



# horizon



Winter 07-08 | an informative quarterly for Arkansas land and royalty owners of Southwestern Energy Company

the issue

## Good Decisions

Arkansas is known as “the Natural State,” and Southwestern Energy employees live and work here, too. So naturally, they want to ensure company operations are environmentally friendly and have minimal impact on the beauty of this state.

To help accomplish this, Southwestern Energy Company has created a comprehensive environmental management system to guide activities and employee decision-making related to health, safety and the environment. This system defines articulates the company’s vision for HS&E, establishes the framework, and sets the expectations for responsible operations. The plan encompasses everything from strategic planning and risk management to crisis preparedness and training.

“It’s critical to have a strategic yet practical approach to making HS&E a part of everyday life,” said Mike McAllister, Southwestern Energy’s HS&E director. “It makes good business sense to stay focused on HS&E to help us get things done right the first time and have processes to continuously improve.”

A few of the system’s highlights include:

- Extensive training for employees on a variety of topics to help them make good decisions in all aspects of their job. Training is a key component of the company’s HS&E management system. The company has 22 core programs that have been conducted 519 times in the past year alone.

- Strong ongoing relationships with the company’s many stakeholders such as regulatory agencies, land and royalty owners, community leaders, elected officials and others.
- A proactive approach to working around sensitive areas. The company has established a data-sharing arrangement with the University of Arkansas’s Low-Impact Natural Gas and Oil (LINGO) LINGO project. This helps Southwestern Energy identify in advance endangered species, critical habitat or known archaeological or historical sites. With this information, Southwestern Energy can begin planning well locations, access roads and pipeline routes to avoid sensitive areas and create minimal ground disturbance. (Editor’s note: Read more about the LINGO project at <http://dailyheadlines.uark.edu/11301.htm>).

“Our company’s commitment to HS&E is truly an extension of our formula for success,” said McAllister, “because we want to be the Right People doing the Right Things every day.”

the inside

## Underneath it all... we're working together

The challenge of providing enough natural gas for the nation's energy needs has never been greater. As noted in the National Petroleum Council's recent study of global energy issues, "energy security" must be a national focus.

Natural gas from a safe domestic supply such as the Fayetteville Shale is helping to meet those needs while also benefiting many Arkansans. Southwestern Energy remains committed to doing both: exploring for and producing energy while working to benefit all stakeholders.

This balanced, collaborative approach to the business is based on the company formula for success: "The Right People doing the Right Things wisely investing the cash flow from the underlying Assets will create Value +."

Southwestern Energy employees believe the formula positively influences their actions on a daily basis and helps balance the many different needs of a project like the Fayetteville Shale.

### Growing energy demands

One of the country's greatest needs is to produce oil and gas at home. Fossil fuels are this country's primary energy sources today. Demand for these fuel sources continues to skyrocket as our residential, industrial, commercial and transportation needs grow.

All strong, sustainable economies in the world need ready access to fuel to run factories and office buildings, drive vehicles, turn on the lights, and keep homes heated and cooled. As expanding global economies like India and China put added pressure on existing fuel sources worldwide, the demand for energy is getting even stronger.

On the supply side, it's becoming more difficult and expensive to find natural gas. The easy-to-produce locations are scarcer. Political uncertainty in the Middle East, coupled with the high cost of overseas transportation of liquefied natural gas, makes importing fuel both expensive and volatile. The cost equation and business environment must be attractive enough to justify an investment.

### Tackling challenges

Increasing economic development is usually accompanied by a need for expanded infrastructure, a skilled work force and access to a variety of resources. Southwestern Energy is committed to working with a variety of stakeholders to tackle the challenges the

industry faces and benefit as many groups as possible.

- **Working with elected officials** – Southwestern Energy communicates regularly with local and state elected officials to address any concerns or needs. Representatives from Southwestern Energy meet monthly with county officials to discuss ongoing operations and identify new ways to minimize impact.
- **Working with regulatory agencies** – The company has long had a commitment to environmental stewardship. Southwestern Energy employees maintain open, two-way dialogue with regulatory agencies, and in many cases the company has established new "best practices" for getting things done.
- **Working with owners** – The company takes a proactive approach to working with owners through a dedicated landowner relations group, toll-free hotline, Web site, fax, e-mail and newsletter. Southwestern Energy works closely with owners to minimize impact on their property and in many cases enhance their land by putting in access roads and ponds.

### Creating a brighter future

Southwestern Energy is optimistic about the natural gas industry, its future in Arkansas and specifically the Fayetteville Shale. Southwestern Energy is an exploration company that not only produces natural gas but also helps fuel our state's economy. Here's how:

- **Investing in Arkansas** – By the end of 2007, the company will have made a \$1.5 billion capital investment in the Fayetteville Shale in Arkansas.
- **Creating good jobs** – Southwestern Energy has hired more than 500 employees for good-paying jobs in its Conway and Damascus operations.
- **Helping small businesses** – In addition to the company's own growth, Arkansas's thriving natural gas industry has helped many small businesses to grow, from machine shops to restaurants, from excavating companies to realtors.
- **Donating to good causes** – Southwestern Energy has donated hundreds of thousands of dollars to improve the quality of life in communities, including such major gifts as \$250,000 to Junior Achievement, \$250,000 to help establish the Damascus Bobwhite Quail Habitat and \$200,000 to the University of Arkansas Community College at Morrilton to help establish the state's only petroleum technology program.

By working together, many challenges can be overcome to enable the exploration for and production of energy to help meet the country's needs while also working to benefit a variety of stakeholders in Arkansas.

in touch

# Income taxes on natural gas royalties

Before long it will be time to file income tax returns for 2007. Owners who began receiving royalty payments in 2007 should consider the impact that this new source of income will have on the amount of income taxes owed.

Unlike salaries and wages received from an employer, the IRS does not require income taxes to be withheld from royalty payments. Federal and state income taxes may need to be paid directly to the IRS and the state by the royalty owner.


Around the end of January, anyone who received royalty payments of more than \$10 during the previous year should receive a Form 1099-Misc from the payor showing the gross amount paid during the year. The gross royalties paid to the owner will be shown in box 2 of the Form 1099-Misc and should be reported as ordinary income on the owner's income tax return. For individuals, royalties are normally reported on Form 1040 - Schedule E - Supplemental Income and Loss.

Any deductions applicable to this royalty income can be used to reduce the amount of royalty income that is taxable. Deductible items normally include state severance taxes withheld from royalties and any property taxes applicable to the royalty interest. A royalty owner may also be allowed to take a depletion deduction to further reduce their taxable income.

Land owners who receive payments related to oil and gas exploration, such as rental payments, rights-of-way purchases and damage payments may also need to report those items on their tax return.

All owners are encouraged to consult a tax advisor who is knowledgeable about the tax treatment of payments related to oil and gas operations.

DISCLAIMER: The information contained herein is general in nature and based on authorities that are subject to change. It is not intended and should not be construed as legal, accounting or tax advice or opinion provided to the reader. This material may not be applicable to or suitable for specific circumstances or needs and may require consideration of nontax and other tax factors. Contact an accredited tax professional prior to taking any action based upon this information.



Entrepreneur spotlight

# Benefits from Boom

Local business benefits from natural gas industry boom

Alone in his business more than 20 years ago, Bobby Kennedy operated his Caterpillar D5 dozer building farm ponds, spreading gravel, leveling ruts and filling potholes along the county roads of central Arkansas.

“I had to work a pretty long day back then just to cover my payment on that Cat dozer,” said Kennedy, “especially with the rate we were getting back in the 1980s to build a mile of road.”

Things have changed a lot since then. Kennedy Construction Company has grown this past year from 10 to 70 full-time employees. The entrepreneur attributes the growth to the natural gas exploration and production business – specifically Southwestern Energy Company, which is the most active producer in the area and is credited with kicking off the economic development boom by drilling the first natural gas wells in Central Arkansas in 2005.

Since that time, Kennedy’s interactions with Southwestern Energy have also grown. The two businesses have built a relationship based on reliable information and good communication.

“Whatever they have told me about the business has always been true,” said Kennedy.

The growth in his company has allowed Kennedy to not only provide for his family but employ many local residents who used drive to Little Rock or other areas for their work. Kennedy has also been able to bring both his daughters home from out of state to join the family business.

“We’re providing good solid jobs to the local economy, and my employees don’t have to drive away to find good work,” said Kennedy.

On any given day, observers can find Kennedy’s crews working on a variety of jobs such as building gas drilling pads or making improvements to county roads. His latest business venture is providing erosion control for work sites through seeding grasses and planting vegetation.

Kennedy is proud to say he supports other Arkansas-based companies. He provides his crews with equipment obtained from within the state such as a rock crusher, excavator, front-end loader, articulating hauler and dump trucks.

Kennedy believes he is living out the American dream by building his business, providing for his family and creating jobs for others in his community.

“I am grateful for the success we’ve enjoyed because of the investment Southwestern Energy is making in this region. We look forward to the future.”

on our minds

# Frequently asked questions

In each issue of this newsletter, we will share some questions commonly asked by royalty owners. Please visit [www.swn.com/ownerrelations](http://www.swn.com/ownerrelations) for more FAQs.

## What is an oil and gas lease?

An oil and gas lease is a written agreement in which a mineral owner (the “lessor”) allows another person or company (the “lessee”) to explore for, drill, and produce oil or gas on specified lands for a certain period of time in exchange for the payment of royalties. The lease provides a legal description of the property, the amount of royalty to be paid (typically expressed as a fraction, e.g., 1/8 or one-eighth), the length of the lease (also known as the “primary term,” typically for a specific number of years), and the rights and obligations of the lessor and lessee.

## What are royalties?

Royalties are the mineral owner’s share of production as reserved in an oil and gas lease. The royalty amount is usually expressed as a fraction of the total amount of hydrocarbons produced from the leased premises (or the proceeds attributable to such production).

## When will I receive a check?

Typically, the first revenue distributed by Southwestern Energy Company is 60 days after the first month of sales. Therefore, if a well begins producing in January the first revenue to be distributed would be in March.

Checks are typically mailed on the 25th of each month. However, several things may affect the issuance of an owner’s first royalty check. The first distribution of revenue may be delayed if clear title to the property has not been received. Also, monthly checks are issued if the owner’s total royalty is greater than \$100. If an owner’s total royalty is less than \$100, a check will be issued once a year.

Occasionally, wells may be capable of producing gas but lack adequate pipeline connections. Therefore, production will begin pending connection to a pipeline. Once production through this pipeline begins, the 60-day revenue distribution will apply.

## What documents are required if I buy or sell an interest in a property?

You should provide Southwestern Energy Company’s Owner Relations Department with a certified copy of the deed, assignment, or other instrument of conveyance properly recorded in the county or parish in which the property is located.

our partners

# Energy comes to life

Southwestern Energy kicks off partnership with Junior Achievement

More than 500 high school students in Conway are part of the inaugural class benefiting from an energizing new curriculum called “Careers with a Purpose.”

Southwestern Energy Company and Junior Achievement have partnered to bring the program to high schools students starting this school year not only in Conway but around the region. The two organizations announced a three-year partnership last April along with a \$250,000 donation from Southwestern Energy.

The customized curriculum will help educate students about careers in general, making them aware of opportunities available within the energy industry specifically and teaching them the fundamentals of succeeding in a global economy. High school students in Morrilton and Heber Springs will be receiving the new curriculum this spring, and other schools will be added in the future.

Dozens of Southwestern Energy employees are volunteering in the classroom this school

year to teach the seven-week course. This is the first time a combined careers and energy curriculum has been offered to students in the state.

“We are thrilled with this new partnership,” said Peggy Woosley, director of secondary education, Conway Public Schools.

“(INSERT QUOTE)”

“Our employees jumped at the opportunity to volunteer in the classroom and bring the energy industry to life for hundreds of Arkansas students,” said Harold Korell, president and CEO, Southwestern Energy. “Through our partnership with Junior Achievement, we hope to engage and excite the next generation of leaders from Arkansas to use their skills to help our country meet its growing energy needs for years to come.”



in a word

## Glossary of terms

In each issue we will share the definitions of some common oil and gas industry terms.

### Casing

In the Fayetteville Shale, most gas wells are thousands of feet deep to reach the natural gas trapped underground. Casing, which is steel pipe, is used to protect both the well and the earth during the drilling and production process.

#### Here's how it works.

During the initial drilling process, crews place casing in the center of the well bore to prevent the wall of the hole from caving in, to prevent the movement of fluids from one formation to another, and to improve the efficiency of extracting the natural gas if the well is productive.

Surface casing is installed very near the earth's surface in the early stages of drilling (up to about 550 feet), and production casing is installed very deep into the ground (up to several thousand feet) near the final stages of drilling but before the well is completed and begins producing natural gas.

Since it is steel pipe, casing is very strong. In addition, cement is poured around the casing to secure the pipe in the hole. Together, the pipe and the cement create a thick wall, which prevents fluids from coming into or leaving the well.

Because the casing is installed prior to production activities, the casing protects potential underground or shallow fresh water resources from coming into contact with production fluids or the natural gas itself.



### Contact us

We want to make it easy for you to get in touch with our Landowner Relations Group.

#### Southwestern Energy Company

Attn: Division Orders/Lease Records  
2350 N. Sam Houston Parkway East,  
Suite 125  
Houston, TX 77032

#### Or e-mail Southwestern Energy Company at:

ownerrelations@swn.com

#### Check us out on the web:

[www.swn.com/ownerrelations](http://www.swn.com/ownerrelations)

#### Or contact Southwestern Energy Company by phone:

Owner Relations: 1-866-322-0801  
Fax: (281) 618-4757

During our office hours, someone in our Landowner Relations Group will be happy to speak with you and assist you as needed.

#### Office hours:

Monday through Friday 7:30 a.m. to 4:30 p.m. Central Time.

**NOTICE AND DISCLAIMER:** The information contained in this document is as of April 30, 2007, and has not been updated to reflect subsequent events or revisions of the company's plans, projections, expectations or other statements that may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. For additional information with respect to Southwestern Energy Company and factors that may affect its performance, see the reports filed by the company with the Securities and Exchange Commission.

# horizon

Winter 07-08 | an informative quarterly for Arkansas land and royalty owners of Southwestern Energy Company



**Southwestern Energy  
Company**