WHITING PETROLEUM CORP
Form 10-K
February 28, 2007

**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 December 31, 2006**

**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: 001-31899**
**Whiting Petroleum Corporation**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 20-0098515 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 1700 Broadway, Suite 2300 Denver, Colorado | 80290-2300 |
| (Address of principal executive offices) | (Zip code) |

Registrant s telephone number, including area code: (303) 837-1661

Securities registered pursuant to Section 12(b) of the Act:

| | |
|---|---|
| Common Stock, $.001 par value | New York Stock Exchange |
| Preferred Share Purchase Rights | New York Stock Exchange |
| (Title of Class) | (Name of each exchange on which registered) |

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. Yes þ No o

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

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

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. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Aggregate market value of the voting common stock held by non-affiliates of the registrant at June 30, 2006: $1,540,817,968.

Number of shares of the registrant s common stock outstanding at February 15, 2007: 36,947,681 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III.

Table of Contents

# TABLE OF CONTENTS

**Table of Contents**

## CERTAIN DEFINITIONS

Unless the context otherwise requires, the terms we, us, our or ours when used in this Annual Report on Form 10-K refer to Whiting Petroleum Corporation, together with its operating subsidiaries. When the context requires, we refer to these entities separately.

We have included below the definitions for certain crude oil and natural gas terms used in this Annual Report on Form 10-K:

*3-D seismic* Geophysical data that depict the subsurface strata in three dimensions. 3-D seismic typically provides a more detailed and accurate interpretation of the subsurface strata than 2-D, or two-dimensional, seismic.

*Bbl* One stock tank barrel, or 42 U.S. gallons liquid volume, used in this report in reference to oil and other liquid hydrocarbons.

*Bcf* One billion cubic feet of natural gas.

*BOE* One stock tank barrel equivalent of oil, calculated by converting natural gas volumes to equivalent oil barrels at a ratio of six Mcf to one Bbl of oil.

*BOE/d* One BOE per day.

*Bopd* Barrels of oil or other liquid hydrocarbons per day.

*completion* The installation of permanent equipment for the production of crude oil or natural gas, or in the case of a dry hole, the reporting of abandonment to the appropriate agency.

*MBOE* One thousand BOE.

*MBOE/d* One thousand BOE per day.

*Mcf* One thousand cubic feet of natural gas.

*Mcf/d* One Mcf per day.

*MMbbl* One million barrels of oil or other liquid hydrocarbons.

*MMBOE* One million BOE.

*MMbtu* One million British Thermal Units.

*MMcf* One million cubic feet of natural gas.

*NGLs* Natural gas liquids.

*PDNP* Proved developed nonproducing.

*PDP* Proved developed producing.

**Table of Contents**

*plugging and abandonment* Refers to the sealing off of fluids in the strata penetrated by a well so that the fluids from one stratum will not escape into another or to the surface. Regulations of many states require plugging of abandoned wells.

*PUD* Proved undeveloped.

*pre-tax PV10%* The present value of estimated future revenues to be generated from the production of proved reserves calculated in accordance with Securities and Exchange Commission ( SEC ) guidelines, net of estimated lease operating expense, production taxes and future development costs, using price and costs as of the date of estimation without future escalation, without giving effect to non-property related expenses such as general and administrative expenses, debt service and depreciation, depletion and amortization, or Federal income taxes and discounted using an annual discount rate of 10%. Pre-tax PV10% may be considered a non-GAAP financial measure as defined by the SEC. See footnote (1) to the Proved Reserves table in Item 1. Business for more information.

*reservoir* A porous and permeable underground formation containing a natural accumulation of producible crude oil and/or natural gas that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

*working interest* The interest in an crude oil and natural gas property (normally a leasehold interest) that gives the owner the right to drill, produce and conduct operations on the property and to share in production, subject to all royalties, overriding royalties and other burdens and to share in all costs of exploration, development and operations and all risks in connection therewith.

Table of Contents

## PART I

### Item 1. Business

### Overview

We are an independent oil and gas company engaged in acquisition, development, exploitation, production and exploration activities primarily in the Permian Basin, Rocky Mountains, Mid-Continent, Gulf Coast and Michigan regions of the United States. We were incorporated in 2003 in connection with our initial public offering.

Since our inception in 1980, we have built a strong asset base and achieved steady growth through property acquisitions, development and exploration activities. As of December 31, 2006, our estimated proved reserves totaled 248.1 MMBOE, representing a 6% decrease in our proved reserves since December 31, 2005. Our estimated December 2006 average daily production was 40.5 MBOE/d, which remained consistent with December 2005 average daily production and implied an average reserve life of approximately 16.8 years.

The following table summarizes our estimated proved reserves by core area, the corresponding pre-tax PV10% value, our standardized measure of discounted future net cash flows as of December 31, 2006, and our December 2006 average daily production:

| | Proved Reserves | | | | | December 2006 Average Daily |
|---|---|---|---|---|---|---|
| Core Area | Oil (MMbbl) | Natural Gas (Bcf) | Total (MMBOE) | % Oil | Pre-Tax PV10% Value[1] (In millions) | Production (MBOE/d) |
| Permian Basin | 103.1 | 78.3 | 116.1 | 89% | $ 1,345.3 | 12.6 |
| Rocky Mountains | 37.1 | 96.9 | 53.2 | 70% | $ 816.4 | 12.6 |
| Mid-Continent | 47.4 | 36.4 | 53.5 | 88% | $ 771.8 | 5.2 |
| Gulf Coast | 2.2 | 62.2 | 12.6 | 18% | $ 211.6 | 6.4 |
| Michigan | 5.2 | 45.1 | 12.7 | 41% | $ 207.1 | 3.7 |
| **Total** | **195.0** | **318.9** | **248.1** | **79%** | **$ 3,352.2** | **40.5** |
| Discounted Future Income Taxes | | | | | (960.0) | |
| Standardized Measure of Discounted Future Net Cash Flows | | | | | **$ 2,392.2** | |

(1) Pre-tax PV10% may be considered a non-GAAP financial measure as defined by the SEC and is derived from the

standardized measure of discounted future net cash flows, which is the most directly comparable GAAP financial measure. Pre-tax PV10% is computed on the same basis as the standardized measure of discounted future net cash flows but without deducting future income taxes. We believe pre-tax PV10% is a useful measure for investors for evaluating the relative monetary significance of our oil and natural gas properties. We further believe investors may utilize our pre-tax PV10% as a basis for comparison of the relative size and value of our reserves to other companies because many factors that are unique to each individual company impact the amount of future income taxes to be paid. Our management uses this measure when assessing the potential return on investment related to our oil and gas properties and acquisitions. However, pre-tax PV10% is not a substitute for the standardized measure of discounted future net cash flows. Our pre-tax PV10% and the standardized measure of discounted future net cash flows do not purport to present the fair value of our oil and natural gas reserves.

We expect to continue to build on our successful acquisition track record and seek property acquisitions that complement our existing core properties. Additionally, we believe that our significant drilling inventory, combined with our operating experience and cost structure, provides us with significant organic growth opportunities. During 2006, we incurred $559.1 million in acquisition, development and exploration activities, including $455.0 million for the drilling of 437 gross (322.1 net) wells. Of these new wells, 418 resulted in productive completions and 19 were unsuccessful, yielding a 96% success rate. We have budgeted $350.0 million for development and exploration drilling expenditures in 2007.

**Acquisitions and Divestitures**

The following is a summary of our acquisitions and divestitures during the last two years. See Management s Discussion and Analysis of Financial Condition and Results of Operations for more information on these acquisitions and divestitures.

*2006 Acquisitions.* On August 29, 2006, we acquired a 15% working interest in approximately 170,000 acres of unproved properties in the central Utah Hingeline play for $25.0 million. No producing properties or proved reserves were associated with this acquisition. As part of this transaction, the operator will pay 100% of our drilling and completion costs for the first three wells in the project.

On August 15, 2006, we acquired 65 producing properties, a gathering line, gas processing plant and 30,437 net acres of leasehold held by production in Michigan. The purchase price was $26.0 million for estimated proved reserves of 1.4 MMBOE as of the acquisition effective date of May 1, 2006, resulting in a cost of $18.55 per BOE of estimated proved reserves. Proved developed reserve quantities represented 99% of the total proved reserves acquired. The average net production from the properties was 0.6 MBOE/d as of the acquisition effective date. We operate 85% of the acquired properties.

On June 1, 2006, we acquired the Postle field oil gathering system and oil transportation line extending 13 miles from the eastern side of the Postle field to a connection point with an interstate oil pipeline in Hooker, Oklahoma. We purchased the oil gathering system and pipeline for $5.3 million.

We funded our 2006 acquisitions with cash on hand and borrowings under Whiting Oil and Gas Corporation s credit agreement.

*2006 Divestitures.* During 2006, we sold our interests in several non-core properties for an aggregate amount of $24.4 million in cash for total estimated proved reserves of 1.4 MMBOE as of the effective dates of the divestitures. The divested properties included interests in the Cessford field in Alberta, Canada; Permian Basin of West Texas and New Mexico; and the Ashley Valley field in Uintah County, Utah. The average net production from the divested property interests was 0.4 MBOE/d as of the effective dates of disposition, and we recognized a pre-tax gain on sale of $12.1 million related to these divestitures.

*2005 Acquisitions.* We completed four separate acquisitions of producing properties during 2005. The combined purchase price for these four acquisitions was $897.7 million for total estimated proved reserves as of the effective dates of the acquisitions of 133.7 MMBOE, resulting in a cost of $6.72 per BOE of estimated proved reserves.

**Business Strategy**

Our goal is to generate meaningful growth in both production and free cash flow by investing in oil and gas projects with attractive rates of return on capital employed. To date, we have achieved this goal largely through the acquisition of additional reserves in our core areas. Based on the extensive property base we have built, we now have several economically attractive opportunities to exploit and develop within our oil and gas properties and several opportunities to explore our acreage positions for production growth and additional proved reserves. Specifically, we have focused, and plan to continue to focus, on the following:

*Developing and Exploiting Existing Properties*. Our existing property base and our acquisitions over the past three years have provided us with significant low-risk opportunities for exploitation and development drilling. As of

December 31, 2006, we have identified a drilling inventory of approximately 900 gross wells that we believe will add substantial production over the next five years. Our drilling inventory consists largely of the development of our proved undeveloped reserves on which we have spent significant time evaluating the costs and expected results. Additionally, we have several opportunities to apply enhanced recovery techniques that we expect will increase proved reserves and extend the productive lives of our mature fields. Over the next five years, we anticipate significant increases in production from the North Ward Estes field and Postle field properties we acquired in 2005 through the use of secondary and tertiary recovery techniques, including water and $CO_2$ floods.

*Growing Through Accretive Acquisitions*. Since our initial public offering in November 2003, we have completed twelve acquisitions of producing properties totaling 207.7 MMBOE of estimated total proved reserves. Our experienced team of management, engineering and geoscience professionals has developed and refined an acquisition program designed to increase reserves and complement our existing properties, including identifying and evaluating acquisition opportunities, negotiating and closing purchases, and managing acquired properties. As a result of our disciplined approach, we have achieved significant growth in our core areas at an average cost of $7.02 per BOE of proved reserves through these twelve acquisitions, not including future costs to develop proved undeveloped reserves.

*Pursuing High-Return Organic Reserve Additions*. We plan to allocate approximately 75% of our $350.0 million capital budget for 2007 to the development of our existing proved reserves. The remaining 25% will be invested in higher risk drilling, including field extensions drilled outside the current limits of our development projects as well as new exploration, which we believe will increase our proved reserves and future cash flow. We expect to add reserves at costs competitive with our acquisitions. The development of large, unconventional resource plays such as our Piceance basin and Robinson Lake projects have become a central objective of ours. These projects allow us to leverage our technical team s experience to focus on conventional drilling projects such as our Red River gas play in which we can utilize our 3-D seismic data and other advanced exploration techniques to reduce risk and deliver a high return on investment. We own interests in 897,133 gross (484,495 net) undeveloped acres as well as additional rights to deeper horizons within many of our developed acreage positions.

*Disciplined Financial Approach*. Our goal is to remain financially strong, yet flexible, through the prudent management of our balance sheet and active management of commodity price volatility. We have historically funded our acquisitions and growth activity through a combination of equity and debt issuances, bank borrowings and internally generated cash flow, as appropriate, to maintain our strong financial position. To support cash flow generation on our existing properties and secure acquisition economics, we periodically enter into derivative contracts. Typically, we use costless collars to provide an attractive base commodity price level, while maintaining the ability to benefit from improvements in commodity prices.

**Competitive Strengths**

We believe that our key competitive strengths lie in our balanced asset portfolio, our experienced management and technical team and our commitment to effective application of new technologies.

*Balanced, Long-Lived Asset Base*. As of December 31, 2006, we had interests in 8,437 gross (3,659 net) productive wells across 976,379 gross (472,144 net) developed acres in our five core geographical areas. We believe this geographic mix of properties and organic drilling opportunities, combined with our continuing business strategy of acquiring and exploiting properties in these areas, presents us with multiple opportunities for success in executing our strategy because we are not dependent on any particular producing regions or geological formations. As a result of our acquisitions of the North Ward Estes field and Postle field properties in 2005 we have enhanced the production stability and reserve life of our developed reserves. Additionally, these properties contain identifiable growth opportunities to significantly increase production.

*Experienced Management Team*. Our management team averages over 30 years of experience in the oil and gas industry. Our personnel have extensive experience in each of our core geographical areas and in all of our operational disciplines. In addition, each of our acquisition professionals has at least 25 years of experience in the evaluation, acquisition and operational assimilation of oil and gas properties.

*Commitment to Technology*. In each of our core operating areas, we have accumulated detailed geologic and geophysical knowledge and have developed significant technical and operational expertise. In recent years, we have developed considerable expertise in conventional and 3-D seismic imaging and interpretation. Our technical team has access to approximately 1,580 square miles of 3-D seismic data, digital well logs and other subsurface information. This data is analyzed with state of the art geophysical and geological computer resources dedicated to the accurate and efficient characterization of the subsurface oil and gas reservoirs that comprise our asset base. Computer applications enable us to quickly generate reports and schematics on our wells. In addition, our information systems enable us to update our production databases through daily uploads from hand held computers in the field. This commitment to technology has increased the productivity and efficiency of our field operations and development activities.

Table of Contents

**Proved Reserves**

Our estimated proved reserves as of December 31, 2006 are summarized in the table below.

| | Oil (MMBbl) | Natural Gas (Bcf) | Total (MMBOE) | % of Total Proved | Future Capital Expenditures (In thousands) |
|---|---|---|---|---|---|
| **Permian Basin:** | | | | | |
| PDP | 32.0 | 39.5 | 38.6 | 33% | |
| PDNP | 20.7 | 9.9 | 22.2 | 19% | |
| PUD | 50.4 | 28.9 | 55.3 | 48% | |
| **Total Proved** | **103.1** | **78.3** | **116.1** | **100%** | **$ 713.7** |
| **Rocky Mountains:** | | | | | |
| PDP | 32.1 | 66.5 | 43.1 | 81% | |
| PDNP | 1.2 | 5.1 | 2.1 | 4% | |
| PUD | 3.8 | 25.3 | 8.0 | 15% | |
| **Total Proved** | **37.1** | **96.9** | **53.2** | **100%** | **$ 84.2** |
| **Mid-Continent:** | | | | | |
| PDP | 20.5 | 23.2 | 24.3 | 45% | |
| PDNP | 11.9 | 5.5 | 12.9 | 24% | |
| PUD | 15.0 | 7.7 | 16.3 | 31% | |
| **Total Proved** | **47.4** | **36.4** | **53.5** | **100%** | **$ 310.0** |
| **Gulf Coast:** | | | | | |
| PDP | 1.4 | 34.1 | 7.1 | 56% | |
| PDNP | 0.2 | 7.0 | 1.4 | 11% | |
| PUD | 0.6 | 21.1 | 4.1 | 33% | |
| **Total Proved** | **2.2** | **62.2** | **12.6** | **100%** | **$ 43.1** |
| **Michigan:** | | | | | |
| PDP | 1.6 | 34.0 | 7.3 | 57% | |
| PDNP | 0.8 | 1.7 | 1.1 | 9% | |
| PUD | 2.8 | 9.4 | 4.3 | 34% | |
| **Total Proved** | **5.2** | **45.1** | **12.7** | **100%** | **$ 25.8** |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Total Company:** | | | | | | |
| PDP | 87.6 | 197.3 | 120.4 | 49% | | |
| PDNP | 34.8 | 29.2 | 39.7 | 16% | | |
| PUD | 72.6 | 92.4 | 88.0 | 35% | | |
| **Total Proved** | **195.0** | **318.9** | **248.1** | **100%** | **$** | **1,176.8** |

**Marketing and Major Customers**

We principally sell our oil and gas production to end users, marketers and other purchasers that have access to nearby pipeline facilities. In areas where there is no practical access to pipelines, oil is trucked to storage facilities. Our marketing of oil and gas can be affected by factors beyond our control, the effects of which cannot be accurately predicted. During 2006, sales to Plains Marketing LP and Valero Energy Corporation accounted for 16% and 12%, respectively, of our total oil and natural gas sales. During 2005, sales to Teppco Crude Oil LLC accounted for 10% of our total oil and natural gas sales. In 2004, no single customer was responsible for generating 10% or more of our total oil and natural gas sales.

Table of Contents

### Title to Properties

Our properties are subject to customary royalty interests, liens under indebtedness, liens incident to operating agreements, liens for current taxes and other burdens, including other mineral encumbrances and restrictions. Whiting Oil and Gas Corporation s credit agreement is also secured by a first lien on substantially all of our assets. We do not believe that any of these burdens materially interfere with the use of our properties in the operation of our business.

We believe that we have satisfactory title to or rights in all of our producing properties. As is customary in the oil and gas industry, minimal investigation of title is made at the time of acquisition of undeveloped properties. In most cases, we investigate title and obtain title opinions from counsel only when we acquire producing properties or before commencement of drilling operations.

### Competition

We operate in a highly competitive environment for acquiring properties, marketing oil and gas and securing trained personnel. Many of our competitors possess and employ financial, technical and personnel resources substantially greater than ours, which can be particularly important in the areas in which we operate. Those companies may be able to pay more for productive oil and gas properties and exploratory prospects and to evaluate, bid for and purchase a greater number of properties and prospects than our financial or personnel resources permit. Our ability to acquire additional prospects and to find and develop reserves in the future will depend on our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment. Also, there is substantial competition for capital available for investment in the oil and gas industry.

### Regulation

*Regulation of Transportation and Sale of Natural Gas*

The Federal Energy Regulatory Commission ( FERC ) regulates the transportation and sale for resale of natural gas in interstate commerce pursuant to the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 and regulations issued under those Acts. In 1989, however, Congress enacted the Natural Gas Wellhead Decontrol Act, which removed all remaining price and nonprice controls affecting wellhead sales of natural gas, effective January 1, 1993. While sales by producers of natural gas and all sales of crude oil, condensate and natural gas liquids can currently be made at uncontrolled market prices, in the future Congress could reenact price controls or enact other legislation with detrimental impact on many aspects of our business.

Our sales of natural gas are affected by the availability, terms and cost of transportation. The price and terms of access to pipeline transportation are subject to extensive federal and state regulation. From 1985 to the present, several major regulatory changes have been implemented by Congress and the FERC that affect the economics of natural gas production, transportation and sales. In addition, the FERC is continually proposing and implementing new rules and regulations affecting those segments of the natural gas industry that remain subject to the FERC s jurisdiction, most notably interstate natural gas transmission companies. These initiatives may also affect the intrastate transportation of natural gas under certain circumstances. The stated purpose of many of these regulatory changes is to promote competition among the various sectors of the natural gas industry by making natural gas transportation more accessible to natural gas buyers and sellers on an open and non-discriminatory basis.

FERC implements The Outer Continental Shelf Lands Act as to transportation and pipeline issues, which requires that all pipelines operating on or across the outer continental shelf provide open access, non-discriminatory transportation service. One of the FERC s principal goals in carrying out this Act s mandate is to increase transparency in the market to provide producers and shippers on the outer continental shelf with greater assurance of open access services on pipelines located on the outer continental shelf and non-discriminatory rates and conditions of service on such pipelines.

We cannot accurately predict whether the FERC s actions will achieve the goal of increasing competition in markets in which our natural gas is sold. In addition, many aspects of these regulatory developments have not become final, but are still pending judicial and final FERC decisions. Regulations implemented by the FERC in recent years could result in an increase in the cost of transportation service on certain petroleum product pipelines. The natural gas industry historically has been very heavily regulated. Therefore, we cannot provide any assurance that the less stringent regulatory approach recently established by the FERC will continue. However, we do not believe that any action taken will affect us in a way that materially differs from the way it affects other natural gas producers.

Intrastate natural gas transportation is subject to regulation by state regulatory agencies. The basis for intrastate regulation of natural gas transportation and the degree of regulatory oversight and scrutiny given to intrastate natural gas pipeline rates and services varies from state to state. Insofar as such regulation within a particular state will generally affect all intrastate natural gas shippers within the state on a comparable basis, we believe that the regulation of similarly situated intrastate natural gas transportation in any states in which we operate and ship natural gas on an intrastate basis will not affect our operations in any way that is of material difference from those of our competitors.

*Regulation of Transportation of Oil*

Sales of crude oil, condensate and natural gas liquids are not currently regulated and are made at negotiated prices. Nevertheless, Congress could reenact price controls in the future.

Our sales of crude oil are affected by the availability, terms and cost of transportation. The transportation of oil in common carrier pipelines is also subject to rate regulation. The FERC regulates interstate oil pipeline transportation rates under the Interstate Commerce Act. In general, interstate oil pipeline rates must be cost-based, although settlement rates agreed to by all shippers are permitted and market-based rates may be permitted in certain circumstances. Effective January 1, 1995, the FERC implemented regulations establishing an indexing system (based on inflation) for crude oil transportation rates that allowed for an increase or decrease in the cost of transporting oil to the purchaser. A review of these regulations by the FERC in 2000 was successfully challenged on appeal by an association of oil pipelines. As a result, the FERC in February 2003 increased the index slightly, effective July 2001. Intrastate oil pipeline transportation rates are subject to regulation by state regulatory commissions. The basis for intrastate oil pipeline regulation, and the degree of regulatory oversight and scrutiny given to intrastate oil pipeline rates, varies from state to state. Insofar as effective interstate and intrastate rates are equally applicable to all comparable shippers, we believe that the regulation of oil transportation rates will not affect our operations in any way that is of material difference from those of our competitors.

Further, interstate and intrastate common carrier oil pipelines must provide service on a non-discriminatory basis. Under this open access standard, common carriers must offer service to all shippers requesting service on the same terms and under the same rates. When oil pipelines operate at full capacity, access is governed by prorationing provisions set forth in the pipelines published tariffs. Accordingly, we believe that access to oil pipeline transportation services generally will be available to us to the same extent as to our competitors.

*Regulation of Production*

The production of oil and gas is subject to regulation under a wide range of local, state and federal statutes, rules, orders and regulations. Federal, state and local statutes and regulations require permits for drilling operations, drilling bonds and reports concerning operations. All of the states in which we own and operate properties have regulations governing conservation matters, including provisions for the unitization or pooling of oil and gas properties, the establishment of maximum allowable rates of production from oil and gas wells, the regulation of well spacing, and plugging and abandonment of wells. The effect of these regulations is to limit the amount of oil and gas that we can produce from our wells and to limit the number of wells or the locations at which we can drill, although we can apply for exceptions to such regulations or to have reductions in well spacing. Moreover, each state generally imposes a production or severance tax with respect to the production and sale of oil, gas and natural gas liquids within its jurisdiction.

Some of our offshore operations are conducted on federal leases that are administered by Minerals Management Service, or MMS, and are required to comply with the regulations and orders issued by MMS under the Outer Continental Shelf Lands Act. Among other things, we are required to obtain prior MMS approval for any exploration plans we pursue and our development and production plans for these leases. MMS regulations also establish construction requirements for production facilities located on our federal offshore leases and govern the plugging and abandonment of wells and the removal of production facilities from these leases. Under limited circumstances, MMS could require us to suspend or terminate our operations on a federal lease.

MMS also establishes the basis for royalty payments due under federal oil and gas leases through regulations issued under applicable statutory authority. State regulatory authorities establish similar standards for royalty payments due under state oil and gas leases. The basis for royalty payments established by MMS and the state regulatory authorities is generally applicable to all federal and state oil and gas lessees. Accordingly, we believe that the impact of royalty regulation on our operations should generally be the same as the impact on our competitors.

The failure to comply with these rules and regulations can result in substantial penalties. Our competitors in the oil and gas industry are subject to the same regulatory requirements and restrictions that affect our operations.

*Environmental Regulations*

*General*. Our oil and gas exploration, development and production operations are subject to stringent federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to environmental protection. Numerous governmental agencies, such as the U.S. Environmental Protection Agency (the EPA ) issue regulations to implement and enforce such laws, which often require difficult and costly compliance measures that carry substantial administrative, civil and criminal penalties or that may result in injunctive relief for failure to comply. These laws and regulations may require the acquisition of a permit before drilling or facility construction commences, restrict the types, quantities and concentrations of various materials that can be released into the environment in connection with drilling and production activities, limit or prohibit project siting, construction, or drilling activities on certain lands laying within wilderness, wetlands, ecologically sensitive and other protected areas, require remedial action to prevent pollution from former operations, such as plugging abandoned wells or closing pits, and impose substantial liabilities for pollution resulting from our operations. The EPA and analogous state agencies may delay or refuse the issuance of required permits or otherwise include onerous or limiting permit conditions that may have a significant adverse impact on our ability to conduct operations. The regulatory burden on the oil and gas industry increases the cost of doing business and consequently affects its profitability.

Changes in environmental laws and regulations occur frequently, and any changes that result in more stringent and costly material handling, storage, transport, disposal or cleanup requirements could materially and adversely affect our operations and financial position, as well as those of the oil and gas industry in general. While we believe that we are in substantial compliance with current applicable environmental laws and regulations and have not experienced any material adverse effect from compliance with these environmental requirements, there is no assurance that this trend will continue in the future.

The environmental laws and regulations which have the most significant impact on the oil and gas exploration and production industry are as follows:

*Superfund*. The Comprehensive Environmental Response, Compensation and Liability Act of 1980, also known as CERCLA or Superfund, and comparable state laws impose liability, without regard to fault or the legality of the original conduct, on certain classes of persons that contributed to the release of a hazardous substance into the environment. These persons include the owner or operator of a disposal site or sites where a release occurred and entities that disposed or arranged for the disposal of the hazardous substances found at the site. Under CERCLA, such persons may be subject to strict, joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies, and it is not uncommon for neighboring landowners and other third parties to file claims for personal

**Table of Contents**

injury and property damage allegedly caused by the hazardous substances released into the environment. In the course of our ordinary operations, we may generate material that may fall within CERCLA s definition of a hazardous substance. Consequently, we may be jointly and severally liable under CERCLA or comparable state statutes for all or part of the costs required to clean up sites at which these materials have been disposed or released.

We currently own or lease, and in the past have owned or leased, properties that for many years have been used for the exploration and production of oil and gas. Although we and our predecessors have used operating and disposal practices that were standard in the industry at the time, hydrocarbons or other materials may have been disposed or released on, under, or from the properties owned or leased by us or on, under, or from other locations where these hydrocarbons and materials have been taken for disposal. In addition, many of these owned and leased properties have been operated by third parties whose management and disposal of hydrocarbons and materials were not under our control. Similarly, the disposal facilities where discarded materials are sent are also often operated by third parties whose waste treatment and disposal practices may not be adequate. While we only use what we consider to be reputable disposal facilities, we might not know of a potential problem if the disposal occurred before we acquired the property or business, if the problem itself is not discovered until years later. Our properties, adjacent affected properties, the disposal sites, and the material itself may be subject to CERCLA and analogous state laws. Under these laws, we could be required:

- to remove or remediate previously disposed materials, including materials disposed or released by prior owners or operators or other third parties;
- to clean up contaminated property, including contaminated groundwater; or
- to perform remedial operations to prevent future contamination, including the plugging and abandonment of wells drilled and left inactive by prior owners and operators.

At this time, we do not believe that we are a potentially responsible party with respect to any Superfund site and we have not been notified of any claim, liability or damages under CERCLA.

*Oil Pollution Act*. The Oil Pollution Act of 1990, also known as OPA, and regulations issued under OPA impose strict, joint and several liability on responsible parties for damages resulting from oil spills into or upon navigable waters, adjoining shorelines or in the exclusive economic zone of the United States. A responsible party includes the owner or operator of an onshore facility and the lessee or permittee of the area in which an offshore facility is located. The OPA establishes a liability limit for onshore facilities of $350.0 million, while the liability limit for offshore facilities is the payment of all removal costs plus up to $75.0 million in other damages, but these limits may not apply if a spill is caused by a party s gross negligence or willful misconduct, the spill resulted from violation of a federal safety, construction or operating regulation, or if a party fails to report a spill or to cooperate fully in a cleanup. The OPA also requires the lessee or permittee of the offshore area in which a covered offshore facility is located to establish and maintain evidence of financial responsibility in the amount of $35.0 million ($10.0 million if the offshore facility is located landward of the seaward boundary of a state) to cover liabilities related to an oil spill for which such person is statutorily responsible. The amount of financial responsibility required under OPA may be increased up to $150.0 million, depending on the risk represented by the quantity or quality of oil that is handled by the facility. Any failure to comply with OPA s requirements or inadequate cooperation during a spill response action may subject a responsible party to administrative, civil or criminal enforcement actions. We believe we are in compliance with all applicable OPA financial responsibility obligations. Moreover, we are not aware of any action or event that would subject us to liability under OPA, and we believe that compliance with OPA s financial responsibility and other operating requirements will not have a material adverse effect on us.

*Resource Conservation Recovery Act*. The Resource Conservation and Recovery Act, also known as RCRA, is the principal federal statute governing the treatment, storage and disposal of hazardous wastes. RCRA imposes stringent operating requirements, and liability for failure to meet such requirements, on a person who is either a generator or transporter of hazardous waste or an owner or operator of a hazardous waste treatment, storage or disposal facility. RCRA and many state counterparts specifically exclude from the definition of hazardous waste drilling fluids, produced waters, and other wastes associated with the exploration, development, or production of crude oil, natural gas or geothermal energy and thus we are not required to comply with a substantial portion of RCRA s requirements because our operations generate minimal quantities of hazardous wastes. However, these wastes may be regulated by EPA or state agencies as solid waste. In addition, ordinary industrial wastes, such as paint wastes, waste solvents, laboratory wastes, and waste compressor oils, may be regulated as hazardous waste. Although we do not believe the current costs of managing our materials constituting wastes as they are presently classified to be significant, any repeal or modification of the oil and gas exploration and production exemption by administrative, legislative or judicial process, or modification of similar exemptions in analogous state statutes, would increase the volume of hazardous waste we are required to manage and dispose of and would cause us, as well as our competitors, to incur increased operating expenses.

*Clean Water Act*. The Federal Water Pollution Control Act of 1972, or the Clean Water Act (the CWA ), imposes restrictions and controls on the discharge of produced waters and other pollutants into navigable waters. Permits must be obtained to discharge pollutants into state and federal waters and to conduct construction activities in waters and wetlands. The CWA and certain state regulations prohibit the discharge of produced water, sand, drilling fluids, drill cuttings, sediment and certain other substances related to the oil and gas industry into certain coastal and offshore waters without an individual or general National Pollutant Discharge Elimination System discharge permit.

Historically, the EPA had regulations under the authority of the CWA that required certain oil and gas exploration and production projects to obtain permits for construction projects with storm water discharges. However, the Energy Policy Act of 2005 nullified most of the EPA regulations that required permitting of oil and gas construction projects. There are still some States that regulate the discharge of storm water from oil and gas construction projects. Costs may be associated with the treatment of wastewater and/or developing and implementing storm water pollution prevention plans. The Clean Water Act and comparable state statutes provide for civil, criminal and administrative penalties for unauthorized discharges of oil and other pollutants and impose liability on parties responsible for those discharges for the costs of cleaning up any environmental damage caused by the release and for natural resource damages resulting from the release. In Section 40 CFR 112 of the regulations, the EPA promulgated the Spill Prevention, Control, and Countermeasure, or SPCC, regulations, which require certain oil containing facilities to prepare plans and meet construction and operating standards. The SPCC regulations were revised in 2002 and will require the amendment of SPCC plans and the modification of spill control devices at many facilities. The due date for having plans completed and control devices in place was extended on December 12, 2005 with the new compliance date being October 31, 2007. On December 26, 2006 the EPA proposed an additional extension of the compliance dates until July 1, 2009 for both completion and implementation of the Plan. This proposed rule is expected to be finalized in the near future. The extension will allow time for the EPA to complete additional rule amendments and guidance documents. We believe that our operations comply in all material respects with the requirements of the Clean Water Act and state statutes enacted to control water pollution and that any amendment and subsequent implementation of our SPCC plans will be performed in a timely manner and not have a significant impact on our operations.

*Clean Air Act*. The Clean Air restricts the emission of air pollutants from many sources, including oil and gas operations. New facilities may be required to obtain permits before work can begin, and existing facilities may be required to obtain additional permits and incur capital costs in order to remain in compliance. More stringent regulations governing emissions of toxic air pollutants are being developed by the EPA, and may increase the costs of compliance for some facilities. We believe that we are in substantial compliance with all applicable air emissions regulations and that we hold or have applied for all permits necessary to our operations.

*Consideration of Environmental Issues in Connection with Governmental Approvals*. Our operations frequently require licenses, permits and/or other governmental approvals. Several federal statutes, including the Outer Continental Shelf Lands Act, the National Environmental Policy Act, and the Coastal Zone Management Act require federal agencies to evaluate environmental issues in connection with granting such approvals and/or taking other major agency actions. The Outer Continental Shelf Lands Act, for instance, requires the U.S. Department of Interior to evaluate whether certain proposed activities would cause serious harm or damage to the marine, coastal or human environment. Similarly, the National Environmental Policy Act requires the Department of Interior and other federal agencies to evaluate major agency actions having the potential to significantly impact the environment. In the course of such evaluations, an agency would have to prepare an environmental assessment and, potentially, an environmental impact statement. The Coastal Zone Management Act, on the other hand, aids states in developing a coastal management program to protect the coastal environment from growing demands associated with various uses, including offshore oil and gas development. In obtaining various approvals from the Department of Interior, we must certify that we will conduct our activities in a manner consistent with these regulations.

**Employees**

As of December 31, 2006, we had 359 full-time employees, including 27 senior level geoscientists and 35 petroleum engineers. Our employees are not represented by any labor unions. We consider our relations with our employees to be satisfactory, and have never experienced a work stoppage or strike.

**Available Information**

We maintain a website at the address www.w