions that were designated for hedge accounting as of December 31, 2015.

At December 31, 2014, the ceiling value of the Company's reserves was calculated based upon the average quoted price from the first day of each month from the previous 12 months for Henry Hub natural gas of $4.35 per MMBtu, for West Texas Intermediate oil of $91.48 per barrel and NGLs of $23.79 per barrel, adjusted for market differentials. The Company's net book value of its natural gas and oil properties did not exceed the ceiling amount and did not result in a ceiling test impairment at December 31, 2014.

Gathering Systems. The Company's investment in gathering systems is primarily in a system serving its Fayetteville Shale operations in Arkansas. These assets are being depreciated on a straight-line basis over 25 years.

Capitalized Interest. Interest is capitalized on the cost of unevaluated natural gas and oil properties that are excluded from amortization and are actively being evaluated.

Asset Retirement Obligations. The Company owns natural gas and oil properties, which require expenditures to plug and abandon the wells and reclaim the associated pads when the wells are no longer producing. An asset retirement obligation associated with the retirement of a tangible long-lived asset is recognized as a liability in the period incurred or when it becomes determinable, with an associated increase in the carrying amount of the related long-lived asset. The cost of the tangible asset, including the asset retirement cost, is depreciated over the useful life of the asset. The asset retirement obligation is recorded at its estimated fair value, and accretion expense is recognized over time as the discounted liability is accreted to its expected settlement value.

Impairment of long-lived assets. The carrying value of non-full cost pool long-lived assets is evaluated for recoverability whenever events or changes in circumstances indicate that it may not be recoverable.

Intangible assets. The carrying value of intangible assets are evaluated for recoverability whenever events or changes in circumstances indicate that it may not be recoverable. Intangible assets are amortized over their useful life.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recorded for the estimated future tax consequences attributable to the differences between the financial carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the tax rate expected to be in effect for the year in which those temporary differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the year of the enacted rate change. Deferred income taxes are provided to recognize the income tax effect of reporting certain transactions in different years for income tax and financial reporting purposes. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that the related tax benefits will not be realized.

Table of Contents

Index to Financial Statements

The Company accounts for uncertainty in income taxes using a recognition and measurement threshold for tax positions taken or expected to be taken in a tax return. The tax benefit from an uncertain tax position is recognized when it is more likely than not that the position will be sustained upon examination by taxing authorities based on technical merits of the position. The amount of the tax benefit recognized is the largest amount of the benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The effective tax rate and the tax basis of assets and liabilities reflect management's estimates of the ultimate outcome of various tax uncertainties. The Company recognizes penalties and interest related to uncertain tax positions within the provision (benefit) for income taxes line in the accompanying consolidated statements of operations. Additional information regarding uncertain tax positions can be found in Note 9 – Income Taxes.

Derivative Financial Instruments

The Company uses derivative financial instruments to manage defined commodity price risks and does not use them for speculative trading purposes. The Company uses fixed price swap agreements and options to financially protect sales of natural gas. Gains and losses resulting from the settlement of derivative contracts have been recognized in gas sales if designated for hedge accounting treatment or gain (loss) on derivatives if not designated for hedge accounting treatment in the consolidated statements of operations when the contracts expire and the related physical transactions of the commodity hedged are recognized. Changes in the fair value of derivative instruments designated as cash flow hedges and not settled are included in other comprehensive income (loss) to the extent that they are effective in offsetting the changes in the cash flows of the hedged item. In contrast, gains and losses from the ineffective portion of derivative contracts designated for hedge accounting treatment are recognized currently and have an inconsequential impact in the consolidated statement of operations. Gains and losses from the unsettled portion of derivative contracts not designated for hedge accounting treatment are recognized in gain (loss) on derivatives in the consolidated statement of operations. See Note 4 – Derivatives and Risk Management and Note 6 – Fair Value Measurements for a discussion of the Company's hedging activities.

Earnings Per Share

Basic earnings per common share is computed by dividing net income (loss) attributable to common stock by the weighted average number of common shares outstanding during the reportable period. The diluted earnings per share calculation adds to the weighted average number of common shares outstanding: the incremental shares that would have been outstanding assuming the exercise of dilutive stock options, the vesting of unvested restricted shares of common stock, performance units, the assumed conversion of mandatory convertible preferred stock and the shares of common stock declared as a preferred stock dividend. An antidilutive impact is an increase in earnings per share or a reduction in net loss per share resulting from the conversion, exercise, or contingent issuance of certain securities.

In July 2016, the Company completed an underwritten public offering of 98,900,000 shares of its common stock, with an offering price to the public of $13.00 per share. Net proceeds from the common stock offering were approximately $1,247 million, after underwriting discount and offering expenses. The proceeds from the offering were used to repay $375 million of the $750 million term loan entered into in November 2015 and to settle certain tender offers by purchasing an aggregate principal amount of approximately $700 million of the Company's outstanding senior notes due in the first quarter of 2018. The remaining proceeds of the offering have been or will be used for general corporate purposes.

In January 2015, the Company completed concurrent underwritten public offerings of 30,000,000 shares of its common stock and 34,500,000 depositary shares (both share counts include shares issued as a result of the underwriters exercising their options to purchase additional shares). The common stock offering was priced at $23.00 per share. Net proceeds from the common stock offering were approximately $669 million, after underwriting discount and offering expenses. Net proceeds from the depositary share offering were approximately $1.7 billion, after underwriting discount and offering expenses. Each depositary share represents a 1/20th interest in a share of the Company's mandatory convertible preferred stock, with a liquidation preference of $1,000 per share (equivalent to a $50 liquidation preference per depositary share). The proceeds from the offerings were used to partially repay borrowings under the Company's $4.5 billion 364-day bridge facility with the remaining balance of the bridge facility fully repaid with proceeds from the Company's January 2015 public offering of $2.2 billion in long-term senior notes.

The mandatory convertible preferred stock entitles the holder to a proportional fractional interest in the rights and preferences of the convertible preferred stock, including conversion, dividend, liquidation and voting rights. Unless converted earlier at the option of the holders, on or around January 15, 2018 each share of convertible preferred stock will automatically convert into between 37.0028 and 43.4782 shares of the Company's common stock (correspondingly, each depositary share will convert into between 1.85014 and 2.17391 shares of the Company's common stock), subject to customary anti-dilution adjustments, depending on the volume-weighted average price of the Company's common stock over a 20 trading day averaging period immediately prior to that date. The total potential shares of common stock resulting from the conversion will range from 63,829,830 to 74,999,895 shares.

Table of Contents

Index to Financial Statements

The mandatory convertible preferred stock has the non-forfeitable right to participate on an as-converted basis at the conversion rate then in effect in any common stock dividends declared and as such, is considered a participating security. Accordingly, it is included in the computation of basic and diluted earnings per share, pursuant to the two-class method. In the calculation of basic earnings per share attributable to common shareholders, participating securities are allocated earnings based on actual dividend distributions received plus a proportionate share of undistributed net income attributable to common shareholders, if any, after recognizing distributed earnings. The Company's participating securities do not participate in undistributed net losses because they are not contractually obligated to do so.

On December 12, 2016, the Company declared its quarterly dividend, payable to holders of the mandatory convertible preferred stock, and announced that it would pay the quarterly dividend in stock, in lieu of cash, to the extent permitted by the certificate of designations for the Series B preferred stock. The Company issued 2,751,410 shares of common stock on January 17, 2017 in payment for the dividend. Dividends declared in the first, second and third quarters of 2016 also were settled in common stock for a total of 7,166,389 shares, while the dividend declared in December 2015 was paid in cash in January 2016.

The following table presents the computation of earnings per share for the years ended December 31, 2016, 2015 and 2014:

	For the years ended December 31,		
	2016	2015	2014
	(in millions, except share/per share amounts)		
Net income (loss)	$ (2,643)	$ (4,556)	$ 924
Mandatory convertible preferred stock dividend	108	106	–
Net income (loss) attributable to common stock	$ (2,751)	$ (4,662)	$ 924
Number of common shares:			
Weighted average outstanding	435,337,402	380,521,039	351,446,747
Issued upon assumed exercise of outstanding stock options	–	–	241,603
Effect of issuance of non-vested restricted common stock	–	–	448,415
Effect of issuance of non-vested performance units	–	–	273,918
Effect of issuance of mandatory convertible preferred stock	–	–	–
Effect of declaration of preferred stock dividends	–	–	–
Weighted average and potential dilutive outstanding	435,337,402	380,521,039	352,410,683

Earnings (loss) per common share:			
Basic	$ (6.32)	$ (12.25)	$ 2.63
Diluted	$ (6.32)	$ (12.25)	$ 2.62

The following table presents the common stock shares equivalent excluded from the calculation of diluted earnings per share for the years ended December 31, 2016, 2015 and 2014, as they would have had an antidilutive effect:

	For the years ended December 31,		
	2016	2015	2014
Unvested stock options	3,692,697	3,835,234	1,446,004
Unvested share-based payment	959,233	1,990,383	29,879
Performance units	884,644	140,414	–
Mandatory convertible preferred stock	74,999,895	70,890,312	–
Declared and unpaid preferred stock dividends	2,751,410	–	–
Total	83,287,879	76,856,343	1,475,883

Supplemental Disclosures of Cash Flow Information

The following table provides additional information concerning interest and income taxes paid as well as changes in noncash investing activities for the years ended December 31, 2016, 2015, and 2014:

	For the years ended December 31,		
	2016	2015	2014
	(in millions)		
Cash paid during the year for interest, net of amounts capitalized	$ 75	$ 6	$ 50
Cash paid (received) during the year for income taxes	(15)	(6)	28
Increase (decrease) in noncash property additions	55	(10)	174

80

Table of Contents

Index to Financial Statements

Stock-Based Compensation

The Company accounts for stock-based compensation transactions using a fair value method and recognizes an amount equal to the fair value of the stock options and stock-based payment cost in either the consolidated statement of operations or capitalizes the cost into natural gas and oil properties or gathering systems included in property and equipment. Costs are capitalized when they are directly related to the acquisition, exploration and development activities of the Company's natural gas and oil properties or directly related to the construction of the Company's gathering systems.

Treasury Stock

The Company maintains a non-qualified deferred compensation supplemental retirement savings plan for certain key employees whereby participants may elect to defer and contribute a portion of their compensation to a Rabbi Trust, as permitted by the plan. The Company includes the assets and liabilities of its supplemental retirement savings plan in its consolidated balance sheet. Shares of the Company's common stock purchased under the non-qualified deferred compensation arrangement are held in the Rabbi Trust, are presented as treasury stock and are carried at cost. As of December 31, 2016, 31,269 shares were accounted for as treasury stock, compared to 47,149 shares at December 31, 2015.

Foreign Currency Translation

The Company has designated the Canadian dollar as the functional currency for our activities in Canada. The cumulative translation effects of translating the accounts from the functional currency into the U.S. dollar at current exchange rates are included as a separate component of other comprehensive income within stockholders' equity.

New Accounting Standards Implemented in this Report

In September 2015, the FASB issued Accounting Standards Update No. 2015-16, Business Combinations (Topic 805) ("Update 2015-16"), which seeks to reduce the complexity of amounts recognized in a business combination. The amendments in Update 2015-16 require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined.

The amendments in Update 2015-16 require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in Update 2015-16 require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The amendments in Update 2015-16 are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The Company adopted this update in the first quarter of 2016 resulting in no impact on its consolidated results of operations, financial position and cash flows.

In May 2015, the FASB issued Accounting Standards Update No. 2015-07, Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (Or Its Equivalent) ("Update 2015-07"), which amends ASC 820, Fair Value Measurement. The standard removes the requirement to categorize within the fair value hierarchy investments for which fair value is measured using the net asset value per share practical expedient and removes certain related disclosure requirements. The amendments in Update 2015-07 are effective for reporting periods beginning after December 15, 2015, with early adoption permitted. The Company adopted this update in the first quarter of 2016 resulting in no impact on its consolidated results of operations, financial position and cash flows. As a result of adoption, certain of the Company's pension plan assets measured using net asset value as a practical expedient have not been classified in the fair value hierarchy in Note 11 – Retirement and Employee Benefit Plans.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest-Imputation of Interest (Subtopic 835-30) ("Update 2015-03"), in an effort to simplify presentation of debt issuance costs. Update 2015-03 required that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs was not affected by the amendments in this Update. Entities were required to apply the amendments in Update 2015-03 on a retrospective basis, with the balance sheet of each individual period presented adjusted to reflect the period-specific effects of applying the new guidance. In August 2015, the FASB issued Accounting Standards Update No. 2015-15, Interest-Imputation of Interest (Subtopic 835-30) ("Update 2015-15"), which addressed the presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements, given the absence of authoritative guidance within Update 2015-03 for debt issuance costs related to line-of-credit arrangements. For public entities, Update 2015-03 and Update 2015-15 are effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company adopted this update in the first quarter of 2016 resulting in an immaterial impact on its consolidated

Table of Contents

Index to Financial Statements

financial position. The Company had $24 million in unamortized debt expense that was classified as a long-term asset at December 31, 2015, which is now presented as a contra-liability as a result of adoption.

In November 2014, the FASB issued Accounting Standards Update No. 2014-16, Derivatives and Hedging – Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (Subtopic 815-15) ("Update 2014-16"), which addressed diversity in practice related to the determination of whether derivative features embedded in hybrid instruments issued in the form of a share should be bifurcated and accounted for separately. For public entities, Update 2014-16 was effective for annual reporting periods beginning after December 15, 2015 including interim periods within that reporting period. The Company adopted this update in the first quarter of 2016 resulting in no impact on its consolidated results of operations, financial position and cash flows.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (Subtopic 205-40) ("Update 2014-15"), which requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. For public entities, Update 2014-15 was effective for annual reporting periods ending after December 15, 2016. The Company adopted this update in the first quarter of 2016 resulting in no impact on its consolidated results of operations, financial position, cash flows and disclosures.

New Accounting Standards Not Yet Implemented in this Report

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows (Topic 230) ("Update 2016-15"), which seeks to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. For public entities, Update 2016-15 becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the provisions of Update 2016-15 and assessing the impact, if any, it may have on its consolidated results of operations, financial position or cash flows.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation – Stock Compensation (Topic 718) ("Update 2016-09"), which seeks to simplify accounting for share-based payment transactions including income tax consequences, classification of awards as either equity or liabilities, and the classification on the statement of cash flows. For public entities, Update 2016-09 becomes effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted. The Company expects to adopt this guidance effective January 1, 2017. The recognition of previously unrecognized windfall tax benefits is expected to result in a cumulative-effect adjustment of approximately $149 million, which would increase net deferred tax assets and increase the valuation allowance by the same amount as of the beginning of 2017. The remaining provisions of this amendment are not expected to have a material effect on the consolidated results of operations, financial position or cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (“Update 2016-02”), which seeks to increase transparency and comparability among organizations by, among other things, recognizing lease assets and lease liabilities on the balance sheet for leases classified as operating leases under previous GAAP and disclosing key information about leasing arrangements. In 2016, the Company made progress on contract reviews, drafting its accounting policies and evaluating the new disclosure requirements. The Company will continue assessing the effect that the updated standard may have on its consolidated financial statements and related disclosures, and anticipates that its assessment will be complete in 2018. For public entities, Update 2016-02 becomes effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“Update 2014-09”), which seeks to provide clarity for recognizing revenue. The new standard removes inconsistencies in existing standards, changes the way companies recognize revenue from contracts with customers and increases disclosure requirements. The codification was amended through additional ASUs and, as amended, requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. The standard is required to be adopted using either the full retrospective approach, with all prior periods presented adjusted, or the modified retrospective approach, with a cumulative adjustment to retained earnings on the opening balance sheet. The Company has not yet selected a transition method. The Company has a team in place to analyze the impact of Update 2014-09, and the related ASU's, across all revenue streams to evaluate the impact of the new standard on revenue contracts. This includes reviewing current accounting policies and practices to identify potential differences that would result from applying the requirements under the new standard. In 2016, the Company made progress on contract reviews, drafting its accounting policies and evaluating the new disclosure requirements. The Company expects to complete its evaluations of the impacts of the accounting and

Index to Financial Statements

disclosure requirements on its business processes, controls and systems in the second half of 2017. For public entities, the new standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period.

(2) REDUCTION IN WORKFORCE

In January 2016, the Company announced a 40% workforce reduction as a result of lower anticipated drilling activity. This reduction was substantially completed in the first quarter of 2016. In April 2016, the Company also partially restructured executive management, which was substantially completed in the second quarter of 2016.

The following table presents a summary of the restructuring charges for the year ended December 31, 2016:

	(in millions)	
Severance (including payroll taxes)	$	44
Stock-based compensation		24
Pension and other post retirement benefits(1)		5
Other benefits		3
Outplacement services, other		2
Total restructuring charges (2)	$	78

(1) Includes non-cash charges related to the curtailment and settlement of the pension and other postretirement benefit plans. See Note 11 for additional details regarding the Company's retirement and employee benefit plans.

(2) Total restructuring charges were $75 million and $3 million for the Company's E&P and Midstream Services segments, respectively.

The following table presents a summary of liabilities associated with the Company's restructuring activities for the year ended December 31, 2016, which are reflected in accounts payable on the unaudited condensed consolidated balance sheet:

	(in millions)
Liability at December 31, 2015	$ –
Additions	49
Distributions	(48)
Liability at December 31, 2016	$ 1

Severance payments and other separation costs related to restructuring were substantially completed by the end of 2016.

(3) ACQUISITIONS AND DIVESTITURES

In September 2016, the Company sold approximately 55,000 net acres in West Virginia for approximately $422 million, which reflects customary adjustments at closing and is subject to customary post-closing adjustments. The Company accounted for the sale of these natural gas and oil properties as adjustments to capitalized costs, with no recognition of gain or loss as the sales did not involve a significant change in proved reserves or significantly alter the relationship between costs and proved reserves. In September 2016, $48 million of the net proceeds was used to repay borrowings under the Company’s term loan entered into in November 2015. The Company intends to use the remaining net proceeds from the sale for general corporate purposes, including to fund capital projects.

In May 2015, the Company sold conventional oil and gas assets located in East Texas and the Arkoma Basin for approximately $211 million. The Company also accounted for the sale of these natural gas and oil properties as adjustments to capitalized costs, with no recognition of gain or loss as the sales did not involve a significant change in proved reserves or significantly alter the relationship between costs and proved reserves. The proceeds from the transaction were used to reduce the Company’s debt. Approximately $205 million of the proceeds received were recorded as a reduction of the capitalized costs of the Company’s natural gas and oil properties in the United States pursuant to the full cost method of accounting.

In April 2015, the Company sold its gathering assets located in Bradford and Lycoming counties in northeast Pennsylvania for an adjusted sales price of approximately $489 million. The net book value of these assets was $206 million and was held in the Midstream Services segment as of the closing date. A gain on sale of $283 million was recognized and was included in gain on sale of assets, net on the consolidated statement of operations. The assets included approximately 100 miles of natural gas gathering pipelines, with nearly 600 million cubic feet per day of capacity. The proceeds from the transaction were used to substantially repay borrowings under the Company’s $500 million term loan facility that would have matured in December 2016.

83

In January 2015, the Company completed an acquisition of certain natural gas and oil assets including approximately 46,700 net acres in northeast Pennsylvania from WPX Energy, Inc. for an adjusted purchase price of $270 million (the “WPX Property Acquisition”). This acreage was producing approximately 50 million net cubic feet of gas per day from 63 operated horizontal wells as of December 2014. As part of this transaction, the Company assumed firm transportation capacity of 260 million cubic feet of gas per day predominantly on the Millennium pipeline. The firm transport is being amortized over 19 years. As of December 31, 2016 and 2015 the Company has amortized $17 million and $8 million, respectively. This transaction was funded with the revolving credit facility and was accounted for as a business combination. The following table summarizes the consideration paid for the WPX Property Acquisition and the fair value of the assets acquired and liabilities assumed as of the acquisition date:

		(in millions)
Consideration:		
Cash	$	270
Recognized amounts of identifiable assets acquired and liabilities assumed:		
Assets acquired:		
Proved natural gas and oil properties		31
Unproved natural gas and oil properties		114
Intangible asset		109
Gathering system		22
Other		1
Total assets acquired		277
Liabilities assumed:		
Asset retirement obligations		(7)
Total liabilities assumed		(7)
	$	270

In January 2015, the Company completed an acquisition of certain natural gas and oil assets from Statoil ASA including approximately 30,000 net acres in West Virginia and southwest Pennsylvania for $357 million, which was comprised of approximately 20% of Statoil’s interests in the properties, (the “Statoil Property Acquisition”). All of these assets were also assets in which the Company had acquired interests under the Chesapeake Property Acquisition as defined below. This transaction was funded with the revolving credit facility and was accounted for as a business combination. The Company allocated the purchase price to natural gas and oil properties, based on the respective fair values of the assets acquired.

In December 2014, the Company completed an acquisition of certain gas and oil assets from Chesapeake Energy Corporation covering approximately 413,000 net acres in West Virginia and southwest Pennsylvania targeting natural gas, oil and NGLs contained in the Upper Devonian, Marcellus and Utica Shales for approximately $5.0 billion (the "Chesapeake Property Acquisition"). The transaction was temporarily financed using a $4.5 billion 364-day senior unsecured bridge term loan credit facility and a $500 million two-year unsecured term loan. The Company repaid all principal and interest outstanding on the $4.5 billion bridge facility in January 2015 after permanent financing was finalized, and as a result expensed $47 million of short-term unamortized debt issuance costs related to the bridge facility in January 2015, recognized in other interest charges on the consolidated statement of operations. The term loan facility was repaid in full in April 2015 with proceeds from the divestiture of the Company's northeastern Pennsylvania gathering assets and borrowings under the revolving credit facility.

Table of Contents

Index to Financial Statements

The following table summarizes the consideration paid for the Chesapeake Property Acquisition and the fair value of the assets acquired and liabilities assumed as of the acquisition date, updated for subsequent customary post-closing adjustments:

		(in millions)
Consideration:		
Cash	$	4,949
Recognized amounts of identifiable assets acquired and liabilities assumed:		
Assets acquired:		
Proved natural gas and oil properties		1,418
Unproved natural gas and oil properties		3,573
Other property and equipment		33
Inventory		3
Total assets acquired		5,027
Liabilities assumed:		
Asset retirement obligations		(42)
Other liabilities		(36)
Total liabilities assumed		(78)
	$	4,949

The Company recorded the assets acquired and liabilities assumed in the Chesapeake Property Acquisition at their estimated fair value of approximately $5.0 billion, which the Company considered to be representative of the price paid by a typical market participant. This measurement resulted in no goodwill or bargain purchase being recognized. In addition, the Company included $1 million in general and administrative expenses and $5 million in interest expense for fees related to the Chesapeake Property Acquisition on its consolidated statement of operations for the year ended December 31, 2014. The Company included $47 million in other current assets and $1 million in other assets for unamortized fees related to the bridge facility and term loan facility, respectively, for the Chesapeake Property Acquisition on its consolidated balance sheet as of December 31, 2014.

The results of operations of the Chesapeake Property Acquisition have been included in the Company’s consolidated financial statements since the December 22, 2014 closing date, including approximately $10 million of total revenue and $2 million of operating income for the year ended December 31, 2014. Summarized below are the consolidated results of operations for the year ended December 31, 2014 on an unaudited pro forma basis, as if the acquisition and related financing had occurred on January 1, 2013. The unaudited pro forma financial information was derived from the historical consolidated statement of operations of the Company and the statement of revenues and direct operating expenses for the Chesapeake Property Acquisition properties. The unaudited pro forma financial information does not purport to be indicative of results of operations that would have occurred had the acquisition and related financing occurred on the basis assumed above, nor is such information indicative of the Company’s expected future results of operations. The unaudited pro forma financial information excludes the WPX Property and Statoil Property Acquisitions as the impacts are immaterial.

	For the years ended December 31,	
	2014	2013
	(unaudited)	
Revenues (in millions)	$ 4,439	$ 3,713
Net Income attributable to common stock (in millions)	803	594
Earnings per share:		
Basic	$ 2.11	$ 1.56
Diluted	2.10	1.56

The above acquisitions qualified as business combinations, and as a result, the Company estimated the fair value of the assets acquired and liabilities assumed as of the acquisition date. The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements also utilize assumptions of market participants. The Company used a discounted cash flow model and made market assumptions as to future commodity prices, projections of estimated quantities of natural gas, oil and NGL reserves, expectations for timing and amount of future development and operating costs, projections of future rates of production, expected recovery rates and risk adjusted discount rates. These assumptions represent Level 3 inputs, as defined in Note 6 – Fair Value Measurements.

Table of Contents

Index to Financial Statements

(4) DERIVATIVES AND RISK MANAGEMENT

The Company is exposed to volatility in market prices and basis differentials for natural gas, oil and NGLs which impacts the predictability of its cash flows related to the sale of those commodities. These risks are managed by the Company's use of certain derivative financial instruments. As of December 31, 2016, the Company's derivative financial instruments consisted of fixed price swaps, two-way costless collars, three-way costless collars, basis swaps, sold call options and interest rate swaps. During 2016, the Company settled all of its purchased put options. The Company had basis swaps and sold call options as of December 31, 2015. A description of the Company's derivative financial instruments is provided below:

Fixed price swaps	The Company receives a fixed price for the contract and pays a floating market price to the counterparty.
Purchased put options	The Company purchases put options based on an index price from the counterparty by payment of a cash premium. If the index price is lower than the put's strike price at the time of settlement, the Company receives from the counterparty such difference between the index price and the purchased put strike price. If the market price settles above the put's strike price, no payment is due from either party.
Two-way costless collars	Arrangements that contain a fixed floor price (purchased put option) and a fixed ceiling price (sold call option) based on an index price which, in aggregate, have no net cost. At the contract settlement date, (1) if the index price is higher than the ceiling price, the Company pays the counterparty the difference between the index price and ceiling price, (2) if the index price is between the floor and ceiling prices, no payments are due from either party, and (3) if the index price is below the floor price, the Company will receive the difference between the floor price and the index price.
Three-way costless collars	Arrangements that contain a purchased put option, a sold call option and a sold put option based on an index price which, in aggregate, have no net cost. At the contract settlement date, (1) if the index price is higher than the sold call strike price, the Company pays the counterparty the difference between the index price and sold call strike price, (2) if the index price is between the purchased put strike price and the sold call strike price, no payments are due from either party, (3) if the index price is between the sold put strike price and the purchased put strike price, the Company will receive the difference between the purchased put strike price and the index price, and (4) if the index price is below the sold put strike price, the Company will receive the difference between the purchased put strike price and the sold put strike price.
Basis swaps	Arrangements that guarantee a price differential for natural gas from a specified delivery point. The Company receives a payment from the counterparty if the price differential is greater than the stated terms of the contract and pays the counterparty if the price differential is less than the stated terms of the contract.
Sold call options	The Company sells call options in exchange for a premium. If the market price exceeds the strike price of the call option at the time of settlement, the Company pays the counterparty such excess on sold call options. If the market price settles below the call's strike price, no payment is due from either party.
Interest rate swaps	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 utilizes counterparties for its derivative instruments that it believes are creditworthy at the time the transactions are entered into, and the Company closely monitors the credit ratings of these counterparties. Additionally, the Company performs both quantitative and qualitative assessments of these counterparties based on their credit ratings and credit default swap rates where applicable. However, the events in the financial markets in recent years demonstrate there can be no assurance that a counterparty will be able to meet its obligations to the Company.

The following table provides information about the Company’s financial instruments that are sensitive to changes in commodity prices and that are used to protect the Company’s exposure. None of the financial instruments below are designated for hedge accounting treatment. The table presents the notional amount in Bcf, the weighted average contract prices and the fair value by expected maturity dates as of December 31, 2016:

Table of Contents

Index to Financial Statements

		Weighted Average Price per MMBtu					
	Volume (Bcf)	Swaps	Sold Puts	Purchased Puts	Sold Calls	Basis Differential	Fair value at December 31, 2016 (in millions)
Financial protection on production							
2017							
Fixed price swaps	322	$ 3.07	$ –	$ –	$ –	$ –	$ (175)
Two-way costless collars	103	–	–	2.94	3.38	–	(42)
Three-way costless collars	135	–	2.29	2.97	3.30	–	(59)
Basis swaps	132	–	–	–	–	(0.87)	19
Total	692						$ (257)
2018							
Fixed price swaps	18	$ 3.00	$ –	$ –	$ –	$ –	$ (2)
Two-way costless collars	14	–	–	3.00	3.46	–	(6)
Three-way costless collars	208	–	2.37	2.96	3.37	–	(20)
Basis swaps	16	–	–	–	–	(0.94)	(4)
Total	256						$ (32)
2019							
Three-way costless collars	62	$ –	$ 2.50	$ 2.92	$ 3.35	$ –	$ (2)
Total	62						$ (2)
Sold call options							
2017	86	$ –	$ –	$ –	$ 3.25	$ –	$ (46)
2018	63	–	–	–	3.50	–	(18)
2019	52	–	–	–	3.50	–	(11)
2020	32	–	–	–	3.75	–	(6)
Total	233						$ (81)

Table of Contents

Index to Financial Statements

The balance sheet classification of the assets and liabilities related to derivative financial instruments (none of which are designated for hedge accounting treatment) are summarized below as of December 31, 2016 and 2015:

	Derivative Assets Balance Sheet Classification	Fair Value December 31, 2016 (in millions)	December 31, 2015
Derivatives not designated as hedging instruments:			
Two-way costless collars	Derivative assets	$ 8	$ –
Three-way costless collars	Derivative assets	11	–
Basis swaps	Derivative assets	32	3
Fixed price swaps	Other long-term assets	1	–
Two-way costless collars	Other long-term assets	2	–
Three-way costless collars	Other long-term assets	100	–
Basis swaps	Other long-term assets	1	–
Total derivative assets		$ 155	$ 3

	Derivative Liabilities Balance Sheet Classification	Fair Value December 31, 2016 (in millions)	December 31, 2015
Derivatives not designated as hedging instruments:			
Fixed price swaps	Derivative liabilities	$ 175	–
Two-way costless collars	Derivative liabilities	49	–
Three-way costless collars	Derivative liabilities	70	–
Basis swaps	Derivative liabilities	13	–
Sold call options	Derivative liabilities	46	–
Interest rate swaps	Derivative liabilities	2	3
Fixed price swaps	Other long-term liabilities	3	–
Two-way costless collars	Other long-term liabilities	9	–
Three-way costless collars	Other long-term liabilities	122	–
Basis swaps	Other long-term liabilities	5	–
Sold call options	Other long-term liabilities	35	–
Interest rate swaps	Other long-term liabilities	1	2
Total derivative liabilities		$ 530	$ 5

At December 31, 2016, the net fair value of the Company's financial instruments related to natural gas was a $372 million liability. The net fair value of the Company's interest rate swaps was a $3 million liability as of December 31, 2016.

Derivative Contracts Not Designated for Hedge Accounting

As of December 31, 2016, the Company had no positions designated for hedge accounting treatment. Gains and losses on derivatives that are not designated for hedge accounting treatment, or that do not meet hedge accounting requirements, are recorded as a component of gain (loss) on derivatives on the consolidated statements of operations. Accordingly, the gain (loss) on derivatives component of the statement of operations reflects the gains and losses on both settled and unsettled derivatives. The Company calculates gains and losses on settled derivatives as the summation of gains and losses on positions which have settled within the reporting period. Only the settled gains and losses are included in the Company’s realized commodity price calculations.

The Company is a party to interest rate swaps that were entered into to mitigate the Company’s exposure to volatility in interest rates. The interest rate swaps have a notional amount of $170 million and expire in June 2020. The Company did not designate the interest rate swaps for hedge accounting treatment. Changes in the fair value of the interest rate swaps are included in gain (loss) on derivatives on the consolidated statements of operations.

Table of Contents

Index to Financial Statements

The following tables summarize the before-tax effect of fixed price swaps, purchased put options, two-way costless collars, three-way costless collars, basis swaps, sold call options and interest rate swaps not designated for hedge accounting on the consolidated statements of operations for the years ended December 31, 2016 and 2015:

Derivative Instrument	Consolidated Statement of Operations Classification of Gain (Loss) on Derivatives, Unsettled	Gain (Loss) on Derivatives, Unsettled Recognized in Earnings For the years ended December 31, 2016	2015
		(in millions)	
Fixed price swaps	Gain (Loss) on Derivatives	$ (177)	$ (164)
Two-way costless collars	Gain (Loss) on Derivatives	(48)	–
Three-way costless collars	Gain (Loss) on Derivatives	(81)	–
Basis swaps	Gain (Loss) on Derivatives	12	(2)
Sold call options	Gain (Loss) on Derivatives	(81)	13
Interest rate swaps	Gain (Loss) on Derivatives	2	(2)
Total loss on unsettled derivatives		$ (373)	$ (155)

Derivative Instrument	Consolidated Statement of Operations Classification of Gain (Loss) on Derivatives, Settled	Gain (Loss) on Derivatives, Settled (1) Recognized in Earnings For the years ended December 31, 2016	2015
		(in millions)	
Fixed price swaps	Gain (Loss) on Derivatives	$ –	$ 208
Purchased put options	Gain (Loss) on Derivatives	11	–
Two-way costless collars	Gain (Loss) on Derivatives	3	–
Three-way costless collars	Gain (Loss) on Derivatives	1	–
Basis swaps	Gain (Loss) on Derivatives	21	(2)
Interest rate swaps	Gain (Loss) on Derivatives	(2)	(4)
Total gain on settled derivatives (2)		$ 34	$ 202
Total gain (loss) on derivatives		$ (339)	$ 47

(1)

The Company calculates gain (loss) on derivatives, settled, as the summation of gains and losses on positions that have settled within the period.

(2) Excluding interest rate swaps, these amounts are included, along with gas sales revenues, in the calculation of the Company's realized natural gas price.

Derivative Contracts Designated for Hedge Accounting

All derivatives are recognized in the balance sheet as either an asset or liability and are measured at fair value, other than transactions for which normal purchase/normal sale is applied. Certain criteria must be satisfied in order for derivative financial instruments to be designated for hedge accounting. Unrealized gains and losses related to unsettled derivatives that have been designated for hedge accounting are recorded in either earnings or as a component of other comprehensive income until settled. In the period of settlement, the Company recognizes the gains and losses from these qualifying hedges in gas sales revenues. As of December 31, 2016, the Company had no positions designated for hedge accounting treatment. In 2015, the Company had certain fixed price swaps that were designated for hedge accounting. For the year ended December 31, 2015, the Company reported pre-tax gains in other comprehensive income of $45 million related to the effective portion of the unsettled fixed price swaps. The ineffective portion of those fixed price swaps was recognized in earnings and had an inconsequential impact to the consolidated statement of operations for the year ended December 31, 2015. For the year ended December 31, 2015, pre-tax gains of $209 million on settled fixed price swaps were transferred from other comprehensive income into gas sales revenues in the consolidated statement of operations.

Table of Contents

Index to Financial Statements

(5) RECLASSIFICATIONS FROM ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables detail the components of accumulated other comprehensive income (loss), net of related tax effects, for the year ended December 31, 2016:

	For the year ended December 31, 2016		
	Pension and Other Postretirement	Foreign Currency	Total
	(in millions)		
Beginning balance, December 31, 2015	$ (25)	$ (23)	$ (48)
Other comprehensive income (loss) before reclassifications	(7)	3	(4)
Amounts reclassified from other comprehensive income (loss) (2)	13	–	13
Net current-period other comprehensive income (loss)	6	3	9
Ending balance, December 31, 2016	$ (19)	$ (20)	$ (39)

(1) See separate table below for details about these reclassifications.

Details about Accumulated Other Comprehensive Income	Affected Line Item in the Consolidated Statement of Operations	Amount Reclassified from Accumulated Other Comprehensive Income For the year ended December 31, 2016 (in millions)
Pension and other postretirement:		
Amortization of prior service cost and net loss (1)	General and administrative expenses	$ 21
	Provision (benefit) for income taxes	8
	Net income (loss)	$ 13

Total reclassifications for the period	Net income (loss)	$	13

See Note 11 for additional details regarding the Company's retirement and employee benefit plans.

(6) FAIR VALUE MEASUREMENTS

The carrying amounts and estimated fair values of the Company's financial instruments as of December 31, 2016 and 2015 were as follows:

	December 31, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in millions)			
Cash and cash equivalents	$ 1,423	$ 1,423	$ 15	$ 15
Credit facility	–	–	116	116
Term loan facility due December 2020 (1)	327	327	750	750
Term loan facility due December 2020 (1)	1,191	1,191	–	–
Senior notes	3,166	3,182	3,867	2,672
Derivative instruments, net	(375)	(375)	(2)	(2)

(1) The maturity date will accelerate to October 2019 if, by that date, the Company has not amended, redeemed or refinanced at least $765 million of its senior notes due in January 2020.

The carrying values of cash and cash equivalents, accounts receivable, other current assets, accounts payable and other current liabilities on the consolidated balance sheets approximate fair value because of their short-term nature. For debt and derivative instruments, the following methods and assumptions were used to estimate fair value:

Debt: The fair values of the Company's senior notes were based on the market value of the Company's publicly traded debt as determined based on the yield of the Company's senior notes.

Index to Financial Statements

The carrying values of the borrowings under the Company's term loan facilities and unsecured revolving credit facility approximate fair value because the interest rate is variable and reflective of market rates. The Company considers the fair value of its debt to be a Level 2 measurement on the fair value hierarchy.

Derivative Instruments: The fair value of all derivative instruments is the amount at which the instrument could be exchanged currently between willing parties. The amounts are based on quoted market prices, best estimates obtained from counterparties and an option pricing model, when necessary, for price option contracts.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. As presented in the tables below, this hierarchy consists of three broad levels:

Level 1 valuations –	Consist of unadjusted quoted prices in active markets for identical assets and liabilities and have the highest priority.
Level 2 valuations –	Consist of quoted market information for the calculation of fair market value.
Level 3 valuations –	Consist of internal estimates and have the lowest priority.

The Company has classified its derivatives into these levels depending upon the data utilized to determine their fair values. The Company's fixed price swaps (Level 2) are estimated using third-party discounted cash flow calculations using the NYMEX futures index. The Company utilized discounted cash flow models for valuing its interest rate derivatives (Level 2). The net derivative values attributable to the Company's interest rate derivative contracts as of December 31, 2016 are based on (i) the contracted notional amounts, (ii) active market-quoted London Interbank Offered Rate ("LIBOR") yield curves and (iii) the applicable credit-adjusted risk-free rate yield curve. The Company's sold call options, purchased put options, two-way costless collars and three-way costless collars (Level 3) are valued using the Black-Scholes model, an industry standard option valuation model that takes into account inputs such as contract terms, including maturity, and market parameters, including assumptions of the NYMEX futures index, interest rates, volatility and credit worthiness. The Company's basis swaps (Level 3) are estimated using third-party calculations based upon forward commodity price curves.

Inputs to the Black-Scholes model, including the volatility input, which is the significant unobservable input for Level 3 fair value measurements, are obtained from a third-party pricing source, with independent verification of the most significant inputs on a monthly basis. An increase (decrease) in volatility would result in an increase (decrease) in fair value measurement, respectively.

Assets and liabilities measured at fair value on a recurring basis are summarized below (in millions):

	December 31, 2016 Fair Value Measurements Using:			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets (Liabilities) at Fair Value
Fixed price swap assets	$ –	$ 1	$ –	$ 1
Two-way costless collars assets	–	–	10	10
Three-way costless collars assets	–	–	111	111
Basis swap assets	–	–	33	33
Fixed price swap liabilities	–	(178)	–	(178)
Two-way costless collars liabilities	–	–	(58)	(58)
Three-way costless collars liabilities	–	–	(192)	(192)
Basis swap liabilities	–	–	(18)	(18)
Sold call option liabilities	–	–	(81)	(81)
Interest rate swap liabilities	–	(3)	–	(3)
Total	$ –	$ (180)	$ (195)	$ (375)

	December 31, 2015 Fair Value Measurements Using:			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets (Liabilities) at Fair Value
Basis swap assets	$ –	$ –	$ 3	$ 3
Interest rate swap liabilities	–	(5)	–	(5)
Total	$ –	$ (5)	$ 3	$ (2)

91

Table of Contents

Index to Financial Statements

The table below presents reconciliations for the change in net fair value of derivative assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2016 and 2015. The fair values of Level 3 derivative instruments are estimated using proprietary valuation models that utilize both market observable and unobservable parameters. Level 3 instruments presented in the table consist of net derivatives valued using pricing models incorporating assumptions that, in the Company's judgment, reflect reasonable assumptions a marketplace participant would have used as of December 31, 2016 and 2015.

	For the years ended December 31,	
	2016	2015
	(in millions)	
Balance at beginning of period	$ 3	$ (8)
Total gains (losses):		
Included in earnings	(162)	9
Settlements	(36)	2
Transfers into/out of Level 3	–	–
Balance at end of period	$ (195)	$ 3
Change in gains (losses) included in earnings relating to derivatives still held as of December 31	$ (198)	$ 11

See Note 11 – Retirement and Employee Benefit Plans for a discussion of the fair value measurement of the Company's pension plan assets.

(7) DEBT

The components of debt as of December 31, 2016 and 2015 consisted of the following:

	December 31, 2016	
		Total

	Debt Instrument	Unamortized Issuance Cost	Unamortized Debt Discount	
	(in millions)			
Short-term debt:				
7.35% Senior Notes due October 2017	$ 15	$ –	$ –	$ 15
7.125% Senior Notes due October 2017	25	–	–	25
7.15% Senior Notes due June 2018	1	–	–	1
Total short-term debt	$ 41	$ –	$ –	$ 41
Long-term debt:				
Variable rate (3.220% at December 31, 2016) term loan facility, due December 2020 (1)	327	(2)	–	325
Variable rate (3.220% at December 31, 2016) term loan facility, due December 2020 (2)	1,191	(10)	–	1,181
3.30% Senior Notes due January 2018 (3) (4)	38	–	–	38
7.50% Senior Notes due February 2018 (3)	212	–	–	212
7.15% Senior Notes due June 2018	25	–	–	25
4.05% Senior Notes due January 2020 (4)	850	(5)	–	845
4.10% Senior Notes due March 2022	1,000	(4)	(1)	995
4.95% Senior Notes due January 2025 (4)	1,000	(7)	(2)	991
Total long-term debt	$ 4,643	$ (28)	$ (3)	$ 4,612
Total debt	$ 4,684	$ (28)	$ (3)	$ 4,653

(1) In July 2016, $375 million was repaid on the term loan facility, extending the maturity from November 2018 to December 2020, which will accelerate to October 2019 if, by that date, the Company has not amended, redeemed or refinanced at least $765 million of its senior notes due in January 2020. In September 2016, an additional $48 million was repaid.

(2) The maturity date will accelerate to October 2019 if, by that date, the Company has not amended, redeemed or refinanced at least $765 million of its senior notes due in January 2020.

(3) In July 2016, the Company purchased approximately $312 million of the 3.30% Senior Notes due January 2018 and $388 million of the 7.50% Senior Notes due February 2018.

(4) In February and June 2016, Moody's and S&P downgraded certain senior notes, increasing the interest rates by 175 basis points effective July 2016. As a result of the downgrades, interest rates increased to 5.05% for the 2018 Notes, 5.80% for the 2020 Notes and 6.70% for the 2025 Notes.

Table of Contents

Index to Financial Statements

	December 31, 2015			
	Debt Instrument	Unamortized Issuance Cost	Unamortized Debt Discount	Total
	(in millions)			
Short-term debt:				
7.15% Senior Notes due June 2018	$ 1	$ –	$ –	$ 1
Total short-term debt	$ 1	$ –	$ –	$ 1
Long-term debt:				
Variable rate (1.886% at December 31, 2015) credit facility, expires December 2018	116	–	–	116
Variable rate (1.775% at December 31, 2015) term loan facility, due November 2018	750	(3)	–	747
7.35% Senior Notes due October 2017	15	–	–	15
7.125% Senior Notes due October 2017	25	–	–	25
3.30% Senior Notes due January 2018	350	(2)	–	348
7.50% Senior Notes due February 2018	600	(2)	–	598
7.15% Senior Notes due June 2018	26	–	–	26
4.05% Senior Notes due January 2020	850	(5)	(1)	844
4.10% Senior Notes due March 2022	1,000	(5)	(1)	994
4.95% Senior Notes due January 2025	1,000	(7)	(2)	991
Total long-term debt	$ 4,732	$ (24)	$ (4)	$ 4,704
Total debt	$ 4,733	$ (24)	$ (4)	$ 4,705

The following is a summary of scheduled debt maturities by year as of December 31, 2016 (in millions):

2017	$ 41
2018	275
2019	–
2020	2,368
2021	–
Thereafter	2,000
	$ 4,684

2016 Credit Facility

In June 2016, the Company reduced its existing $2.0 billion unsecured revolving credit facility to $66 million and entered into a new credit agreement for $1,934 million, consisting of a $1,191 million secured term loan and a new $743 million unsecured revolving credit facility, which matures in December 2020. The maturity date will accelerate to October 2019 if, by that date, the Company has not amended, redeemed or refinanced at least $765 million of its senior notes due January 2020. The $1,191 million secured term loan is fully drawn, with approximately $285 million of this balance used to pay down the previous revolving credit facility balance in its entirety. As of December 31, 2016, there were no borrowings under either revolving credit facility; however, $174 million in letters of credit was outstanding against the 2016 revolving credit facility.

Loans under the 2016 credit agreement are subject to varying rates of interest based on whether the loan is a Eurodollar loan or an alternate base rate loan. Eurodollar loans bear interest at the Eurodollar rate, which is adjusted LIBOR plus applicable margins ranging from 1.750% to 2.500%. Alternate base rate loans bear interest at the alternate base rate plus the applicable margin ranging from 0.750% to 1.500%. The interest rate on the term loan facility is determined based upon the Company's public debt ratings and was 250 basis points over LIBOR as of December 31, 2016.

The new term loan and revolving credit facility contain financial covenants that impose certain restrictions on the Company. Under the new credit agreement, the Company must maintain a minimum interest coverage of 0.75x in 2016, increasing by 0.25x increments per year to 1.50x in 2019 and 2020. The Company is also subject to a minimum liquidity requirement of $300 million, which could be increased up to $500 million upon certain conditions, as well as an anti-hoarding provision, requiring unrestricted cash in excess of $100 million to pay down any amounts borrowed under the new revolving credit facility. The financial covenant with respect to minimum interest coverage consists of EBITDAX divided by consolidated interest expense. EBITDAX, as defined in our 2016 credit agreement, excludes the effects of interest expense, income taxes, depreciation, depletion and amortization, any non-cash impacts from impairments, certain non-cash hedging activities, stock-based compensation expense, non-cash gains or losses on asset sales, unamortized issuance cost,

Index to Financial Statements

unamortized debt discount and certain restructuring costs. Collateral for the new secured term loan is principally the Company's E&P properties in the Fayetteville Shale area, the equity of its subsidiaries and cash and marketable securities on hand, and the new credit agreement requires a minimum collateral coverage ratio of 1.50x for the 2016 secured term loan. This collateral also may support all or a part of revolving credit extensions depending on restrictions in the Company's senior notes indentures.

As of December 31, 2016, the Company was in compliance with all of the covenants of this credit agreement. Although the Company does not anticipate any violations of the financial covenants, its ability to comply with these covenants is dependent upon the success of its exploration and development program and upon factors beyond the Company's control, such as the market prices for natural gas, oil and NGLs.

2013 Credit Facility

In December 2013, the Company entered into a credit agreement that exchanged its previous revolving credit facility. Under the revolving credit facility, the Company had a borrowing capacity of $2.0 billion. The revolving credit facility was unsecured and was not guaranteed by any subsidiaries. In June 2016, this credit facility was substantially exchanged for a new credit facility comprised of a $1,191 million secured term loan and a new $743 million revolving credit facility. The borrowing capacity of the original 2013 credit agreement was reduced from $2.0 billion to $66 million, remains unsecured and the maturity remains December 2018. As of December 31, 2016, there were no borrowings under this facility.

The existing unsecured 2013 revolving credit facility includes a financial covenant under which the Company may not have total debt in excess of 60% of its total adjusted book capital. This financial covenant with respect to capitalization percentages excludes the effects of any full cost ceiling impairments, certain hedging activities and the Company's pension and other postretirement liabilities. At December 31, 2016, the Company's adjusted book capital was 34% debt and 66% equity.

2015 Term Facility

In November 2015, the Company entered into a $750 million unsecured three-year term loan credit agreement with various lenders that was utilized to repay borrowings under the revolving credit facility. The interest rate on the term loan facility is determined based upon the Company's public debt ratings from Moody's and S&P and was 250 basis points over LIBOR as of December 31, 2016. The term loan facility requires prepayment under certain circumstances from the net cash proceeds of sales of equity or certain assets and borrowings outside the ordinary course of business. In June 2016, this term loan agreement was amended to extend the maturity date upon a repayment threshold. From the net proceeds of the July 2016 equity offering, the Company repaid $375 million of the $750 million unsecured term loan, which had the effect of extending the term loan maturity from November 2018 to December 2020, which will accelerate to October 2019 if, by that date, the Company has not amended, redeemed or refinanced at least $765 million of its senior notes due in January 2020. As a result of the repayment, the Company expensed $3 million of unamortized debt issuance costs, recognized in other interest charges on the consolidated statement of operations for the year ended December 31, 2016. In September 2016, the Company repaid an additional $48 million from the proceeds received from the closing of the sale of approximately 55,000 net acres in West Virginia to Antero Resources Corporation, resulting in an additional $0.4 million of interest expense related to unamortized debt issuance costs.

Commercial Paper

In April 2015, the Company entered into a commercial paper program which allowed it to issue up to $2.0 billion in commercial paper, provided that outstanding borrowings from its commercial paper program, combined with outstanding borrowings under our revolving credit facility, not exceed $2.0 billion. The commercial paper issuance had terms of up to 397 days and carried interest at rates agreed upon at the time of each issuance. As of December 31, 2016 and 2015, the Company had no outstanding issuances under its commercial paper program, respectively, and had no current plans of further utilizing the commercial paper market.

Senior Notes

In July 2016, the Company used a portion of the proceeds from the July 2016 equity offering to settle certain tender offers by purchasing an aggregate principal amount of approximately $700 million of the Company’s outstanding senior notes due in the first quarter of 2018, resulting in a loss of $51 million for the early retirement and redemption of these senior notes including $50 million of premiums paid. Additionally, the Company expensed $2 million of unamortized debt issuance costs and debt discounts, recognized in other interest charges.

Index to Financial Statements

In January 2015, the Company completed a public offering of $350 million aggregate principal amount of its 3.30% senior notes due 2018 (the “2018 Notes”), $850 million aggregate principal amount of its 4.05% senior notes due 2020 (the “2020 Notes”) and $1.0 billion aggregate principal amount of its 4.95% senior notes due 2025 (the “2025 Notes” together with the 2018 and 2020 Notes, the “Notes”), with net proceeds from the offering totaling approximately $2.2 billion after underwriting discounts and offering expenses. The proceeds from this offering were used to repay the remaining principal and interest outstanding under the Company’s $4.5 billion 364-day bridge term loan facility, which was first reduced with proceeds from the Company’s concurrent underwritten public offerings of common and preferred stock, and were also used to repay a portion of amounts outstanding under the Company’s revolving credit facility. As a result of this repayment, the Company expensed $47 million of short-term unamortized debt issuance costs related to the bridge facility in January 2015, recognized in other interest charges on the consolidated statement of operations for the year ended December 31, 2016. The Notes were sold to the public at a price of 99.949% of their face value for the 2018 Notes, 99.897% of their face value for the 2020 Notes and 99.782% of their face value for the 2025 Notes. The interest rates on the Notes are determined based upon the public bond ratings from Moody’s and S&P. Downgrades on the Notes from either rating agency increase interest costs by 25 basis points per downgrade level and upgrades decrease interest costs by 25 basis points per upgrade level, up to the stated coupon rate, on the following semi-annual bond interest payment. In February and June 2016, Moody’s and S&P downgraded the Notes, increasing the interest rates by 175 basis points effective July 2016. As a result of these downgrades, interest rates increased to 5.05% for the 2018 Notes, 5.80% for the 2020 Notes and 6.70% for the 2025 Notes. In the event of future downgrades, the coupons for this series of notes are capped at 5.30%, 6.05% and 6.95%, respectively. The first coupon payment to the bondholders at the higher interest rates was paid in January 2017.

Chesapeake Property Acquisition Financing

On December 19, 2014, the Company entered into a $4.5 billion unsecured 364-day bridge term loan credit agreement with various lenders. The bridge facility required prepayments under certain circumstances from the net cash proceeds of sales of equity or certain assets and borrowings outside the ordinary course of business or for specified uses. The Company repaid the $4.5 billion outstanding and terminated the bridge facility in January 2015 with net proceeds of $669 million and $1.7 billion from common stock and depositary share offerings, respectively, and $2.2 billion from senior note offerings with the difference utilized to pay down amounts under the revolving credit facility.

(8) COMMITMENTS AND CONTINGENCIES

Operating Commitments and Contingencies

As of December 31, 2016, the Company’s contractual obligations for demand and similar charges under firm transportation and gathering agreements to guarantee access capacity on natural gas and liquids pipelines and gathering systems totaled approximately $8.4 billion, $3.4 billion of which related to access capacity on future pipeline and gathering infrastructure projects that still require the granting of regulatory approvals and additional construction efforts. The Company also had guarantee obligations of up to $862 million of that amount. As of December 31, 2016, future payments under non-cancelable firm transportation and gathering agreements are as follows:

	Payments Due by Period					
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	5 to 8 years	More than 8 Years
	(in millions)					
Infrastructure Currently in Service	$ 5,067	$ 612	$ 1,158	$ 825	$ 829	$ 1,643
Pending Regulatory Approval and/or Construction (1)	3,362	15	326	450	678	1,893
Total Transportation Charges	$ 8,429	$ 627	$ 1,484	$ 1,275	$ 1,507	$ 3,536

(1) Based on the estimated in-service dates as of December 31, 2016.

The Company has 13 leases for pressure pumping equipment for its E&P operations under leases that expire between December 2017 and January 2018. The Company's current aggregate annual payment under the leases is approximately $8 million. Certain of these leases provide for a residual value guarantee for any deficiency if the equipment is sold for less than the sale option amount (recognized as a liability of approximately $4 million at December 31, 2016). The Company has 7 leases for drilling rigs for its E&P operations that expire through 2021 with a current aggregate annual payment of approximately $13 million. The lease payments for the pressure pumping equipment, as well as other operating expenses for the Company's drilling operations, are capitalized to natural gas and oil properties and are partially offset by billings to third-party working interest owners for their share of fracture stage charges.

Index to Financial Statements

The Company leases compressors, aircraft, vehicles, office space and equipment under non-cancelable operating leases expiring through 2027. As of December 31, 2016, future minimum payments under these non-cancelable leases accounted for as operating leases are approximately $66 million in 2017, $52 million in 2018, $45 million in 2019, $35 million in 2020, $17 million in 2021 and $14 million thereafter.

The Company also has commitments for compression services related to its Midstream Services and E&P segments. As of December 31, 2016, future minimum payments under these non-cancelable agreements are approximately $16 million in 2017, $7 million in 2018 and $3 million in 2019.

Environmental Risk

The Company is subject to laws and regulations relating to the protection of the environment. Environmental and cleanup related costs of a non-capital nature are accrued when it is both probable that a liability has been incurred and when the amount can be reasonably estimated. Management believes any future remediation or other compliance related costs will not have a material effect on the financial position or results of operations of the Company.

Litigation

The Company is subject to various litigation, claims and proceedings that have arisen in the ordinary course of business, such as for alleged breaches of contract, miscalculation of royalties, and pollution, contamination or nuisance. Management believes that such litigation, claims and proceedings, individually or in aggregate and after taking into account insurance, are not likely to have a material adverse impact on the Company’s financial position, results of operations or cash flows. Many of these matters are in early stages, so the allegations and the damage theories have not been fully developed, and are all subject to inherent uncertainties; therefore, management’s view may change in the future. If an unfavorable final outcome were to occur, there exists the possibility of a material impact on the Company’s financial position, results of operations or cash flows for the period in which the effect becomes reasonably estimable. The Company accrues for such items when a liability is both probable and the amount can be reasonably estimated.

Berry-Helfand (Tovah Energy)

In February 2009, one of the Company's subsidiaries was added as a defendant in a case then styled Tovah Energy, LLC and Toby Berry-Helfand v. David Michael Grimes, et al., then pending in the 273rd District Court in Shelby County, Texas. The plaintiff alleged that the subsidiary used information provided by the plaintiff under a confidentiality agreement, which she claimed, among other things, breached the agreement and constituted a trade secret. Following a trial in December 2010, the court awarded approximately $11 million in actual damages and approximately $24 million in disgorgement of profits, along with interest and attorneys' fees. Both sides appealed, and in July 2013 the Texas Court of Appeals for the Twelfth District reversed on all claims except misappropriation of trade secrets, reduced the judgment to the actual damages award, along with interest and attorneys' fees, and ordered the case remanded for an award of attorneys' fees to the Company's subsidiary on one of the claims on which judgment was reversed. Both parties petitioned the Supreme Court of Texas for review. In June 2016, the Supreme Court ruled that insufficient evidence supported the damage award and remanded the case for a new trial. The parties subsequently reached a settlement, the amount of which is reflected in the Company's financial statements as of, and for the period ended, December 31, 2016.

Arkansas Royalty Litigation

Certain of the Company's subsidiaries are defendants in three cases, two filed in Arkansas state court in 2010 and 2013 and one in federal court in 2014, on behalf of putative classes of royalty owners on some of the Company's leases located in Arkansas. The chief complaint in all three cases is that one of the Company's subsidiaries underpaid the royalty owners by, among other things, deducting from royalty payments costs for gathering, transportation, and compression of natural gas in excess of what is permitted by the relevant leases. In September and October 2014 the judges in the two Arkansas state actions entered orders certifying classes of royalty owners who are citizens of Arkansas.

In November 2015, the court in the federal case denied the plaintiff's motion to certify a class of royalty owners not included in either of the two state cases. In April 2016, the court certified a broader class that includes Arkansas residents and citizens. Class members were notified of the pending action in late 2016, and the period to "opt out" of the class has expired. The plaintiff in the federal case presented two alternative damages theories. Under one theory, plaintiffs have asserted that obligations to affiliates are not "incurred" and therefore the exploration and production subsidiary was not entitled to deduct any post-production costs; the federal court has granted partial summary judgment for the Company's subsidiaries on this theory. Under another theory, plaintiffs assert that the gathering and treating rates the Company deducted from royalty payments exceeded the affiliates' actual costs or otherwise were not reasonable. The plaintiffs have not

96

Index to Financial Statements

disclosed a specific damage calculation for any putative class, but based on the class representative's disclosure regarding the calculation of claimed damages, class-wide damages could exceed $100 million. The court has set a trial date in the second quarter of 2017. The Company has moved for summary judgment on all claims, which remains pending before the trial judge.

The Company's subsidiaries appealed the class certification orders in the state cases. In December 2016 the Arkansas Supreme Court affirmed the certifications. These cases are now before the Arkansas trial judges. The precise configuration of the classes has not been determined, particularly in light of the overlapping composition of the class in the federal case. No date for trial has been set.

In addition, in September 2015 three cases were filed in Arkansas state court on behalf of a total of 248 individually named plaintiffs. Each case asserts complaints that are in substance virtually identical to the above-described case. The Company and its subsidiaries have removed two of the cases to federal court, and those cases have been assigned to the court in which the above-described federal case is pending. All three cases have been stayed.

Management believes that, in all of the above cases, the deductions from royalty payments as calculated are permitted and intends to defend the cases vigorously. The Company's assessment may change in the future due to the occurrence of certain events, such as adverse judgments, and such a re-assessment could lead to the determination that the potential liability is probable and could be material to the Company's results of operations, financial position or cash flows.

Indemnifications

The Company provides certain indemnifications in relation to dispositions of assets. These indemnifications typically relate to disputes, litigation or tax matters existing at the date of disposition. No liability has been recognized in connection with these indemnifications.

(9) INCOME TAXES

The provision (benefit) for income taxes included the following components:

	2016	2015	2014
	(in millions)		
Current:			
Federal	$ (6)	$ 1	$ 11
State	(1)	(3)	10
	(7)	(2)	21
Deferred:			
Federal	(22)	(1,697)	501
State	–	(304)	2
Foreign	–	(2)	1
	(22)	(2,003)	504
Provision (benefit) for income taxes	$ (29)	$ (2,005)	$ 525

The provision for income taxes was an effective rate of 1% in 2016, 31% in 2015 and 36% in 2014. The following reconciles the provision for income taxes included in the consolidated statements of operations with the provision which would result from application of the statutory federal tax rate to pre-tax financial income:

	2016	2015	2014
	(in millions)		
Expected provision (benefit) at federal statutory rate	$ (935)	$ (2,296)	$ 507
Increase (decrease) resulting from:			
State income taxes, net of federal income tax effect	(79)	(194)	58
Nondeductible expenses	–	–	3
State rate redetermination	–	–	(48)
Change in uncertain tax positions	(19)	(7)	–
Change in valuation allowance	1,002	495	5
Other	2	(3)	–
Provision (benefit) for income taxes	$ (29)	$ (2,005)	$ 525

Our effective tax rate decreased in 2016, as compared with 2015, primarily due to the recognition of a valuation allowance in the fourth quarter of 2015 that persisted throughout 2016.

The components of the Company's deferred tax balances as of December 31, 2016 and 2015 were as follows:

	2016	2015
	(in millions)	
Deferred tax liabilities:		
Differences between book and tax basis of property	$ 81	$ 216
Other	1	2
	82	218
Deferred tax assets:		
Accrued compensation	38	19
Alternative minimum tax credit carryforward	100	125
Accrued pension costs	19	19
Asset retirement obligations	53	77
Net operating loss carryforward	1,177	445
Derivative activity	142	–
Other	29	26
	1,558	711
Valuation allowance	(1,476)	(493)
Net deferred tax liability	$ –	$ –

In 2016, the Company paid less than $1 million in state income taxes and received $15 million in federal income tax refunds. In 2015, the Company paid less than $1 million in state income taxes and did not pay federal income taxes. The Company's net operating loss carryforward as of December 31, 2016 was $3.2 billion and $2.2 billion for federal and state reporting purposes, respectively, the majority of which will expire between 2029 and 2036. Additionally, the Company has an income tax net operating loss carryforward related to its Canadian operations of $35 million, with expiration dates of 2030 through 2036. The Company also had an alternative minimum tax credit carryforward of $100 million and a statutory depletion carryforward of $13 million as of December 31, 2016.

A valuation allowance for deferred tax assets, including net operating losses, is recognized when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized. To assess the likelihood, the Company uses estimates and judgment regarding future taxable income, and considers the tax consequences in the jurisdiction where such taxable income is generated, to determine whether a valuation allowance is required. Such evidence can include current financial position, results of operations, both actual and forecasted, the reversal of deferred tax liabilities, and tax planning strategies as well as current and forecasted business economics of the oil and gas industry.

Due to the continued write-downs of the carrying value of natural gas and oil properties, the Company maintained its net deferred tax asset position at December 31, 2016. The Company believes it is more likely than not that these deferred tax assets will not be realized and recorded a $983 million increase in valuation allowance for the year ended December 31, 2016, reflected as a component of income tax expense. Management assesses available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit the use of deferred tax assets. In management's view, the cumulative loss incurred over the three-year period ending December 31, 2016, outweighs any positive factors, such as the possibility of future growth. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income are increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight is given to subjective evidence such as future expected growth.

Deferred tax assets relating to tax benefits of employee stock option grants have been reduced to reflect exercises. Some exercises resulted in tax deductions in excess of previously recorded benefits based on the option value at the time of the grant ("windfalls"). Although these additional tax benefits or "windfalls" are reflected in net operating loss carryforwards, the additional tax benefit associated with the windfall is not recognized until the deduction reduces taxes payable. Accordingly, since the tax benefit does not reduce the Company's current taxes payable in 2016 due to net operating loss carryforwards, these "windfall" tax benefits are not reflected in its net operating losses in deferred tax assets for 2016. Windfalls included in net operating loss carryforwards but not reflected in deferred tax assets for 2016 were $149 million.

A tax position must meet certain thresholds for any of the benefit of the uncertain tax position to be recognized in the financial statements. As of December 31, 2016, the amount of unrecognized tax benefits related to alternative minimum tax was $17 million. The uncertain tax position identified would not have a material effect on the effective tax rate. No material changes to the current uncertain tax position are expected within the next 12 months. As of December 31, 2016, the Company had accrued a liability of less than $1 million of interest related to this uncertain tax position. The Company recognizes

Table of Contents

Index to Financial Statements

penalties and interest related to uncertain tax positions in income tax expense.

A reconciliation of the beginning and ending balances of unrecognized tax benefits is as follows:

	2016	2015
	(in millions)	
Unrecognized tax benefits at beginning of period	$ 37	$ 44
Additions based on tax positions related to the current year	–	7
Additions to tax positions of prior years	–	–
Reductions to tax positions of prior years	(20)	(14)
Unrecognized tax benefits at end of period	$ 17	$ 37

The Internal Revenue Service is currently auditing the Company's federal income tax return for 2014. The income tax years 2013 to 2016 remain open to examination by the major taxing jurisdictions to which the Company is subject.

(10) ASSET RETIREMENT OBLIGATIONS

The following table summarizes the Company's 2016 and 2015 activity related to asset retirement obligations:

	2016	2015
	(in millions)	
Asset retirement obligation at January 1	$ 201	$ 207
Accretion of discount	10	11
Obligations incurred	1	17
Obligations settled/removed (1)	(45)	(30)
Revisions of estimates (2)	(26)	(4)
Asset retirement obligation at December 31	$ 141	$ 201
Current liability	6	10
Long-term liability	135	191
Asset retirement obligation at December 31	$ 141	$ 201

(1)

Obligations settled/removed include $35 million and $25 million related to asset divestitures in 2016 and 2015, respectively.

(2) Estimates in the costs to retire wells and well pads were revised downward based on internal estimates of future obligation requirements and updated third-party cost quotes.

(11) RETIREMENT AND EMPLOYEE BENEFIT PLANS

401(k) Defined Contribution Plan

The Company has a 401(k) defined contribution plan covering eligible employees. The Company expensed $4 million, $3 million and $3 million of contribution expense in 2016, 2015 and 2014, respectively. Additionally, the Company capitalized $2 million, $4 million and $3 million of contributions in 2016, 2015 and 2014, respectively, directly related to the acquisition, exploration and development activities of the Company's natural gas and oil properties or directly related to the construction of the Company's gathering systems.

Defined Benefit Pension and Other Postretirement Plans

Prior to January 1, 1998, the Company maintained a traditional defined benefit plan with benefits payable based upon average final compensation and years of service. Effective January 1, 1998, the Company amended its pension plan to become a "cash balance" plan on a prospective basis for its non-bargaining employees. A cash balance plan provides benefits based upon a fixed percentage of an employee's annual compensation. The Company's funding policy is to contribute amounts which are actuarially determined to provide the plans with sufficient assets to meet future benefit payment requirements and which are tax deductible.

The postretirement benefit plan provides contributory health care and life insurance benefits. Employees become eligible for these benefits if they meet age and service requirements. Generally, the benefits paid are a stated percentage of medical expenses reduced by deductibles and other coverages.

Substantially all employees are covered by the Company's defined benefit pension and postretirement benefit plans. The Company accounts for its defined benefit pension and other postretirement plans by recognizing the funded status of each

Table of Contents

Index to Financial Statements

defined pension benefit plan and other postretirement benefit plan on the Company's balance sheet. In the event a plan is overfunded, the Company recognizes an asset. Conversely, if a plan is underfunded, the Company recognizes a liability.

In January 2016, the Company initiated a reduction in workforce that was effectively completed by the end of the first quarter. As a result of the workforce reduction, the Company recognized a $1 million non-cash curtailment loss related to its pension plan for both the curtailment-related decrease to the benefit obligation and the recognition of the proportionate share of unrecognized prior service cost and net loss from other comprehensive income (loss) in the second quarter of 2016. For the year ended December 31, 2016, the Company recognized a non-cash settlement loss of $11 million related to a total of $37 million of lump sum payments from the pension plan. Additionally, the Company recognized a non-cash curtailment gain of $6 million related to its other postretirement benefit plan in the first quarter of 2016.

The following provides a reconciliation of the changes in the plans' benefit obligations, fair value of assets and funded status as of December 31, 2016 and 2015:

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
	(in millions)			
Change in benefit obligations:				
Benefit obligation at January 1	$ 138	$ 134	$ 20	$ 18
Service cost	11	16	2	3
Interest cost	5	6	1	1
Participant contributions	–	–	–	–
Actuarial loss (gain)	14	(7)	(2)	(2)
Benefits paid	(3)	(11)	(1)	–
Plan amendments	–	–	–	–
Curtailments	(8)	–	(7)	–
Settlements	(40)	–	–	–
Benefit obligation at December 31	$ 117	$ 138	$ 13	$ 20

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
	(in millions)			
Change in plan assets:				
Fair value of plan assets at January 1	$ 108	$ 108	$ –	$ –
Actual return on plan assets	3	(1)	–	–
Employer contributions	10	12	1	–
Participant contributions	–	–	–	–
Benefits paid	(3)	(11)	(1)	–
Settlements	(37)	–	–	–
Fair value of plan assets at December 31	$ 81	$ 108	$ –	$ –
Funded status of plans at December 31	$ (36)	$ (30)	$ (13)	$ (20)

The Company uses a December 31 measurement date for all of its plans and had liabilities recorded for the underfunded status for each period as presented above.

The change in accumulated other comprehensive income related to the pension plans was a gain of $7 million ($4 million after tax) for the year ended December 31, 2016 and a loss of $2 million ($2 million after tax) for the year ended December 31, 2015. The change in accumulated other comprehensive income related to the other postretirement benefit plan was a gain of $3 million ($2 million after tax) for the year ended December 31, 2016 and a gain of $1 million ($1 million after tax) for the year ended December 31, 2015. Included in accumulated other comprehensive income as of December 31, 2016 and 2015 was a $31 million loss ($19 million net of tax) and a $42 million loss ($25 million net of tax), respectively, related to the Company’s pension and other postretirement benefit plans. For the year ended December 31, 2016, $6 million was classified to accumulated other comprehensive income, primarily driven by actuarial loss adjustments. Amortization of prior period service cost reclassified from accumulated other comprehensive income to general and administrative expenses for the year was immaterial.

The amount in accumulated other comprehensive income that is expected to be recognized as a component of net periodic benefit cost during 2017 is a $1 million net loss.

Table of Contents

Index to Financial Statements

The pension plans' projected benefit obligation, accumulated benefit obligation and fair value of plan assets as of December 31, 2016 and 2015 are as follows:

	2016	2015
	(in millions)	
Projected benefit obligation	$ 117	$ 138
Accumulated benefit obligation	116	135
Fair value of plan assets	81	108

Pension and other postretirement benefit costs include the following components for 2016, 2015 and 2014:

	Pension Benefits			Other Postretirement Benefits		
	2016	2015	2014	2016	2015	2014
	(in millions)					
Service cost	$ 11	$ 16	$ 13	$ 2	$ 3	$ 2
Interest cost	5	6	5	1	1	1
Expected return on plan assets	(6)	(9)	(7)	–	–	–
Amortization of transition obligation	–	–	–	–	–	–
Amortization of prior service cost	–	–	–	–	–	–
Amortization of net loss	2	2	1	–	–	–
Net periodic benefit cost	12	15	12	3	4	3
Curtailment loss	1	–	–	(6)	–	–
Settlement loss	11	–	–	–	–	–
Total benefit cost (benefit)	$ 24	$ 15	$ 12	$ (3)	$ 4	$ 3

Amounts recognized in other comprehensive income for the year ended December 31, 2016 were as follows:

	Pension Benefits	Other Postretirement Benefits

	(in millions)	
Net actuarial (loss) gain arising during the year	$ (13)	$ 2
Amortization of prior service cost	–	–
Amortization of net loss	20	–
Settlements	–	1
Tax effect	(3)	(1)
	$ 4	$ 2

The assumptions used in the measurement of the Company’s benefit obligations as of December 31, 2016 and 2015 are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2016	2015	2016	2015
Discount rate	4.20 %	4.60 %	4.20 %	4.60 %
Rate of compensation increase	3.50 %	3.50 %	n/a	n/a %

The assumptions used in the measurement of the Company’s net periodic benefit cost for 2016, 2015 and 2014 are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2016	2015	2014	2016	2015	2014
Discount rate	4.20 %	4.25 %	5.00 %	4.20 %	4.25 %	5.00 %
Expected return on plan assets	7.00 %	7.00 %	7.00 %	n/a	n/a	n/a
Rate of compensation increase	3.50 %	4.50 %	4.50 %	n/a	n/a	n/a

The expected return on plan assets for the various benefit plans is based upon a review of the historical returns experienced, combined with the future expected returns based upon the asset allocation strategy employed. The plans seek to achieve an adequate return to fund the obligations in a manner consistent with the federal standards of the Employee Retirement Income Security Act and with a prudent level of diversification.

Table of Contents

Index to Financial Statements

For measurement purposes, the following trend rates were assumed for 2016 and 2015:

	2016	2015
Health care cost trend assumed for next year	7%	8%
Rate to which the cost trend is assumed to decline	5%	5%
Year that the rate reaches the ultimate trend rate	2034	2034

Assumed health care cost trend rates have a significant effect on the amounts for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
	(in millions)	
Effect on the total service and interest cost components	$ –	$ –
Effect on postretirement benefit obligations	$ 2	$ (2)

Pension Payments and Asset Management

In 2016, the Company contributed $10 million to its pension plans and $1 million to its other postretirement benefit plan. The Company expects to contribute $15 million to its pension and other postretirement benefit plans in 2017.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Pension Benefits		Other Postretirement Benefits	
(in millions)			
2017	$ 8	2017	$ 1
2018	6	2018	1
2019	6	2019	1
2020	7	2020	1
2021	8	2021	1

Years 2022-2026	46	Years 2022-2026	6

The Company’s overall investment strategy is to provide an adequate pool of assets to support both the long-term growth of plan assets and to ensure adequate liquidity exists for the near-term payment of benefit obligations to participants, retirees and beneficiaries. The Benefits Administration Committee of the Company administers the Company’s pension plan assets. The Benefits Administration Committee believes long-term investment performance is a function of asset-class mix and restricts the composition of pension plan assets to a combination of cash and cash equivalents, domestic equity markets, international equity markets or investment grade fixed income assets.

Table of Contents

Index to Financial Statements

The table below presents the allocations targeted by the Benefits Administration Committee and the actual weighted-average asset allocation of the Company's pension plan as of December 31, 2016, by asset category. The asset allocation targets are subject to change and the Benefits Administration Committee allows for its actual allocations to deviate from target as a result of current and anticipated market conditions. Plan assets are periodically balanced whenever the allocation to any asset class falls outside of the specified range.

	Pension Plan Asset Allocations	
Asset category:	Target	Actual
Equity securities:		
U.S. Equity(1)	35 %	36 %
Non-U.S. Developed Equity(2)	30 %	28 %
Emerging Markets Equity(3)	5 %	6 %
Opportunistic(4)	– %	– %
Fixed income(5)	28 %	25 %
Cash(6)	2 %	5 %
Total	100 %	100 %

(1) Includes the following equity securities in the table below: U.S. large cap growth equity, U.S. large cap value equity, U.S. large cap core equity, and U.S. small cap equity.

(2) Includes Non-U.S. equity securities in the table below.

(3) Includes emerging markets equity securities below.

(4) Includes none of the securities in the table below.

(5) Includes fixed income pension plan assets in the table below.

(6) Includes Cash and cash equivalents pension plan assets in the table below.

Utilizing the fair value hierarchy described in Note 6 – Fair Value Measurements, the Company's fair value measurement of pension plan assets as of December 31, 2016 is as follows:

Total

	(in millions)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured within fair value hierarchy				
Equity securities:				
U.S. large cap growth equity (1)	$ 6	$ 6	$ –	$ –
U.S. large cap value equity (2)	6	6	–	–
U.S. small cap equity (3)	3	3	–	–
Non-U.S. equity (4)	23	23	–	–
Emerging markets equity (5)	4	4	–	–
Fixed income (6)	21	21	–	–
Cash and cash equivalents	4	4	–	–
Total measured within fair value hierarchy	$ 67	$ 67	$ –	$ –
Measured at net asset value (7)				
Equity securities:				
U.S. large cap core equity (8)	14			
Total measured at net asset value	$ 14			
Total plan assets at fair value	$ 81			

(1) Mutual fund that seeks to invest in a diversified portfolio of stocks with price appreciation growth opportunities.
(2) Mutual fund that seeks to invest in a diversified portfolio of stocks that will increase in value over the long-term as well as provide current income.
(3) Mutual fund that seeks to invest in a diversified portfolio of stocks with small market capitalizations.
(4) Mutual funds that invest primarily in equity securities of companies domiciled outside of the United States, primarily in developed markets.
(5) An institutional fund that invests primarily in the equity securities of companies domiciled in emerging markets.
(6) Institutional funds that seek an investment return that approximates, as closely as practicable, before expenses, the performance of the Barclays U.S. Intermediate Credit Bond Index over the long term and the Barclays Long U.S. Corporate Bond Index over the long-term.
(7) Plan assets for which fair value was measured using net asset value as a practical expedient.
(8) An institutional fund that seeks to replicate the performance of the S&P 500 Index before fees.

Table of Contents

Index to Financial Statements

Utilizing the fair value hierarchy described in Note 6 – Fair Value Measurements, the Company's fair value measurement of pension plan assets at December 31, 2015 is as follows:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in millions)			
Measured within fair value hierarchy				
Equity securities:				
U.S. large cap growth equity (1)	$ 9	$ 9	$ –	$ –
U.S. large cap value equity (2)	9	9	–	–
U.S. small cap equity (3)	3	3	–	–
Non-U.S. equity (4)	31	31	–	–
Emerging markets equity (5)	5	5	–	–
Cash and cash equivalents	2	2	–	–
Total measured within fair value hierarchy	$ 59	$ 59	$ –	$ –
Measured at net asset value (6)				
Equity securities:				
U.S. large cap core equity (7)	18			
Fixed income (8)	31			
Total measured at net asset value	$ 49			
Total plan assets at fair value	$ 108			

(1) Mutual fund that seeks to invest in a diversified portfolio of stocks with price appreciation growth opportunities.
(2) Mutual fund that seeks to invest in a diversified portfolio of stocks that will increase in value over the long-term as well as provide current income.
(3) Mutual fund that seeks to invest in a diversified portfolio of stocks with small market capitalizations.
(4) Mutual funds that invest primarily in equity securities of companies domiciled outside of the United States, primarily in developed markets.
(5) An institutional fund that invests primarily in the equity securities of companies domiciled in emerging markets.
(6) Plan assets for which fair value was measured using net asset value as a practical expedient.
(7) An institutional fund that seeks to replicate the performance of the S&P 500 Index before fees.
(8) An institutional fund that seeks an investment return that approximates, as closely as practicable, before expenses, the performance of the Barclays U.S. Intermediate Credit Bond Index over the long term and the Barclays Long

U.S. Corporate Bond Index over the long-term.

The Company's pension plan assets that are classified as Level 1 are the investments comprised of either cash or investments in open-ended mutual funds which produce a daily net asset value that is validated with a sufficient level of observable activity to support classification of the fair value measurement as Level 1. Due to the Company's implementation of Accounting Standards Update No. 2015-07, assets measured using net asset value as a practical expedient have not been classified in the fair value hierarchy. No concentration of risk arising within or across categories of plan assets exists due to any significant investments in a single entity, industry, country or investment fund.

(12) STOCK-BASED COMPENSATION

The Southwestern Energy Company 2013 Incentive Plan was adopted in February 2013, approved by stockholders in May 2013 and amended and restated per stockholders' approval in May 2016 (the "2013 Plan"). The 2013 Plan provides for the compensation of officers, key employees and eligible non-employee directors of the Company and its subsidiaries. The 2013 Plan replaced the Southwestern Energy Company 2004 Stock Incentive Plan, the Southwestern Energy Company 2000 Stock Incentive Plan ("2000 Plan") and the Southwestern Energy Company 2002 Employee Stock Incentive Plan ("2002 Plan") but did not affect prior awards under those plans which remained valid and some of which are still outstanding. The awards under the prior plans have been adjusted for stock splits as permitted under such plans.

The 2013 Plan provides for grants of options, stock appreciation rights, and shares of restricted stock and restricted stock units to employees, officers and directors that, in the aggregate, do not exceed 33,850,000 shares. The types of incentives that may be awarded are comprehensive and are intended to enable the Company's board of directors to structure the most appropriate incentives and to address changes in income tax laws which may be enacted over the term of the 2013 Plan.

As initially adopted, the 2004 Plan, the 2000 Plan and the 2002 Plan provided for grants of options, stock appreciation rights, shares of phantom stock and shares of restricted stock that, in the aggregate, did not exceed 16,800,000, 1,250,000 and 300,000 shares, respectively, to employees who are not officers or directors of the Company under provisions of Section 16 of the Securities Exchange Act of 1934, as amended. The Company may utilize treasury shares, if available, or authorized but unissued shares when a stock option is exercised or when restricted stock is granted.

Table of Contents

Index to Financial Statements

The Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. All options are issued at fair market value at the date of grant and expire seven years from the date of grant for awards under both the 2013 Plan and the 2004 Plan and ten years from the date of grant for awards under all other plans. Generally, stock options granted to employees and directors vest ratably over three years from the grant date. The Company issues shares of restricted stock to employees and directors which generally vest over four years. The Company recognizes stock-based compensation expense on a straight-line basis over the requisite service period of the individual grants with the exception of awards granted to participants who have reached retirement age or will reach retirement age during the vesting period. Restricted stock and stock options granted to participants on or after December 6, 2013 immediately vest upon death, disability or retirement (subject to a minimum of three years of service).

In January 2016, the Company announced a 40% workforce reduction that was substantially concluded by the end of March 2016. In April 2016, the Company also partially restructured executive management, which was substantially completed in the second quarter of 2016. Affected employees were offered a severance package that included, if applicable, amendments to certain outstanding equity awards that modified forfeiture provisions upon separation from the Company. As a result, certain unvested stock-based equity awards became fully vested at the time of separation. These shares were revalued and recognized immediately as a component of restructuring charges on the Company's unaudited consolidated statement of operations. The unvested portion of equity-based performance units was forfeited upon separation from the Company.

Stock Options

The Company recorded the following compensation costs related to stock options for the years ended December 31, 2016, 2015 and 2014:

	2016		2015		2014	
		(in millions)				
Stock-based compensation cost related to stock options – general and administrative expense (1)	$	6	$	5	$	5
	$	1	$	3	$	4

Stock-based compensation cost related to stock options – capitalized

(1) Includes less than $1 million and $1 million related to the reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

The Company also recorded a deferred tax asset of $2 million, $2 million and $3 million related to stock options in 2016, 2015 and 2014, respectively. Unrecognized compensation cost related to the Company's unvested stock options totaled $4 million at December 31, 2016. This cost is expected to be recognized over a weighted-average period of 2 years.

The fair value of stock options is estimated on the date of the grant using a Black-Scholes valuation model that uses the weighted average assumptions noted in the following table. Expected volatility is based on historical volatility of the Company's common stock and other factors. The Company uses historical data on the exercise of stock options, post-vesting forfeitures and other factors to estimate the expected term of the stock-based payments granted. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant.

Assumptions	2016	2015	2014
Risk-free interest rate	1.4%	1.7%	1.6%
Expected dividend yield	–	–	–
Expected volatility	41.0%	36.0%	32.5%
Expected term	5 years	5 years	5 years

105

Index to Financial Statements

The following tables summarize stock option activity for the years 2016, 2015 and 2014, and provide information for options outstanding at December 31 of each year:

	2016		2015		2014	
	Number of Shares (in thousands)	Weighted Average Exercise Price	Number of Shares (in thousands)	Weighted Average Exercise Price	Number of Shares (in thousands)	Weighted Average Exercise Price
Options outstanding at January 1	5,623	$ 24.57	3,622	$ 35.41	3,313	$ 35.70
Granted (1)	155	8.60	2,401	9.47	835	32.31
Exercised	(45)	7.74	–	–	(402)	30.60
Forfeited or expired	(317)	38.01	(400)	32.20	(124)	37.80
Options outstanding at December 31	5,416	$ 23.46	5,623	$ 24.57	3,622	$ 35.41

(1) Shares granted in 2016 are considerably lower than historical norms. In 2016, the Company changed the grant date of its annual stock option awards from December to the following February.

	Options Outstanding				Options Exercisable			
Range of Exercise Prices	Options Outstanding at December 31, 2016 (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in millions)	Options Exercisable at December 31, 2016 (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in millions)
$7.74-$29.69	2,501	9.54	5.9		781	9.77	5.8	
$30.59-$35.91	1,384	32.32	3.9		1,146	32.68	3.7	
$36.22-$39.68	1,402	37.49	2.4		1,402	37.49	2.4	
$40.15-$51.47	129	45.79	3.3		99	45.57	3.0	

5,416	$ 23.46	4.4	$ 7	3,428	$ 29.80	3.6	$ 2

The weighted-average grant date fair value of options granted during the years 2016, 2015 and 2014 was $3.22, $3.16 and $10.16, respectively. The total intrinsic value of options exercised during 2016 and 2014 was less than $1 million and $4 million, respectively. There were no options exercised in 2015.

Restricted Stock

The Company recorded the following compensation costs related to restricted stock grants for the years ended December 31, 2016, 2015 and 2014:

	2016	2015	2014
	(in millions)		
Stock-based compensation cost related to restricted stock grants – general and administrative expense (1)	$ 33	$ 14	$ 10
Stock-based compensation cost related to restricted stock grants – capitalized	$ 8	$ 16	$ 12

(1) Includes $16 million and $1 million related to the reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

The Company also recorded a deferred tax asset of $12 million related to restricted stock for the year ended December 31, 2016, compared to a deferred tax asset of $11 million for 2015 and a deferred tax liability of $10 million for 2014. As of December 31, 2016, there was $37 million of total unrecognized compensation cost related to unvested shares of restricted stock that is expected to be recognized over a weighted-average period of 2 years.

Table of Contents

Index to Financial Statements

The following table summarizes the restricted stock activity for the years 2016, 2015 and 2014, and provides information for restricted stock outstanding at December 31 of each year:

	2016		2015		2014	
	Number of Shares (in thousands)	Weighted Average Fair Value	Number of Shares (in thousands)	Weighted Average Fair Value	Number of Shares (in thousands)	Weighted Average Fair Value
Unvested shares at January 1	7,222	$ 13.24	2,376	$ 34.00	1,771	$ 37.55
Granted (1)	81	8.56	5,822	8.07	1,295	30.89
Vested (2)	(3,817)	11.34	(873)	33.33	(548)	37.12
Forfeited	(165)	12.05	(103)	29.14	(142)	37.91
Unvested shares at December 31	3,321	$ 11.85	7,222	$ 13.24	2,376	$ 34.00

(1) Shares granted in 2016 are considerably lower than historical norms. In 2016, the Company changed the grant date of its annual restricted stock awards from December to the following February.
(2) Includes 2,059,626 shares and 151,575 shares related to reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

The fair values of the grants were $1 million for 2016, $47 million for 2015 and $40 million for 2014. The total fair value of shares vested were $43 million for 2016, $29 million for 2015 and $20 million for 2014.

Equity-Classified Performance Units

The Company recorded compensation costs related to equity-classified performance units for the years ended December 31, 2016, 2015 and 2014. The performance units awarded in 2013 and 2014 included a market condition based on relative Total Shareholder Return ("TSR") and a performance condition based on the Company's Present Value

Index (“PVI”), collectively the “Performance Measures.” The fair value of the TSR market condition is based on a Monte Carlo model and is amortized to compensation expense on a straight-line basis over the vesting period of the award. The fair value of the PVI performance condition is based on economic analysis for each investment opportunity based upon the expected present value added for each dollar to be invested and amortized to compensation expense on a straight line basis over the vesting period of the award. The performance units awarded in 2016 and 2015 are based exclusively on TSR. The grant date fair value is calculated using the applicable Performance Measures and the closing price of the Company’s common stock at the grant date.

	2016	2015	2014
	(in millions)		
Stock-based compensation cost related to performance units – general and administrative expense (1)	$ 9	$ 6	$ 3
Stock-based compensation cost related to performance units – capitalized	$ 1	$ 4	$ 2

(1) Includes less than $1 million and $1 million related to reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

The Company also recorded a deferred tax asset of $4 million related to equity-based performance units for the year ended December 31, 2016, compared to deferred tax assets of $4 million and $2 million in 2015 and 2014, respectively. As of December 31, 2016, there was $9 million of total unrecognized compensation cost related to unvested equity-based performance units that is expected to be recognized over a weighted-average period of 2 years.

Table of Contents

Index to Financial Statements

The following table summarizes performance unit activity to be paid out in Company stock for the years ended December 31, 2016, 2015 and 2014, and provides information for unvested units as of December 31, 2016, 2015 and 2014:

	2016		2015		2014	
	Number of Units (1) (in thousands)	Weighted Average Fair Value	Number of Units (1) (in thousands)	Weighted Average Fair Value	Number of Units (1) (in thousands)	Weighted Average Fair Value
Unvested shares at January 1	407	$ 36.65	223	$ 40.44	–	$ –
Granted	1,503	8.60	443	35.22	359	40.44
Vested(2)	(889)	12.78	(259)	37.46	(111)	40.44
Forfeited(3)	(302)	11.26	–	–	(25)	40.44
Unvested shares at December 31	719	$ 11.46	407	$ 36.65	223	$ 40.44

(1) These amounts reflect the number of performance units granted in thousands. The actual payout in shares may range from a minimum of zero shares to a maximum of two shares contingent upon the actual performance against the Performance Measures. The performance units have a three-year vesting term and the actual disbursement of shares, if any, is not determined until March following the end of the three-year vesting period.

(2) Includes 22,918 units and 37,590 units related to the reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

(3) Includes 87,595 units and 195,834 units related to the reduction in workforce and executive management restructuring, respectively, for the year ended December 31, 2016.

Liability-Classified Performance Units

Prior to 2013, certain employees were provided performance units vesting equally over three years that were settled in cash. The payout of these units was based on certain metrics, such as total shareholder return and reserve replacement efficiency, compared to a predetermined group of peer companies and Company goals. At the end of each performance period, the value of the vested performance units, if any, would be paid in cash. In the first quarter of

2016, the Company completed the final payout under these performance unit agreements.

(13) SEGMENT INFORMATION

The Company's reportable business segments have been identified based on the differences in products or services provided. Revenues for the E&P segment are derived from the production and sale of natural gas and liquids. The Midstream Services segment generates revenue through the marketing of both Company and third-party produced natural gas and liquids volumes and through gathering fees associated with the transportation of natural gas to market.

Summarized financial information for the Company's reportable segments is shown in the following table. The accounting policies of the segments are the same as those described in Note 1 – Organization and Summary of Significant Accounting Policies. Management evaluates the performance of its segments based on operating income, defined as operating revenues less operating costs. Income before income taxes, for the purpose of reconciling the operating income amount shown below to consolidated income before income taxes, is the sum of operating income, interest expense, gain (loss) on derivatives, loss on early extinguishment of debt and other income (loss). The "Other" column includes items not related to the Company's reportable segments, including real estate and corporate items.

108

Index to Financial Statements

	Exploration and Production (in millions)		Midstream Services		Other		Total
2016							
Revenues from external customers	$ 1,435		$ 1,001		$ –		$ 2,436
Intersegment revenues	(22)		1,568		–		1,546
Depreciation, depletion and amortization expense	371		65		–		436
Impairment of natural gas and oil properties	2,321		–		–		2,321
Operating income (loss)	(2,404)	(1)	209	(2)	–		(2,195)
Interest expense (3)	87		1		–		88
Gain (loss) on derivatives	(338)		(1)		–		(339)
Loss on early extinguishment of debt	–		–		(51)		(51)
Other income (loss), net	5		(2)		(2)		1
Provision (benefit) for income taxes(3)	(29)		–		–		(29)
Assets	4,178	(4)	1,331		1,567	(5)	7,076
Capital investments (6)	623		21		4		648
2015							
Revenues from external customers	$ 2,095		$ 1,038		$ –		$ 3,133
Intersegment revenues	(21)		2,081		–		2,060
Depreciation, depletion and amortization expense	1,028		62		1		1,091
Impairment of natural gas and oil properties	6,950		–		–		6,950
Operating income (loss)	(7,104)		583	(7)	(1)		(6,522)
Interest expense (3)	47		9		–		56
Gain (loss) on derivatives	51		–		(4)		47
Other loss, net	(21)		(9)		–		(30)
Provision (benefit) for income taxes (3)	(2,273)		268		–		(2,005)
Assets	6,588	(4)	1,290		208		8,086
Capital investments (6)	2,258		167		12		2,437
2014							
Revenues from external customers	$ 2,850		$ 1,188		$ –		$ 4,038
Intersegment revenues	12		3,170		–		3,182
Depreciation, depletion and amortization expense	884		58		–		942
Operating income (loss)	1,013		361		(1)		1,373
Interest expense (3)	47		12		–		59
Gain (loss) on derivatives	142		(1)		(2)		139
Other loss, net	(3)		(1)		–		(4)
Provision for income taxes (3)	402		123		–		525
Assets	13,018	(4)	1,554		343		14,915
Capital investments (6)	7,254		144		49		7,447

(1) Operating loss for the E&P segment includes $86 million related to restructuring and other one-time charges for the year ended December 31, 2016.
(2) Operating income for the Midstream Services segment includes $3 million related to restructuring charges for the year ended December 31, 2016.
(3) Interest expense and the provision (benefit) for income taxes by segment are an allocation of corporate amounts as they are incurred at the corporate level.
(4) Includes office, technology, drilling rigs and other ancillary equipment not directly related to natural gas and oil property acquisition, exploration and development activities.
(5) Other assets represent corporate assets not allocated to segments and assets for non-reportable segments. At December 31, 2016, other assets includes approximately $1.4 billion in cash and cash equivalents.
(6) Capital investments include an increase of $43 million for 2016, a decrease of $33 million for 2015 and an increase of $155 million for 2014 related to the change in accrued expenditures between years.
(7) Operating income (loss) for the Midstream Services segment includes a $277 million gain on sale of assets for the year ended December 31, 2015.

Included in intersegment revenues of the Midstream Services segment are $1.3 billion, $1.8 billion and $2.8 billion for 2016, 2015 and 2014, respectively, for marketing of the Company’s E&P sales. Corporate assets include cash and cash equivalents, furniture and fixtures and other costs. Corporate general and administrative costs, depreciation expense and taxes other than income are allocated to the segments.

Index to Financial Statements

(14) SUBSEQUENT EVENTS

None.

SUPPLEMENTAL QUARTERLY RESULTS (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended December 31, 2016 and 2015:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
	(in millions, except per share amounts)			
	2016			
Operating revenues	$ 579	$ 522	$ 651	$ 684
Operating income (loss) (1)	(1,100)	(492)	(725)	122
Net loss attributable to common stock	(1,159)	(620)	(735)	(237)
Loss per share - Basic	(3.03)	(1.61)	(1.52)	(0.48)
Loss per share - Diluted	(3.03)	(1.61)	(1.52)	(0.48)
	2015			
Operating revenues	$ 933	$ 764	$ 749	$ 687
Operating income (loss) (1)	165	(1,284)	(2,842)	(2,561)
Net income (loss) attributable to common stock (2)	46	(815)	(1,766)	(2,134)
Earnings (Loss) per share - Basic	0.12	(2.13)	(4.62)	(5.58)
Earnings (Loss) per share - Diluted	0.12	(2.13)	(4.62)	(5.58)

(1) The operating losses for the first, second and third quarters of 2016 included non-cash full cost impairments of natural gas and oil properties of $1,034 million, $470 million, and $817 million, respectively. There was no full cost impairment in the fourth quarter of 2016. The operating losses for the second, third and fourth quarters of 2015 included non-cash full cost impairments of natural gas and oil properties of $1,535 million, $2,839 million and $2,576 million, respectively.

(2) Net income attributable to common stock was reduced by $7 million in the first quarter of 2015 to recognize the portion of the Company's net income that would be distributed to the holders of preferred securities (mandatory convertible preferred stock) at year-end. However, as a result of the Company's net loss in the second quarter that persisted for the year ended December 31, 2015, participating securities were ultimately not entitled to receive a distribution.

SUPPLEMENTAL OIL AND GAS DISCLOSURES (UNAUDITED)

The Company's operating natural gas and oil properties are located solely in the United States. The Company also has licenses to properties in Canada, the development of which is subject to an indefinite moratorium. See "Our Operations — Other — New Brunswick, Canada" in Item 1 of Part 1 of this Annual Report.

Net Capitalized Costs

The following table shows the capitalized costs of natural gas and oil properties and the related accumulated depreciation, depletion and amortization as of December 31, 2016 and 2015:

	2016	2015
	(in millions)	
Proved properties	$ 20,548	$ 18,751
Unproved properties	2,105	3,727
Total capitalized costs	22,653	22,478
Less: Accumulated depreciation, depletion and amortization	(18,897)	(16,248)
Net capitalized costs	$ 3,756	$ 6,230

Index to Financial Statements

Natural gas and oil properties not subject to amortization represent investments in unproved properties and major development projects in which the Company owns an interest. These unproved property costs include unevaluated costs associated with leasehold or drilling interests and unevaluated costs associated with wells in progress. The table below sets forth the composition of net unevaluated costs excluded from amortization as of December 31, 2016:

	2016	2015	2014	Prior	Total
	(in millions)				
Property acquisition costs	$ 22	$ 213	$ 1,501	$ 54	$ 1,790
Exploration and development costs	55	64	24	16	159
Capitalized interest	70	55	10	21	156
	$ 147	$ 332	$ 1,535	$ 91	$ 2,105

Of the total net unevaluated costs excluded from amortization as of December 31, 2016, approximately $1.6 billion is related to the Chesapeake and Statoil Property Acquisitions, approximately $100 million is related to the acquisition of undeveloped properties outside the Appalachian Basin and the Fayetteville Shale, excluding licenses in Canada subject to an indefinite moratorium, and approximately $94 million is related to the acquisition of the Company's undeveloped properties in Northeast Appalachia. Additionally, the Company has approximately $113 million of unevaluated costs related to costs of wells in progress. The remaining costs excluded from amortization are related to properties which are not individually significant and on which the evaluation process has not been completed. The timing and amount of property acquisition and seismic costs included in the amortization computation will depend on the location and timing of drilling wells, results of drilling and other assessments. The Company is, therefore, unable to estimate when these costs will be included in the amortization computation.

Costs Incurred in Natural Gas and Oil Exploration and Development

The table below sets forth capitalized costs incurred in natural gas and oil property acquisition, exploration and development activities:

2016	2015	2014

	(in millions, except per Mcfe amounts)		
Proved property acquisition costs	$ –	$ 81	$ 1,455
Unproved property acquisition costs	171	692	3,934
Exploration costs	17	50	232
Development costs	433	1,417	1,600
Capitalized costs incurred	621	2,240	7,221
Full cost pool amortization per Mcfe	$ 0.38	$ 1.00	$ 1.10

Capitalized interest is included as part of the cost of natural gas and oil properties. The Company capitalized $152 million, $204 million and $55 million during 2016, 2015 and 2014, respectively, based on the Company's weighted average cost of borrowings used to finance expenditures.

In addition to capitalized interest, the Company capitalized internal costs totaling $112 million, $307 million and $320 million during 2016, 2015 and 2014, respectively, which were directly related to the acquisition, exploration and development of the Company's natural gas and oil properties. Included in these amounts are internal costs from the Company's subsidiaries involved with vertical integration of the Company's exploration and development activities, which totaled $19 million, $118 million and $123 million during 2016, 2015 and 2014, respectively. All internal costs are included in the Company's cost of natural gas and oil properties.

Table of Contents

Index to Financial Statements

Results of Operations from Natural Gas and Oil Producing Activities

The table below sets forth the results of operations from natural gas and oil producing activities:

	2016	2015	2014
	(in millions)		
Sales	$ 1,413	$ 2,074	$ 2,862
Production (lifting) costs	(839)	(989)	(776)
Depreciation, depletion and amortization	(371)	(1,028)	(884)
Impairment of natural gas and oil properties	(2,321)	(6,950)	–
	(2,118)	(6,893)	1,202
Provision (benefit) for income taxes	– (1)	(2,619)	457
Results of operations (2)	$ (2,118)	$ (4,274)	$ 745

(1) Prior to the Company’s recognition of a valuation allowance in 2016, the Company recognized an income tax benefit of $805 million.

(2) Results of operations exclude the gain (loss) on unsettled commodity derivative instruments. See Note 4 - Derivatives and Risk Management

The results of operations shown above exclude general and administrative expenses and interest expense and are not necessarily indicative of the contribution made by the Company’s natural gas and oil operations to its consolidated operating results. Income tax expense is calculated by applying the statutory tax rates to the revenues less costs, including depreciation, depletion and amortization, and after giving effect to permanent differences and tax credits.

Natural Gas and Oil Reserve Quantities

The Company engaged the services of Netherland, Sewell & Associates, Inc., or NSAI, an independent petroleum engineering firm, to audit the reserves estimated by the Company’s reservoir engineers. In conducting its audit, the engineers and geologists of NSAI studied the Company’s major properties in detail and independently developed reserve estimates. NSAI’s audit consists primarily of substantive testing, which includes a detailed review of the Company’s major properties, and accounted for approximately 99%, 100% and 97% of the present worth of the Company’s total proved reserves as of December 31, 2016, 2015 and 2014, respectively. A reserve audit is not the same as a financial audit, and a reserve audit is less rigorous in nature than a reserve report prepared by an independent petroleum engineering firm containing its own estimate of reserves. Reserve estimates are inherently imprecise, and the Company's reserve estimates are generally based upon extrapolation of historical production trends, historical prices of natural gas and crude oil and analogy to similar properties and volumetric calculations. Accordingly, the Company's estimates are expected to change, and such changes could be material and occur in the near term as future information becomes available. For more information over reserves, refer to the table titled "Changes in Proved Undeveloped Reserves (Bcfe)" in "Business – Exploration and Production" in Item 1 of this Annual Report.

The following table summarizes the changes in the Company's proved natural gas, oil and NGL reserves for 2016, 2015 and 2014, all of which were located in the United States:

	2016 Natural Gas (Bcf)	Oil (MBbls)	NGL (MBbls)	2015 Natural Gas (Bcf)	Oil (MBbls)	NGL (MBbls)	2014 Natural Gas (Bcf)	Oil (MBbls)	NGL (MBbls)
Proved reserves, beginning of year	5,917	8,753	40,947	9,809	37,615	118,699	6,974	373	–
Revisions of previous estimates	(446)	1,564	13,794	(3,458)	(28,394)	(75,664)	542	(14)	66
Extensions, discoveries and other additions	198	2,417	11,576	546	1,367	6,274	1,692	250	48
Production	(788)	(2,192)	(12,372)	(899)	(2,265)	(10,702)	(766)	(235)	(231)
Acquisition of reserves in place	–	–	–	97	525	2,340	1,367	37,246	118,816
Disposition of reserves in place	(15)	(19)	(14)	(178)	(95)	–	–	(5)	–
Proved reserves, end of year	4,866	10,523	53,931	5,917	8,753	40,947	9,809	37,615	118,699
Proved developed reserves:									
Beginning of year	5,474	8,753	40,947	5,675	7,445	38,632	4,237	372	–
End of year	4,789	10,523	53,931	5,474	8,753	40,947	5,675	7,445	38,632
Proved undeveloped reserves:									
Beginning of year	443	–	–	4,134	30,170	80,067	2,737	1	–
End of year	77	–	–	443	–	–	4,134	30,170	80,067

Table of Contents

Index to Financial Statements

The Company's estimated proved natural gas, oil and NGL reserves were 5,253 Bcfe at December 31, 2016, compared to 6,215 Bcfe at December 31, 2015. The decrease in the Company's reserves in 2016 was primarily due to the decrease in commodity prices. The significant decrease in the Company's reserves in 2015 was primarily due to the decrease in commodity prices. The significant increase in the Company's reserves in 2014 was primarily due to the acquisition of approximately 413,000 net acres in Southwest Appalachia, successful development drilling programs in the Fayetteville Shale and Northeast Appalachia and upward performance revisions in Northeast Appalachia. In 2014, the Company replaced 550% of its production volumes with proved reserve additions and proved reserve additions as a result of acquisitions primarily associated with acreage in Southwest Appalachia. The following table summarizes the changes in reserves for 2014, 2015 and 2016:

	Total (in Bcfe)	Appalachia Northeast	Southwest	Fayetteville Shale	Other(1)
December 31, 2013	6,976	1,963	–	4,795	218
Production	(768)	(254)	(3)	(494)	(17)
Disposition of reserves in place	–	–	–	–	–
Acquisition of reserves in place	2,303	1	2,300	–	2
Net revisions					
Price revisions	54	10	–	38	6
Performance and production revisions	489	636	–	(126)	(21)
Total net revisions	543	646	–	(88)	(15)
Reserve additions					
Proved developed	531	246	–	283	2
Proved undeveloped	1,162	589	–	573	–
Total reserve additions	1,693	835	–	856	2
December 31, 2014	10,747	3,191	2,297	5,069	190
Production	(976)	(360)	(143)	(465)	(8)
Disposition of reserves in place	(180)	–	–	–	(180)
Acquisition of reserves in place	115	80	35	–	–
Net revisions					
Price revisions	(5,718)	(2,315)	(1,875)	(1,496)	(32)
Performance and production revisions	1,635	1,383	209	10	33
Total net revisions	(4,083)	(932)	(1,666)	(1,486)	1
Reserve additions					
Proved developed	416	202	84	129	1
Proved undeveloped	176	138	4	34	–
Total reserve additions	592	340	88	163	1
December 31, 2015	6,215	2,319	611	3,281	4
Production	(875)	(350)	(148)	(375)	(2)
Disposition of reserves in place	(15)	–	(15)	–	–
Acquisition of reserves in place	–	–	–	–	–
Net revisions					
Price revisions	(1,037)	(794)	(127)	(116)	–
Performance and production revisions	683	318	199	163	3

Total net revisions	(354)	(476)	72	47	3
Reserve additions					
Proved developed	257	81	157	19	–
Proved undeveloped	25	–	–	25	–
Total reserve additions	282	81	157	44	–
December 31, 2016	5,253	1,574	677	2,997	5

(1) Other includes properties outside of the Appalachian Basin and Fayetteville Shale along with Ark-La-Tex properties divested in May 2015.

The Company's December 31, 2016 proved reserves included 77 Bcfe of proved undeveloped reserves from 15 locations that had a positive present value on an undiscounted basis in compliance with proved reserve requirements, but do not have a positive present value when discounted at 10%. These properties had a negative present value of $11 million when discounted at 10%. The Company made a final investment decision and is committed to developing these reserves within the next five years from the date of initial booking. The Company's December 31, 2015 proved reserves included 217 Bcfe of proved undeveloped reserves from 75 locations that had a positive present value on an undiscounted basis in compliance with proved reserve requirements, but that have a negative $34 million present value when discounted at 10%. The Company's December 31, 2014 proved reserves included 181 Bcfe of proved undeveloped reserves from 60 locations that had a positive present value on an undiscounted basis in compliance with proved reserve requirements, but that have a negative $28 million present value when discounted at 10%.

Table of Contents

Index to Financial Statements

The Company has no reserves from synthetic gas, synthetic oil or nonrenewable natural resources intended to be upgraded into synthetic gas or oil. The Company used standard engineering and geoscience methods, or a combination of methodologies in determining estimates of material properties, including performance and test date analysis, offset statistical analogy of performance data, volumetric evaluation, including analysis of petrophysical parameters (including porosity, net pay, fluid saturations (i.e., water, oil and gas) and permeability) in combination with estimated reservoir parameters (including reservoir temperature and pressure, formation depth and formation volume factors), geological analysis, including structure and isopach maps and seismic analysis, including review of 2-D and 3-D data to ascertain faults, closure and other factors.

Standardized Measure of Discounted Future Net Cash Flows

The following standardized measures of discounted future net cash flows relating to proved natural gas, oil and NGL reserves as of December 31, 2016, 2015 and 2014 are calculated after income taxes, discounted using a 10% annual discount rate and do not purport to present the fair market value the Company's proved gas, oil and NGL reserves:

	2016	2015	2014
	(in millions)		
Future cash inflows	$ 9,064	$ 11,887	$ 41,812
Future production costs	(5,880)	(7,376)	(16,477)
Future development costs (1)	(485)	(792)	(5,750)
Future income tax expense (2)	–	–	(4,743)
Future net cash flows	2,699	3,719	14,842
10% annual discount for estimated timing of cash flows	(1,034)	(1,302)	(7,299)
Standardized measure of discounted future net cash flows	$ 1,665	$ 2,417	$ 7,543

(1) Includes abandonment costs.

(2) The December 31, 2016 and 2015 standardized measure computation does not have future income taxes because the Company's tax basis in the associated oil and gas properties exceeded expected pre-tax cash inflows. Future net cash flows are not permitted to be increased by excess tax basis.

Under the standardized measure, future cash inflows were estimated by applying an average price from the first day of each month from the previous 12 months, adjusted for known contractual changes, to the estimated future production of year-end proved reserves. Prices used for the standardized measure above were $2.48 per MMBtu for natural gas, $39.25 per barrel for oil and $6.74 per barrel for NGLs in 2016, $2.59 per MMBtu for natural gas, $46.79 per barrel for oil and $6.82 per barrel for NGLs in 2015, and $4.35 per MMBtu for natural gas, $91.48 per barrel for oil and $23.79 per barrel for NGLs in 2014. Future cash inflows were reduced by estimated future production and development costs based on year-end costs to determine pre-tax cash inflows. Future income taxes were computed by applying the year-end statutory rate to the excess of pre-tax cash inflows over the Company’s tax basis in the associated proved gas and oil properties after giving effect to permanent differences and tax credits.

Following is an analysis of changes in the standardized measure during 2016, 2015 and 2014:

	2016	2015	2014
	(in millions)		
Standardized measure, beginning of year	$ 2,417	$ 7,543	$ 3,736
Sales and transfers of natural gas and oil produced, net of production costs	(574)	(1,082)	(2,084)
Net changes in prices and production costs	(415)	(8,075)	1,192
Extensions, discoveries, and other additions, net of future production and development costs	45	162	1,049
Acquisition of reserves in place	–	28	1,897
Sales of reserves in place	(10)	(244)	–
Revisions of previous quantity estimates	(140)	(1,385)	622
Accretion of discount	242	946	513
Net change in income taxes	–	1,915	(522)
Changes in estimated future development costs	71	2,007	110
Previously estimated development costs incurred during the year	114	875	815
Changes in production rates (timing) and other	(85)	(273)	215
Standardized measure, end of year	$ 1,665	$ 2,417	$ 7,543

Table of Contents

Index to Financial Statements

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act. Our disclosure controls and procedures are the controls and other procedures that we have designed to ensure that we record, process, accumulate and communicate information to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures and submission within the time periods specified in the SEC's rules and forms. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those determined to be effective can provide only a level of reasonable assurance with respect to financial statement preparation and presentation. Based on the evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of December 31, 2016 at a reasonable assurance level.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting is included on page 69 of this Annual Report.

PricewaterhouseCoopers LLP's report on Southwestern Energy's internal control over financial reporting is included in its Report of Independent Registered Public Accounting Firm on page 70 of this Annual Report.

ITEM 9B. OTHER INFORMATION

Election of Director

On February 21, 2017, the Board of Directors elected Jon A. Marshall, 65, as a director of the Company effective February 27, 2017, for a term expiring at the 2017 annual meeting of stockholders. With the election of Mr. Marshall, the Board of Directors has nine members.

Mr. Marshall served as President and Chief Operating Officer of Transocean Ltd. from 2007 to 2008 and as the Chief Executive Officer and President of GlobalSantaFe Corporation from 2003 to 2007, when it merged with Transocean. He also served on the boards of directors of those companies. Currently he is a director of Noble Corporation plc (chairman of its HSE & Engineering Committee and member of its Audit and Finance Committees) and of Cobalt International Energy, Inc. (chairman of its Compensation Committee). He is a former chairman of the board of directors of the National Ocean Industries Association. Mr. Marshall received a bachelor of science degree from the United States Military Academy.

The selection of Mr. Marshall was not pursuant to any arrangement or understanding between him and any other person. Mr. Marshall has not been appointed to serve on any standing committees of the Board of Directors and is not expected to be so appointed at this time.

There are no transactions between Mr. Marshall and the Company that are required to be reported under Item 404(a) of Regulation S-K.

In connection with his election, Mr. Marshall will receive a pro rata portion of the annual cash compensation, the equity compensation and the additional compensation amounts received by non-employee directors, which are described in the Company’s definitive proxy statement delivered to its stockholders in connection with the 2016 annual meeting of stockholders and filed with the Securities and Exchange Commission on April 6, 2016.

Table of Contents

Index to Financial Statements

Appointment of Vice President and Controller

On February 21, 2017, effective as of that date, the Board of Directors promoted Colin O'Beirne, 41, to the position of Vice President and Controller and designated him as our principal accounting officer, to serve until the next annual meeting of stockholders and/or until his successor shall be duly elected and shall qualify. In his capacity as the Company's principal accounting officer, Mr. O'Beirne will report to R. Craig Owen, Senior Vice President and Chief Financial Officer, who had reassumed the duties of principal accounting officer on an interim basis beginning in July 2017. Mr. O'Beirne joined the Company in October 2010 as a senior manager over the Company's internal controls and compliance team and, since 2012, has served as a director over various groups within the accounting function. Immediately prior to joining the Company, Mr. O'Beirne was a senior manager at PricewaterhouseCoopers LLP in Houston with over twelve years of accounting and financial reporting experience in the energy industry. Mr. O'Beirne holds a master of science in accounting from Texas A&M University. He is a Certified Public Accountant.

The selection of Mr. O'Beirne was not pursuant to any arrangement or understanding between him and any other person. There is no family relationship between Mr. O'Beirne and any director or executive officer of the Company.

There are no transactions between Mr. O'Beirne and the Company that are required to be reported under Item 404(a) of Regulation S-K.

Other than as disclosed below, we do not have any agreement with Mr. O'Beirne, either written or oral, that guarantees salaries, salary increases, bonuses or benefits. Mr. O'Beirne and the Company will enter into an indemnity agreement and an executive severance agreement to be effective as of the date of his promotion, the forms of which are expected to be consistent with the forms of indemnity agreement incorporated by reference as Exhibit 10.1 to this annual report on Form 10-K and executive severance agreement incorporated by reference as Exhibit 10.2 to this annual report on Form 10-K (as amended by Exhibits 10.3 and 10.4 to this annual report on Form 10-K). The executive severance agreement will entitle him to receive a payment if, within three years after a "Change in Control," (i) his employment is terminated without "Cause" or (ii) he voluntarily terminates employment with the Company for "Good Reason." The severance payment for Mr. O'Beirne will be equal to the product of 2.0 and the sum of base salary as of his termination date plus the maximum bonus opportunity available to him. Mr. O'Beirne also is eligible to participate in the Company's compensation and benefit plans available to executives.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The definitive proxy statement to holders of the Company's common stock in connection with the solicitation of proxies to be used in voting at the Annual Meeting of Stockholders to be held on or about May 23, 2017 (the "Proxy Statement"), is hereby incorporated by reference for the purpose of providing information about the Company's directors, and for discussion of its audit committee and its audit committee financial expert. Refer to the sections "Proposal No. 1: Election of Directors" and "Share Ownership of Management, Directors and Nominees" in the Proxy Statement for information concerning our directors. Refer to the section "Corporate Governance – Committees of the Board of Directors" in the 2017 Proxy Statement for discussion of its audit committee and its audit committee financial expert. Information concerning the Company's executive officers is presented in Part I of this Annual Report. The Company refers you to the section "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for information relating to compliance with Section 16(a) of the Exchange Act.

Code of Business Ethics and Conduct for Directors and Employees

The Company has adopted a code of ethics that applies to its Chief Executive Officer, Chief Financial Officer and Controller as well as other officers and employees. We have posted a copy of our code of ethics on the "Corporate Governance" section of our website at www.swn.com, and it is available free of charge in print to any stockholder who requests it. Requests for copies should be addressed to the Secretary at 10000 Energy Drive, Spring, Texas 77389. Any amendments to, or waivers from, our code of ethics that apply to our executive officers and directors will be posted on the "Corporate Governance" section of our website.

ITEM 11. EXECUTIVE COMPENSATION

Information required by Item 11 of Part III will be included in our Proxy Statement relating to our 2017 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A on or before May 23, 2017, and is incorporated herein by reference.*

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by Item 12 of Part III will be included in our Proxy Statement relating to our 2017 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A on or before May 23, 2017, and is incorporated herein by reference.*

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by Item 13 of Part III will be included in our Proxy Statement relating to our 2017 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A on or before May 23, 2017, and is incorporated herein by reference.*

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information required by Item 14 of Part III will be included in our Proxy Statement relating to our 2017 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A on or before May 23, 2017, and is incorporated herein by reference.*

* Except for information or data specifically incorporated by reference under Items 10 through 14, all other information in our 2017 Proxy Statement is not deemed to be a part of this Annual Report on Form 10-K or deemed to be filed with the Commission as part of this report.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) (1)The consolidated financial statements of Southwestern Energy Company and its subsidiaries and the report of independent registered public accounting firm are included in Item 8 of this Annual Report.

(2)The consolidated financial statement schedules have been omitted because they are not required under the related instructions, or are not applicable.

(3)The exhibits listed on the accompanying Exhibit Index are filed as part of, or incorporated by reference into, this Annual Report.

ITEM 16. SUMMARY

None.

Table of Contents

Index to Financial Statements

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused the report to be signed on its behalf by the undersigned, thereunto duly authorized.

	SOUTHWESTERN ENERGY COMPANY
Dated: February 23, 2017	By: /s/ R. CRAIG OWEN
	R. Craig Owen
	Senior Vice President
	and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed, as of February 23, 2017, on behalf of the Registrant below by the following officers and by a majority of the directors.

. CRAIG OWEN	
/s/ WILLIAM J. WAY William J. Way	Director, President and Chief Executive Officer (Principal executive officer)
/s/ R. CRAIG OWEN R. Craig Owen	Senior Vice President and Chief Financial Officer (Principal financial officer)
/s/ COLIN P. O’BEIRNE Colin P. O’Beirne	Vice President, Controller (Principal accounting officer)
/s/ JOHN D. GASS John D. Gass	Director
/s/ CATHERINE A. KEHR Catherine A. Kehr	Director
/s/ GREG D. KERLEY Greg D. Kerley	Director
/s/ KENNETH R. MOURTON Kenneth R. Mourton	Director
/s/ ELLIOTT PEW Elliott Pew	Director

/s/ TERRY W. RATHERT Terry W. Rathert	Director
/s/ ALAN H. STEVENS Alan H. Stevens	Director

118

Table of Contents

Index to Financial Statements

EXHIBIT INDEX

Exhibit Number	Description
2.1	Purchase Agreement dated as of October 14, 2014 between Southwestern Energy Production Company and Chesapeake Appalachia, L.L.C. (Incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on October 17, 2014)
3.1	Amended and Restated Certificate of Incorporation of Southwestern Energy Company. (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed May 24, 2010)
3.2	Amended and Restated Bylaws of Southwestern Energy Company, as amended on November 9, 2015. (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed November 13, 2015)
3.3	Certificate of Designations of 6.25% Series B Mandatory Convertible Preferred Stock (including form of stock certificate). (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on January 21, 2015)
3.4	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock, dated April 9, 2009. (Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on April 9, 2009)
4.1	Form of Common Stock Certificate. (Incorporated by reference to Exhibit 4.4 to the Registrant's Current Report on Form 8-K/A filed August 3, 2006)
4.2	Indenture, dated as of December 1, 1995 between Southwestern Energy Company and The First National Bank of Chicago, as trustee. (Incorporated by reference to Exhibit 4 to Amendment No. 1 to the Registrant's Registration Statement on Form S-3 (File No. 33-63895) filed on November 17, 1995)
4.3	First Supplemental Indenture between Southwestern Energy Company and J.P. Morgan Trust Company, N.A. (as successor to the First National Bank of Chicago) dated June 30, 2006. (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K/A filed August 3, 2006)
4.4	Second Supplemental Indenture by and among Southwestern Energy Company, SEECO, Inc., Southwestern Energy Production Company, Southwestern Energy Services Company and The Bank of New York Trust Company, N.A., as trustee (as successor to J.P. Morgan Trust Company, N.A.), dated as of May 2, 2008. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K/A filed on May 8, 2008)
4.5	Indenture dated June 1, 1998 by and among NOARK Pipeline Finance, L.L.C. and The Bank of New York. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed May 4, 2006)
4.6	First Supplemental Indenture dated May 2, 2006 by and among Southwestern Energy Company, NOARK Pipeline Finance, L.L.C., and UMB Bank, N.A., as trustee (as successor to the Bank of New York). (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed May 4, 2006)
4.7	Second Supplemental Indenture between Southwestern Energy Company and UMB Bank, N.A., as trustee, dated June 30, 2006. (Incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K/A filed August 3, 2006)
4.8	Third Supplemental Indenture by and among Southwestern Energy Company, SEECO, Inc., Southwestern Energy Production Company, Southwestern Energy Services Company and UMB Bank, N.A., as trustee,

	dated as of May 2, 2008. (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K/A filed on May 8, 2008)
4.9	Guaranty dated June 1, 1998 by Southwestern Energy Company in favor of The Bank of New York, as trustee, under the Indenture dated as of June 1, 1998 between NOARK Pipeline Finance L.L.C. and such trustee. (Incorporated by reference to Exhibit 4.6 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2005)
4.10	Indenture dated January 16, 2008 among Southwestern Energy Company, the Guarantors named therein and The Bank of New York Trust Company, N.A., as trustee. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed January 16, 2008)

Index to Financial Statements

4.11 Indenture by and among Southwestern Energy Company, SEECO, Inc., Southwestern Energy Production Company, Southwestern Energy Services Company and The Bank of New York Trust Company, N.A., as trustee, dated as of March 5, 2012. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed March 6, 2012)
4.12 Policy on Confidential Voting of Southwestern Energy Company. (Incorporated by reference to the Appendix of the Registrant's Definitive Proxy Statement (Commission File No. 1-08246) for the 2006 Annual Meeting of Stockholders)
4.13 Credit Agreement dated December 16, 2013 among Southwestern Energy Company, JPMorgan Chase Bank, NA, Bank of America, N.A., Wells Fargo N.A., The Royal Bank of Scotland PLC, Citibank, N.A. and the other lenders named therein, JPMorgan Chase Bank, NA, as administrative agent. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed December 17, 2013)
4.14 Commitment Letter dated October 14, 2014 between Southwestern Energy Company, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Bank of America, N.A. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 17, 2014)
4.15 Bridge Term Loan Credit Agreement, dated December 19, 2014, among Southwestern Energy Company, Bank of America, N.A., as Administrative Agent, Citibank, N.A., JPMorgan Chase Bank, N.A., Wells Fargo Bank, National Association and The Royal Bank of Scotland plc, as Co-Syndication Agents, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Sole Lead Arranger and Sole Bookrunner, and the lenders from time to time party thereto (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 23, 2014)
4.16 Term Loan Credit Agreement, dated December 19, 2014, among Southwestern Energy Company, Bank of America, N.A., as Administrative Agent, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Sole Lead Arranger and Sole Bookrunner, and the lenders from time to time party thereto (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on December 23, 2014)
4.17 Form of certificate for the 6.25% Series B Mandatory Convertible Preferred Stock. (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 21, 2015)
4.18 Deposit Agreement, dated as of January 21, 2015, between Southwestern Energy Company and Computershare Trust Company, N.A., as depositary, on behalf of all holders from time to time of the receipts issued thereunder (including form of Depositary Receipt). (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on January 21, 2015)
4.19 Form of Depositary Receipt for the Depositary Shares. (Incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed on January 21, 2015)
4.20 Indenture, dated as of January 23, 2015 between Southwestern Energy Company and U.S. Bank National Association, as trustee (Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 23, 2015)
4.21 First Supplemental Indenture, dated as of January 23, 2015 between Southwestern Energy Company and U.S. Bank National Association, as trustee (Incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on January 23, 2015)
4.22 Form of 3.300% Notes due 2018. (Incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed on January 23, 2015)
4.23 Form of 4.050% Notes due 2020. (Incorporated by reference to Exhibit 4.4 to the Registrant's Current Report on Form 8-K filed on January 23, 2015)
4.24 Form of 4.95% Notes due 2025. (Incorporated by reference to Exhibit 4.5 to the Registrant's Current Report on Form 8-K filed on January 23, 2015)
10.1

Form of Second Amended and Restated Indemnity Agreement between Southwestern Energy Company and each Executive Officer and Director of the Registrant. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A filed August 3, 2006)

Index to Financial Statements

10.2	Form of Executive Severance Agreement between Southwestern Energy Company and each of the Executive Officers of Southwestern Energy Company, effective February 17, 1999. (Incorporated by reference to Exhibit 10.12 of the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 1998)
10.3	Form of Amendment to Executive Severance Agreement between Southwestern Energy Company and each of the Executive Officers of Southwestern Energy Company prior to 2011. (Incorporated by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2008)
10.4	Form of Executive Severance Agreement between Southwestern Energy Company and Executive Officers Post 2011. (Incorporated by reference to Exhibit 10.4 to the Registrant's Annual Report on Form 10-K (Commission File No.1-08426) for the year ended December 31, 2012)
10.5	Southwestern Energy Company Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.2(b) to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 1998)
10.6	Amendment to Southwestern Energy Company Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.5 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2008)
10.7	Second Amendment to Southwestern Energy Company Incentive Compensation Plan (Incorporated by reference to Exhibit 10.6 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2009)
10.8	Southwestern Energy Company Supplemental Retirement Plan as amended. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 19, 2008)
10.9	Southwestern Energy Company Non-Qualified Retirement Plan as amended. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on February 19, 2008)
10.10	Amendment One to the Southwestern Energy Company Non-Qualified Retirement Plan (Incorporated by reference to Exhibit 10.9 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2009)
10.11	Southwestern Energy Company 2000 Stock Incentive Plan dated February 18, 2000. (Incorporated by reference to the Appendix of the Registrant's Definitive Proxy Statement (Commission File No. 1-08246) for the 2000 Annual Meeting of Stockholders)
10.12	Southwestern Energy Company 2002 Employee Stock Incentive Plan, effective October 23, 2002. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 13, 2005)
10.13	Southwestern Energy Company 2002 Performance Unit Plan, as amended, effective December 8, 2011. (Incorporated by reference to Exhibit 10.4 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2012)
10.14	Southwestern Energy Company 2004 Stock Incentive Plan. (Incorporated by reference to Appendix A to the Registrant's Proxy Statement dated March 29, 2004)
10.15	Southwestern Energy Company 2013 Incentive Plan. (Incorporated by reference to Annex A of the Registrant's Proxy Statement filed April 8, 2013)
10.16	First Amendment to Southwestern Energy Company 2013 Incentive Plan. (Incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on May 20, 2016)
10.17	Southwestern Energy Company 2013 Incentive Plan Form of Performance Unit Award Agreement. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2016)

10.18 Southwestern Energy Company 2013 Incentive Plan Guidelines for Annual Incentive Awards. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)

10.19 Southwestern Energy Company 2013 Incentive Plan Form of Incentive Stock Option Award Agreement. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)

121

10.20 Southwestern Energy Company 2013 Incentive Plan Form of Non-Qualified Stock Option Award Agreement. (Incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.21 Southwestern Energy Company 2013 Incentive Plan Form of Non-Qualified Stock Option Award Agreement for Directors. (Incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.22 Southwestern Energy Company 2013 Incentive Plan Form of Restricted Stock Award Agreement. (Incorporated by reference to Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.23 Southwestern Energy Company 2013 Incentive Plan Form of Restricted Stock Award Agreement for Directors. (Incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.24 Southwestern Energy Company 2013 Incentive Plan Form of Restricted Stock Unit Award Agreement. (Incorporated by reference to Exhibit 10.9 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.25 Southwestern Energy Company 2013 Incentive Plan Form of Restricted Stock Unit Award Agreement for Directors. (Incorporated by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013)
10.26 Form of Incentive Stock Option Agreement for awards prior to December 8, 2005. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 20, 2004)
10.27 Form of Non-Qualified Stock Option Agreement for non-employee directors for awards prior to December 8, 2005. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on December 20, 2004)
10.28 Form of Incentive Stock Option for awards granted on or after December 8, 2005. (Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on December 13, 2005)
10.29 Form of Restricted Stock Agreement for awards granted on or after December 8, 2005. (Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on December 13, 2005)
10.30 Form of Non-Qualified Stock Option Agreement for awards granted on or after December 8, 2005 and through December 8, 2011 (Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on December 13, 2005)
10.31 Form of Non-Qualified Stock Option Agreement for awards granted on or after December 8, 2011. (Incorporated by reference to Exhibit 10.4 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08426) for the year ended December 31, 2012)
10.32 Master Lease Agreement by and between Southwestern Energy Company and SunTrust Leasing Corporation dated December 29, 2006. (Incorporated by reference to Exhibit 10.22 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2006)
10.33 Guaranty by and between Southwestern Energy Company and Texas Gas Transmission, LLC, dated as of October 27, 2008. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q (Commission File No. 1-08246) for the period ended September 30, 2008)
10.34 Guaranty by and between Southwestern Energy Company and Fayetteville Express Pipeline, LLC dated September 30, 2008 (Incorporated by reference to Exhibit 10.22 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2008)
10.35 Retirement Letter Agreement dated February 24, 2012 between Southwestern Energy Company and Gene A. Hammons. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 27, 2012)

10.36 Retirement Agreement dated August 11, 2009 between Southwestern Energy Company and Harold M. Korell. (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 14, 2009)

Index to Financial Statements

10.37	Settlement Agreement, dated December 22, 2014, between Chesapeake Appalachia, L.L.C. and SWN Production Company, LLC (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on December 23, 2014)
10.38	Retirement Agreement dated January 11, 2016 between Southwestern Energy Company and Steven L. Mueller. (Incorporated by reference to Exhibit 10.38 to the Registrant's Annual Report on Form 10-K (Commission File No. 1-08246) for the year ended December 31, 2015)
10.39	Retirement Agreement dated May 19, 2016 between Southwestern Energy Company and Jeffrey B. Sherrick. (Incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016)
10.40	Amendment to Awards Agreement dated May 19, 2016 between Southwestern Energy Company and Jeffrey B. Sherrick. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016)
10.41	Amended and Restated Term Loan Credit Agreement, dated June 27, 2016 among Southwestern Energy Company, Bank of America, N.A., as Administrative Agent, and the lenders from time to time party thereto. (Incorporated by reference to Exhibit A to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on June 27, 2016)
10.42	Credit Agreement, dated June 27, 2016 among Southwestern Energy Company, JPMorgan Chase Bank, N.A., as Administrative Agent, and the lenders from time to time party thereto. (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on June 27, 2016)
10.43	Amendment and Restatement Agreement, dated as of June 27, 2016 among Southwestern Energy Company, Bank of America, N.A., as Administrative Agent, and the lenders party thereto, giving effect to the Amended and Restated Term Loan Credit Agreement. (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on June 27, 2016)
10.44	Amendment No. 1 to Credit Agreement, dated as of June 27, 2016 among Southwestern Energy Company, JPMorgan Chase Bank, N.A., as Administrative Agent, and the lenders party thereto. (Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on June 27, 2016)
21.1*	List of Subsidiaries
23.1*	Consent of PricewaterhouseCoopers LLP
23.2*	Consent of Netherland, Sewell & Associates, Inc.
31.1*	Certification of CEO filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of CFO filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of CEO furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of CFO furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
95.1*	Mine Safety Disclosure
99.1*	Reserve Audit Report of Netherland, Sewell & Associates, Inc., dated January 15, 2016
101.INS*	Interactive Data File Instance Document
101.SCH*	Interactive Data File Schema Document
101.CAL*	Interactive Data File Calculation Linkbase Document
101.LAB*	Interactive Data File Label Linkbase Document
101.PRE*	Interactive Data File Presentation Linkbase Document
101.DEF*	Interactive Data File Definition Linkbase Document

*Filed herewith