

FOREST OIL CORP  
Form 10-Q  
October 30, 2012  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2012

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 1-13515

FOREST OIL CORPORATION

(Exact name of registrant as specified in its charter)

New York

25-0484900

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

707 17th Street, Suite 3600

80202

Denver, Colorado

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (303) 812-1400

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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

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As of October 24, 2012 there were 118,356,478 shares of the registrant's common stock, par value \$.10 per share, outstanding.

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September 30, 2012

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## PART I—FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

FOREST OIL CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In Thousands, Except Share Amounts)

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$39,169	\$3,012
Accounts receivable	77,210	79,089
Derivative instruments	43,853	89,621
Other current assets	16,278	38,950
Total current assets	176,510	210,672
Property and equipment:		
Oil and natural gas properties, full cost method of accounting:		
Proved, net of accumulated depletion of \$7,892,873 and \$6,901,997	1,774,587	1,923,145
Unproved	442,275	675,995
Net oil and natural gas properties	2,216,862	2,599,140
Other property and equipment, net of accumulated depreciation and amortization of \$46,040 and \$47,989	16,327	51,976
Assets held for sale	27,373	—
Net property and equipment	2,260,562	2,651,116
Deferred income taxes	9,851	231,116
Goodwill	239,420	239,420
Derivative instruments	5,273	10,422
Other assets	90,762	38,405
	\$2,782,378	\$3,381,151
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$189,753	\$247,880
Accrued interest	29,663	23,259
Derivative instruments	7,759	28,944
Deferred income taxes	9,851	20,172
Current portion of long-term debt	296,002	—
Other current liabilities	20,743	20,582
Total current liabilities	553,771	340,837
Long-term debt	1,796,369	1,693,044
Asset retirement obligations	79,133	77,898
Derivative instruments	16,640	—
Other liabilities	93,688	76,259
Total liabilities	2,539,601	2,188,038
Shareholders' equity:		
Preferred stock, none issued and outstanding	—	—
Common stock, 118,225,731 and 114,525,673 shares issued and outstanding	11,823	11,454
Capital surplus	2,538,129	2,486,994

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Accumulated deficit	(2,289,461	) (1,287,063	)
Accumulated other comprehensive loss	(17,714	) (18,272	)
Total shareholders' equity	242,777	1,193,113	
	\$2,782,378	\$3,381,151	

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In Thousands, Except Per Share Amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Oil, natural gas, and natural gas liquids sales	\$156,014	\$174,012	\$450,609	\$526,915
Interest and other	54	109	123	939
Total revenues	156,068	174,121	450,732	527,854
Costs, expenses, and other:				
Lease operating expenses	27,426	23,480	82,167	70,593
Production and property taxes	8,842	7,926	26,935	32,187
Transportation and processing costs	3,580	3,197	11,167	10,263
General and administrative	13,416	19,942	45,221	49,122
Depreciation, depletion, and amortization	73,845	54,323	213,802	155,227
Ceiling test write-down of oil and natural gas properties	329,957	—	713,750	—
Impairment of properties	79,529	—	79,529	—
Interest expense	36,223	37,225	103,932	113,081
Realized and unrealized losses (gains) on derivative instruments, net	22,795	(65,961)	(40,744)	(70,632)
Other, net	11,727	(177)	42,102	12,280
Total costs, expenses, and other	607,340	79,955	1,277,861	372,121
Earnings (loss) from continuing operations before income taxes	(451,272)	94,166	(827,129)	155,733
Income tax	7,280	34,556	175,269	76,940
Net earnings (loss) from continuing operations	(458,552)	59,610	(1,002,398)	78,793
Net earnings from discontinued operations	—	28,108	—	44,569
Net earnings (loss)	(458,552)	87,718	(1,002,398)	123,362
Less: net earnings attributable to noncontrolling interest	—	4,923	—	4,987
Net earnings (loss) attributable to Forest Oil Corporation common shareholders	\$(458,552)	\$82,795	\$(1,002,398)	\$118,375
Basic earnings (loss) per common share attributable to Forest Oil Corporation common shareholders:				
Earnings (loss) from continuing operations	\$(3.97)	\$ .52	\$(8.73)	\$ .69
Earnings from discontinued operations	—	.20	—	.35
Basic earnings (loss) per common share	\$(3.97)	\$ .72	\$(8.73)	\$ 1.04
Diluted earnings (loss) per common share attributable to Forest Oil Corporation common shareholders:				
Earnings (loss) from continuing operations	\$(3.97)	\$ .52	\$(8.73)	\$ .69
Earnings from discontinued operations	—	.20	—	.34
Diluted earnings (loss) per common share	\$(3.97)	\$ .72	\$(8.73)	\$ 1.03

Amounts attributable to Forest Oil Corporation common shareholders:

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Net earnings (loss) from continuing operations	\$(458,552 )	\$59,610	\$(1,002,398 )	\$78,793
Net earnings from discontinued operations	—	23,185	—	39,582
Net earnings (loss)	\$(458,552 )	\$82,795	\$(1,002,398 )	\$118,375

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)  
(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2012	2011	2012	2011	
Net earnings (loss)	\$(458,552	) \$87,718	\$(1,002,398	) \$123,362	
Other comprehensive income (loss):					
Foreign currency translation losses	—	(38,234	) —	(27,763	)
Unfunded postretirement benefits, net of tax	185	93	558	311	
Total other comprehensive income (loss)	185	(38,141	) 558	(27,452	)
Total comprehensive income (loss)	(458,367	) 49,577	(1,001,840	) 95,910	
Less: total comprehensive loss attributable to noncontrolling interest	—	(1,824	) —	(1,330	)
Total comprehensive income (loss) attributable to Forest Oil Corporation common shareholders	\$(458,367	) \$51,401	\$(1,001,840	) \$97,240	

See accompanying Notes to Condensed Consolidated Financial Statements.



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FOREST OIL CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF EQUITY  
 (Unaudited)  
 (In Thousands)

	Common Stock		Capital	Accumulated	Accumulated	Total
	Shares	Amount	Surplus	Deficit	Other Comprehensive Income (Loss)	Shareholders' Equity
Balances at December 31, 2011	114,526	\$11,454	\$2,486,994	\$(1,287,063)	\$ (18,272 )	\$1,193,113
Common stock issued for acquisition of unproved oil and natural gas properties	2,657	266	36,165	—	—	36,431
Employee stock purchase plan	128	13	907	—	—	920
Restricted stock issued, net of forfeitures	1,198	120	(120 )	—	—	—
Amortization of stock-based compensation	—	—	18,181	—	—	18,181
Other, net	(283 )	(30 )	(3,998 )	—	—	(4,028 )
Net loss	—	—	—	(1,002,398 )	—	(1,002,398 )
Other comprehensive income	—	—	—	—	558	558
Balances at September 30, 2012	118,226	\$11,823	\$2,538,129	\$(2,289,461)	\$ (17,714 )	\$242,777

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In Thousands)

	Nine Months Ended September 30,	
	2012	2011
Operating activities:		
Net earnings (loss)	\$(1,002,398 )	\$123,362
Less: net earnings from discontinued operations	—	44,569
Net earnings (loss) from continuing operations	(1,002,398 )	78,793
Adjustments to reconcile net earnings (loss) from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation, depletion, and amortization	213,802	155,227
Deferred income tax	208,990	46,724
Unrealized losses (gains) on derivative instruments, net	46,372	(40,538 )
Ceiling test write-down of oil and natural gas properties	713,750	—
Impairment of properties	79,529	—
Stock-based compensation expense	12,227	17,809
Accretion of asset retirement obligations	4,914	4,496
Other, net	6,438	6,074
Changes in operating assets and liabilities:		
Accounts receivable	9,070	29,686
Other current assets	4,426	8,262
Accounts payable and accrued liabilities	2,182	(5,096 )
Accrued interest and other	(13,477 )	3,977
Net cash provided by operating activities of continuing operations	285,825	305,414
Investing activities:		
Capital expenditures for property and equipment:		
Exploration, development, and leasehold acquisition costs	(598,882 )	(656,894 )
Other fixed assets	(6,011 )	(4,370 )
Proceeds from sales of assets	8,902	120,956
Net cash used by investing activities of continuing operations	(595,991 )	(540,308 )
Financing activities:		
Proceeds from bank borrowings	651,000	12,000
Repayments of bank borrowings	(756,000 )	(12,000 )
Issuance of senior notes, net of issuance costs	491,250	—
Payment of debt issue costs	(872 )	(8,198 )
Change in bank overdrafts	(37,716 )	(20,660 )
Other, net	(1,339 )	(4,109 )
Net cash provided (used) by financing activities of continuing operations	346,323	(32,967 )
Cash flows of discontinued operations:		
Operating cash flows	—	101,292
Investing cash flows	—	(255,470 )
Financing cash flows	—	478,324
Net cash provided by discontinued operations	—	324,146
Effect of exchange rate changes on cash	—	(3,476 )
Net increase in cash and cash equivalents	36,157	52,809

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Net increase in cash and cash equivalents of discontinued operations	—	(289	)
Net increase in cash and cash equivalents of continuing operations	36,157	52,520	
Cash and cash equivalents of continuing operations at beginning of period	3,012	217,569	
Cash and cash equivalents of continuing operations at end of period	\$39,169	\$270,089	
Cash paid by continuing operations during the period for:			
Interest (net of capitalized amounts)	\$88,619	\$94,398	
Income taxes (net of refunded amounts)	979	31,523	
Non-cash investing activities of continuing operations:			
Increase (decrease) in accrued capital expenditures	\$(22,878	) \$38,927	
Increase in asset retirement costs	4,786	2,553	
Common stock issued for acquisition of unproved oil and natural gas properties	36,431	—	
See accompanying Notes to Condensed Consolidated Financial Statements.			

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FOREST OIL CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(1) ORGANIZATION AND BASIS OF PRESENTATION

Organization

Forest Oil Corporation is an independent oil and gas company engaged in the acquisition, exploration, development, and production of oil, natural gas, and natural gas liquids (“NGL”) primarily in the United States. Forest was incorporated in New York in 1924, as the successor to a company formed in 1916, and has been a publicly held company since 1969. Forest holds assets in several exploration and producing areas in the United States and has exploratory and development interests in two other countries. On June 1, 2011, Forest completed an initial public offering of approximately 18% of the common stock of its then wholly-owned subsidiary, Lone Pine Resources Inc. (“Lone Pine”), which held Forest’s ownership interests in its Canadian operations. On September 30, 2011, Forest distributed, or spun-off, its remaining 82% ownership in Lone Pine to Forest’s shareholders, by means of a special stock dividend of Lone Pine common shares. Unless the context indicates otherwise, the terms “Forest,” the “Company,” “we,” “our,” and “us,” as used in this Quarterly Report on Form 10-Q, refer to Forest Oil Corporation and its subsidiaries.

Basis of Presentation

The Condensed Consolidated Financial Statements included herein are unaudited and include the accounts of Forest and its consolidated subsidiaries. As a result of the spin-off, Lone Pine’s results of operations are reported as discontinued operations in Forest’s Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011. See Note 10 for more information regarding the results of operations of Lone Pine. In the opinion of management, all adjustments, which are of a normal recurring nature, have been made that are necessary for a fair presentation of the financial position of Forest at September 30, 2012, and the results of its operations, its comprehensive income, its cash flows, and changes in its shareholders’ equity for the periods presented. Interim results are not necessarily indicative of expected annual results because of the impact of fluctuations in the prices of oil, natural gas, and natural gas liquids and the impact the prices have on Forest’s revenues and the fair values of its derivative instruments.

In the course of preparing the Condensed Consolidated Financial Statements, management makes various assumptions, judgments, and estimates to determine the reported amounts of assets, liabilities, revenues, and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time, and the occurrence of future events and, accordingly, actual results could differ from amounts previously established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of oil, natural gas, and natural gas liquids reserves used in calculating depletion, the amount of future net revenues used in computing the ceiling test limitations, and the amount of future capital costs and abandonment obligations used in such calculations, determining impairments of investments in unproved properties and goodwill, valuing deferred tax assets, and estimating fair values of financial instruments, including derivative instruments.

Certain amounts in the prior year financial statements have been reclassified to conform to the 2012 financial statement presentation.

For a more complete understanding of Forest’s operations, financial position, and accounting policies, reference is made to the consolidated financial statements of Forest, and related notes thereto, filed with Forest’s Annual Report on

Form 10-K for the year ended December 31, 2011, previously filed with the Securities and Exchange Commission ("SEC").

## (2) EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed using the two-class method by dividing net earnings (loss) attributable to common stock by the weighted average number of common shares outstanding during each period. The two-class method of computing earnings (loss) per share is required to be used since Forest has participating securities. The two-class method is an earnings allocation formula that determines earnings (loss) per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Holders of restricted stock issued under Forest's stock incentive plans have the right to receive non-forfeitable cash and certain non-cash dividends, participating on an equal basis with common stock. Holders of phantom stock units issued to directors under Forest's stock

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incentive plans also have the right to receive non-forfeitable cash and certain non-cash dividends, participating on an equal basis with common stock, while phantom stock units issued to employees do not participate in dividends. Stock options issued under Forest's stock incentive plans do not participate in dividends. Performance units issued under Forest's stock incentive plans do not participate in dividends in their current form. Holders of performance units participate in dividends paid during the performance units' vesting period only after the performance units vest and common shares have been earned by the holders of the performance units. Performance units may vest with no common shares being earned, depending on Forest's shareholder return over the performance units' vesting period in relation to the shareholder returns of specified peer companies. See Note 3 for more information on Forest's stock-based incentive awards. In summary, restricted stock issued to employees and directors and phantom stock units issued to directors are participating securities, and earnings are allocated to both common stock and these participating securities under the two-class method. However, these participating securities do not have a contractual obligation to share in Forest's losses. Therefore, in periods of net loss, none of the loss is allocated to these participating securities.

Under the treasury stock method, diluted earnings (loss) per share is computed by dividing (a) net earnings (loss), adjusted for the effects of certain contracts that provide the issuer or holder with a choice between settlement methods, by (b) the weighted average number of common shares outstanding, adjusted for the dilutive effect, if any, of potential common shares (e.g., stock options, unvested restricted stock grants, unvested phantom stock units that may be settled in shares, and unvested performance units). No potential common shares are included in the computation of any diluted per share amount when a net loss exists, as was the case for the three and nine months ended September 30, 2012. Unvested restricted stock grants were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2011 as their inclusion would have an antidilutive effect. Unvested performance stock units were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2011 as no shares would have been earned under the performance stock unit agreements if September 30, 2011 had been the end of the vesting period under these agreements.

The following reconciles net earnings (loss) as reported in the Condensed Consolidated Statements of Operations to net earnings (loss) used for calculating basic and diluted earnings (loss) per share for the periods presented.

	Three Months Ended September 30,			2011		
	2012					
	Continuing Operations	Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total
	(In Thousands)					
Net earnings (loss)	\$(458,552 )	\$ —	\$(458,552 )	\$59,610	\$ 28,108	\$87,718
Net earnings attributable to noncontrolling interest	—	—	—	—	(4,923 )	(4,923 )
Net earnings attributable to participating securities	—	—	—	(1,341 )	(522 )	(1,863 )
Net earnings (loss) attributable to common stock for basic earnings per share	\$(458,552 )	\$ —	\$(458,552 )	\$58,269	\$ 22,663	\$80,932
Adjustment for liability classified stock-based compensation awards	—	—	—	—	(603 )	(603 )
Net earnings (loss) for diluted earnings per share	\$(458,552 )	\$ —	\$(458,552 )	\$58,269	\$ 22,060	\$80,329

Nine Months Ended September 30,

	2012			2011		
	Continuing Operations	Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total

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	(In Thousands)					
Net earnings (loss)	\$(1,002,398)	\$ —	\$(1,002,398)	\$78,793	\$ 44,569	\$123,362
Net earnings attributable to noncontrolling interest	—	—	—	—	(4,987 )	(4,987 )
Net earnings attributable to participating securities	—	—	—	(1,606 )	(807 )	(2,413 )
Net earnings (loss) attributable to common stock for basic earnings per share	\$(1,002,398)	\$ —	\$(1,002,398)	\$77,187	\$ 38,775	\$115,962
Adjustment for liability classified stock-based compensation awards	—	—	—	—	(707 )	(707 )
Net earnings (loss) for diluted earnings per share	\$(1,002,398)	\$ —	\$(1,002,398)	\$77,187	\$ 38,068	\$115,255

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The following reconciles basic weighted average common shares outstanding to diluted weighted average common shares outstanding for the periods presented.

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2012	2011	2012	2011
	(In Thousands)			
Weighted average common shares outstanding during the period for basic earnings (loss) per share	115,417	111,810	114,784	111,598
Dilutive effects of potential common shares	—	352	—	521
Weighted average common shares outstanding during the period, including the effects of dilutive potential common shares, for diluted earnings (loss) per share	115,417	112,162	114,784	112,119

**(3) STOCK-BASED COMPENSATION****Equity Incentive Plans**

Forest maintains the 2001 and 2007 Stock Incentive Plans (the “Plans”) under which qualified and non-qualified stock options, restricted stock, performance units, phantom stock units, and other awards may be granted to employees, consultants, and non-employee directors of Forest and its subsidiaries.

**Compensation Costs**

The table below sets forth stock-based compensation of continuing operations for the three and nine months ended September 30, 2012 and 2011, and the remaining unamortized amounts and weighted average amortization period as of September 30, 2012.

	Stock Options (In Thousands)	Restricted Stock	Performance Units	Phantom Stock Units	Total <sup>(1)</sup>
Three months ended September 30, 2012:					
Total stock-based compensation costs	\$—	\$3,500	\$ 1,273	\$909	\$5,682
Less: stock-based compensation costs capitalized	—	(1,435)	(455)	(402)	(2,292)
Stock-based compensation costs expensed	\$—	\$2,065	\$ 818	\$507	\$3,390
Nine months ended September 30, 2012:					
Total stock-based compensation costs	\$—	\$12,219	\$ 5,630	\$796	\$18,645
Less: stock-based compensation costs capitalized	—	(4,630)	(1,322)	(532)	(6,484)
Stock-based compensation costs expensed	\$—	\$7,589	\$ 4,308	\$264	\$12,161
Unamortized stock-based compensation costs	\$—	\$19,517	\$ 5,978	\$4,618	\$30,113
Weighted average amortization period remaining	—	1.9 years	1.7 years	1.5 years	1.8 years
Three months ended September 30, 2011:					
Total stock-based compensation costs	\$1,095	\$15,434	\$ 775	\$(1,456)	\$15,848
Less: stock-based compensation costs capitalized	(437)	(6,994)	(253)	529	(7,155)
Stock-based compensation costs expensed	\$658	\$8,440	\$ 522	\$(927)	\$8,693



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Nine months ended September 30, 2011:

Total stock-based compensation costs	\$1,536	\$26,566	\$2,181	\$(1,788)	\$28,495
Less: stock-based compensation costs capitalized	(663)	(11,522)	(683)	696	(12,172)
Stock-based compensation costs expensed	\$873	\$15,044	\$1,498	\$(1,092)	\$16,323

- 
- The Company also maintains an employee stock purchase plan (which is not included in the table) under which \$.1 million and \$.3 million of compensation cost was recognized for the three and nine month periods ended
- (1) September 30, 2012, respectively, and \$.1 million and \$.4 million of compensation cost was recognized for the three and nine month periods ended September 30, 2011, respectively.
- (2) Based on the closing price of Forest's common stock on September 30, 2012.

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## Stock Options

The following table summarizes stock option activity in the Plans for the nine months ended September 30, 2012.

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (In Thousands) <sup>(1)</sup>	Number of Options Exercisable
Outstanding at January 1, 2012	1,766,587	\$ 14.55	\$ 2,731	1,766,587
Granted	—	—	—	—
Exercised	—	—	—	—
Cancelled	(879,843 )	11.08	—	—
Outstanding at September 30, 2012	886,744	\$ 17.99	\$ —	886,744

(1) The intrinsic value of a stock option is the amount by which the market value of the underlying stock, as of the date outstanding or exercised, exceeds the exercise price of the option.

## Restricted Stock, Performance Units, and Phantom Stock Units

The following table summarizes the restricted stock, performance unit, and phantom stock unit activity in the Plans for the nine months ended September 30, 2012.

	Restricted Stock			Performance Units			Phantom Stock Units		
	Number of Shares	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)	Number of Units <sup>(1)</sup>	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)	Number of Units <sup>(2)</sup>	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)
Unvested at January 1, 2012	2,474,112	\$ 24.00		655,120	\$ 19.50		1,238,817	\$ 14.32	
Awarded	1,524,594	10.16		511,500	14.70		—	—	
Vested	(891,207 )	19.46	\$ 7,236	(323,760)	18.18	\$ —	(274,897 )	12.23	\$ 2,313
Forfeited	(326,430 )	19.20		(181,680)	17.55		(73,249 )	15.71	
Unvested at September 30, 2012	2,781,069	\$ 18.43		661,180	\$ 16.97		890,671	\$ 14.85	

Forest granted 511,500 performance units on March 12, 2012, with a grant date fair value of \$14.70 each. Under the terms of the award agreements, each performance unit represents a contractual right to receive one share of Forest's common stock; provided that the actual number of shares that may be deliverable under an award will range from 0% to 200% of the number of performance units awarded, depending on Forest's relative total shareholder return in comparison to an identified peer group during the thirty-six-month performance period ending on February 28, 2015.

All of the unvested phantom stock units at September 30, 2012 must be settled in cash. The phantom stock units have been accounted for as a liability within the Condensed Consolidated Financial Statements. Of the 274,897 phantom stock units that vested during the nine months ended September 30, 2012, 268,817 were settled in cash, while the remaining 6,080 were settled in shares.



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## (4) DEBT

The components of debt are as follows:

	September 30, 2012			December 31, 2011		
	Principal	Unamortized Premium (Discount)	Total	Principal	Unamortized Premium (Discount)	Total
	(In Thousands)					
Credit Facility	\$—	\$—	\$—	\$105,000	\$—	\$105,000
7% Senior Subordinated Notes due 2013	12	—	12	12	—	12
8½% Senior Notes due 2014 <sup>(1)</sup>	600,000	(8,020)	) 591,980	600,000	(12,389)	) 587,611
7¼% Senior Notes due 2019	1,000,000	379	1,000,379	1,000,000	421	1,000,421
7½% Senior Notes due 2020	500,000	—	500,000	—	—	—
Total debt	\$2,100,012	\$(7,641)	) \$2,092,371	\$1,705,012	\$(11,968)	) \$1,693,044
Less: current portion of long-term debt <sup>(1)</sup>	(300,012)	) 4,010	(296,002)	—	—	—
Long-term debt	\$1,800,000	\$(3,631)	) \$1,796,369	\$1,705,012	\$(11,968)	) \$1,693,044

In September 2012, the Company irrevocably called \$300.0 million (50% of the aggregate principal amount) of the (1) 8½% senior notes due 2014 and redeemed those called notes in October 2012 at 110.24% of par, recognizing a loss of \$36.3 million upon redemption.

**Bank Credit Facility**

As of September 30, 2012, the Company had a \$1.5 billion credit facility (the “Credit Facility”) with a syndicate of banks led by JPMorgan Chase Bank, N.A. (the “Administrative Agent”), which matures in June 2016. The size of the Credit Facility may be increased by \$300.0 million, to a total of \$1.8 billion, upon agreement between the applicable lenders and Forest.

Forest’s availability under the Credit Facility is governed by a borrowing base. As of September 30, 2012, the borrowing base under the Credit Facility was \$1.20 billion. The determination of the borrowing base is made by the lenders in their sole discretion, on a semi-annual basis, taking into consideration the estimated value of Forest’s oil and gas properties based on pricing models determined by the lenders at such time, in accordance with the lenders’ customary practices for oil and gas loans. The available borrowing amount under the Credit Facility could increase or decrease based on such redetermination. In addition to the scheduled semi-annual redeterminations, Forest and the lenders each have discretion at any time, but not more often than once during a calendar year, to have the borrowing base redetermined. The borrowing base is also subject to automatic adjustments if certain events occur, such as if Forest or any of its Restricted Subsidiaries (as defined in the Credit Facility) issue senior unsecured notes, in which case the borrowing base will immediately be reduced by an amount equal to 25% of the stated principal amount of such issued senior notes, excluding any senior unsecured notes that Forest or any of its Restricted Subsidiaries may issue to refinance then-existing senior notes. This was the case in September 2012, when the borrowing base was reduced by \$50.0 million from \$1.25 billion to \$1.20 billion. The borrowing base is also subject to automatic adjustment if Forest or any of its Restricted Subsidiaries sell oil and natural gas properties included in the borrowing base, as applicable, having a fair market value in excess of 10% of the borrowing base then in effect. In this case, the borrowing base would be reduced by an amount either (i) equal to the percentage of the borrowing base attributable to the sold properties, as determined by the Administrative Agent, or (ii) if none of the borrowing base is attributable to the sold properties, a value agreed upon by Forest and the required lenders. Forest expects the sale of its south

Louisiana properties for \$220.0 million, discussed in Note 5 below, will result in an approximate \$80.0 million reduction to its borrowing base when the transaction closes.

Effective October 5, 2012, the lenders completed the most recent scheduled semi-annual redetermination of the borrowing base, reducing the borrowing base to \$1.15 billion. The next scheduled semi-annual redetermination of the borrowing base will occur on or about May 1, 2013. A lowering of the borrowing base could require Forest to repay indebtedness in excess of the borrowing base in order to cover the deficiency. The Credit Facility is collateralized by Forest's assets, and Forest is required to mortgage and grant a security interest in 75% of the present value of the estimated proved oil and gas properties and related assets of Forest and its U.S. subsidiaries.

The Credit Facility includes terms and covenants that place limitations on certain types of activities, including restrictions or requirements with respect to additional debt, liens, asset sales, hedging activities, investments, dividends, mergers, and acquisitions, and also includes a financial covenant. The Credit Facility provides that Forest will not permit its

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ratio of total debt outstanding to EBITDA (as adjusted for non-cash charges) for a trailing twelve-month period to be greater than 4.5 to 1.0 at any time.

At September 30, 2012, there were no outstanding borrowings under the Credit Facility.

### 7½% Senior Notes Due 2020

On September 17, 2012, Forest issued \$500.0 million in principal amount of 7½% senior notes due 2020 (the “7½% Notes”) at par for net proceeds of \$491.3 million, after deducting initial purchaser discounts. Net proceeds from the 7½% Notes were used to redeem \$300.0 million in principal amount of the 8½% senior notes due 2014 at 110.24% of par in October 2012 (after the required notice of redemption period elapsed), with the balance of the net proceeds used to reduce outstanding borrowings under the Credit Facility. Prior to redeeming a portion of the 8½% senior notes due 2014, the net proceeds were used to temporarily reduce outstanding borrowings under the Credit Facility. Interest on the 7½% Notes is payable semiannually on March 15 and September 15.

The 7½% Notes are redeemable, at Forest’s option, at the prices set forth below, expressed as percentages of the principal amount redeemed, plus accrued but unpaid interest, if redeemed during the 12-month period beginning on or after September 15 of the years indicated below:

2016	103.75 %
2017	101.88 %
2018 and thereafter	100.00 %

Forest may also redeem the 7½% Notes, in whole or in part, at any time prior to September 15, 2016, at a price equal to the principal amount plus a make-whole premium, calculated using the applicable Treasury yield plus 0.5%, plus accrued but unpaid interest. In addition, prior to September 15, 2015, Forest may, at any time or from time to time, redeem up to 35% of the aggregate principal amount of the 7½% Notes with the net proceeds of certain equity offerings at 107.5% of the principal amount of the 7½% Notes, plus any accrued but unpaid interest, if at least 65% of the aggregate principal amount of the 7½% Notes remains outstanding after such redemption and the redemption occurs within 120 days of the date of the closing of such equity offering.

## (5) PROPERTY AND EQUIPMENT

### Full Cost Method of Accounting

The Company uses the full cost method of accounting for oil and gas properties. Separate cost centers are maintained for each country in which the Company has operations. During the periods presented, the Company’s primary oil and gas operations were conducted in the United States and Canada. Concurrent with the spin-off of Lone Pine on September 30, 2011, the Company no longer has any operations in Canada. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes, and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized. During the three months ended September 30, 2012 and 2011, Forest capitalized \$9.3 million and \$15.8 million, respectively, of general and administrative costs (including stock-based compensation) related to its continuing operations. During the nine months ended September 30, 2012 and 2011, Forest capitalized \$29.6 million and \$37.9 million, respectively, of general and administrative costs (including stock-based compensation) related to its continuing operations. Interest costs related to significant unproved properties that are under development are also capitalized to oil and gas properties. During the three months ended September 30, 2012 and 2011, Forest capitalized \$1.7 million and \$3.0 million, respectively, of interest costs attributed to the unproved properties of its continuing operations. During the nine months ended September 30, 2012 and 2011, Forest capitalized \$5.8 million and \$7.5 million, respectively, of

interest costs attributed to the unproved properties of its continuing operations.

Investments in unproved properties, including capitalized interest costs, are not depleted pending determination of the existence of proved reserves. Unproved properties are assessed at least annually to ascertain whether impairment has occurred. Unproved properties whose costs are individually significant are assessed individually by considering the primary lease terms of the properties, the holding period of the properties, geographic and geologic data obtained relating to the properties, and estimated discounted future net cash flows from the properties. Estimated discounted future net cash flows are based on discounted future net revenues associated with probable and possible reserves, risk adjusted as appropriate. Where it is not practicable to individually assess the amount of impairment of properties for which costs are not individually significant, such

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properties are grouped for purposes of assessing impairment. The amount of impairment assessed is added to the costs to be amortized, or is reported as a period expense, as appropriate.

During the quarter ended September 30, 2012, Forest recorded a \$66.9 million impairment of its unproved properties in South Africa. After several unsuccessful attempts to sell the South African properties, Forest determined that it would likely not recover the carrying amount of its investment in these properties. Because Forest has no proved reserves in South Africa, the impairment was reported as a period expense rather than being added to the costs to be amortized and is included in the Condensed Consolidated Statements of Operations within the “Impairment of properties” line item.

Gain or loss is not recognized on the sale of oil and natural gas properties unless the sale significantly alters the relationship between capitalized costs and estimated proved oil and natural gas reserves attributable to a cost center.

Depletion of proved oil and gas properties is computed on the units-of-production method, whereby capitalized costs, as adjusted for future development costs and asset retirement obligations, are amortized over the total estimated proved reserves. The Company uses its quarter-end reserves estimates to calculate depletion for the current quarter.

The Company performs a ceiling test each quarter on a country-by-country basis under the full cost method of accounting. The ceiling test is a limitation on capitalized costs prescribed by SEC Regulation S-X Rule 4-10. The ceiling test is not a fair value based measurement. Rather, it is a standardized mathematical calculation. The ceiling test provides that capitalized costs less related accumulated depletion and deferred income taxes for each cost center may not exceed the sum of (1) the present value of future net revenue from estimated production of proved oil and gas reserves using current prices, excluding the future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet, at a discount factor of 10%; plus (2) the cost of properties not being amortized, if any; plus (3) the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any; less (4) income tax effects related to differences in the book and tax basis of oil and gas properties. Should the net capitalized costs for a cost center exceed the sum of the components noted above, a ceiling test write-down would be recognized to the extent of the excess capitalized costs.

As a result of this limitation on capitalized costs, the accompanying financial statements include provisions for ceiling test write-downs of oil and natural gas property costs for the three and nine months ended September 30, 2012 of \$330.0 million and \$713.8 million, respectively. During the three months ended September 30, 2012, Forest recorded a \$330.0 million ceiling test write-down of its United States cost center and during the three months ended June 30, 2012, Forest recorded a \$349.0 million ceiling test write-down of its United States cost center. Both of these ceiling test write-downs resulted primarily from a decrease in natural gas and natural gas liquids prices. During the three months ended March 31, 2012, Forest recorded a \$34.8 million ceiling test write-down of its Italian cost center due to an Italian regional regulatory body’s denial of Forest’s environmental impact assessment (“EIA”). Approval of the EIA is necessary in order for Forest to commence production in Italy. Forest is currently appealing the region’s denial; however, in the meantime, Forest determined that it can no longer conclude with reasonable certainty that its Italian natural gas reserves are producible and, therefore, can no longer be classified as proved reserves. Additional write-downs of the United States cost center may be required in subsequent periods if, among other things, the unweighted arithmetic average of the first-day-of-the-month oil, natural gas, or NGL prices used in the calculation of the present value of future net revenue from estimated production of proved oil and natural gas reserves decline compared to prices used as of September 30, 2012, unproved property values decrease, estimated proved reserve volumes are revised downward, or costs incurred in exploration, development, or acquisition activities exceed the discounted future net cash flows from the additional reserves, if any, attributable to the cost center.

## Divestitures



In August 2012, the Company entered into an agreement to sell the majority of its East Texas natural gas gathering assets for \$34.0 million in cash. Forest can also earn up to \$9.0 million of additional performance payments contingent on future activity. The transaction is expected to close on October 31, 2012 and is subject to customary closing conditions and purchase price adjustments, including effective date and title defect adjustments. In conjunction with the sale, Forest entered into a ten-year natural gas gathering agreement with the buyer under which Forest will pay market-based gathering rates and commit the production from its existing and future operated wells located within five miles of the current configuration of the gathering system. As of September 30, 2012, these assets are presented in the Condensed Consolidated Balance Sheet as assets held for sale and were written down to their estimated fair value less cost to sell of \$27.4 million, with a \$12.7 million impairment charge included in the Condensed Consolidated Statements of Operations within the "Impairment of properties" line item. Forest determined that the estimated cash proceeds from the sale of these assets approximates the fair value of the assets since the sales agreement was negotiated at arm's length with an unrelated third-party. This non-recurring fair value measurement is categorized within the Level 3 fair value hierarchy (see Note 7 for more information on the fair value hierarchy). Since there will be a continuation of cash flows between Forest and the disposed component by way of the natural

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gas gathering agreement, these assets do not qualify for discontinued operations reporting. Forest intends to use the proceeds from this divestiture to repay outstanding borrowings under the Credit Facility.

In October 2012, Forest entered into an agreement to sell all of its oil and natural gas properties located in south Louisiana for \$220.0 million in cash. The transaction is expected to close in November 2012, subject to customary closing conditions and purchase price adjustments. Forest intends to use the proceeds from this divestiture to repay outstanding borrowings under the Credit Facility.

During the three and nine months ended September 30, 2012, Forest also sold miscellaneous oil and natural gas properties for proceeds of \$7.8 million and \$8.8 million, respectively.

## Acquisitions

In February 2012, the Company issued 2.7 million shares of common stock, valued at \$36.4 million, pursuant to a lease purchase agreement whereby Forest acquired leases on unproved oil and natural gas properties in the Wolfbone oil play in the Permian Basin in Texas.

## (6) INCOME TAXES

A reconciliation of reported income tax attributable to continuing operations to the amount of income tax that would result from applying the United States federal statutory income tax rate to pretax earnings (loss) from continuing operations is as follows:

	Three Months Ended September 30, 2012		2011		Nine Months Ended September 30, 2012		2011					
	(In Thousands)											
Federal income tax at 35% of earnings (loss) from continuing operations before income taxes	\$	(157,945	)	\$	32,958	\$	(289,495	)	\$	54,507		
State income taxes, net of federal income tax benefits		(5,442	)		1,107		(9,983	)		1,830		
Canadian dividend tax, net of U.S. tax benefit		—			—		—			18,460		
Effect of federal, state, and foreign tax on permanent items		342			1,397		997			2,243		
Change in valuation allowance		170,065			—		472,569			—		
Other		260			(906	)	1,181			(100	)	
Total income tax		\$	7,280		\$	34,556		\$	175,269		\$	76,940

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## (7) FAIR VALUE MEASUREMENTS

The Company's assets and liabilities measured at fair value on a recurring basis at September 30, 2012 and December 31, 2011 are set forth in the table below.

	September 30, 2012 Using Significant Observable Inputs (Level 2) <sup>(1)</sup> (In Thousands)	December 31, 2011 Using Significant Other Observable Inputs (Level 2) <sup>(1)</sup> (In Thousands)
Assets:		
Derivative instruments <sup>(2)</sup> :		
Commodity	\$33,282	\$79,487
Interest rate	15,844	20,556
Total assets	\$49,126	\$100,043
Liabilities:		
Derivative instruments <sup>(2)</sup> :		
Commodity	\$24,399	\$28,944
Interest rate	—	—
Total liabilities	\$24,399	\$28,944

- The authoritative accounting guidance regarding fair value measurements for assets and liabilities measured at fair value establishes a three-tier fair value hierarchy, which prioritizes the inputs used to measure fair value. These tiers consist of: Level 1, defined as unadjusted quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for use when relevant observable inputs are not available.
- (1) There were no transfers between levels of the fair value hierarchy during the three and nine months ended September 30, 2012. The Company's policy is to recognize transfers between levels of the fair value hierarchy as of the beginning of the reporting period in which the event or change in circumstances caused the transfer.
- The Company's derivative assets and liabilities include commodity and interest rate derivatives (see Note 8 for more information on these instruments). The Company utilizes present value techniques and option-pricing models for valuing its derivatives. Inputs to these valuation techniques include published forward prices, volatilities, and credit risk considerations, including the incorporation of published interest rates and credit spreads. All of the significant inputs are observable, either directly or indirectly; therefore, the Company's derivative instruments are included within the Level 2 fair value hierarchy.
- (2)

The fair values and carrying amounts of the Company's financial instruments are summarized below as of the dates indicated.

September 30, 2012		Fair Value Measurements:	
Carrying Amount	Total Fair Value <sup>(1)</sup>	Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2)

(In Thousands)

## Assets:

Derivative instruments	\$49,126	\$49,126	\$—	\$49,126
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## Liabilities:

Derivative instruments	24,399	24,399	—	24,399
8½% Senior Notes due 2014	591,980	651,000	651,000	—
7¼% Senior Notes due 2019	1,000,379	990,000	990,000	—
7½% Senior Notes due 2020	500,000	497,190	497,190	—

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(1) The Company used various assumptions and methods in estimating the fair values of its financial instruments. The fair values of the senior notes were estimated based on quoted market prices. The methods used to determine the fair values of the derivative instruments are discussed above. See also Note 8 for more information on the derivative instruments.

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	December 31, 2011	
	Carrying Amount	Fair Value <sup>(1)</sup>
	(In Thousands)	
Assets:		
Derivative instruments	\$ 100,043	\$ 100,043
Liabilities:		
Derivative instruments	28,944	28,944
Credit Facility	105,000	105,000
8½% Senior Notes due 2014	587,611	653,250
7¼% Senior Notes due 2019	1,000,421	1,025,000

The Company used various assumptions and methods in estimating the fair values of its financial instruments. The fair values of the senior notes were estimated based on quoted market prices. The carrying amount of the credit (1) facility approximated fair value due to the short original maturities of the borrowings and because the borrowings bear interest at variable market rates. The methods used to determine the fair values of the derivative instruments are discussed above. See also Note 8 for more information on the derivative instruments.

**(8) DERIVATIVE INSTRUMENTS****Commodity Derivatives**

Forest periodically enters into commodity derivative instruments such as swap and collar agreements as an attempt to moderate the effects of wide fluctuations in commodity prices on Forest's cash flow and to manage the exposure to commodity price risk. Forest's commodity derivative instruments generally serve as effective economic hedges of commodity price exposure; however, Forest has elected not to designate its derivatives as hedging instruments for accounting purposes. As such, Forest recognizes all changes in fair value of its derivative instruments as unrealized gains or losses on derivative instruments in the Condensed Consolidated Statement of Operations.

The table below sets forth Forest's outstanding commodity swaps as of September 30, 2012.

**Commodity Swaps**

	Natural Gas (NYMEX HH)		Oil (NYMEX WTI)		NGL (OPIS Refined Products)	
	Bbtu Per Day	Weighted Average Hedged Price per MMBtu	Barrels Per Day	Weighted Average Hedged Price per Bbl	Barrels Per Day	Weighted Average Hedged Price per Bbl
Remaining Term						
October 2012 - December 2012 <sup>(1)</sup>	155	\$4.63	4,500	\$97.26	2,000	\$45.22
Calendar 2013	160	3.98	4,000	95.53	—	—

50 Bbtu per day of 2012 gas swaps with a weighted average hedged price per MMBtu of \$5.30 are layered with a written put of \$3.53 and a call spread of \$4.00 to \$4.50. Together with the put and call spread, Forest will receive (1) the \$5.30 swap price on 50 Bbtu per day except as follows: Forest will receive (i) NYMEX HH plus \$1.77 when NYMEX HH is below \$3.53; (ii) \$5.30 plus the value of the call spread when NYMEX HH is between \$4.00 and \$4.50; and (iii) \$5.80 when NYMEX HH is \$4.50 or above.



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In connection with several natural gas and oil swaps entered into, Forest granted option instruments (several commodity swaptions and puts) to the swap counterparties in exchange for Forest receiving premium hedged prices on the natural gas and oil swaps. Under the terms of the commodity swaption agreements, the counterparties have the right, but not the obligation, to enter into a specified swap agreement with Forest before the option expires. The table below sets forth key provisions of the outstanding options as of September 30, 2012. (As of October 24, 2012, none of the options in the table have been exercised by the counterparties.)

## Commodity Options

		Natural Gas (NYMEX HH)		Oil (NYMEX WTI)	
Underlying Term	Option Expiration	Underlying Bbtu Per Day	Underlying Hedged Price per MMBtu	Underlying Barrels Per Day	Underlying Hedged Price per Bbl
Gas Swaptions:					
Calendar 2013	December 2012	30	\$ 4.02	—	\$ —
Calendar 2013	December 2012	10	4.01	—	—
Oil Swaptions:					
Calendar 2013	December 2012	—	—	2,000	95.00
Calendar 2014	December 2013	—	—	2,000	110.00
Calendar 2014	December 2013	—	—	1,000	109.00
Calendar 2014	December 2013	—	—	2,000	100.00
Calendar 2015	December 2014	—	—	3,000	100.00
Oil Put Options:					
Monthly Oct - Dec 2012	Monthly Oct - Dec 2012	—	—	5,000	75.00

## Derivative Instruments Entered Into Subsequent to September 30, 2012

Subsequent to September 30, 2012, through October 24, 2012, we entered into the following derivative agreements:

## Commodity Swaps

Swap Term	Natural Gas (NYMEX HH)	
	Bbtu Per Day	Weighted Average Hedged Price per MMBtu
Calendar 2014 <sup>(1)</sup>	40	\$4.50

In connection with entering into these natural gas swaps with premium hedged prices, Forest granted options to the (1) counterparties to enter into gas swaps with Forest for Calendar 2014 covering 40 Bbtu per day at a weighted average hedged price per MMBtu of \$4.50, with such options expiring in December 2013.

## Interest Rate Derivatives

Forest periodically enters into interest rate derivative instruments in an attempt to manage the mix of fixed and floating interest rates within its debt portfolio. The Company has elected not to designate its derivatives as hedging instruments. As such, the Company recognizes all changes in fair value of its derivative instruments as unrealized gains or losses on derivative instruments in the Condensed Consolidated Statement of Operations. The table below sets forth Forest's outstanding fixed-to-floating interest rate swaps as of September 30, 2012.

## Interest Rate Swaps

Remaining Term	Notional Amount (In Thousands)	Weighted Average Floating Rate	Weighted Average Fixed Rate	
October 2012 - February 2014	\$500,000	1 month LIBOR + 5.89%	8.50	%





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## Fair Value and Gains and Losses

The table below summarizes the location and fair value amounts of Forest's derivative instruments reported in the Condensed Consolidated Balance Sheets as of the dates indicated. These derivative instruments are not designated as hedging instruments for accounting purposes. For financial reporting purposes, Forest does not offset asset and liability fair value amounts recognized for derivative instruments with the same counterparty under its master netting arrangements. See Note 7 to the Condensed Consolidated Financial Statements for more information on the fair values of Forest's derivative instruments.

	September 30, 2012	December 31, 2011
	(In Thousands)	
Current assets:		
Commodity derivatives:		
Derivative instruments	\$32,369	\$79,487
Interest rate derivatives:		
Derivative instruments	11,484	10,134
Total current assets	\$43,853	\$89,621
Long-term assets:		
Commodity derivatives:		
Derivative instruments	\$913	\$—
Interest rate derivatives:		
Derivative instruments	4,360	10,422
Total long-term assets	\$5,273	\$10,422
Current liabilities:		
Commodity derivatives:		
Derivative instruments	\$7,759	\$28,944
Long-term liabilities:		
Commodity derivatives:		
Derivative instruments	\$16,640	\$—

The table below summarizes the amount of derivative instrument gains and losses reported in the Condensed Consolidated Statements of Operations as net realized and unrealized (gains) losses on derivative instruments for the periods indicated. These derivative instruments are not designated as hedging instruments for accounting purposes.

	Three Months Ended September 30, 2012		2011	Nine Months Ended September 30, 2012		2011
	(In Thousands)					
Commodity derivatives:						
Realized gains	\$ (26,242	)	\$ (8,639	)	\$ (78,637	) \$ (21,478
Unrealized losses (gains)	50,231		(51,886	)	41,659	(36,113
Interest rate derivatives:						
Realized gains	(2,758	)	(2,774	)	(8,479	) (8,616
Unrealized losses (gains)	1,564		(2,662	)	4,713	(4,425
Realized and unrealized losses (gains) on derivative instruments, net	\$22,795		\$ (65,961	)	\$ (40,744	) \$ (70,632

Due to the volatility of natural gas and liquids prices, the estimated fair values of Forest's commodity derivative instruments are subject to large fluctuations from period to period. Forest has experienced the effects of these commodity price fluctuations in both the current period and prior periods and expects that volatility in commodity prices will continue.

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### Credit Risk

Forest executes with each of its derivative counterparties an International Swap and Derivatives Association, Inc. (“ISDA”) Master Agreement, which is a standard industry form contract containing general terms and conditions applicable to many types of derivative transactions. Additionally, Forest executes, with each of its derivative counterparties, a Schedule, which modifies the terms and conditions of the ISDA Master Agreement according to the parties’ requirements and the specific types of derivatives to be traded. As of September 30, 2012, all but one of Forest’s derivative counterparties are lenders, or affiliates of lenders, under the Credit Facility. The terms of the Credit Facility provide that any security granted by Forest thereunder shall also extend to and be available to those lenders that are counterparties to derivative transactions. None of these counterparties requires collateral beyond that already pledged under the Credit Facility. The remaining counterparty, a purchaser of Forest’s natural gas production, generally owes money to Forest and therefore does not require collateral under the ISDA Master Agreement and Schedule it has executed with Forest.

The ISDA Master Agreements and Schedules contain cross-default provisions whereby a default under the Credit Facility will also cause a default under the derivative agreements. Such events of default include non-payment, breach of warranty, non-performance of the financial covenant, default on other indebtedness, certain pension plan events, certain adverse judgments, change of control, and a failure of the liens securing the Credit Facility. In addition, bankruptcy and insolvency events with respect to Forest or certain of its U.S. subsidiaries will result in an automatic acceleration of the indebtedness under the Credit Facility. None of these events of default is specifically credit-related, but some could arise if there were a general deterioration of Forest’s credit. The ISDA Master Agreements and Schedules contain a further credit-related termination event that would occur if Forest were to merge with another entity and the creditworthiness of the resulting entity was materially weaker than that of Forest.

The majority of Forest’s derivative counterparties are financial institutions that are engaged in similar activities and have similar economic characteristics that, in general, could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Forest does not require the posting of collateral for its benefit under its derivative agreements. However, the ISDA Master Agreements and Schedules generally contain netting provisions whereby if on any date amounts would otherwise be payable by each party to the other, then on such date, the party that owes the larger amount will pay the excess of that amount over the smaller amount owed by the other party, thus satisfying each party’s obligations. These provisions generally apply to all derivative transactions, or all derivative transactions of the same type (e.g., commodity, interest rate, etc.), with the particular counterparty. If all counterparties failed, Forest would be exposed to a risk of loss equal to this net amount owed to Forest, the fair value of which was \$28.7 million at September 30, 2012. If Forest suffered an event of default, each counterparty could demand immediate payment, subject to notification periods, of the net obligations due to it under the derivative agreements. At September 30, 2012, Forest owed a net derivative liability to three counterparties, the fair value of which was \$4.0 million. In the absence of netting provisions, at September 30, 2012, Forest would be exposed to a risk of loss of \$49.1 million under its derivative agreements, and Forest’s derivative counterparties would be exposed to a risk of loss of \$24.4 million.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was enacted. As part of a broader financial regulatory reform, the Dodd-Frank Act includes derivatives reform that may impact Forest’s business. Congress delegated many of the details of the Dodd-Frank Act to federal regulatory agencies, which are in the process of writing and implementing new rules. Forest is monitoring the impact, if any, that the Dodd-Frank Act and related rules will have on its existing derivative transactions under its outstanding ISDA Master Agreements and Schedules, as well as its ability to enter into such transactions and agreements in the future.



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## (9) COSTS, EXPENSES, AND OTHER

The table below sets forth the components of “Other, net” in the Condensed Consolidated Statements of Operations for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In Thousands)			
Accretion of asset retirement obligations	\$1,719	\$1,539	\$4,914	\$4,496
Legal proceeding liabilities	6,404	—	29,251	6,500
Other, net	3,604	(1,716)	7,937	1,284
	\$11,727	\$(177)	\$42,102	\$12,280

## Legal Proceeding Liabilities

On February 29, 2012, two members of a three-member arbitration panel reached a decision adverse to Forest in the proceeding styled, Forest Oil Corporation, et al. v. El Rucio Land & Cattle Company Inc., et al., which occurred in Harris County, Texas. The third member of the arbitration panel has dissented. The proceeding was initiated in January 2005 and involves claims asserted by the landowner-claimant based on the diminution in value of its land and related damages allegedly resulting from operational and reclamation practices employed by Forest in the 1970s, 1980s, and early 1990s. The arbitration decision awards the claimant \$22.8 million in damages and attorneys’ fees and additional injunctive relief regarding future surface-use issues. On October 9, 2012, after vacating a portion of the decision imposing a future bonding requirement on Forest, the trial court for the 55<sup>th</sup> Judicial District, in the District Court in Harris County, Texas, reduced the arbitration decision to a judgment. Forest is seeking to have this judgment reversed on appeal and believes it has meritorious arguments in support thereof. However, Forest is unable to predict the final outcome in this matter and has accrued a liability, which is classified within “Other liabilities” in the Condensed Consolidated Balance Sheet, of \$22.8 million for this matter.

In August 2007, Forest sold all of its Alaska assets to Pacific Energy Resources Ltd. and its related entities (“PERL”). On March 9, 2009, PERL filed for bankruptcy. As part of the plan of liquidation of its bankruptcy, PERL “abandoned” its interests in many of the Alaska assets sold to it by Forest, including the Trading Bay Unit and Trading Bay Field (“Trading Bay”). On December 2, 2010, Union Oil Company of California (“Unocal”) filed a lawsuit styled, Union Oil Company of California v. Forest Oil Corporation. In the lawsuit, the plaintiff complained about PERL’s abandonment of Trading Bay and asserted that PERL has failed to pay approximately \$49.0 million in joint interest billings owed on those properties to date from the time PERL owned them. The plaintiff claimed that, as predecessor of PERL, Forest was liable for PERL’s share of all joint interest billings owed on Trading Bay. As of December 31, 2011, Unocal sold its interest in the Trading Bay assets, including its claims against Forest, to Hilcorp Alaska, LLC, and Hilcorp was substituted for Unocal as plaintiff in the lawsuit. In August 2012, Forest and the plaintiff reached a settlement whereby the plaintiff released Forest from all claims, agreed to indemnify Forest with respect to all decommissioning and abandonment liabilities associated with Trading Bay, and dismissed the complaint against Forest in exchange for a \$7.0 million payment from Forest.

On March 7, 2011, Pacific Energy Resources Ltd., Pacific Energy Alaska Holdings LLC, and Pacific Energy Alaska Operating LLC filed suit against Forest Oil Corporation and Forest Alaska Holdings LLC in United States Bankruptcy Court in the District of Delaware. In this suit, the plaintiffs claimed that, at the time Forest sold Pacific Energy Resources Ltd. its Alaska assets, those assets were overvalued due to Forest’s alleged nondisclosure, fraud, and negligent misrepresentations and that, as a result, the sales transaction rendered Pacific Energy Resources Ltd. insolvent. The plaintiffs sought to recover over \$250.0 million in value from Forest. During the second quarter of

2011, Forest and the plaintiffs in this action reached a settlement whereby the plaintiffs released Forest from all claims and agreed to dismiss the complaint against Forest in exchange for a \$6.5 million payment from Forest.

(10) DISCONTINUED OPERATIONS

On June 1, 2011, Forest completed an initial public offering of approximately 18% of the common stock of its then wholly-owned subsidiary, Lone Pine, which held Forest's ownership interests in its Canadian operations. In May 2011, as part of a corporate restructuring in anticipation of Lone Pine's initial public offering, Lone Pine Resources Canada Ltd. ("LPR Canada"), Forest's former Canadian subsidiary, declared a stock dividend to Forest immediately before Forest's contribution of LPR Canada to Lone Pine, with such stock dividend resulting in Forest incurring a dividend tax payable to Canadian federal tax

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authorities of \$28.9 million, which Forest paid in June 2011. This dividend tax is classified within “Income tax” in the Condensed Consolidated Statement of Operations. The net proceeds from the initial public offering received by Lone Pine, after deducting underwriting discounts and commissions and offering expenses, were approximately \$178.0 million. Lone Pine used the net proceeds to pay \$29.2 million to Forest as partial consideration for Forest’s contribution to Lone Pine of Forest’s direct and indirect interests in its Canadian operations. Additionally, Lone Pine used the remaining net proceeds and borrowings under Lone Pine’s credit facility to repay Lone Pine’s outstanding indebtedness owed to Forest, consisting of a note payable, intercompany advances, and accrued interest, of \$400.5 million. On September 30, 2011, Forest distributed, or spun-off, its remaining 82% ownership in Lone Pine to Forest’s shareholders, by means of a special stock dividend whereby Forest shareholders received 0.61248511 of a share of Lone Pine common stock for every share of Forest common stock held.

The table below sets forth the effects of changes in Forest’s ownership interest in Lone Pine on Forest’s equity, during the three and nine months ended September 30, 2011 when Forest had an ownership interest in Lone Pine.

	Three Months Ended September 30, 2011 (In Thousands)	Nine Months Ended September 30, 2011
Net earnings attributable to Forest Oil Corporation common shareholders	\$82,795	\$118,375
Transfers from (to) the noncontrolling interest:		
Increase in Forest Oil Corporation’s capital surplus for sale of 15 million Lone Pine Resources Inc. common shares	(269	) 112,610
Decrease in Forest Oil Corporation’s capital surplus for spin-off of 70 million Lone Pine Resources Inc. common shares	(333,568	) (333,568
Change from net earnings attributable to Forest Oil Corporation and transfers from (to) noncontrolling interest	\$(251,042	) \$(102,583

Lone Pine was a component of Forest with operations and cash flows clearly distinguishable, both operationally and for financial reporting purposes, from those of Forest. As a result of the spin-off, Lone Pine’s operations and cash flows have been eliminated from the ongoing operations of Forest, and Forest will not have any significant continuing involvement in the operations of Lone Pine. Accordingly, Forest has presented Lone Pine’s results of operations as discontinued operations in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011.

The table below presents the major components of earnings from discontinued operations for the periods presented.

	Three Months Ended September 30, 2011 (In Thousands) (Unaudited)	Nine Months Ended September 30, 2011
Total revenues	\$50,298	\$137,834
Production expenses	13,902	40,350
General and administrative	3,255	8,846
Depreciation, depletion, and amortization	20,799	60,780
Interest expense	3,000	3,866
Realized and unrealized gains on derivative instruments	(28,498	) (33,628

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Realized foreign currency exchange losses (gains)	23	(33,869 )
Unrealized foreign currency exchange (gains) losses, net	(52 )	28,488
Other, net	264	1,328
Earnings from discontinued operations before tax	37,605	61,673
Income tax	9,497	17,104
Net earnings from discontinued operations	\$28,108	\$44,569

(11) CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company's 8½% senior notes due 2014, 7¼% senior notes due 2019, and 7½% senior notes due 2020 have been fully and unconditionally guaranteed by Forest Oil Permian Corporation (the "Guarantor Subsidiary"), a wholly-owned subsidiary of Forest. Forest's remaining subsidiaries (the "Non-Guarantor Subsidiaries") have not provided guarantees. Based on this distinction, the following presents condensed consolidating financial information as of September 30, 2012 and December 31, 2011 and for the three and nine months ended September 30, 2012 and 2011 on an issuer (parent company), guarantor subsidiary, non-guarantor subsidiaries, eliminating entries, and consolidated basis. Elimination entries presented are necessary to combine the entities.



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## CONDENSED CONSOLIDATING BALANCE SHEETS

(Unaudited)

(In Thousands)

	September 30, 2012					December 31, 2011				
	Parent Company	Guarantor Subsidiary	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated	Parent Company	Guarantor Subsidiary	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>										
Current assets:										
Cash and cash equivalents	\$39,098	\$—	\$71	\$—	\$39,169	\$1,734	\$1	\$1,277	\$—	\$1,734
Accounts receivable	46,533	26,978	4,161	(462)	77,210	43,999	34,142	2,201	(1,253)	79,199
Other current assets	59,190	319	622	—	60,131	127,667	313	591	—	128,571
Total current assets	144,821	27,297	4,854	(462)	176,510	173,400	34,456	4,069	(1,253)	210,652
Property and equipment	8,578,281	1,413,677	207,517	—	10,199,475	8,000,466	1,317,917	282,719	—	9,601,109
Less accumulated depreciation, depletion, and amortization	6,611,026	1,157,456	170,431	—	7,938,913	5,782,409	1,102,339	65,238	—	7,949,986
Net property and equipment	1,967,255	256,221	37,086	—	2,260,562	2,218,057	215,578	217,481	—	2,651,123
Investment in subsidiaries	80,577	—	—	(80,577)	—	160,591	—	—	(160,591)	—
Goodwill	216,460	22,960	—	—	239,420	216,460	22,960	—	—	262,380
Due from subsidiaries	145,817	58,730	—	(204,547)	—	214,394	46,944	—	(261,338)	—
Deferred income taxes	100,874	—	35,064	(126,087)	9,851	312,564	—	25,564	(107,012)	230,116
Other assets	96,035	—	—	—	96,035	48,827	—	—	—	48,827
	\$2,751,839	\$365,208	\$77,004	\$(411,673)	\$2,782,378	\$3,344,293	\$319,938	\$247,114	\$(530,194)	\$3,399,141
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>										
Current liabilities:										
Accounts payable and accrued liabilities	\$181,923	\$2,583	\$5,709	\$(462)	\$189,753	\$235,788	\$8,846	\$4,499	\$(1,253)	\$247,833
Current portion of long-term debt	296,002	—	—	—	296,002	—	—	—	—	—
Other current liabilities	61,574	129	6,313	—	68,016	86,618	63	6,276	—	93,570
Total current liabilities	539,499	2,712	12,022	(462)	553,771	322,406	8,909	10,775	(1,253)	342,438
Long-term debt	1,796,369	—	—	—	1,796,369	1,693,044	—	—	—	1,693,044
Due to parent and subsidiaries	—	—	204,547	(204,547)	—	—	—	261,338	(261,338)	—

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Deferred income taxes	—	126,087	—	(126,087 )	—	—	107,012	—	(107,012 )	—
Other liabilities	173,194	3,650	12,617	—	189,461	135,730	2,614	15,813	—	1
Total liabilities	2,509,062	132,449	229,186	(331,096 )	2,539,601	2,151,180	118,535	287,926	(369,603 )	2
Shareholders' equity	242,777	232,759	(152,182)	(80,577 )	242,777	1,193,113	201,403	(40,812 )	(160,591 )	1
	\$2,751,839	\$365,208	\$77,004	\$(411,673)	\$2,782,378	\$3,344,293	\$319,938	\$247,114	\$(530,194)	\$

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## CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In Thousands)

	Three Months Ended September 30, 2012					2011				
	Parent Company	Guarantor Subsidiary	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated	Parent Company	Guarantor Subsidiary	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues:										
Oil, natural gas, and NGL sales	\$ 119,588	\$ 36,002	\$ 424	\$ —	\$ 156,014	\$ 128,849	\$ 44,529	\$ 634	\$ —	\$ 174,012
Interest and other	1,694	1,278	—	(2,918)	54	348	76	—	(315)	109
Equity earnings in subsidiaries	(73,712)	—	—	73,712	—	39,093	—	—	(39,093)	—
Total revenues	47,570	37,280	424	70,794	156,068	168,290	44,605	634	(39,408)	174,121
Costs, expenses, and other:										
Lease operating expenses	23,115	4,195	116	—	27,426	20,218	3,161	101	—	23,480
Other production expenses	12,546	(165)	41	—	12,422	11,816	(735)	42	—	11,123
General and administrative	12,341	689	386	—	13,416	18,672	881	389	—	19,942
Depreciation, depletion, and amortization	55,978	17,433	434	—	73,845	40,675	13,251	397	—	54,323
Ceiling test write-down of oil and natural gas properties	324,155	—	5,802	—	329,957	—	—	—	—	—
Impairment of properties	—	—	79,529	—	79,529	—	—	—	—	—
Interest expense	36,224	706	2,211	(2,918)	36,223	37,225	(159)	474	(315)	37,225
Realized and unrealized losses (gains) on derivative instruments, net	17,883	4,848	64	—	22,795	(73,757)	7,780	16	—	(65,961)
Other, net	8,692	96	2,939	—	11,727	(1,895)	186	1,532	—	(177)
Total costs, expenses, and other	490,934	27,802	91,522	(2,918)						