

# Rising to the challenge

Energy Board Symposium Viewpoints



## Continuing the conversation



**Richard D. Paterson**  
Global Energy Leader  
PricewaterhouseCoopers

On May 22, forty directors from energy companies attended our inaugural PricewaterhouseCoopers Energy Board Symposium. The event included presentations from a wide array of speakers and offered opportunities for informal conversations among the board member participants.

This compilation of articles provides a brief, easy-to-read overview of each of the day's presentations. If you were able to be with us in Houston that day, it will serve as a reminder of the issues that were raised. If you were not able to join us, you can get a sense of what was discussed and the value that the event delivered. Our hope, of course, is that your schedule will permit you to be with us next time.

At PricewaterhouseCoopers, we are committed to the energy industry and its objective of meeting global energy demand. Each and every day, we strive to build and foster long-lasting business relationships that provide results through collaboration. The Energy Board Symposium is a key element in our commitment to you and the companies that you represent so ably.

Please enjoy this overview of our inaugural Energy Board Symposium discussion topics. I look forward to seeing you at future PricewaterhouseCoopers Energy Board Network events.

Sincerely,

A handwritten signature in black ink that reads "Rich Paterson". The signature is fluid and cursive, with a long horizontal stroke at the end.

Rich Paterson

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To learn more or RSVP,  
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at 713-356-4031 or  
kirstin.feazel@us.pwc.com

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## Energy policy must make economic sense



**Lee R. Raymond**

Retired Chairman and Chief Executive Officer, Exxon Mobil Corporation Chairman

National Petroleum Council

Mr. Lee R. Raymond is the retired Chairman of the Board and Chief Executive Officer of Exxon Mobil Corporation. He had been Chairman of the Board and Chief Executive Officer of Exxon from 1993 until its merger with Mobil in 1999 and held the same position with ExxonMobil until he retired in December 2005. He began his career with Exxon after graduating from the University of Wisconsin with a B.S. in Chemical Engineering in 1960 and receiving a Ph.D. in the same discipline from the University of Minnesota in 1963. Mr. Raymond is a Director of JPMorgan Chase and Vice Chairman of the Board of Trustees of the American Enterprise Institute. He is Chairman of the National Petroleum Council, a trustee of the Wisconsin Alumni Research Foundation, a trustee of the Mayo Clinic, a member of the President's Export Council, and a member of the Innovations in Medicine Leadership Council of UT Southwestern Medical Center.

A general misunderstanding of today's global energy industry makes it difficult for the United States to formulate thoughtful, strategic policies, says Lee Raymond, retired chairman and chief executive officer of Exxon Mobil Corporation and current chairman of the National Petroleum Council.

The industry's scale and the lengthy timeline needed to plan and implement projects that can make an impact are elements that elude the public and unfortunately many U.S. lawmakers. In addition, U.S. lawmakers fail to see energy in a "big picture" view and therefore can't adequately formulate meaningful policy, Raymond told directors in his keynote address at the Energy Board Symposium.

The industry's broad size is especially misunderstood by those who believe the U.S. can change its energy portfolio overnight and who tout alternatives that would take decades to scale to commercial levels.

"In this country, we burn 150 billion gallons of gasoline a year," he

explained. "It is almost impossible to understand how big a number that is. Think about 150 billion one-gallon gas cans stacked one against one another—they would circle the Earth 1,000 times.

"You can't move the needle easily on an industry with that kind of scale."

### **Long-term thinking**

Raymond also used some dramatic comparisons to illustrate the industry's long-term strategic thinking, a necessity due to lengthy project completion cycles.

"At ExxonMobil, we first began exploring for oil in Angola in 1993, and we fast-tracked every aspect of the project that we could," he said. "Even still, the first oil didn't come online until 2005. During those 12 years, we had five or six Congressional elections and three or four presidential elections.

"But to formulate meaningful, lasting energy policy, you have to choose a path and stick to it—you can't change direction every two to four years based on which political party is in office."

## “Independence is a myth; our goal should be energy security through interdependence.”

Raymond described how France was able to ease its dependence on foreign energy following the oil embargo of the early 1970s.

“Before 1973, 75 percent of France’s electric power was generated by heavy oil,” he said. “When the country suffered during the embargo, the government made the decision to replace its existing power generation facilities with nuclear power plants, and they never wavered from that path. Today, 80 percent of France’s electricity comes from nuclear generation—and they enjoy the lowest cost of power in Europe.

“The lesson is that they didn’t meddle politically with their strategic plan—it was a sustained effort over a long, long time. And that is a real challenge for us in the United States.”

### **No ‘false choices’**

The American Petroleum Council’s report on the nation’s energy future—titled *Facing the Hard Truths about Energy*—details a list of issues facing consumers, politicians and of course, energy companies themselves. Raymond, who currently serves as

chairman of the council, said the report makes it clear that U.S. government and industry must do everything possible—on both the demand and supply sides of the equation—to ensure affordable energy.

“Every alternative that is economically viable must be pursued,” Raymond said. “And even if we do everything possible over the next 15-20 years, we will still be importing energy. Independence is a myth; our goal should be energy security through interdependence.

“Energy is just one example of globalization. The U.S. is no longer the center of the universe.”

Raymond cautioned against the lure of false choices—the “either-or” mindset that causes us to overlook viable alternatives.

“We should be building infrastructure that adds to our energy security and that enables us to reduce the supplies we import, which helps keep the dollar strong against foreign currency,” he said.

“For example, we have to find a way to make better use of the enormous coal

resources we have here in the U.S.—something like 200 years worth. And the U.S. is the only major country in the world not building a nuclear power infrastructure, and that is a mistake. We expect the world to do for us what we will not do for ourselves...we don’t want to allow drilling in deepwater off our coast, we don’t utilize our domestic coal, we don’t have nuclear power—yet we want affordable energy.”

The solution, Raymond believes, is for government to set the direction and policy and then let the free enterprise system develop ideas that can stand the test of competition.

“Someone is going to have to stand up and deliver straight talk about our nation’s energy future,” he said. “The problem has been developing for 30 years in this nation, and to believe that we can quickly reverse our situation is naïve. It will take us 30 years to change course, if we have a plan that we can follow without fear of intervention or politics.”

## Predicting the winners in today's fast-moving energy industry



**Robert Johnston**

Director,  
Global Energy &  
Natural Resources  
Eurasia Group

Mr. Robert Johnston specializes in energy and commodity markets, with eleven years of experience in the financial, corporate, and academic sectors. At Eurasia Group, he directs a research team covering oil, gas/power, and metals/agriculture. He is the lead strategist responsible for Eurasia Group's outlook on commodities and serves as the primary contact for financial, corporate, and government clients on natural resources issues.

Foreseeing the energy industry's future has never been more difficult, Robert Johnston told participants at the PricewaterhouseCoopers Energy Board Symposium.

With oil prices moving quickly, geopolitical risks building under the surface in so many key producing areas and issues such as biofuels and emissions creating uncertainty both domestically and internationally, the industry is being buffeted by a confluence of factors that make accurate predictions a major challenge, said the director of Global Energy & Natural Resources at Eurasia Group.

"This is not just a story of oil," Johnson said. "The natural gas market is being impacted by some of the same geopolitical factors that are roiling the oil business."

Johnston stressed that some industry players were better equipped to come out on top despite of – or in some cases, because of – the fast pace of change.

### **Who will win?**

Saudi Arabia is a clear-cut winner, Johnston said, because geopolitical power has shifted to favor OPEC's primary producers, and Saudi production is peaking at the right time, with a significant 2008-2012

upstream ramp that includes Khurais, the largest new Persian Gulf field since the 1950s. Still, Saudi Arabia is increasingly looking to China and India as its primary market, at the expense of Atlantic Basin countries.

"The Saudis plan to cap production at 12.5 million barrels per day because they believe that is all the market needs right now," Johnston said. "No one else believes that; most experts say that the market could absorb as much as the Saudis could produce. But they are concerned about the growth in biofuels in North America and production from Canada's oil sands, even though those sources won't have a sizeable impact for several years."

Iran will also be a winner in the near term, Johnston said. Since the release of a new National Intelligence Estimate in December 2007 that downplayed security concerns over the country's nuclear program, a number of significant energy infrastructure deals have been signed between Iran and producers from Asia and Europe. While there are still potential geopolitical risks looming due to the war in Iraq and the uncertain nuclear policy of the current political regime in Iran, the advance in foreign investment is a positive sign for the country's long-term prospects.

“...the industry is being buffeted by a confluence of factors that make accurate predictions a major challenge.”

Johnston said a third winner in the coming months will be the commodity index funds. “There is a lot of new capital coming in as these funds are used by a wide variety of investors to hedge against inflation,” Johnston said. “Supply will continue to be tight, and demand will be high. We will see the inflow continue until market concerns about global inflation and overly-accommodative monetary policy in the US diminish.”

Other players likely to prosper in the coming years include Brazil, a fast-growing oil exporter to the U.S, which like Canada is open to new investments; Kazakhstan, with its strong oil, uranium, copper and agriculture production; and Libya, with a surge in foreign investments under terms very favorable to the national oil company.

#### **Who will lose?**

Johnston also said that some industry players would struggle in coming years as market and geopolitical forces take a toll.

One group likely to face difficulties over the next few years includes LNG importers, who will be forced to deal with supply insecurity as traditional exporters limit shipments to meet growing demand in their own countries and new regasification infrastructure

comes online, adding markets to the mix and driving up prices.

In addition, Johnston said Venezuela and Mexico are “missing the party” due to persistent resource nationalism, ineffective energy reform and lack of investment in their current infrastructure.

Johnston also said that ethanol – once touted as an important contributor to the nation’s fuel mix – is now a “bad word” politically, and that surging grain prices are causing researchers to work even harder to find sources for second-generation, or non-food, biofuels.

“Biofuels from jatropha, camelina, castor oil and other non-edible feedstocks are getting lots of attention from investors, even though they don’t exist in a commercially viable way yet,” he said.

#### **Players facing increased risk**

Johnson highlighted a number of key areas of risk around the world, including:

- Iraq, with political uncertainties complicated by security concerns and a murky outlook for hydrocarbons law.
- U.S. energy policy, with major pieces of activist legislation almost certain to be presented in the next few years.

- Canada, with oil sands costs rising due to recent royalty increases and changes in income tax law structure, compounded by expected carbon costs.
- U.S. power generation, with carbon price uncertainties and a new administration seeking to push renewables.
- More fallout from the Kyoto Accord, with China’s massive coal supplies making it difficult to bring that country to agreement on the greenhouse gas emission programs already adopted in the European Union and being considered in the U.S.

In closing, Johnson reminded participants that the price of oil had gone from around \$50 a barrel to more than \$135 a barrel without any major geopolitical shocks in producing regions around the world. With so much of the near-term future increase in daily production pegged to just three nations – Saudi Arabia, Nigeria and Angola – any geopolitical issue in those countries would have major implications for the energy industry as a whole, and certainly for consumers.

## No set way to manage risk in today's volatile world



**Robert Otteson**

Risk Control Officer  
Chevron Corporation

Mr. Robert L. Otteson is the Risk Control Officer for Chevron Corporation based in Houston, Texas. He is a graduate of The University of Utah (B.A. in Accounting—1981) and is a licensed Certified Public Accountant. Since joining Chevron in 1982, he has served in various Chevron Finance Department capacities with increasing responsibilities. Mr. Otteson has extensive experience with Chevron's global commodity trading operations in the finance function, as well as, having managed a comprehensive advanced systems development project.



**Jonathan Stein**

Vice President,  
Chief Risk Officer  
Hess Corporation

Mr. Jonathan Stein is the Chief Risk Officer of Hess Corporation responsible for providing transparency to senior management of the corporation of underlying risks and the control of these risks within limits for each business unit, with primary focus on trading, marketing and hedging activities across Marketing and Refining and Exploration and Production business segments. He manages a global team of professionals in Market Risk Controls, Credit Risk Controls, Compliance Controls, Product Control, Middle Office Operations and Risk Infrastructure.



**Chuck C. Cook**

Senior Vice President  
and Treasurer  
Dynergy Corporation

Mr. Charles C. Cook serves as Senior Vice President of Strategic Planning, Corporate Business Development and Treasurer. His responsibilities include all financing, treasury, and risk control activities, as well as strategic planning and corporate business development.

The different ways that energy companies manage risk is as varied as the companies themselves, a group of risk management experts told the Energy Board Symposium audience.

Robert Otteson, risk control officer for Chevron Corporation, Jonathan Stein chief risk officer for Hess Corporation and Chuck Cook, senior vice president and treasurer for Dynergy Corporation, all agreed that the management of risk was becoming increasingly important to energy companies – from the complexity of hedging and other financial tools to geopolitical risk that accompanies the search for oil and gas into developing “frontier” countries.

Even companies that are experienced in managing sub-surface risk are finding that geopolitical issues present a whole new set of challenges, Stein told the group.

“Political risk is more important to our company, and we are looking for ways to analyze that type of risk the same way we do market risk,” he explained. “The question we are asking is, ‘How can we build the same type of political risk models that we have for market,

“...all agreed that the management of risk was becoming increasingly important to energy companies – from the complexity of hedging and other financial tools to geopolitical risk that accompanies the search for oil and gas into developing “frontier” countries.”

credit and technical risk issues and utilize those in our business decisions?”

#### **Risk and company culture**

While each of the panelists has a different organizational reporting structure, the common factor among them is that risk management is embedded into the company culture.

At Dynegey, Cook said, the process in place reflects the organization’s flattened organizational structure.

“There are any number of different models that work, as long as the issue of risk management is addressed from the standpoint of the company’s unique corporate culture,” he said. “The key is whether management has bought into the idea that risk can and should be managed. Ideally, you would take a holistic approach, a team approach, and be able to trust each business unit addresses their risk issues, while providing a forum for them to communicate upwards when they have issues.”

At Chevron, Otteson’s role is to oversee risk and report potential issues to the chief financial officer. “But our model is to give responsibility to the business

unit management team to manage their particular risks,” he said.

#### **Brand risk**

Another increasingly important skill is the ability to understand and manage intangible risks to the company’s brand reputation or market position as an industry leader.

“Virtually every decision we make takes reputational risk into account,” Otteson said. “It is a very large, very real risk and it is very important to us. When you damage the company’s reputation, you also hurt its value – not just in terms of share price, but also its ability to work with partners and potential partners.

“Reputation means a lot – especially in the trading business. Our intellectual property, our ethics, the people we have...all of those are very important. We take reputation seriously.”

#### **Board’s role**

Stein said the board at Hess plays a critical role in setting the risk management agenda. “They are there to ask questions, to insist on transparency,” he said. “We believe that failure is often the result of a lack of transparency, because gathering

data is one key element to uncovering potential risks.”

Otteson seconded that thought, saying that the Chevron board works to ensure there is alignment between the responsibility for identifying risk, and the authority to mitigate it. “A strategic view of risk is essential,” he said.

“Capital investment programs offer a good example – how much risk are you willing to take on an individual project or in a particular country? The board can help set that agenda.”

The board can also help prevent issues such as trading fraud by asking pertinent questions about controls and about the type of data that is being presented to senior management.

“These kinds of breakdowns are about a lack of focus on basics,” Stein said. “The board can ensure that management is following the rules that you need to follow to maintain financial control.”

## Preparing for regulatory change



**The Honorable  
Bill Archer**

Senior Policy Advisor  
PricewaterhouseCoopers

As the Senior Policy Advisor to PricewaterhouseCoopers LLP, the Honorable Bill Archer provides strategic advice to clients on a broad range of federal policy issues affecting business, including taxation, international trade, energy, Social Security and health care. Mr. Archer also works with PricewaterhouseCoopers' leaders to formulate strategic plans for the firm on federal policy matters.

Mr. Archer served as a Member of the U.S. House of Representatives from 1971 to 2001, representing the 7th Congressional District of Texas. From 1995 to 2001, Mr. Archer served as Chairman of the Committee on Ways and Means.



**Vincent P. Colman**

National Professional  
Service Leader  
PricewaterhouseCoopers

Mr. Vincent Colman has a wide range of experience in accounting, auditing, financial reporting, mergers and acquisitions, and risk management. Currently Mr. Colman serves as the Firm's U.S. National Professional Services Group Leader. The National Professional Services Group has overall responsibility for formulating the Firm's positions on technical accounting, auditing and SEC reporting matters, developing the Firm's audit policies and methodology and providing technical accounting and auditing guidance to the Firm's audit professionals.

Regulatory and political change is in the air, and the results are likely to come more quickly than most energy companies anticipate, said Vincent Colman, a PricewaterhouseCoopers partner and National Professional Services leader, in his shared presentation to Energy Board Symposium attendees.

His message was seconded by the Honorable Bill Archer, former member of the U.S. House of Representatives and currently managing director and senior policy advisor at PricewaterhouseCoopers, who told the gathered board members that there is "tremendous discontent" among American citizens and that the calls for change would be heard by the next Congress.

Colman started his portion of the presentation by discussing the significant challenges the accounting and auditing profession has faced over the last five years – weakened investor confidence due to fraud and scandals; implementation of Sarbanes-Oxley 404; implementation of the SEC's 404 guidance and AS 5; and compliance with ever-growing complexity in accounting and reporting rules.

In addition, the credit crisis that struck in the second half of 2007 and early 2008 created a number of significant issues, such as increased scrutiny of securitization transactions, a renewed focus on off-balance sheet entities, the valuation of illiquid investments and the

relevance of fair value accounting – all of which caused many companies to take a fresh look at their internal controls and enterprise risk management systems.

### **Areas of change**

Colman predicted that in the coming months, the SEC will focus on a number of key areas for change before a new administration takes office in 2009:

- To improve U.S. competitiveness, the SEC will work to untangle some regulations passed in recent years and reduce their complexity. Colman said that current SEC leadership is concerned that some rules – made in response to corporate accounting scandals – are too restrictive.
- The commission will provide additional guidance on materiality in order to try and stem the number of financial restatements companies are making. In 2006, 1,850 U.S. companies were forced to restate earnings, with another 1,200 companies issuing restatements in 2007. Yet just over a decade ago, in 1995, the number of restatements was around 300. "The goal will be to provide managements and boards additional guidance to make judgments about what is material and what isn't," Colman said. "The SEC wants to get back to a 'range of reasonableness' with regard to restatements, and reduce the numbers by eliminating unnecessary restatements."

“...the SEC will focus on a number of key areas for change before a new administration takes office in 2009.”

- The SEC will provide more support for “judgment.” If companies follow a process to document their accounting judgments including linkage to the professional literature and alternatives considered along with transparent disclosure, these companies will be in a much better position when a regulator comes along to review and challenge those judgments. “It’s a benefit to companies that are trying to do the right thing,” Colman said.
- Finally, the SEC is actively working on an updated “roadmap” to the implementation of International Financial Reporting Standards (IFRS) in the U.S., with an expected timeline toward ultimate mandatory application of IFRS in the U.S. of approximately five to seven years.

Colman also predicted that the Public Company Accounting Oversight Board – which has been criticized for not conducting a thorough review of market capitalizations of U.S.-based companies – would take steps to improve its market cap coverage and would get involved in setting audit standards that further converge with international auditing standards – following the lead set by the FASB-IASB’s convergence of professional accounting standards.

Colman suggested that the board members in attendance could encourage their companies to engage

in the IFRS standards setting process by drafting comment letter responses to new proposed standards and other activities.

#### **Political landscape shifting**

Archer followed Colman’s presentation with an in-depth look at the changing regulatory climate in Washington, D.C., with insight gained from years of public service and experience as chairman of the House Ways and Means Committee.

“The political landscape changes regularly in Washington, and that is by design,” Archer said. “But we are headed into the biggest change in policy and philosophy ever seen, at least in my lifetime.”

Archer said that the American people are unhappy with the direction the country has taken in recent years and that they want change – regardless of whether that change is good in the long-term. Congress, he said, will go along, because politicians will always do what they believe the people want them to do.

“Our tax policy – like our energy policy – is not driven by what is good for the country,” he said. “It’s driven by politics and the budget.”

Archer predicted that since the Congress can’t summon the political will to cut spending, the next Administration will likely propose major increases in tax

revenues to reduce burgeoning deficits and debt. In 2009, he said, there will most likely be “dramatic changes” in the tax code that will impact every U.S. company. And that scenario bodes ill for the energy industry, with potential issues ranging from increased corporate income taxes to carbon taxes to an elimination of tax deferral on income earned in other countries.

#### **Tax issues looming**

“There is great vulnerability on the foreign tax credit issue with Congress,” Archer said. “Yet at the same time, other countries that currently allow double taxation of foreign revenues are beginning to rethink that position because of the negative impact it has on competitiveness. And here we are considering it as a politically viable way of raising tax revenues.”

Archer said the energy industry may wind up being penalized for its efficiency and global reach.

“The oil and gas industry does a great job – prices may be high today but gasoline is always available at every corner station in this country, round the clock and seven days a week,” he said. “The American people don’t appreciate that enough.”

“But we are pushing toward a giant tax train wreck in this country, and there will be folks who have to pay the price when all is said and done.”

“But we are pushing toward a giant tax train wreck in this country, and there will be folks who have to pay the price when all is said and done.”

## IFRS is inevitable, and the time to act is now



**John Phillips**

U.S. Energy IFRS Leader  
PricewaterhouseCoopers

Mr. John Phillips is a Houston partner with over 18 years of experience in servicing clients in the energy industry. He is a certified public accountant licensed to practice in both Texas and Louisiana. Mr. Phillips has international experience with companies such as Royal Dutch Shell, Saudi Aramco, and Motiva Enterprises LLC. Mr. Phillips has considerable International Financial Reporting Standards (IFRS) experience and is the U.S. Energy IFRS transition leader, having recently helped Shell Oil Company with their IFRS conversion.

The ever-increasing globalization of business is driving the adoption of worldwide accounting standards, but U.S.-based energy companies can benefit from those changes with the right strategic approach, John Phillips told Energy Board Symposium attendees.

The PricewaterhouseCoopers partner, John Phillips, serves as the U.S. Energy transition leader for companies implementing International Financial Reporting Standards (IFRS). He was joined in the discussion by Randy Braud, U.S. Country Controller for Shell Oil Company, which recently underwent IFRS implementation.

Phillips stressed that while some companies see IFRS as merely a compliance issue, smart directors and officers view it as a business transformation that can create value by streamlining accounting activities, implementing appropriate controls and reducing costs.

“Vendors, partners, competitors – everyone – is beginning to use this

system, and you need to speak the same language,” he explained. “The time to act is now. Companies that begin thinking and planning for IFRS implementation – those that take the time to truly understand the differences between the U.S.-based accounting standards they use now and IFRS – will benefit the most.”

### **U.S. adoption just beginning**

Phillips provided attendees with a quick overview of the growth in IFRS adoption around the world, pointing out that the U.S. was the only major capital market that had yet to convert, although he predicted that some U.S.-based companies could begin conversion as soon as 2009.

Those that do will find that the differences between IFRS and current domestic accounting practices are substantial – touching almost all major processes, transactions and balances – and require significant decision-making and process development prior to implementation, Phillips said.



**Randy J. Braud**

U.S. Country Controller  
Shell Oil Company

Mr. Randy Braud, U.S. Country Controller, Shell Oil Company, joined Shell in 1974 after receiving a Bachelor of Science Degree in Business Administration and Finance from Nicholls State University, Thibodaux, Louisiana. He has supplemented his undergraduate degree by participating in Leadership/Executive Development Programs at Kellogg, Rice, and INSEAD. Mr. Braud’s assignments include financial leadership positions at several refineries and chemical plants, as well as various roles in Shell’s U.S. headquarters in Houston, Texas.

“IFRS guidelines are about 2,500 pages. So it’s not only easier for us, but it also makes it possible to harmonize our global reporting systems because everyone around the world is using the same accounting principles.”

While U.S. GAAP is more prescriptive and rules-based, IFRS is a principles-based system that allows greater use of “fair value,” he explained.

Braud opened his segment of the presentation by telling directors that while he was immersed in his company’s transition to IFRS during 2002, he was skeptical he would talk about the new standards in a positive way six years later. But his opinion changed as he and his company became comfortable with IFRS, and he believes the benefits have been meaningful.

“The guidelines for U.S. GAAP run upwards of 25,000 pages,” Braud said. “IFRS guidelines are about 2,500 pages. So it’s not only easier for us, but it also makes it possible to harmonize our global reporting systems because everyone around the world is using the same accounting principles.”

#### **Managing the change**

Braud likened IFRS implementation to the process required for adoption of Sarbanes-Oxley, “except it was less

expensive.” The key, he explained, is taking a change management approach to the implementation:

- Changing people – communicating with both international and external audiences, such as analysts, and training financial/accounting personnel along with operational staff.
- Changing processes – enhancing existing processes to fit the new accounting principles, drafting and approving new processes and rethinking internal controls all play a role in this part of the transition effort.
- Changing systems – aligning systems with new processes.

Braud and Phillips stressed that boards play an important oversight role in the transition to IFRS, making certain that their companies follow a strategic, well-planned approach to transition that includes:

- Forming an IFRS steering committee.
- Analyzing the costs and benefits of transition.

- Approving change managing strategies.
- Analyzing IFRS accounting policies and their impact on reported results.
- Assessing debt agreements and other contracts for modification as needed.
- Looking for opportunities to centralize accounting functions.
- Embedding IFRS into operations and existing systems.
- Communicating with investors and other stakeholders.

“The hard part of a transition to IFRS is making the numerous accounting and policy decisions that are required,” Phillips said. “But companies that devote the proper resources – experienced staff members and qualified outside guidance – are those that will reap the benefits, which include reduced complexity, simplified financial reporting, increased global comparability and reduced cost of capital.”

## Clear benefits to being sustainable



**Fred Cohen**

Global and U.S. Energy  
Leader for Finance,  
Operations, Risk and  
Compliance Advisory  
Services

PricewaterhouseCoopers

Mr. Fred Cohen is the Global and U.S. Energy Leader for Finance, Operations, Risk and Compliance Advisory Services at PricewaterhouseCoopers. He has over thirty-five years of consulting and management experience with global energy corporations on business strategy, organizational structure, financial risk management and financial reporting.

Mr. Cohen has extensive experience helping leading energy and utility clients identify and address their business and financial risks and develop and implement new strategies and enterprise management procedures.



**Robert M. Schick**

Partner,  
Co-Head of Litigation

Vinson & Elkins LLP

Mr. Bob M. Schick has over twenty-five years of experience in all aspects of products liability, environmental and complex tort and class-wide litigation at both the trial and appellate levels. He has begun over 50 jury and arbitration trials and taken more than 30 cases to a jury verdict. Mr. Schick handles significant premises liability and construction-related litigation, as well as litigation arising from the oil and gas industry.

Understanding and managing your company's "carbon footprint" – its total emissions of carbon dioxide and other greenhouse gases – is a key element of corporate social responsibility and a necessity for today's large energy companies, Fred Cohen told attendees at the Energy Board Symposium.

Cohen, who serves as the Global Energy Advisory Services Leader for PricewaterhouseCoopers, told the group that behind every unit of carbon is a unit of energy, which makes managing emissions a supply issue as well as an environmental one. Properly managing carbon emissions can reduce costs, improve profitability and reduce risks related to litigation and regulation.

"There are clear benefits to being sustainable," Cohen said. "Recent studies show that consumers will pay a premium for ethical behavior and employees increasingly care about

issues such as emissions. Companies that have a measurable, verifiable carbon reduction program in place have a definite advantage in their brand positioning and their recruiting and retention – all key benefits in a competitive marketplace."

### **Emissions-related risks**

Following Cohen's remarks, Robert Schick, partner and co-head of litigation for Vinson & Elkins, addressed the risks that companies face as the issue of emissions grows in importance:

- Legislative action
- Judicial action
- Regulations
- Regional initiatives

Schick said in the U.S., the debate on legislative action centers on two potential programs – a carbon tax or a cap-and-trade system. A carbon tax involves a fee or charge on greenhouse gas emissions, fixing

“Companies that have a measurable, verifiable carbon reduction program in place have a definite advantage in their brand positioning and their recruiting and retention – all key benefits in a competitive marketplace.”

a set price for emissions without guaranteeing a certain amount of reduction. Companies can continue or even increase their emissions as long as they are willing to pay for that privilege via the carbon tax. Cap-and-trade sets a limit on emissions and allows companies that are below their permitted amount to trade allowances to companies that exceed the limits.

In the European Union, the trading of emissions credits is a \$60 billion a year business, with costs for carbon dioxide running about \$50 per ton.

“It is very likely that we will see a cap-and-trade bill introduced into Congress by 2009,” Schick said. “And most observers believe the U.S. will eventually settle on cap-and-trade because there is a successful model already in place in Europe.”

#### **Potential for litigation**

The risk of expensive, time-consuming litigation is also playing a role in the increased focus on carbon footprint reduction. Regulatory litigation, permit challenges, nuisance pollution cases, government enforcement cases and cap-and-trade contract disputes all threaten to create headaches for companies not attuned to the importance of carbon emissions.

“We are already seeing an increase in these types of cases around the country,” Schick said, “and they are having a definite impact, causing government entities to tighten their focus on the issue of emissions.”

The SEC could also play a role in emissions reporting by requiring companies to more uniformly disclose potential liabilities and negative impacts from climate change and

emissions reduction efforts. Cohen said it was inevitable that the volume of measuring and reporting on carbon footprints would increase in the future, and that the importance of third-party verification of emissions data would become critical for companies seeking to have their emissions efforts taken seriously.

In closing, both Cohen and Schick stressed that sustainability is good business when managed appropriately and can deliver cost savings and help meet stakeholder expectations. Companies that view emissions reductions as a key business improvement – embedding that thinking throughout their operations – will gain the most benefit from their efforts.

## Why are MLPs so popular in today's markets and what are the recent trends for this growth vehicle?



**Simon Tait**  
MLP Practice Leader  
PricewaterhouseCoopers

Mr. Simon Tait is a Houston-based Assurance partner with 17 years experience serving energy clients. Mr. Tait's primary focus is on oil and gas companies and energy service companies. From 2000 to 2005, he joined the energy practice in Moscow, serving Gazprom, TNK-BP and Tatneft. Mr. Tait has focused most of his recent time working with master limited partnerships and taking an active role in developing the MLP practice in Houston.



**Tim Fenn**  
Partner  
Vinson & Elkins LLP

As a Houston-based partner with Vinson & Elkins LLP, Mr. Tim Fenn's principal area of practice is domestic and international business taxation, with a focus on partnerships. Much of his practice involves the taxation of publicly traded partnerships ("MLPs") and other clients in the energy industry.

Many management teams of energy companies have a reasonable understanding of master limited partnerships (MLPs) but the extent of their use and the successes and recent trends of existing MLPs can often be overlooked, says Simon Tait, partner at PricewaterhouseCoopers.

Tait was joined at the presentation by Tim Fenn, a partner at Vinson & Elkins, who specializes in helping companies structure new MLPs and MLP related transactions. Fenn explained to directors gathered for the Energy Board Symposium that MLPs – either as limited partnerships or limited liability corporations – are publicly traded companies but with typically less float than 'C-Corps'. They are primarily a high yield cash vehicle for retail and institutional investors who want a growing distribution stream in a tax efficient vehicle and a strongly aligned relationship with management. The benefits to sponsors include continued control of assets, lower cost of capital and a unit that generally trades at a higher multiple than its C-Corp counterparts.

Fenn explained the legal structure of a typical MLP and provided some

examples of how that structure works in actuality. This included the general governance structure and impact of incentive distribution rights.

### **Industry flourishing**

Although the first MLPs emerged in the early 1980s, many of the first MLPs – primarily E&P and refinery assets – imploded due to adverse economic conditions, insufficient focus on reinvestment in the businesses, and unhedged exposures to commodity prices with resulting difficulties in paying distributions. "MLPs provide a tax efficient vehicle for investors but they are still a business and it is possible to go bankrupt," Fenn said.

However, the industry rebounded in the 1990s - primarily through larger midstream MLPs who had assets that were relatively low cost to maintain, offered minimal exposure to volatile commodity prices and had relatively stable revenue flows. More recently, we have seen the re-emergence of MLPs in other energy sub-sectors, including upstream, downstream, LNG, coal and shipping. Tait highlighted that today there are more than 70 MLPs in the US with a total market cap of more than \$130 billion. This is a significant

“The benefits to sponsors include continued control of assets, lower cost of capital and a unit that generally trades at a higher multiple than its C-Corp counterparts.”

increase from 1995 when the total market cap of the MLP sector was only \$5 billion.

Fenn stressed that there are a number of recent trends that are impacting the MLP landscape, including:

- A significant increase in the number of MLPs entering the market.
- A diversification in the types of qualifying assets and their location.
- A reduction in the minimum size for MLP initial public offerings.
- Growth in the aggregate market capitalization.
- An increase in institutional interest and ownership.
- Public offerings of general partner entities.
- The advent of foreign MLPs.

Fenn said that MLPs can be structured and governed so that they are almost immune to hostile takeovers and that as long as the board’s special committee does its job properly – by conscientiously performing its duties and, in appropriate cases, hiring advisors and outside counsel – legal protection is enhanced with respect to board membership.

### Looking for growth

In the past, most MLPs grew primarily through acquisitions. However, as accretive acquisitions have become more difficult to find, today’s MLPs seek growth through a combination of organic capital projects and opportunistic business combinations. In 2007, MLPs announced 92 acquisitions for \$17.6 billion and spent over \$10 billion on organic growth projects. In terms of growth in aggregate market capitalization, market cap increased from \$111 billion in 2006 to over \$130 billion today and generated an average increase in distributions of 9.2%, according to market data published by Wachovia. MLPs are very active and constantly need new capital to feed the growth - thus they are very active in the capital markets with regular debt and equity offerings.

Tait commented that delays in the completion of capital projects and cost overruns have the potential of adversely impacting desired future distributions and growth rate targets. In contrast to C-Corps, MLPs have limited shock absorbers for cost overruns because of the focus on available cash. Identifying and managing all relevant risks related to organic projects can not

only save money, but also save a MLPs reputation. Investors want growth but they also want predictable cash flows. Late warnings of cost overruns can cause them to lose confidence in management and question growth targets.

Boards also must take the lead to ensure that their MLPs have sufficient back office capacity to keep up with growth. “Management must understand the resource needs that the MLP will face when new projects come online and it is the board’s responsibility to ensure that the leadership team is prepared to manage growth,” Tait said.

In his closing remarks, Tait said, “MLPs are often very dynamic entities and cash is certainly king. The opportunities and challenges MLPs face will generally depend on the stage of development that an MLP finds itself in and the current business and investment environment, but one can be assured that MLP board members should never be bored.”

## Changes in reporting ‘fair value’ require vigilance



**Martha Z. Carnes**  
U.S. Energy Assurance  
Leader  
PricewaterhouseCoopers

Ms. Martha Carnes has over twenty-five years of experience with PricewaterhouseCoopers and is the leader of our U.S. Energy and Mining Assurance practice, as well as one of the Firm's global subject matter experts for the natural gas industry. Ms. Carnes serves energy Assurance clients, including natural gas transmission and distribution, natural gas and power trading and marketing, and oil and gas exploration and production.

New standards in determining and reporting on “fair value” have significant implications to be considered as energy company board members execute their fiduciary duties, Martha Carnes told attendees at the Energy Board Symposium.

The PricewaterhouseCoopers partner explained that the issuance of FAS 157, which took effect in the first quarter of 2008, is designed to give preparers a standard by which fair value should be determined as well as investors a better view of the liquidity and reliability of amounts presented in companies' financial statements at fair value.

“FAS 157 provides a tighter definition of fair value and requires more transparency around how those values are determined,” Carnes said. For example, in the past fair value was determined by the entry price of an asset; now, companies are required to use the exit price of an asset, which can be significantly different, especially for assets held over a period of time.

“In the case of a business combination, the new rules take into account how a market participant would use a particular asset, and values it accordingly,” Carnes said. “That means companies will have to assign value to assets they have no plans to use.”

Carnes walked participants through a hypothetical example of how participants might value a 10-year structured natural gas swap between a merchant energy company and an E&P company. “It's entirely possible that the two companies – looking at the same transaction – might come up with very different values,” Carnes said. “The merchant energy company is more likely to have reliable 10-year price data, and might have access to different data sources. The upstream energy company may be more of a price-taker and have much less reliable information to use in their valuation.”

In these types of cases, Carnes said, the key to compliance is proper disclosure. For example, the company should disclose the specifics around:

## “FAS 157 provides a tighter definition of fair value and requires more transparency around how those values are determined”

- How and where fair value is used.
- The methods used to measure fair value.
- A perspective about the reliability of the inputs used to determine those fair values.

The new standard includes what is called a “fair value hierarchy” which is designed to provide greater transparency and comparability among reporting entities. Within this hierarchy there are three levels.

Level 1 includes fair value determined by observable, quoted prices for identical assets or liabilities in active markets. “These are the most liquid and reliable values,” Carnes said.

Level 2 includes fair value determined by quoted prices for similar items in active markets, or similar/identical items in non-active markets.

Level 3 comprises fair value determined by unobservable inputs, such as a company’s own data, and requires significant disclosure in the company’s financial reporting.

“In more complex valuations, boards and senior management should ask if outside experts were involved in helping to determine fair value and if not, were the internal staff involved skilled in modeling,” Carnes said.

“They will also want to know what types of internal controls were in place and whether the determination of fair value of certain assets and liabilities plays a role in compensation agreements. These are key questions that should be addressed.”

Carnes ended her presentation by providing two key questions board members should ask their management teams regarding fair value:

- How has management determined the fair value of its portfolio?
- What significant assumptions and inputs are used in valuation models?

“It’s important that directors understand how management has evaluated and validated these key assumptions, and whether they are reflective of current market conditions,” Carnes said.

“Along with that, directors should understand the extent of the use of models to derive fair value, the source of those models and how those models behave during extreme market conditions.”

The implementation and impact of fair value accounting must also be disclosed thoroughly in management’s discussion and analysis.

“Finally, it is critical that board members understand the implications of any increased volatility in earnings that may result from the utilization of fair value standards” Carnes said. She suggested that companies involve their investor relations group to help communicate the impact of the new fair value standards on earnings to key stakeholders.

### **About PricewaterhouseCoopers**

PricewaterhouseCoopers provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 146,000 people in 150 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

### **About the PricewaterhouseCoopers Energy Practice**

Recognized globally for deep energy industry experience, PricewaterhouseCoopers has an extensive history of providing expert resources and proven solutions that enable energy companies to meet their business imperatives. By providing audit, tax, and business advisory services to the Supermajors and key National Oil Companies and the vast majority of the Fortune 500, PricewaterhouseCoopers' professionals possess the experience necessary to provide optimal insight and impact. The global energy practice of more than 3,100 professionals, including 300 partners, is headquartered in Houston, Texas, and is committed to building meaningful relationships with energy clients. Commitment to the energy industry goes beyond service delivery and is demonstrated by an additional focus on knowledge sharing accomplished through thought leadership publications, educational opportunities, and industry event participation and sponsorship.