

PIONEER NATURAL RESOURCES CO

Form 10-Q

November 03, 2017

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

or

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

For the transition period from _____ to _____

Commission File Number: 1-13245

PIONEER NATURAL RESOURCES COMPANY

(Exact name of Registrant as specified in its charter)

Delaware

75-2702753

(I.R.S.

(State or other jurisdiction of incorporation or organization)

Employer Identification No.)

5205 N. O'Connor Blvd., Suite 200, Irving, Texas

75039

(Address of principal executive offices)

(Zip Code)

(972) 444-9001

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

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Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Number of shares of Common Stock outstanding as of October 30, 2017 170,165,265

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PIONEER NATURAL RESOURCES COMPANY

Cautionary Statement Concerning Forward-Looking Statements

The information in this Quarterly Report on Form 10-Q (this "Report") contains forward-looking statements that involve risks and uncertainties. When used in this document, the words "believes," "plans," "expects," "anticipates," "forecasts," "intends," "continue," "may," "will," "could," "should," "future," "potential," "estimate" or the negative of such terms and similar expressions as they relate to Pioneer Natural Resources Company ("Pioneer" or the "Company") are intended to identify forward-looking statements, which are generally not historical in nature. The forward-looking statements are based on the Company's current expectations, assumptions, estimates and projections about the Company and the industry in which the Company operates. Although the Company believes that the expectations and assumptions reflected in the forward-looking statements are reasonable as and when made, they involve risks and uncertainties that are difficult to predict and, in many cases, beyond the Company's control. These risks and uncertainties include, among other things, volatility of commodity prices, product supply and demand, competition, the ability to obtain environmental and other permits and the timing thereof, other government regulation or action, the ability to obtain approvals from third parties and negotiate agreements with third parties on mutually acceptable terms, litigation, the costs and results of drilling and operations, availability of equipment, services, resources and personnel required to perform the Company's drilling and operating activities, access to and availability of transportation, processing, fractionation and refining facilities, Pioneer's ability to replace reserves, implement its business plans or complete its development activities as scheduled, access to and cost of capital, the financial strength of counterparties to Pioneer's credit facility, investment instruments and derivative contracts and purchasers of Pioneer's oil, NGL and gas production, uncertainties about estimates of reserves, identification of drilling locations and the ability to add proved reserves in the future, the assumptions underlying production forecasts, quality of technical data, environmental and weather risks, including the possible impacts of climate change, the risks associated with the ownership and operation of the Company's industrial sand mining and oilfield services businesses, and acts of war or terrorism. These and other risks are described in the Company's Annual Report on Form 10-K, this and other Quarterly Reports on Form 10-Q and other filings with the United States Securities and Exchange Commission. In addition, the Company may be subject to currently unforeseen risks that may have a materially adverse effect on it. Accordingly, no assurances can be given that the actual events and results will not be materially different than the anticipated results described in the forward-looking statements. See "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," "Part 1, Item 3. Quantitative and Qualitative Disclosures About Market Risk" and "Part II, Item 1A. Risk Factors" in this Report and "Part I, Item 1. Business — Competition, Markets and Regulations," "Part I, Item 1A. Risk Factors," "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk" in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 for a description of various factors that could materially affect the ability of Pioneer to achieve the anticipated results described in the forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. The Company undertakes no duty to publicly update these statements except as required by law.

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PIONEER NATURAL RESOURCES COMPANY

Definitions of Certain Terms and Conventions Used Herein

Within this Report, the following terms and conventions have specific meanings:

• "Bbl" means a standard barrel containing 42 United States gallons.

• "BOE" means a barrel of oil equivalent and is a standard convention used to express oil and gas volumes on a comparable oil equivalent basis. Gas equivalents are determined under the relative energy content method by using the ratio of six thousand cubic feet of gas to one Bbl of oil or natural gas liquid.

• "BOEPD" means BOE per day.

• "Btu" means British thermal unit, which is a measure of the amount of energy required to raise the temperature of one pound of water one degree Fahrenheit.

• "Conway" means the daily average natural gas liquids components as priced in Oil Price Information Service ("OPIS") in the table "U.S. and Canada LP – Gas Weekly Averages" at Conway, Kansas.

• "DD&A" means depletion, depreciation and amortization.

• "GAAP" means accounting principles that are generally accepted in the United States of America.

• "LIBOR" means London Interbank Offered Rate, which is a market rate of interest.

• "Mcf" means one thousand cubic feet and is a measure of gas volume.

• "MMBtu" means one million Btus.

• "Mont Belvieu" means the daily average natural gas liquids components as priced in OPIS in the table "U.S. and Canada LP – Gas Weekly Averages" at Mont Belvieu, Texas.

• "NGL" means natural gas liquid.

• "NYMEX" means the New York Mercantile Exchange.

• "Pioneer" or the "Company" means Pioneer Natural Resources Company and its subsidiaries.

• "Proved reserves" mean the quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible – from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations – prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

(i) The area of the reservoir considered as proved includes: (A) The area identified by drilling and limited by fluid contacts, if any, and (B) Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.

(ii) In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons ("LKH") as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.

(iii) Where direct observation from well penetrations has defined a highest known oil ("HKO") elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.

(iv) Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when: (A) Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and (B) The project has been approved for development by all necessary parties and entities, including governmental entities.

(v) Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month

within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

•"U.S." means United States.

With respect to information on the working interest in wells, drilling locations and acreage, "net" wells, drilling locations and acres are determined by multiplying "gross" wells, drilling locations and acres by the Company's working interest in such wells, drilling locations or acres. Unless otherwise specified, wells, drilling locations and acreage statistics quoted herein represent gross wells, drilling locations or acres.

•Unless otherwise indicated, all currency amounts are expressed in U.S. dollars.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PIONEER NATURAL RESOURCES COMPANY

CONSOLIDATED BALANCE SHEETS

(in millions)

	September 30, 2017	December 31, 2016
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 636	\$ 1,118
Short-term investments	1,357	1,441
Accounts receivable:		
Trade, net	649	517
Due from affiliates	—	1
Income taxes receivable	1	3
Inventories	187	181
Derivatives	43	14
Other	28	23
Total current assets	2,901	3,298
Property, plant and equipment, at cost:		
Oil and gas properties, using the successful efforts method of accounting:		
Proved properties	19,630	18,566
Unproved properties	558	486
Accumulated depletion, depreciation and amortization	(8,841) (8,211)
Total property, plant and equipment	11,347	10,841
Long-term investments	151	420
Goodwill	270	272
Other property and equipment, net	1,683	1,529
Derivatives	7	—
Other assets, net	106	99
	\$ 16,465	\$ 16,459

The financial information included as of September 30, 2017 has been prepared by management without audit by independent registered public accountants.

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

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PIONEER NATURAL RESOURCES COMPANY
CONSOLIDATED BALANCE SHEETS (continued)
(in millions, except share data)

	September 30, 2017	December 31, 2016
	(Unaudited)	
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable:		
Trade	\$ 1,015	\$ 741
Due to affiliates	90	134
Interest payable	38	68
Current portion of long-term debt	449	485
Derivatives	17	77
Other	106	61
Total current liabilities	1,715	1,566
Long-term debt	2,282	2,728
Derivatives	12	7
Deferred income taxes	1,475	1,397
Other liabilities	384	350
Equity:		
Common stock, \$.01 par value; 500,000,000 shares authorized; 173,794,108 and 173,221,845 shares issued as of September 30, 2017 and December 31, 2016, respectively	2	2
Additional paid-in capital	8,957	8,892
Treasury stock at cost: 3,628,843 and 3,497,742 shares as of September 30, 2017 and December 31, 2016, respectively	(250) (218)
Retained earnings	1,882	1,728
Total equity attributable to common stockholders	10,591	10,404
Noncontrolling interests in consolidated subsidiaries	6	7
Total equity	10,597	10,411
Commitments and contingencies	\$ 16,465	\$ 16,459

The financial information included as of September 30, 2017 has been prepared by management without audit by independent registered public accountants.

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

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CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues and other income:				
Oil and gas	\$855	\$643	\$2,433	\$1,665
Sales of purchased oil and gas	721	444	1,722	1,062
Interest and other	17	7	44	21
Derivative gains (losses), net	(133)	91	153	(95)
Gain on disposition of assets, net	—	1	205	4
	1,460	1,186	4,557	2,657
Costs and expenses:				
Oil and gas production	152	141	440	438
Production and ad valorem taxes	53	32	152	97
Depletion, depreciation and amortization	355	386	1,033	1,123
Purchased oil and gas	735	458	1,769	1,113
Impairment of oil and gas properties	—	—	285	32
Exploration and abandonments	18	19	78	96
General and administrative	81	82	245	235
Accretion of discount on asset retirement obligations	5	5	14	14
Interest	37	50	118	161
Other	58	69	176	223
	1,494	1,242	4,310	3,532
Income (loss) before income taxes	(34)	(56)	247	(875)
Income tax benefit (provision)	11	78	(79)	362
Net income (loss) attributable to common stockholders	\$(23)	\$22	\$168	\$(513)
Basic and diluted net income (loss) per share attributable to common stockholders	\$(0.13)	\$0.13	\$0.98	\$(3.10)
Basic and diluted weighted average shares outstanding	170	170	170	165
Dividends declared per share	\$0.04	\$0.04	\$0.08	\$0.08

The financial information included herein has been prepared by management without audit by independent registered public accountants. The accompanying notes are an integral part of these consolidated financial statements.

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PIONEER NATURAL RESOURCES COMPANY
CONSOLIDATED STATEMENT OF EQUITY
(in millions, except share data and dividends per share)
(Unaudited)

	Equity Attributable To Common Stockholders						Total Equity
	Shares Outstanding	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Noncontrolling Interests	
	(in thousands)						
Balance as of December 31, 2016	169,724	\$ 2	\$ 8,892	\$ (218)	\$ 1,728	\$ 7	\$ 10,411
Dividends declared (\$0.08 per share)	—	—	—	—	(14)	—	(14)
Exercise of long-term incentive stock options and employee stock purchases	60	—	3	4	—	—	7
Purchases of treasury stock	(191)	—	—	(36)	—	—	(36)
Compensation costs:							
Vested compensation awards	572	—	—	—	—	—	—
Compensation costs included in net income	—	—	61	—	—	—	61
Purchase of noncontrolling interest	—	—	1	—	—	(1)	—
Net income	—	—	—	—	168	—	168
Balance as of September 30, 2017	170,165	\$ 2	\$ 8,957	\$ (250)	\$ 1,882	\$ 6	\$ 10,597

The financial information included herein has been prepared by management
without audit by independent registered public accountants.

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Nine Months Ended September 30, 2017 2016	
Cash flows from operating activities:		
Net income (loss)	\$168	\$(513)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion, depreciation and amortization	1,033	1,123
Impairment of oil and gas properties	285	32
Impairment of inventory and other property and equipment	1	6
Exploration expenses, including dry holes	19	41
Deferred income taxes	79	(340)
Gain on disposition of assets, net	(205)	(4)
Accretion of discount on asset retirement obligations	14	14
Interest expense	4	11
Derivative related activity	(91)	628
Amortization of stock-based compensation	61	66
Other	48	50
Change in operating assets and liabilities:		
Accounts receivable	(131)	(64)
Income taxes receivable	2	17
Inventories	(9)	(7)
Derivatives	—	(24)
Investments	5	—
Other current assets	(4)	(3)
Accounts payable	82	(8)
Interest payable	(30)	(26)
Income taxes payable	—	(2)
Other current liabilities	(33)	(38)
Net cash provided by operating activities	1,298	959
Cash flows from investing activities:		
Proceeds from disposition of assets, net of cash sold	347	503
Payments for acquisitions	—	(429)
Proceeds from investments	1,194	255
Purchase of investments	(845)	(2,300)
Additions to oil and gas properties	(1,703)	(1,387)
Additions to other assets and other property and equipment, net	(252)	(156)
Net cash used in investing activities	(1,259)	(3,514)
Cash flows from financing activities:		
Principal payments on long-term debt	(485)	(455)
Proceeds from issuance of common stock, net of issuance costs	—	2,534
Exercise of long-term incentive plan stock options and employee stock purchases	7	7
Purchases of treasury stock	(36)	(24)
Dividends paid	(7)	(7)
Net cash provided by (used in) financing activities	(521)	2,055

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Net decrease in cash and cash equivalents	(482)	(500)
Cash and cash equivalents, beginning of period	1,118	1,391
Cash and cash equivalents, end of period	\$636	\$891

The financial information included herein has been prepared by management without audit by independent registered public accountants.

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

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PIONEER NATURAL RESOURCES COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2017
(Unaudited)

NOTE A. Organization and Nature of Operations

Pioneer Natural Resources Company ("Pioneer" or the "Company") is a Delaware corporation whose common stock is listed and traded on the New York Stock Exchange. The Company is a large independent oil and gas exploration and production company that explores for, develops and produces oil, natural gas liquids ("NGLs") and gas within the United States, with operations primarily in the Permian Basin in West Texas, the Eagle Ford Shale play in South Texas, the Raton field in southeast Colorado and the West Panhandle field in the Texas Panhandle.

NOTE B. Basis of Presentation

Presentation. In the opinion of management, the consolidated financial statements of the Company as of September 30, 2017 and for the three and nine months ended September 30, 2017 and 2016 include all adjustments and accruals, consisting only of normal, recurring accrual adjustments, which are necessary for a fair presentation of the results for the interim periods. These interim results are not necessarily indicative of results for a full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed in or omitted from this report pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC"). These consolidated financial statements should be read together with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Certain reclassifications have been made to the 2016 financial statement and footnote amounts in order to conform to the 2017 presentation.

Issuance of common stock. During the first and second quarters of 2016, the Company issued 13.8 million and 6.0 million shares of common stock, respectively, and received cash proceeds of \$1.6 billion and \$937 million, respectively, net of associated underwriter discounts and offering expenses.

New accounting pronouncements. In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, "Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as certain classification changes in the statement of cash flows. The Company adopted this standard on January 1, 2017. See Note M for discussion on the impact of the adoption to the Company's income tax provision.

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 requires the recognition of lease assets and lease liabilities by lessees for those leases currently classified as operating leases and makes certain changes to the accounting for lease expenses. This update is effective for fiscal years beginning after December 15, 2018 and for interim periods beginning the following year. This update should be applied using a modified retrospective approach, and early adoption is permitted. The Company anticipates that the adoption of ASU 2016-02 for its leasing arrangements will likely (i) increase the Company's recorded assets and liabilities, (ii) increase depreciation, depletion and amortization expense, (iii) increase interest expense and (iv) decrease lease/rental expense. The Company is currently evaluating each of its lease arrangements and has not determined the aggregate amount of change expected for each category.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") Topic 605, "Revenue Recognition," and most industry-specific guidance. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for one year to fiscal years beginning after December 15, 2017. Early adoption is permitted for fiscal years beginning after December 15, 2016.

In addition, in May 2016, the FASB issued ASU 2016-11, which rescinds guidance from the SEC on accounting for gas balancing arrangements and will eliminate the use of the entitlements method.

The Company has been working through a project plan for the implementation of Topic 606 and has identified the following revenue streams: oil, NGL and gas sales and sales of purchased oil and gas. The Company's analysis of contracts with customers

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PIONEER NATURAL RESOURCES COMPANY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2017
 (Unaudited)

in accordance with the requirements of Topic 606 is largely complete. The Company has not identified any changes to the timing of revenue recognition based upon the requirements of Topic 606 that would have a material impact on the Company's consolidated financial statements. The Company plans to utilize the modified approach to adopt the new standards upon their effective dates with a cumulative effect adjustment, if any, recorded to retained earnings as of January 1, 2018. The Company's evaluation of the new disclosure requirements is ongoing.

NOTE C. Acquisitions and Divestitures

Permian Basin Acquisition. In August 2016, the Company acquired approximately 28,000 net acres in the Permian Basin, with net production of approximately 1,400 barrels of oil equivalent per day ("BOEPD"), from an unaffiliated third party for \$428 million, including normal closing adjustments. The acquisition was accounted for using the acquisition method under ASC 805, "Business Combinations," which requires acquired assets and liabilities to be recorded at fair value as of the acquisition date.

The following table represents the allocation of the acquisition price to the assets acquired and the liabilities assumed based on their fair value at the acquisition date (in millions):

Assets acquired:

Proved properties	\$79
Unproved properties	347
Other property and equipment	5

Liabilities assumed:

Asset retirement obligations	(2)
Other liabilities	(1)
Net assets acquired	\$428

The fair value measurements of the net assets acquired are based on inputs that are not observable in the market and, therefore, represent Level 3 inputs in the fair value hierarchy (see Note D for a description of the input levels in the fair value hierarchy). The Company calculated the fair values of the acquired proved properties and asset retirement obligations using a discounted future cash flow model that utilizes management's estimates of (i) proved reserves, (ii) forecasted production rates, (iii) future operating, development and plugging and abandonment costs, (iv) future commodity prices and (v) a discount rate of 10 percent for proved properties and seven percent for asset retirement obligations. The Company calculated the fair values of the acquired unproved properties based on the average price per acre in comparable market transactions. The operating results attributable to the acquired assets and liabilities assumed are included in the Company's accompanying consolidated statements of operations since the date of acquisition.

Divestitures. For the three and nine months ended September 30, 2017, the Company recorded net gains on the disposition of assets of nil and \$205 million, respectively. For the three and nine months ended September 30, 2016, the Company recorded net gains on the disposition of assets of \$1 million and \$4 million, respectively.

In April 2017, the Company completed the sale of approximately 20,500 acres in the Martin County region of the Permian Basin, with net production of approximately 1,500 BOEPD, to an unaffiliated third party for cash proceeds of \$266 million, before normal closing adjustments. The sale resulted in a gain of \$194 million. In conjunction with the divestiture, the Company reduced the carrying value of goodwill by \$2 million, reflecting the portion of the Company's goodwill related to the assets sold.

During the nine months ended September 30, 2017, the Company also completed the sales of other nonstrategic proved and unproved properties in the Permian Basin for cash proceeds of \$78 million, which resulted in a gain of \$12 million.

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PIONEER NATURAL RESOURCES COMPANY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2017
 (Unaudited)

NOTE D. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are based upon inputs that market participants use in pricing an asset or liability, which are characterized according to a hierarchy that prioritizes those inputs based on the degree to which they are observable. Observable inputs represent market data obtained from independent sources, whereas unobservable inputs reflect a company's own market assumptions, which are used if observable inputs are not reasonably available without undue cost and effort. The three input levels of the fair value hierarchy are as follows:

Level 1 – quoted prices for identical assets or liabilities in active markets.

Level 2 – quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates) and inputs derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – unobservable inputs for the asset or liability.

Assets and liabilities measured at fair value on a recurring basis. The fair value input hierarchy level to which an asset or liability measurement in its entirety falls is determined based on the lowest level input that is significant to the measurement in its entirety.

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016 for each of the fair value hierarchy levels:

	Fair Value Measurement as of September 30, 2017 Using Quoted Prices in Active Markets for Identical Assets (Level 1)				Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value as of September 30, 2017
(in millions)							
Assets:							
Commodity derivatives	\$—	\$ 45	\$	—	\$	—	\$ 45
Interest rate derivatives	—	5	—	—	—	—	5
Deferred compensation plan assets	90	—	—	—	—	—	90
Total assets	90	50	—	—	—	—	140
Liabilities:							
Commodity derivatives	—	29	—	—	—	—	29
Total liabilities	—	29	—	—	—	—	29
Total recurring fair value measurements	\$90	\$ 21	\$	—	\$	—	\$ 111

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PIONEER NATURAL RESOURCES COMPANY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2017
 (Unaudited)

	Fair Value Measurement as of December 31, 2016 Using Quoted Prices in Active Markets for Identifiable Assets (Level 1)			Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Fair value as of December 31, 2016
Assets:								
Commodity derivatives	\$—	\$ 8		\$				—\$ 8
Interest rate derivatives	—	6		—				6
Deferred compensation plan assets	83	—		—				83
Total assets	83	14		—				97
Liabilities:								
Commodity derivatives	—	84		—				84
Total liabilities	—	84		—				84
Total recurring fair value measurements	\$83	\$ (70)		\$				—\$ 13

Commodity derivatives. The Company's commodity derivatives represent oil, NGL and gas swap contracts, collar contracts and collar contracts with short puts. The asset and liability measurements for these derivative contracts represent Level 2 inputs in the hierarchy. The Company utilizes discounted cash flow and option-pricing models for valuing its commodity derivatives.

The asset and liability values attributable to the Company's commodity derivatives were determined based on inputs that include (i) the contracted notional volumes, (ii) independent active market price quotes, (iii) the applicable estimated credit-adjusted risk-free rate yield curve and (iv) the implied rate of volatility inherent in the collar contracts and collar contracts with short puts, which is based on active and independent market-quoted volatility factors.

Deferred compensation plan assets. The Company's deferred compensation plan assets represent investments in equity and mutual fund securities that are actively traded on major exchanges. These investments are measured based on observable prices on major exchanges. As of September 30, 2017, the significant inputs to these asset values represented Level 1 independent active exchange market price inputs.

Interest rate derivatives. The Company's interest rate derivative assets represent interest rate swap contracts. The Company utilizes discounted cash flow models for valuing its interest rate derivatives. The derivative values attributable to the Company's interest rate derivative contracts are based on (i) the contracted notional amounts, (ii) forward active market-quoted London Interbank Offered Rates ("LIBOR") and (iii) the applicable credit-adjusted risk-free rate yield curve. The Company's interest rate derivative fair value measurements represent Level 2 inputs in the hierarchy.

Assets and liabilities measured at fair value on a nonrecurring basis. Certain assets and liabilities are measured at fair value on a nonrecurring basis. These assets and liabilities are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances. These assets and liabilities can include inventory, proved and unproved oil and gas properties and other long-lived assets or liabilities that are acquired or written down to fair value when they are impaired or held for sale. See Note C for information on the fair value of assets and liabilities acquired in the Permian Basin acquisition.

Proved oil and gas properties. As a result of the Company's proved property impairment assessments, the Company recognized noncash impairment charges to reduce the carrying values of the Raton and West Panhandle fields during the three months ended March 31, 2017 and 2016, respectively, to their estimated fair values.

The Company calculated the fair values of the Raton and West Panhandle fields using a discounted future cash flow model. Significant Level 3 assumptions associated with the calculations included management's longer-term commodity price outlooks ("Management's Price Outlooks") and management's outlooks for (i) production, (ii) production costs, (iii) capital expenditures and (iv) estimated proved reserves and risk-adjusted probable reserves. Management's Price Outlooks are developed based on third-party longer-term commodity futures price outlooks as of each measurement date. The expected future net cash flows were discounted using an annual rate of 10 percent to determine fair value.

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The following table presents the fair value and fair value adjustments (in millions) for the Company's 2017 and 2016 proved property impairments, as well as the average oil price per barrel ("Bbl") and gas price per British thermal unit ("MMBtu") utilized in the respective Management's Price Outlooks:

	Impairment Date	Fair Value	Fair Value Adjustment	Management's Price Outlooks	
				Oil	Gas
Raton	March 2017	\$ 186	\$ (285)	\$53.65	\$3.00
West Panhandle	March 2016	\$ 33	\$ (32)	\$49.77	\$3.24

It is reasonably possible that the estimate of undiscounted future net cash flows attributable to these or other properties may change in the future resulting in the need to impair their carrying values. The primary factors that may affect estimates of future cash flows are (i) future adjustments, both positive and negative, to proved and risk-adjusted probable and possible oil and gas reserves, (ii) results of future drilling activities, (iii) Management's Price Outlooks and (iv) increases or decreases in production and capital costs associated with these reserves.

Unproved oil and gas properties. During March 2016, the Company recorded an impairment charge of \$32 million to write-off the carrying value of its unproved royalty acreage in Alaska (reported in exploration and abandonments in the accompanying consolidated statements of operations) as a result of the operator curtailing operations in the area and Management's Price Outlooks.

Financial instruments not carried at fair value. Carrying values and fair values of financial instruments that are not carried at fair value in the accompanying consolidated balance sheets as of September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Commercial paper, corporate bonds and time deposits	\$1,508	\$1,506	\$1,906	\$1,901
Current portion of long-term debt	\$449	\$462	\$485	\$490
Long-term debt	\$2,282	\$2,495	\$2,728	\$2,956

Commercial paper, corporate bonds and time deposits. Periodically, the Company invests in commercial paper and corporate bonds with investment grade rated entities. The Company also periodically enters into time deposits with financial institutions. The investments are carried at amortized cost and classified as held-to-maturity as the Company has the intent and ability to hold them until they mature. The carrying values of held-to-maturity investments are adjusted for amortization of premiums and accretion of discounts over the remaining life of the investment. Income related to these investments is recorded in interest and other income in the Company's consolidated statements of operations. The Company's investments in corporate bonds represent Level 1 inputs in the hierarchy, while other investments represent Level 2 inputs in the hierarchy. Commercial paper and time deposits are included in cash and cash equivalents if they have maturity dates that are less than 90 days at the date of purchase; otherwise, investments are reflected in short-term investments or long-term investments in the accompanying consolidated balance sheets based on their maturity dates. The following table provides the components of the Company's cash and cash equivalents and investments as of September 30, 2017 and December 31, 2016:

Consolidated Balance Sheet Location	September 30, 2017					Total
	Cash	Commercial Paper	Corporate Bonds	Time Deposits		

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	(in millions)				
Cash and cash equivalents	\$539	\$ —	\$ —	\$ 97	\$636
Short-term investments	—	124	741	492	1,357
Long-term investments	—	—	151	—	151
	\$539	\$ 124	\$ 892	\$ 589	\$2,144

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Consolidated Balance Sheet Location	December 31, 2016				
	Cash	Commercial Paper	Corporate Bonds	Time Deposits	Total
	(in millions)				
Cash and cash equivalents	\$873	\$ 45	\$ —	\$ 200	\$1,118
Short-term investments	—	368	691	382	1,441
Long-term investments	—	—	420	—	420
	\$873	\$ 413	\$ 1,111	\$ 582	\$2,979

Debt obligations. The Company's debt obligations are composed of its credit facility and senior notes. The fair value of the Company's debt obligations is determined utilizing inputs that are Level 2 measurements in the fair value hierarchy. The fair value of the Company's credit facility is calculated using a discounted cash flow model based on (i) forecasted contractual interest and fee payments, (ii) forward active market-quoted United States Treasury Bill rates and (iii) the applicable credit-adjustments. The Company's senior notes represent debt securities that are not actively traded on major exchanges. The fair values of the Company's senior notes are based on their periodic values as quoted on the major exchanges.

The Company has other financial instruments consisting primarily of receivables, payables and other current assets and liabilities that approximate fair value due to the nature of the instrument and their relatively short maturities.

Non-financial assets and liabilities initially measured at fair value include assets acquired and liabilities assumed in a business combination, goodwill and asset retirement obligations.

NOTE E. Derivative Financial Instruments

The Company utilizes commodity swap contracts, collar contracts and collar contracts with short puts to (i) reduce the effect of price volatility on the commodities the Company produces and sells or consumes, (ii) support the Company's annual capital budgeting and expenditure plans and (iii) reduce commodity price risk associated with certain capital projects. The Company also, from time to time, utilizes interest rate contracts to reduce the effect of interest rate volatility on the Company's indebtedness.

Periodically, the Company may pay a premium to enter into commodity contracts. Premiums paid, if any, have been nominal in relation to the value of the underlying asset in the contract. The Company recognizes the nominal premium payments as an increase to the value of derivative assets when paid. All derivatives are adjusted to fair value as of each balance sheet date.

Oil production derivative activities. All material physical sales contracts governing the Company's oil production are tied directly to, or are highly correlated with, New York Mercantile Exchange ("NYMEX") West Texas Intermediate ("WTI") oil prices. The Company uses derivative contracts to manage oil price volatility and basis swap contracts to reduce basis risk between NYMEX prices and the actual index prices at which the oil is sold.

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The following table sets forth the volumes per day associated with the Company's outstanding oil derivative contracts as of September 30, 2017 and the weighted average oil prices for those contracts:

	2017	Year
	Fourth	Ending
	Quarter	December
		31, 2018
Collar contracts (a):		
Volume (Bbl)	6,000	—
Price per Bbl:		
Ceiling	\$70.40	\$ —
Floor	\$50.00	\$ —
Collar contracts with short puts (b):		
Volume (Bbl)	155,000	150,781
Price per Bbl:		
Ceiling	\$62.12	\$ 57.70
Floor	\$49.82	\$ 47.39
Short put	\$41.02	\$ 37.35
Basis swap contracts:		
Midland-Cushing index swap volume (Bbl)	6,630	—
Price differential (\$/Bbl) (c)	\$(1.09)	\$ —

(a) Subsequent to September 30, 2017, the Company entered into additional collar contracts for 3,000 Bbls per day of 2018 production with a ceiling price of \$58.05 per Bbl and a floor price of \$45.00 per Bbl.

Subsequent to September 30, 2017, the Company entered into additional collar contracts with short puts for 2,000 (b) Bbls per day of 2018 production with a ceiling price of \$59.25 per Bbl, a floor price of \$45.00 per Bbl and a short put price of \$35.00 per Bbl.

(c) Represents the basis differential between Midland, Texas oil prices and WTI oil prices at Cushing, Oklahoma.

NGL production derivative activities. All material physical sales contracts governing the Company's NGL production are tied directly or indirectly to either Mont Belvieu, Texas or Conway, Kansas NGL component product prices. The Company uses derivative contracts to manage NGL component price volatility.

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The following table sets forth the volumes per day associated with the Company's outstanding NGL derivative contracts as of September 30, 2017 and the weighted average NGL prices for those contracts:

	2017	Year Ending December 31,	
	Fourth Quarter	2018	2019
Ethane collar contracts (a):			
Volume (Bbl)	3,000	—	—
Price per Bbl:			
Ceiling	\$ 11.83	\$—	\$—
Floor	\$ 8.68	\$—	\$—
Ethane basis swap contracts (b):			
Volume (MMBtu)	6,920	6,920	6,920
Price differential (\$/MMBtu)	\$ 1.60	\$ 1.60	\$ 1.60

(a) Represent collar contracts that reduce the price volatility of ethane forecasted for sale by the Company at Mont Belvieu, Texas-posted prices.

(b) Represent basis swap contracts that reduce the price volatility of ethane forecasted for sale by the Company at Mont Belvieu, Texas-posted prices. The basis swap contracts fix the basis differential on a NYMEX Henry Hub ("HH") MMBtu equivalent basis. The Company will receive the HH price plus the price differential on 6,920 MMBtu per day, which is equivalent to 2,500 Bbls per day of ethane.

Subsequent to September 30, 2017, the Company entered into propane swap contracts for 2,500 Bbls per day of November and December 2017 production with a fixed price of \$37.80 per Bbl.

Gas production derivative activities. All material physical sales contracts governing the Company's gas production are tied directly or indirectly to HH gas prices or regional index prices where the gas is sold. The Company uses derivative contracts to manage gas price volatility and basis swap contracts to reduce basis risk between HH prices and actual index prices at which the gas is sold.

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The following table sets forth the volumes per day associated with the Company's outstanding gas derivative contracts as of September 30, 2017 and the weighted average gas prices for those contracts:

	2017	Year Ending December 31,	
	Fourth Quarter	2018	2019
Swap contracts:			
Volume (MMBtu) (a)	—	30,000—	
Price per MMBtu	\$—	\$3.08	\$—
Collar contracts with short puts:			
Volume (MMBtu)	300,000	62,329—	
Price per MMBtu:			
Ceiling	\$3.60	\$3.56	\$—
Floor	\$2.96	\$2.91	\$—
Short put	\$2.47	\$2.37	\$—
Basis swap contracts:			
Mid-Continent index swap volume (MMBtu) (b)	45,000	—	—
Price differential (\$/MMBtu)	\$(0.32)	\$—	\$—
Permian Basin index swap volume (MMBtu) (c)	26,522	51,671	70,000
Price differential (\$/MMBtu)	\$0.30	\$0.30	\$0.30

(a) Subsequent to September 30, 2017, the Company entered into additional swap contracts for 70,000 MMBtu per day of April through December 2018 production with a price of \$3.00 per MMBtu.

(b) Represent swap contracts that fix the basis differentials between the index price at which the Company sells its Mid-Continent gas and the HH index price used in collar contracts with short puts.

Represent swap contracts that fix the basis differentials between Permian Basin index prices and southern California index prices for Permian Basin gas forecasted for sale in southern California. Subsequent to September (c)30, 2017, the Company entered into additional basis swap contracts for (i) 20,000 MMBtu per day of November 2017 through March 2018 production with a price of \$0.49 per MMBtu and (ii) 10,000 MMBtu per day of 2019 production with a price of \$0.32 per MMBtu.

Marketing derivatives. Periodically, the Company enters into buy and sell marketing arrangements to fulfill firm pipeline transportation commitments. Associated with these marketing arrangements, the Company may enter into index swaps that mitigate price risk. As of September 30, 2017, the Company was party to (i) oil index swap contracts for 10,000 Bbls per day of November and December 2017 transportation commitments with a price differential of \$4.18 per Bbl between NYMEX WTI and Louisiana Light Sweet oil ("LLS") and (ii) oil index swap contracts for 10,000 Bbls per day of January through August 2018 transportation commitments with a price differential of \$3.18 per Bbl between NYMEX WTI and LLS.

Interest rate derivative activities. As of September 30, 2017, the Company was party to interest rate derivative contracts whereby the Company will receive the three-month LIBOR rate for the 10-year period from December 2017 through December 2027 in exchange for paying a fixed interest rate of 1.81 percent on a notional amount of \$100 million on December 15, 2017. Subsequent to September 30, 2017, the Company liquidated its interest rate derivative contracts for cash proceeds of \$5 million.

Tabular disclosure of derivative financial instruments. All of the Company's derivatives are accounted for as non-hedge derivatives as of September 30, 2017 and December 31, 2016, and therefore all changes in the fair values of its derivative contracts are recognized as gains or losses in the earnings of the periods in which they occur. The

Company classifies the fair value amounts of derivative assets and liabilities as net current or noncurrent derivative assets or net current or noncurrent derivative liabilities, whichever the case may be, by commodity and counterparty. The Company enters into derivatives under master netting arrangements, which, in an event of default, allows the Company to offset payables to and receivables from the defaulting counterparty.

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The aggregate fair value of the Company's derivative instruments reported in the accompanying consolidated balance sheets by type and counterparty, including the classification between current and noncurrent assets and liabilities, consists of the following:

Fair Value of Derivative Instruments as of September 30, 2017

Type	Consolidated Balance Sheet Location	Gross Amounts Fair Offset in the Value Consolidated Balance Sheet	Net Fair Value Presented in the Consolidated Balance Sheet
(in millions)			
Derivatives not designated as hedging instruments			
Asset Derivatives:			
Commodity price derivatives	Derivatives - current	\$50 \$ (12)	\$ 38
Interest rate derivatives	Derivatives - current	\$5 \$ —	5
Commodity price derivatives	Derivatives - noncurrent	\$10 \$ (3)	7
			\$ 50
Liability Derivatives:			
Commodity price derivatives	Derivatives - current	\$29 \$ (12)	\$ 17
Commodity price derivatives	Derivatives - noncurrent	\$15 \$ (3)	12
			\$ 29

Fair Value of Derivative Instruments as of December 31, 2016

Type	Consolidated Balance Sheet Location	Gross Amounts Fair Offset in the Value Consolidated Balance Sheet	Net Fair Value Presented in the Consolidated Balance Sheet
(in millions)			
Derivatives not designated as hedging instruments			
Asset Derivatives:			
Commodity price derivatives	Derivatives - current	\$33 \$ (25)	\$ 8
Interest rate derivatives	Derivatives - current	\$6 \$ —	6
			\$ 14
Liability Derivatives:			
Commodity price derivatives	Derivatives - current	\$102 \$ (25)	\$ 77
Commodity price derivatives	Derivatives - noncurrent	\$7 \$ —	7
			\$ 84

The Company uses credit and other financial criteria to evaluate the credit standing of, and to select, counterparties to its derivative instruments. Although the Company does not obtain collateral or otherwise secure the fair value of its derivative instruments, associated credit risk is mitigated by the Company's credit risk policies and procedures. The following table details the location of gains and losses recognized on the Company's derivative contracts in the accompanying consolidated statements of operations:

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Derivatives Not Designated as Location of Gain / (Loss) Recognized in Earnings		Three Months Ended September 30,		Nine Months Ended September 30,	
		2017	2016	2017	2016
Hedging Instruments	on Derivatives	(in millions)			
Commodity price derivatives	Derivative gains (losses), net	\$(133)	\$ 91	\$154	\$(87)
Interest rate derivatives	Derivative gains (losses), net	—	—	(1)	(8)
Total		\$(133)	\$ 91	\$153	\$(95)

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NOTE F. Exploratory Costs

The Company capitalizes exploratory well and project costs until a determination is made that the well or project has either found proved reserves, is impaired or is sold. The Company's capitalized exploratory well and project costs are presented in proved properties in the accompanying consolidated balance sheets. If the exploratory well or project is determined to be impaired, the impaired costs are charged to exploration and abandonments expense.

The following table reflects the Company's capitalized exploratory well and project activity during the three and nine months ended September 30, 2017:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
	(in millions)	
Beginning capitalized exploratory well costs	\$443	\$ 323
Additions to exploratory well costs pending the determination of proved reserves	474	1,369
Reclassification due to determination of proved reserves	(482)	(1,247)
Exploratory well costs charged to exploration and abandonment expense	(1)	(11)
Ending capitalized exploratory well costs	\$434	\$ 434

The following table provides an aging as of September 30, 2017 and December 31, 2016 of capitalized exploratory costs and the number of projects for which exploratory well costs have been capitalized for a period greater than one year, based on the date drilling was completed:

	September 30, 2017	December 31, 2016
	(in millions, except well counts)	
Capitalized exploratory well costs that have been suspended:		
One year or less	\$422	\$ 318
More than one year	12	5
	\$434	\$ 323
Number of wells or projects with exploratory well costs that have been suspended for a period greater than one year	7	3

The seven wells that were suspended for a period greater than one year as of September 30, 2017 are in the Eagle Ford Shale area. The Company expects to complete all seven of these wells in 2018.

NOTE G. Long-term Debt

Credit facility. The Company's long-term debt consists of senior notes, a revolving corporate credit facility (the "Credit Facility") and the effects of issuance costs and discounts. The Credit Facility is maintained with a syndicate of financial institutions and has aggregate loan commitments of \$1.5 billion that expire in August 2020. As of September 30, 2017, the Company had no outstanding borrowings under the Credit Facility and was in compliance with its debt covenants.

Senior notes. The Company's 6.65% senior notes (the "6.65% Senior Notes") and 5.875% senior notes (the "5.875% Senior Notes") matured and were repaid in March 2017 and July 2016, respectively. The Company funded both the \$485 million repayment of the 6.65% Senior Notes and the \$455 million repayment of the 5.875% Senior Notes with

cash on hand. The Company's 6.875% senior notes (the "6.875% Senior Notes"), with an outstanding debt principal balance of \$450 million, will mature in May 2018. The 6.875% Senior Notes are classified as current in the accompanying consolidated balance sheets as of September 30, 2017.

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NOTE H. Incentive Plans

Stock-based compensation. For the three and nine months ended September 30, 2017, the Company recorded \$21 million and \$78 million, respectively, of stock-based compensation expense for all plans, as compared to \$31 million and \$84 million for the same respective periods in 2016. As of September 30, 2017, there was \$113 million of unrecognized stock-based compensation expense related to unvested share-based compensation plans, including \$24 million attributable to stock-based awards that are expected to be settled on their vesting date in cash, rather than in equity shares ("Liability Awards"). The unrecognized compensation expense will be recognized on a straight-line basis over the remaining vesting periods of the awards, which is a period of less than three years on a weighted average basis. As of September 30, 2017 and December 31, 2016, accounts payable – due to affiliates included \$13 million and \$22 million, respectively, of liabilities attributable to Liability Awards.

The following table summarizes the activity that occurred during the nine months ended September 30, 2017 for restricted stock awards and performance units issued by Pioneer:

	Restricted Stock Equity Awards	Restricted Stock Liability Awards	Performance Units
Outstanding as of December 31, 2016	1,077,227	290,552	178,556
Awards granted	332,635	118,003	59,044
Awards forfeited	(31,426)	(15,956)	—
Awards vested	(454,898)	(134,381)	—
Outstanding as of September 30, 2017	923,538	258,218	237,600

As of September 30, 2017 and December 31, 2016, the Company also had 159,378 stock options outstanding and exercisable. There were no stock options exercised during the nine months ended September 30, 2017.

NOTE I. Asset Retirement Obligations

The Company's asset retirement obligations primarily relate to the future plugging and abandonment of wells and related facilities. The following table summarizes the Company's asset retirement obligation activity during the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
	2017	2016	2017	2016
	(in millions)			
Beginning asset retirement obligations	\$294	\$281	\$297	\$285
Liabilities assumed in acquisitions	—	3	—	3
New wells placed on production	—	—	2	—
Changes in estimates	—	—	7	—
Dispositions	—	—	(7)	—
Liabilities settled	(7)	(8)	(21)	(21)
Accretion of discount	5	5	14	14
Ending asset retirement obligations	\$292	\$281	\$292	\$281

The Company records the current and noncurrent portions of asset retirement obligations in other current liabilities and other liabilities, respectively, in the accompanying consolidated balance sheets. As of September 30, 2017 and

December 31, 2016, the current portion of the Company's asset retirement obligations was \$42 million and \$39 million, respectively.

NOTE J. Commitments and Contingencies

In addition to the legal action described below, the Company is a party to other proceedings and claims incidental to its business. While many of these matters involve inherent uncertainty, the Company believes that the amount of the liability, if any, ultimately incurred with respect to such proceedings and claims will not have a material adverse effect on the Company's financial

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position as a whole or on its liquidity, capital resources or future annual results of operations. The Company records reserves for contingencies when information available indicates that a loss is probable and the amount of the loss can be reasonably estimated.

U.S. Environmental Protection Agency ("EPA") potential enforcement action. The Company has been advised by the EPA that the agency is considering an enforcement action against the Company and may seek monetary sanctions for alleged failures to prevent emissions occurring at the Company's Fain gas plant in the West Panhandle region of Texas on five separate occasions. The Company has asserted defenses to the EPA's allegations and is in discussions with the EPA regarding these matters. Although the Company cannot predict the outcome of these discussions with any certainty, the Company believes such monetary sanctions will not exceed \$45,000 for any single event, but could exceed \$100,000 in the aggregate.

Obligations following divestitures. In connection with its divestiture transactions, the Company may retain certain liabilities and provide the purchaser certain indemnifications, subject to defined limitations, which may apply to identified pre-closing matters, including matters of litigation, environmental contingencies, royalty obligations and income taxes. The Company does not believe these obligations are probable of having a material impact on its liquidity, financial position or future results of operations.

Lease agreements. In June 2017, the Company entered into a 20-year operating lease for the Company's new corporate headquarters that is currently being constructed in Irving, Texas. Annual base rent is expected to be \$33 million and lease payments are expected to commence once the building is complete, which is anticipated to occur during the second half of 2019. The Company has a variable equity interest in the entity that is constructing the building. The Company is not the primary beneficiary of the variable interest entity and only has a profit sharing interest after certain economic returns are achieved. The Company has no exposure to the variable interest entity's losses or future liabilities, if any. The Company is the deemed owner of the building (for accounting purposes) during the construction period and is following the build-to-suit accounting guidance. Accordingly, as of September 30, 2017, the Company has capitalized \$36 million of construction costs within other property and equipment and has recognized a corresponding build-to-suit lease liability. The recording of these assets and liabilities are considered noncash investing and financing items, respectively, for purposes of the consolidated statements of cash flows.

NOTE K. Interest and Other Income

The following table provides the components of the Company's interest and other income for the three and nine months ended September 30, 2017 and 2016:

	Three		Nine	
	Months		Months	
	Ended		Ended	
	September		September	
	30,		30,	
	2017		2016	
	2017		2016	
	(in millions)			
Interest income	\$9	\$ 5	\$25	\$ 14
Severance and sales tax refunds	5	—	13	—
Deferred compensation plan income	1	—	3	2
Other income	2	2	3	5
Total interest and other income	\$17	\$ 7	\$44	\$ 21

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NOTE L. Other Expense

The following table provides the components of the Company's other expense for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2016	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2016
	(in millions)			
Transportation commitment charges (a)	\$45	\$27	\$127	\$77
Loss from vertical integration services (b)	—	17	11	46
Idle drilling and well service equipment charges (c)	—	10	—	57
Other	13	15	38	43
Total other expense	\$58	\$69	\$176	\$223

(a) Primarily represents firm transportation payments on excess pipeline capacity commitments.

Loss from vertical integration services primarily represents net margins (attributable to third party working interest owners) that result from Company-provided fracture stimulation and well service operations, which are ancillary to and supportive of the Company's oil and gas joint operating activities, and do not represent intercompany

(b) transactions. For the three and nine months ended September 30, 2017, these vertical integration net margins included \$42 million and \$84 million, respectively, of revenues and \$42 million and \$95 million, respectively, of costs and expenses. For the same respective periods in 2016, these vertical integration net margins included \$19 million and \$144 million of revenues and \$36 million and \$190 million of costs and expenses.

(c) Primarily represents expenses attributable to idle drilling rig fees that are not chargeable to joint operations and charges to terminate rig contracts that were not required to meet planned drilling activities.

NOTE M. Income Taxes

The Company's income tax benefit (provision) consisted of the following for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2016	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2016
	(in millions)			
Current tax benefit	\$—	\$22	\$—	\$22
Deferred tax benefit (provision)	11	56	(79)	340
Income tax benefit (provision)	\$11	\$78	\$(79)	\$362

For the three and nine months ended September 30, 2017, the Company's effective tax rate, excluding income attributable to noncontrolling interests, was 34 percent and 32 percent, respectively, as compared to an effective rate of 140 percent and 41 percent for the same respective periods in 2016. The Company's effective tax rate for the nine months ended September 30, 2017 differs from the U.S. statutory rate of 35 percent primarily due to recognizing excess tax benefits of \$8 million associated with the adoption of ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," which requires excess tax benefits or deficiencies associated with the vesting of

long-term incentive awards to be recorded as income tax expense or benefit in the statement of operations rather than as an adjustment to additional paid-in capital in the balance sheet. The Company's effective tax rates for the three and nine months ended September 30, 2016 differ from the U.S. statutory rate of 35 percent primarily due to recognizing research and experimental expenditure credits of \$59 million during the three months ended September 30, 2016. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities based upon the technical merits of the position. As of September 30, 2017 and December 31, 2016, the Company had unrecognized tax benefits of \$123 million and \$112 million, respectively, resulting from research and experimental expenditures related to horizontal drilling and completions innovations. If all or a portion of the unrecognized tax benefit is sustained upon examination by the taxing authorities, the tax benefit will be recognized as a reduction to the Company's deferred tax liability and will affect the Company's effective tax rate in the period it is recognized. The Company expects to substantially resolve the uncertainties associated with the unrecognized tax benefit by December 2018.

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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 (Unaudited)

The Company files income tax returns in the U.S. federal and various state and foreign jurisdictions. The Internal Revenue Service has closed examinations of the 2012 and prior tax years and, with few exceptions, the Company believes that it is no longer subject to examinations by state and foreign tax authorities for years before 2011. As of September 30, 2017, no adjustments had been proposed in any jurisdiction that would have a significant effect on the Company's liquidity, future results of operations or financial position.

NOTE N. Net Income (Loss) Per Share

The following table reconciles the Company's net income (loss) attributable to common stockholders to basic and diluted net income (loss) attributable to common stockholders for the three and nine months ended September 30, 2017 and 2016:

	Three		Nine Months	
	Months		Months	
	Ended		Ended	
	September	September	September	September
	30,	30,	30,	30,
	2017	2016	2017	2016
	(in millions)			
Net income (loss) attributable to common stockholders	\$(23)	\$ 22	\$168	\$(513)
Participating share-based earnings	—	—	(1)	—
Basic and diluted net income (loss) attributable to common stockholders	\$(23)	\$ 22	\$167	\$(513)