

FOREST OIL CORP
Form 10-Q
August 18, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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 June 30, 2014

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 August 14, 2014 there were 119,338,561 shares of the registrant's common stock, par value \$.10 per share, outstanding.

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June 30, 2014

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EXPLANATORY NOTE

Rule 10-01(d) of Regulation S-X requires that interim financial statements included in quarterly reports on Form 10-Q be reviewed by an independent registered public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the SEC. As previously announced in Item 8.01 of our Current Report on Form 8-K filed on August 11, 2014, our management has determined that certain material weaknesses existed in our internal control over financial reporting at year end 2013. Ernst & Young LLP has reached the same conclusion. Accordingly, our internal control over financial reporting was ineffective at December 31, 2013. Consequently, both management's assessment and the report of Ernst & Young LLP on internal control over financial reporting as of December 31, 2013 should no longer be relied upon. In addition, our management has determined that Forest's disclosure controls and procedures were not effective at a reasonable level as of December 31, 2013 and March 31, 2014. To the knowledge of our chief executive officer and chief financial officer, the material weaknesses in internal control over financial reporting did not result in a misstatement of the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013. However, because the identified material weaknesses relate to our accounting software system, which is a critical component of our financial statement preparation process, Ernst & Young LLP and Forest are performing additional testing of Forest's financial statements for each of the three years included in our Annual Report Form 10-K for the year ended December 31, 2013. Ernst & Young LLP therefore will be unable to complete a review of the interim consolidated financial statements in accordance with AU sec. 722, Interim Financial Statements ("AU 722") until such time as the additional testing is completed on our Annual Report on Form 10-K for the ended December 31, 2013. Accordingly, the accompanying consolidated financial statements as of June 30, 2014 and for the three and six months ended June 30, 2014 have not been reviewed by an independent public accountant in accordance with AU 722 and, therefore, this quarterly report on Form 10-Q is deficient.

Section 302 of the Sarbanes-Oxley Act of 2002 requires our chief executive officer and chief financial officer to certify, among other things, that they (i) have designed the internal controls to ensure that material information relating to us and our consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared, and (ii) have disclosed all significant deficiencies in the design or operation of internal controls which could adversely affect our ability to record, process, summarize, and report financial data and have identified for Ernst & Young LLP any material weaknesses in internal controls. Moreover, Section 906 of the Sarbanes-Oxley Act of 2002 requires our chief executive officer and chief financial officer to certify that this Quarterly Report on Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the report fairly presents, in all material respects, our financial condition and results of operations. Before our officers can make such certifications, Ernst & Young LLP must complete its review of the consolidated financial statements appearing elsewhere in this report under AU 722, as required by SEC rules. Once Ernst & Young LLP completes its review under AU 722, we expect to file an amendment to this report in which our chief executive officer and chief financial officer will make the certifications required under Section 302 and Section 906 of the Sarbanes-Oxley Act.

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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)

	June 30, 2014 Not Reviewed	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$14,582	\$66,192
Accounts receivable	25,981	35,654
Derivative instruments	395	5,192
Other current assets	8,894	6,756
Total current assets	49,852	113,794
Property and equipment, at cost:		
Oil and natural gas properties, full cost method of accounting:		
Proved, net of accumulated depletion of \$8,575,255 and \$8,460,589	737,260	753,079
Unproved	49,146	53,645
Net oil and natural gas properties	786,406	806,724
Other property and equipment, net of accumulated depreciation and amortization of \$45,265 and \$50,058	9,376	11,845
Net property and equipment	795,782	818,569
Deferred income taxes	444	2,230
Goodwill	134,434	134,434
Derivative instruments	363	400
Other assets	15,950	48,525
	\$996,825	\$1,117,952
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities	\$129,744	\$141,107
Accrued interest	6,653	6,654
Derivative instruments	13,503	4,542
Deferred income taxes	444	2,230
Other current liabilities	4,864	12,201
Total current liabilities	155,208	166,734
Long-term debt	800,163	800,179
Asset retirement obligations	21,821	22,629
Derivative instruments	1,940	—
Other liabilities	63,332	73,941
Total liabilities	1,042,464	1,063,483
Shareholders' equity (deficit):		
Preferred stock, none issued and outstanding	—	—
Common stock, 119,347,173 and 119,399,983 shares issued and outstanding	11,935	11,940
Capital surplus	2,558,271	2,554,997
Accumulated deficit	(2,605,794)	(2,502,070)

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Accumulated other comprehensive loss	(10,051) (10,398)
Total shareholders' equity (deficit)	(45,639) 54,469	
	\$996,825	\$1,117,952	

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	Not Reviewed		Not Reviewed	
Revenues:				
Oil, natural gas, and natural gas liquids sales	\$60,106	\$116,786	\$124,563	\$234,828
Interest and other	329	28	1,066	160
Total revenues	60,435	116,814	125,629	234,988
Costs, expenses, and other:				
Lease operating expenses	14,295	19,167	28,805	40,371
Production and property taxes	2,740	5,029	5,965	7,245
Transportation and processing costs	2,379	3,098	4,894	6,378
General and administrative	8,260	13,114	16,500	33,128
Depreciation, depletion, and amortization	20,303	43,804	41,718	92,347
Ceiling test write-down of oil and natural gas properties	77,176	—	77,176	—
Interest expense	15,738	29,392	31,749	65,520
Realized and unrealized losses (gains) on derivative instruments, net	11,641	(31,610)	) 24,492	(6,030)
Other, net	(9,302)	) 1,593	(654)	) 30,413
Total costs, expenses, and other	143,230	83,587	230,645	269,372
Earnings (loss) before income taxes	(82,795)	) 33,227	(105,016)	) (34,384)
Income tax (benefit) expense	(78)	) (212)	) (1,292)	) 125
Net earnings (loss)	\$(82,717)	) \$33,439	\$(103,724)	) \$(34,509)
Basic earnings (loss) per common share	\$(.71)	) \$.28	\$(.89)	) \$(.30)
Diluted earnings (loss) per common share	\$(.71)	) \$.28	\$(.89)	) \$(.30)

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In Thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	Not Reviewed		Not Reviewed	
Net earnings (loss)	\$(82,717	) \$33,439	\$(103,724	) \$(34,509)
Other comprehensive income:				
Defined benefit postretirement plans -				
amortization of actuarial losses, net of tax	174	345	347	687
Total other comprehensive income	174	345	347	687
Total comprehensive income (loss)	\$(82,543	) \$33,784	\$(103,377	) \$(33,822)

See accompanying Notes to Condensed Consolidated Financial Statements.

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FOREST OIL CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (DEFICIT)

(Unaudited)

(In Thousands)

	Common Stock		Capital	Accumulated	Accumulated	Total
	Shares	Amount	Surplus	Deficit	Other Comprehensive Loss	Shareholders' Equity (Deficit)
Balances at December 31, 2013	119,400	\$11,940	\$2,554,997	\$(2,502,070)	\$(10,398)	\$54,469
	Not Reviewed	Not Reviewed	Not Reviewed	Not Reviewed	Not Reviewed	Not Reviewed
Employee stock purchase plan	74	7	113	—	—	120
Restricted stock issued, net of forfeitures	109	11	(11)	—	—	—
Amortization of stock-based compensation	—	—	3,824	—	—	3,824
Other, net	(236)	(23)	(652)	—	—	(675)
Net loss	—	—	—	(103,724)	—	(103,724)
Other comprehensive income	—	—	—	—	347	347
Balances at June 30, 2014	119,347	\$11,935	\$2,558,271	\$(2,605,794)	\$(10,051)	\$(45,639)

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended	
	June 30,	2013
	2014	Not Reviewed
Operating activities:		
Net loss	\$(103,724	) \$(34,509)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, depletion, and amortization	41,718	92,347
Unrealized losses on derivative instruments, net	15,736	15,398
Ceiling test write-down of oil and natural gas properties	77,176	—
Stock-based compensation expense	2,294	6,479
Loss on debt extinguishment	—	25,223
Gain on asset dispositions, net	(21,391) —
Other, net	3,034	2,903
Changes in operating assets and liabilities:		
Accounts receivable	9,042	(4,168)
Other current assets	(2,165	) (269)
Accounts payable and accrued liabilities	(27,957	) 17,956
Accrued interest and other	19,970	(10,948)
Net cash provided by operating activities	13,733	110,412
Investing activities:		
Capital expenditures for property and equipment:		
Exploration, development, and leasehold acquisition costs	(94,786	) (205,099)
Other property and equipment	(4,794	) (1,115)
Proceeds from sales of assets	24,145	338,977
Net cash (used) provided by investing activities	(75,435	) 132,763
Financing activities:		
Proceeds from bank borrowings	—	320,000
Repayments of bank borrowings	—	(255,000)
Redemption of senior notes	—	(321,327)
Change in bank overdrafts	11,111	13,523
Other, net	(1,019	) (1,006)
Net cash provided (used) by financing activities	10,092	(243,810)
Net decrease in cash and cash equivalents	(51,610	) (635)
Cash and cash equivalents at beginning of period	66,192	1,056
Cash and cash equivalents at end of period	\$14,582	\$421
Cash paid during the period for:		
Interest (net of capitalized amounts)	\$29,910	\$70,428
Income taxes (net of refunded amounts)	(21,312	) 1,070
Non-cash investing activities:		
Increase (decrease) in accrued capital expenditures	\$1,449	\$(4,259)

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 (“NGLs”) primarily in North America. 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 one other country. 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. All intercompany balances and transactions have been eliminated. 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 June 30, 2014, and the results of its operations, its comprehensive income (loss), its cash flows, and changes in its shareholders’ equity (deficit) for the periods presented. Interim results are not necessarily indicative of expected annual results because of various factors including the impact of fluctuations in the prices of oil, natural gas, and NGLs 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 NGL 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, assessing investments in unproved properties and goodwill for impairment, determining the need for and the amount of deferred tax asset valuation allowances, and estimating fair values of financial instruments, including derivative instruments.

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, included in Forest’s Annual Report on Form 10-K for the year ended December 31, 2013, previously filed with the Securities and Exchange Commission (“SEC”).

Pending Merger

On May 5, 2014, Forest entered into an Agreement and Plan of Merger with Sabine Oil & Gas LLC (“Sabine”), under which Forest and Sabine will combine their businesses in an all-stock transaction. This agreement was amended on

July 9, 2014 primarily to change the structure of the transaction, in which Forest now will be the surviving entity. The revised transaction structure does not change the economic terms of the transaction. Under the terms of the amended merger agreement, the owners of Sabine will contribute their interests in Sabine to Forest in exchange for Forest common and preferred stock. Upon closing of the combination transaction, Forest's shareholders will own common shares that represent an approximate 26.5% economic interest in the combined

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company and approximately 20% of the total voting power, and Sabine's equity holders will own common shares and preferred shares that represent an approximate 73.5% economic interest and approximately 80% of the total voting power in the combined company. Consummation of the transaction is subject to approval by Forest shareholders, regulatory approvals, and other customary closing conditions. The combined entity will change its name to Sabine Oil & Gas Corporation and be headquartered in Houston.

In connection with entering into the amended merger agreement, Forest also adopted a shareholder rights agreement (the "Rights Agreement"), and on July 10, 2014 declared a dividend of one preferred share purchase right (a "Right") on each outstanding share of Forest's common stock. This dividend was issued on July 21, 2014. Each Right allows its holder to purchase from Forest one one-hundredth of a share of Series A Junior Participating Preferred Stock for \$10, once the Rights become exercisable. This portion of a preferred share will give the shareholder approximately the same dividend and liquidation rights as would one Forest common share. Prior to exercise, the Rights do not give their holders any dividend, voting, or liquidation rights. The Rights will expire on December 31, 2014.

The Rights will not be exercisable until ten days after the public announcement that a person or group has become an "Acquiring Person" by obtaining "beneficial ownership" (as defined in the Rights Agreement) of 5% or more of Forest's outstanding common shares; provided that a stockholder will not become an "Acquiring Person" if such stockholder certifies to Forest that (i) such stockholder, together with all affiliates and associates of such stockholder, does not and will not at any time prior to December 31, 2014 own or have any beneficial interest in any transaction, security, or derivative or synthetic arrangements having the characteristics of a "short" position in or with respect to any Forest indebtedness or that would increase in value as a result of a decline in the value of any Forest indebtedness or decline in Forest's credit rating and (ii) such stockholder will continue to satisfy clause (i) for so long as the Rights would otherwise become exercisable.

The Rights Agreement is intended to prevent persons from acquiring beneficial ownership of 5% or more of Forest's common stock or, for investors that owned in excess of 5% as of July 10, 2014, from increasing their beneficial ownership, but only to the extent such a person has a "short" equivalent position with respect to Forest's debt. This is to prevent certain hedge funds from rejecting the proposed transaction in order to profit from their short positions in Forest's debt (and similar derivative positions).

(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 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 and cash-settled performance units issued under Forest's stock incentive plans do not participate in dividends. Share-settled performance units issued under Forest's stock incentive plans do not participate in dividends in their current form. Holders of these performance units participate in dividends paid during the performance units' vesting period only after the performance units vest and common shares are deliverable under the terms of the performance unit awards. Share-settled performance units may vest with no common shares being deliverable, depending on Forest's shareholder return over the performance units' vesting period in relation to the shareholder returns of specified peers. 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.

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Diluted earnings (loss) per share is computed by dividing net earnings (loss) attributable to common stock by the weighted average number of common shares outstanding during each period, increasing the denominator to include the number of additional common shares that would have been outstanding if the dilutive potential common shares (e.g. stock options, unvested restricted stock, unvested share-settled phantom stock units, and unvested share-settled performance units) had been issued. Additionally, the numerator is also adjusted for certain contracts that provide the issuer or holder with a choice between settlement methods. Diluted earnings per share is computed using the more dilutive of the treasury stock method or the two-class method. Under the treasury stock method, the dilutive effect of potential common shares is computed by assuming common shares are issued for these securities at the beginning of the period, with the assumed proceeds from exercise, which include average unamortized stock-based compensation costs, assumed to be used to purchase common shares at the average market price for the period, and the incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) included in the denominator of the diluted earnings per share computation. The number of contingently issuable shares pursuant to the outstanding share-settled performance units is included in the denominator of the computation of diluted earnings per share based on the number of shares, if any, that would be issuable if the end of the reporting period were the end of the contingency period and if the result would be dilutive. Under the two-class method, the dilutive effect of non-participating potential common shares is determined and undistributed earnings are reallocated between common shares and participating securities. 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 six months ended June 30, 2014 and the six months ended June 30, 2013. Unvested restricted stock grants were not included in the calculation of diluted earnings per share for the three months ended June 30, 2013 as their inclusion would have an antidilutive effect.

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

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013		2013	
	(In Thousands)			
Net earnings (loss)	\$(82,717	) \$33,439	\$(103,724	) \$(34,509)
Less: net earnings attributable to participating securities	—	(1,014)	—	—
Net earnings (loss) for basic and diluted earnings (loss) per share	\$(82,717	) \$32,425	\$(103,724	) \$(34,509)

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

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
	2013		2013	
	(In Thousands)			
Weighted average common shares outstanding during the period for basic earnings (loss) per share	117,117	116,033	116,979	115,845
Dilutive effects of potential common shares	—	—	—	—
Weighted average common shares outstanding during the period, including the effects of dilutive potential common shares, for diluted earnings (loss) per share	117,117	116,033	116,979	115,845

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(3) STOCK-BASED COMPENSATION

Stock-based Compensation 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 for the three and six months ended June 30, 2014 and 2013, and the remaining unamortized amounts and weighted average amortization period as of June 30, 2014.

	Restricted Stock (In Thousands)	Performance Units	Phantom Stock Units	Total ⁽¹⁾⁽²⁾
Three Months Ended June 30, 2014:				
Total stock-based compensation costs	\$1,605	\$598	\$428	\$2,631
Less: stock-based compensation costs capitalized	(604)	(122)	(158)	(884)
Stock-based compensation costs expensed	\$1,001	\$476	\$270	\$1,747
Six Months Ended June 30, 2014:				
Total stock-based compensation costs	\$3,176	\$600	\$603	\$4,379
Less: stock-based compensation costs capitalized	(1,403)	(128)	(272)	(1,803)
Stock-based compensation costs expensed	\$1,773	\$472	\$331	\$2,576
Unamortized stock-based compensation costs ⁽³⁾	\$5,887	\$2,294	\$2,113	\$10,294
Weighted average amortization period remaining	1.2 years	1.5 years	1.6 years	1.3 years
Three Months Ended June 30, 2013:				
Total stock-based compensation costs	\$3,210	\$1,105	\$513	\$4,828
Less: stock-based compensation costs capitalized	(1,172)	(241)	(218)	(1,631)
Stock-based compensation costs expensed	\$2,038	\$864	\$295	\$3,197
Six Months Ended June 30, 2013:				
Total stock-based compensation costs	\$7,445	\$2,733	\$1,775	\$11,953
Less: stock-based compensation costs capitalized	(2,994)	(714)	(887)	(4,595)
Stock-based compensation costs expensed	\$4,451	\$2,019	\$888	\$7,358

Forest also maintains an employee stock purchase plan (which is not included in the table) under which \$.02 million and \$.1 million of compensation cost was recognized for the three and six months ended June 30, 2014, respectively, and \$.1 million and \$.2 million of compensation cost was recognized for the three and six months ended June 30, 2013, respectively.

In connection with the divestiture of the South Texas oil and natural gas properties in the first quarter of 2013, Forest incurred \$2.0 million (\$1.0 million net of capitalized amounts) in stock-based compensation costs due to accelerated vesting of involuntarily terminated employees’ awards. See Note 5 for more information regarding this divestiture.

The unamortized stock-based compensation costs for liability-based awards are based on the closing price of Forest’s common stock at the reporting period end.

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Stock Options

The following table summarizes stock option activity in the Plans for the six months ended June 30, 2014.

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (In Thousands) ⁽¹⁾	Number of Options Exercisable
Outstanding at January 1, 2014	631,206	\$17.21	\$—	631,206
Granted	—	—	—	—
Exercised	—	—	—	—
Cancelled	(237,100)	13.86	—	—
Outstanding at June 30, 2014	394,106	\$19.23	\$—	394,106

(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 six months ended June 30, 2014.

	Restricted Stock			Performance Units			Phantom Stock Units		
	Number of Shares ⁽¹⁾	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)	Number of Units ⁽²⁾	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)	Number of Units ⁽³⁾	Weighted Average Grant Date Fair Value	Vest Date Fair Value (In Thousands)
Unvested at January 1, 2014	2,790,542	\$10.23		1,511,140	\$8.48		1,924,819	\$6.75	
Awarded	407,202	2.22		—	—		67,000	3.51	
Vested	(905,882)	14.41	\$2,455	(63,840)	18.11	\$—	(343,583)	7.07	\$1,127
Forfeited	(297,954)	10.29		(170,300)	9.33		(184,139)	7.54	
Unvested at June 30, 2014	1,993,908	\$6.69		1,277,000	\$7.89		1,464,097	\$6.43	

Of the unvested restricted stock as of June 30, 2014, 436,956 shares, which were granted in 2013, vest in one-third (1) increments on each of the first three anniversary dates of the grant. All other unvested shares of restricted stock cliff vest on the third anniversary of the date of grant.

Of the unvested performance units as of June 30, 2014, 598,500, which were granted in 2013, are cash-based and the remaining unvested performance units are share-based. For both cash- and share-based performance units, the (2) actual settlement amount is dependent upon Forest's relative total shareholder return in comparison to a specified peer group over a thirty-six month performance period. The cash-based performance units are accounted for as a liability within the Condensed Consolidated Financial Statements.

(3) All of the unvested phantom stock units as of June 30, 2014 must be settled in cash. The phantom stock units have been accounted for as a liability within the Condensed Consolidated Financial Statements. All of the phantom stock units that vested during the six months ended June 30, 2014 were settled in cash. Of the unvested phantom stock units as of June 30, 2014, (i) 122,509 were granted in 2011 and 466,588 were granted in 2013 and vest in one-third increments on each of the first three anniversaries of the grant date, (ii) 493,000 were granted in 2013 and

67,000 were granted in 2014 and cliff vest on the third anniversary of the grant date, and (iii) 270,000 were granted in 2012 and 45,000 were granted in 2013 and vest over a four-year period in accordance with the following schedule: (a) 10% on the first anniversary of the grant date; (b) 20% on the second anniversary of the grant date; (c) 30% on the third anniversary of the grant date; and (d) 40% on the fourth anniversary of the grant date.

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(4) DEBT

The components of debt are as follows:

	June 30, 2014			December 31, 2013		
	Principal	Unamortized Premium	Total	Principal	Unamortized Premium	Total
	(In Thousands)					
Credit facility	\$—	\$—	\$—	\$—	\$—	\$—
7¼% senior notes due 2019	577,914	162	578,076	577,914	178	578,092
7½% senior notes due 2020	222,087	—	222,087	222,087	—	222,087
Total long-term debt	\$800,001	\$162	\$800,163	\$800,001	\$178	\$800,179

Bank Credit Facility

As of June 30, 2014, the Company had a \$500.0 million 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 \$800.0 million, upon agreement between the applicable lenders and Forest.

On March 31, 2014, the Company entered into the Second Amendment to the Credit Facility (the “Second Amendment”), which was effective as of that date. The Second Amendment amended, among other things, the permitted ratio of total debt to EBITDA and the definition of total debt used in the ratio calculation, and reduced the aggregate lender commitments from \$1.5 billion to \$500.0 million and the borrowing base, which governs Forest’s availability under the Credit Facility, from \$400.0 million to \$300.0 million, where it remained as of June 30, 2014.

The determination of the Credit Facility 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 natural gas properties based on pricing models determined by the lenders at such time, in accordance with the lenders’ customary practices for oil and natural 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 senior notes that were outstanding on June 30, 2011. The borrowing base is also subject to automatic adjustment if Forest or any of its Restricted Subsidiaries sell oil and natural gas properties having a fair market value, including any economic loss of unwinding any related hedging agreement, in excess of 10% of the borrowing base then in effect. In this case, the borrowing base will be reduced by an amount equal to either (i) 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. The next scheduled semi-annual redetermination of the borrowing base will occur on or about November 1, 2014. 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. Under the Credit Facility, Forest is required to mortgage and grant a security interest in 75% of the present value of the estimated proved oil and natural gas properties and related assets. If Forest’s corporate credit ratings issued by Moody’s and Standard & Poor’s meet pre-established levels, the

security requirements would cease to apply and, at Forest's request, the banks would release their liens and security interest on Forest's properties.

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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 Second Amendment to the Credit Facility provides that Forest will not permit its ratio of total debt to EBITDA (as adjusted for non-cash charges) calculated for the preceding four consecutive fiscal quarter period then most recently ended to be greater than (i) 5.75 to 1.00 at the end of the calendar quarters ending March 31, 2014, June 30, 2014 and September 30, 2014, (ii) 5.50 to 1.00 at the end of the calendar quarter ending December 31, 2014, (iii) 5.25 to 1.00 at the end of the calendar quarter ending March 31, 2015, (iv) 5.00 to 1.00 at the end of the calendar quarter ending June 30, 2015, (v) 4.75 to 1.00 at the end of the calendar quarter ending September 30, 2015, and (vi) 4.50 to 1.00 at the end of any calendar quarter ending after September 30, 2015. The Second Amendment also amends the definition of total debt such that, among other things, during any period of four fiscal quarters ending on or before September 30, 2015, any cash proceeds from the sale of any property permitted pursuant to the terms and provisions of the loan documents that are reported on Forest's consolidated balance sheet on such date are subtracted from total debt. Depending on Forest's overall level of indebtedness, this covenant may limit Forest's ability to borrow funds as needed under the Credit Facility. Forest's ratio of total debt to EBITDA for the four consecutive fiscal quarter period ended June 30, 2014, as calculated in accordance with the Credit Facility, was 5.07.

Based on Forest's current projections, the ratio of total debt to EBITDA may exceed the maximum allowed under the Credit Facility sometime prior to the end of 2014 if it does not obtain a waiver or an additional amendment to the Credit Facility. Forest believes that it will be able to obtain such a waiver or an amendment prior to the ratio exceeding the maximum amount currently allowed. If Forest fails to obtain a waiver or an amendment, the Credit Facility could be terminated. However, Forest believes it can obtain alternative sources of debt financing sufficient for its needs, including securing liens against its properties or selling additional properties.

At June 30, 2014, there were no outstanding borrowings under the Credit Facility and Forest had used the Credit Facility for \$2.2 million in letters of credit.

(5) PROPERTY AND EQUIPMENT

Full Cost Method of Accounting

The Company uses the full cost method of accounting for oil and natural 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 natural gas operations were conducted in the United States. 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 June 30, 2014 and 2013, Forest capitalized \$4.9 million and \$8.1 million, respectively, of general and administrative costs (including stock-based compensation). During the six months ended June 30, 2014 and 2013, Forest capitalized \$9.4 million and \$20.4 million, respectively, of general and administrative costs (including stock-based compensation). During the three and six months ended June 30, 2013, Forest capitalized \$.9 million and \$1.1 million of interest costs attributed to significant unproved acreage positions under development. No interest costs were capitalized during the three and six months ended June 30, 2014.

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 factors such as the primary lease terms of the properties, the holding period of the properties, geographic and geologic data obtained relating to the properties, market acreage prices, 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 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.

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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 natural 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 natural 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.

At June 30, 2014, Forest recorded a \$77.2 million ceiling test write-down of its United States cost center. This ceiling test write-down was primarily a result of (i) a reduction in the estimated reserves attributable to a portion of Forest's proved undeveloped locations in the Eagle Ford and (ii) a reduction in the total number of proved undeveloped locations in the Eagle Ford to properly align the number of future drilling locations with Forest's current development pace relative to the SEC five year limitation on the age of proved undeveloped locations. Additional ceiling test write-downs may be required in future 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 revenues from estimated production of proved oil and natural gas reserves declines compared to prices used as of June 30, 2014, unproved properties are impaired, 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.

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. A significant alteration would not ordinarily be expected to occur for sales involving less than 25% of the reserve quantities of a given cost center.

Depletion of proved oil and natural 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.

Divestitures

Texas Panhandle

In October 2013, Forest entered into an agreement to sell all of its oil and natural gas properties located in the Texas Panhandle for \$1.0 billion in cash. This divestiture closed on November 25, 2013 and Forest has received proceeds of \$985.3 million through June 2014, with the purchase price having been adjusted to, among other things, reflect an economic effective date of October 1, 2013. The proceeds received include \$20.2 million that Forest received in May 2014 from the final settlement of the escrow account that had been established for this transaction. Forest used a portion of the Panhandle divestiture proceeds to repay the balance outstanding at the time of the closing on its credit facility and to redeem \$700.0 million aggregate principal amount of its 7¼% senior notes due 2019 and 7½% senior notes due 2020 in November 2013.

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In connection with the Panhandle divestiture, Forest incurred exit costs consisting of \$4.7 million of one-time employee termination benefits and \$8.1 million of other associated costs. No further significant exit costs are expected to be incurred for this divestiture. A reconciliation of the beginning and ending liability balances for these exit costs for the six months ended June 30, 2014 is set forth in the table below.

	One-Time Employee Termination Benefits (In Thousands)	Other Associated Costs ⁽¹⁾	Total
Liability balance as of December 31, 2013	\$1,095	\$5,840	\$6,935
Costs incurred ⁽²⁾	687	116	803
Costs paid	(1,782)	(5,840)	(7,622)
Liability balance as of June 30, 2014 ⁽³⁾	\$—	\$116	\$116

(1) Other associated costs consist of financial advisor fees and retention bonuses paid to certain employees.

Of the \$8 million costs incurred during the six months ended June 30, 2014, (i) \$.7 million was recognized as an expense in “General and administrative” expense, \$.5 million during the quarter ended March 31, 2014 and \$.1 million during the quarter ended June 30, 2014, and (ii) \$.1 million was recognized as an expense in “Other, net” (2) during the quarter ended June 30, 2014. During the year ended December 31, 2013, \$12.0 million of costs were incurred, with (i) \$5.0 million recognized as an expense in “General and administrative” expense, (ii) \$5.8 million recognized as an expense in “Other, net”, and (iii) \$1.1 million capitalized in “Oil and natural gas properties” pursuant to the full cost method of accounting.

(3) The June 30, 2014 estimated liability balance is included in “Accounts payable and accrued liabilities” in the Condensed Consolidated Balance Sheet, and Forest expects it will be paid in the third quarter of 2014.

The proved reserves associated with the Panhandle divestiture represented more than 25% of Forest’s total proved reserves at the time the divestiture closed. Forest concluded that accounting for the divestiture as an adjustment of capitalized costs would significantly alter the relationship between capitalized costs and proved reserves. Therefore, a gain was recognized on the divestiture. The net gain recognized on the divestiture for the year ended December 31, 2013 was \$193.0 million. Net gains of \$19.0 million and \$18.2 million were recognized on the divestiture for the three and six months ended June 30, 2014, respectively, as customary post-closing purchase price adjustments were made and additional proceeds were received. These gains are included in “Other, net” in the Condensed Consolidated Statements of Operations.

South Texas

In January 2013, Forest entered into an agreement to sell all of its oil and natural gas properties located in South Texas, excluding its Eagle Ford oil properties, for \$325.0 million in cash. This transaction closed on February 15, 2013, and Forest has received proceeds of \$320.9 million, after customary purchase price adjustments. Forest used the proceeds from this divestiture to redeem the remaining \$300.0 million of its 8½% senior notes due 2014. In connection with this divestiture, Forest incurred one-time employee termination benefit costs of \$7.5 million (\$5.7 million net of capitalization), which are included in “General and administrative” expense in the Condensed Consolidated Statement of Operations for the six months ended June 30, 2013 and were paid in full during 2013.

South Africa

In December 2012, Forest entered into an agreement with a third-party to sell its South African subsidiary which holds a production right related to Block 2A in South Africa. Following approval of the sale by the government of South Africa, the sale closed and Forest received a payment of \$1.0 million during the three months ended June 30, 2014.

This sale completes Forest's exit from South Africa, though certain regulatory matters are delaying transfer of physical possession of the subsidiary's shares to the purchaser. As a result of this closing, Forest recorded a net gain of \$3.2 million in other income within the "Other, net" line item in the Condensed Consolidated Statement of Operations. Forest may receive future payments depending on the purchaser's success in obtaining natural gas sales contracts and commencing development operations.

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Acquisition and Development Agreement

In April 2013, Forest entered into an Acquisition and Development Agreement (“ADA”) with a third-party for the future development of Forest’s Eagle Ford acreage in Gonzales County, Texas. Under the terms of the ADA, the third-party will pay a \$90.0 million drilling carry in the form of future drilling and completion services and related development capital in exchange for a 50% working interest in Forest’s Eagle Ford acreage position. Upon completion of the phased contribution of the drilling carry, Forest and the third-party will participate in future drilling on a 50/50 basis. The ADA applies to wells spud on or subsequent to November 28, 2012, none of which had been placed on production prior to April 1, 2013, and Forest retained all of its interests in wells that were spud prior to November 28, 2012 and production from those wells. Forest is the operator of the drilling program. As of June 30, 2014, Forest had realized \$70.4 million of the drilling carry.

Asset Retirement Obligations

Forest records the fair value of a liability for an asset retirement obligation in the period in which it is incurred with a corresponding increase in the carrying amount of the related long-lived asset. Subsequent to initial measurement, the asset retirement obligation is required to be accreted each period to its present value. Capitalized costs are depleted as a component of the full cost pool using the units-of-production method. Forest’s asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and natural gas properties.

(6) INCOME TAXES

The significant differences between Forest’s blended federal and state statutory income tax rate of 36% and its effective income tax rates of .1% and 1.2% for the three and six months ended June 30, 2014, respectively, and (.6)% and (.4)% for the three and six months ended June 30, 2013, respectively, were primarily due to changes in the valuation allowance on Forest’s deferred tax assets.

In assessing the need for a valuation allowance, Forest considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. In making this assessment, Forest considers the scheduled reversal of deferred tax liabilities, available taxes in carryback periods, tax planning strategies, and projected future taxable income. If the ultimate realization of deferred tax assets is dependent upon future book income, assessing the need for, or the sufficiency of, a valuation allowance requires the evaluation of all available evidence, both negative and positive, as to whether it is more likely than not that a deferred tax asset will be realized.

Negative evidence considered by Forest included a three-year cumulative book loss driven primarily by the ceiling test write-downs. Positive evidence considered by Forest included forecasted book income in future periods based on expected future oil, natural gas, and NGL production and expected commodity prices based on NYMEX oil and natural gas futures. Based upon the evaluation of what was determined to be relevant evidence, Forest has recorded a valuation allowance against its deferred tax assets.

As of December 31, 2013, Forest had a non-current income tax receivable of \$20.7 million, which was included in “Other assets”. During the three months ended March 31, 2014, Forest received a refund of \$6.6 million, including interest income of \$.7 million, and during the three months ended June 30, 2014, Forest received a refund of \$15.8 million, including interest income of \$.3 million, for a total refund received during the six months ended June 30, 2014 of \$22.3 million, including \$1.0 million of interest income. Credits to current income tax expense of \$.6 million and \$.1 million were recorded for the three months ended March 31, 2014 and June 30, 2014, respectively, as a result of these refunds.

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(7) FAIR VALUE MEASUREMENTS

Forest's assets and liabilities measured at fair value on a recurring basis at June 30, 2014 and December 31, 2013 are set forth in the table below.

	June 30, 2014 Using Significant Other Observable Inputs (Level 2) ⁽¹⁾ (In Thousands)	December 31, 2013
Assets:		
Derivative instruments ⁽²⁾ :		
Commodity	\$758	\$5,592
Liabilities:		
Derivative instruments ⁽²⁾ :		
Commodity	\$15,443	\$4,542

- 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. There were no transfers between levels of the fair value hierarchy during the three and six months ended June 30, 2014. Forest'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.
- Forest's currently outstanding derivative assets and liabilities include commodity derivatives (see Note 8 for more information on these instruments). Forest 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, Forest's derivative instruments are included within the Level 2 fair value hierarchy.

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

	June 30, 2014		Fair Value Measurements	
	Carrying Amount	Total Fair Value ⁽¹⁾	Using Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Using Significant Other Observable Inputs (Level 2)
	(In Thousands)			
Assets:				
Derivative instruments	\$758	\$758	\$—	\$758
Liabilities:				
Derivative instruments	15,443	15,443	—	15,443

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7¼% senior notes due 2019	578,076	572,499	572,499	—
7½% senior notes due 2020	222,087	221,116	221,116	—

(1) Forest 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, 2013			
		Carrying Amount	Total Fair Value ⁽¹⁾	Fair Value Measurements	
				Using Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Using Significant Other Observable Inputs (Level 2)
		(In Thousands)			
Assets:					
Derivative instruments		\$5,592	\$5,592	\$—	\$5,592
Liabilities:					
Derivative instruments		4,542	4,542	—	4,542
7¼% senior notes due 2019		578,092	568,147	568,147	—
7½% senior notes due 2020		222,087	224,030	224,030	—

(1) Forest 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.

(8) DERIVATIVE INSTRUMENTS**Commodity Derivatives**

Forest periodically enters into commodity derivative instruments in order to moderate the effects of wide fluctuations in commodity prices on Forest's cash flow and to manage its 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 line item "Realized and unrealized losses (gains) on derivative instruments, net" in the Condensed Consolidated Statement of Operations.

The table below sets forth Forest's outstanding commodity swaps as of June 30, 2014.

Commodity Swaps

	Natural Gas (NYMEX HH)		Oil (NYMEX WTI)	
	Bbtu Per Day	Weighted Average Hedged Price per MMBtu	Barrels Per Day	Weighted Average Hedged Price per Bbl
Remaining Swap Term				
July 2014 - December 2014	70	\$4.38	3,500	\$95.34
Calendar 2015	50	4.21	1,000	89.25

The table below sets forth Forest's outstanding commodity collars as of June 30, 2014.

Commodity Collars

Natural Gas
(NYMEX HH)

Collar Term	Bbtu Per Day	Hedged Floor and Ceiling Price per MMBtu
January 2015 - March 2015	20	\$ 4.50/5.31
Calendar 2015	10	4.10/4.30

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In connection with several of its natural gas and oil swaps, Forest granted option instruments (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 swaption agreements, the counterparties have the option to enter into future swaps with Forest. The swaptions may not be exercised until their expiration dates. Under the terms of the put agreements, the counterparties have the option to put specified quantities of oil to Forest at specified prices. The puts may be exercised monthly by the counterparties. The table below sets forth the outstanding options as of June 30, 2014.

Commodity Options

Underlying Term	Option Expiration	Natural Gas (NYMEX HH)		Oil (NYMEX WTI)	
		Underlying Bbtu Per Day	Underlying Hedged Price per MMBtu	Underlying Barrels Per Day	Underlying Hedged Price per Bbl
Natural Gas Swaptions:					
Calendar 2016	December 2014	10	\$ 4.18	—	\$—
Oil Swaptions:					
Calendar 2015	December 2014	—	—	3,000	100.00
Calendar 2015	December 2014	—	—	1,000	106.00
Calendar 2015	December 2014	—	—	1,000	99.00
Calendar 2016	December 2015	—	—	1,000	98.00
Oil Put Options:					
Monthly Calendar 2014	Monthly Calendar 2014	—	—	2,000	70.00

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 "Credit Risk" below for more information regarding Forest's master netting arrangements and gross and net presentation of derivative instruments. See also Note 7 for more information on the fair values of Forest's derivative instruments.

	June 30, 2014	December 31, 2013
	(In Thousands)	
Current assets:		
Derivative instruments:		
Commodity	\$395	\$5,192
Long-term assets:		
Derivative instruments:		
Commodity	\$363	\$400
Current liabilities:		
Derivative instruments:		
Commodity	\$13,503	\$4,542
Long-term liabilities:		
Derivative instruments:		
Commodity	\$1,940	\$—

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

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
		2013		2013
	(In Thousands)			
Commodity derivatives:				
Realized losses (gains)	\$4,296	\$1,106	\$8,756	\$(8,543)
Unrealized losses (gains)	7,345	(32,823)	15,736	2,338
Interest rate derivatives:				
Realized gains	—	(9,803)	—	(12,885)
Unrealized losses	—	9,910	—	13,060
Realized and unrealized losses (gains) on derivative instruments, net	\$11,641	\$(31,610)	\$24,492	\$(6,030)

Due to the volatility of oil and natural gas 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 and expects that volatility in commodity prices will continue.

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 transacted. As of June 30, 2014, 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 events, 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

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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 \$.1 million at June 30, 2014. 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 June 30, 2014, Forest owed a net derivative liability to its counterparties, the fair value of which was \$14.8 million. In the absence of netting provisions, at June 30, 2014, Forest would be exposed to a risk of loss of \$.8 million under its derivative agreements, and Forest's derivative counterparties would be exposed to a risk of loss of \$15.4 million.

For financial reporting purposes, Forest has elected not to offset asset and liability fair value amounts recognized for derivative instruments with the same counterparty under its master netting arrangements, although such derivative instruments are subject to enforceable master netting arrangements. The following tables disclose information regarding the potential effect of netting arrangements on Forest's Condensed Consolidated Balance Sheets as of the dates indicated.

	Derivative Assets	
	June 30, 2014	December 31, 2013
	(In Thousands)	
Gross amounts of recognized assets	\$758	\$5,592
Gross amounts offset in the balance sheet	—	—
Net amounts of assets presented in the balance sheet	758	5,592
Gross amounts not offset in the balance sheet:		
Derivative instruments	(641	) (1,049
Cash collateral received	—	—
Net amount	\$117	\$4,543
	Derivative Liabilities	
	June 30, 2014	December 31, 2013
	(In Thousands)	
Gross amounts of recognized liabilities	\$15,443	\$4,542
Gross amounts offset in the balance sheet	—	—
Net amounts of liabilities presented in the balance sheet	15,443	4,542
Gross amounts not offset in the balance sheet:		
Derivative instruments	(641	) (1,049
Cash collateral pledged	—	—
Net amount	\$14,802	\$3,493

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted, which included derivatives reform as part of a broader financial regulatory reform. Congress delegated many of the details of the Dodd-Frank Act to federal regulatory agencies. Forest currently expects that the Dodd-Frank Act and related rules will have little impact on its existing derivative transactions under its outstanding ISDA Master Agreements and Schedules. However, the legislation could have a substantial impact on Forest's counterparties and increase the cost of Forest's derivative 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		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(In Thousands)			
Accretion of asset retirement obligations	\$381	\$549	\$894	\$1,793
Write-off of debt issuance costs	—	—	3,323	—
Loss on debt extinguishment	—	—	—	25,223
Gain on asset dispositions, net	(22,185	) —	(21,391) —
Merger-related costs	10,202	—	10,202	—
Rig stacking/lease termination	3,075	1,258	8,259	4,296
Other, net	(775	) (214	) (1,941	) (899
	\$ (9,302	) \$ 1,593	\$ (654	) \$ 30,413

Accretion of Asset Retirement Obligations

Accretion of asset retirement obligations is the expense recognized to increase the carrying amount of the liability associated with Forest’s asset retirement obligations as a result of the passage of time. Forest’s asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and natural gas properties.

Write-off of Debt Issuance Costs

On March 31, 2014 Forest entered into the Second Amendment to the Credit Facility, which was effective as of that date. The Second Amendment reduced aggregate lender commitments from \$1.5 billion to \$500.0 million, necessitating a proportionate write-off of \$3.3 million in unamortized debt issuance costs associated with the Credit Facility prior to the Second Amendment.

Loss on Debt Extinguishment

In March 2013, Forest redeemed \$300.0 million in principal amount of 8½% senior notes at 107.11% of par, recognizing a loss of \$25.2 million upon redemption due to the \$21.3 million call premium and write-off of \$3.9 million of unamortized debt issuance costs and discount.

Gain on Asset Dispositions, Net

In October 2013, Forest entered into an agreement to sell all of its oil and natural gas properties located in the Texas Panhandle for \$1.0 billion in cash. This divestiture closed in November 2013 and Forest has received proceeds of \$985.3 million through June 2014, after customary purchase price adjustments. Net gains of \$19.0 million and \$18.2 million were recognized on the divestiture for the three and six months ended June 30, 2014, respectively, as customary post-closing purchase price adjustments were made and additional proceeds were received, including the \$20.2 million received in May 2014. Also included in the gain on asset disposition line item is a \$3.2 million gain recognized on the sale of Forest’s South African subsidiary. See Note 5 for more information on these divestitures.

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Merger-Related Costs

In connection with the pending merger with Sabine, Forest has incurred expenses that are comprised primarily of legal and financial advisor costs. See Note 1 for more information on the pending merger.

Rig Stacking/Lease Termination

Rig stacking comprises the expenses incurred to operate and maintain drilling rigs, which Forest has historically leased under operating leases, that were not being utilized on capital projects. Rig stacking expenses for the three and six months ended June 30, 2014 were \$1.6 million and \$4.4 million, respectively. Rig stacking expenses for the three and six months ended June 30, 2013 were \$1.3 million and \$4.3 million, respectively.

During the three months ended March 31, 2014, Forest terminated the operating leases on seven drilling rigs and during the three months ended June 30, 2014, Forest terminated the operating leases on two additional drilling rigs. In connection with these lease terminations, Forest recognized expense of \$1.4 million and \$3.9 million during the three and six months ended June 30, 2014, respectively.

As of June 30, 2014, Forest has six rigs remaining under non-cancelable operating leases which are scheduled to terminate in September 2014. Lease payments under the remaining operating leases are \$.4 million per month.

(10) COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is a term used to refer to net earnings (loss) plus other comprehensive income (loss). Other comprehensive income (loss) is comprised of revenues, expenses, gains, and losses that, under generally accepted accounting principles, are reported as separate components of shareholders' equity instead of net earnings (loss). Forest's other comprehensive income during the three and six months ended June 30, 2014 consists of actuarial losses reclassified from accumulated other comprehensive loss and included in net periodic benefit cost, which is included in the line item "General and administrative" in the Condensed Consolidated Statements of Operations.

The components of other comprehensive income, both before-tax and net-of-tax, for the three and six months ended June 30, 2014 are as follows:

	Before-Tax (In Thousands)	Tax (Expense) / Benefit ⁽¹⁾	Net-of-Tax
Three Months Ended June 30, 2014:			
Defined benefit postretirement plans			
Actuarial losses reclassified from accumulated other comprehensive loss and included in net periodic benefit cost	\$ 174	\$ —	\$ 174
Other comprehensive income	\$ 174	\$ —	\$ 174
Six Months Ended June 30, 2014:			
Defined benefit postretirement plans			
Actuarial losses reclassified from accumulated other comprehensive loss and included in net periodic benefit cost	\$ 347	\$ —	\$ 347
Other comprehensive income	\$ 347	\$ —	\$ 347

(1) Tax expense is offset by an equal decrease in the valuation allowance.

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The change in the accumulated balance of other comprehensive loss during the six months ended June 30, 2014 is as follows:

	Accumulated Other Comprehensive Loss ⁽¹⁾ (In Thousands)
Defined benefit postretirement plans	
Balance at December 31, 2013	\$(10,398)
Amounts reclassified from accumulated other comprehensive loss	347
Other comprehensive income	347
Balance at June 30, 2014	\$(10,051)

(1) All amounts are net of tax.

(11) RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 is the result of a joint project with the International Accounting Standards Board intended to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. generally accepted accounting principles and International Financial Reporting Standards. The guidance is expected to enhance comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. Entities must adopt ASU 2014-09 using either a full retrospective approach or a modified retrospective approach with a cumulative effect of adoption recognized in the opening balance of retained earnings at the date of adoption. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. Forest has not yet determined the effect that adoption of ASU 2014-09 will have on its financial statements, nor has Forest determined which transition method it will use upon adoption.

In April 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360)—Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” (“ASU 2014-08”). ASU 2014-08 changes the requirements for reporting discontinued operations and requires expanded disclosures for discontinued operations and individually significant components of an entity that either have been disposed of or are classified as held for sale, but do not qualify for discontinued operations reporting. Only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity’s operations and financial results will be reported as discontinued operations in the financial statements. ASU 2014-08 is effective for annual periods, and interim periods within those years, beginning on or after December 15, 2014 and is applied prospectively. Early adoption is permitted, but only for disposals or classifications as held for sale that have not been reported in financial statements previously issued or available for issuance. Forest adopted ASU 2014-08 during the quarter ended March 31, 2014 and there was no impact to its consolidated financial statements.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

All expectations, forecasts, assumptions, and beliefs about our future financial results, condition, operations, strategic plans, and performance are forward-looking statements, as described in more detail under the heading "Forward-Looking Statements" below. Our actual results may differ materially because of a number of risks and uncertainties. Historical statements made herein are accurate only as of the date of filing of this Quarterly Report on Form 10-Q with the Securities and Exchange Commission ("SEC"), and may be relied upon only as of that date. The following discussion and analysis should be read in conjunction with Forest's Condensed Consolidated Financial Statements and the Notes thereto, the information included or incorporated by reference under the headings "Forward-Looking Statements" and "Risk Factors" below, and the information included or incorporated by reference in Forest's 2013 Annual Report on Form 10-K under the headings "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations." Unless the context indicates otherwise, all references in this document to "Forest," "the Company," "we," "our," "ours," and "us" refer to Forest Oil Corporation and its consolidated subsidiaries.

Forest is an independent oil and gas company engaged in the acquisition, exploration, development, and production of oil, natural gas, and natural gas liquids ("NGLs") primarily in North America. 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. We currently conduct our operations in one reportable geographical segment - the United States. Our core operational areas are in the Eagle Ford in South Texas and the Ark-La-Tex region in Texas, Louisiana, and Arkansas.

Recent Events

On May 5, 2014, we entered into an Agreement and Plan of Merger with Sabine Oil & Gas LLC ("Sabine"), under which Forest and Sabine will combine their businesses in an all-stock transaction. This agreement was amended on July 9, 2014 primarily to change the structure of the transaction, in which Forest now will be the surviving entity. The revised transaction structure does not change the economic terms of the transaction. Under the terms of the amended merger agreement, the owners of Sabine will contribute their interests in Sabine to Forest, in exchange for Forest common and preferred stock. Upon closing of the combination transaction, Forest's shareholders will own common shares that represent an approximate 26.5% economic interest in the combined company and approximately 20% of the total voting power, and Sabine's equity holders will own common shares and preferred shares that represent an approximate 73.5% economic interest and approximately 80% of the total voting power in the combined company. Consummation of the transaction is subject to approval by Forest shareholders, regulatory approvals, and other customary closing conditions. The combined entity will change its name to Sabine Oil & Gas Corporation and be headquartered in Houston.

In October 2013, we entered into an agreement to sell all of our oil and natural gas properties located in the Texas Panhandle for \$1 billion in cash. This transaction closed in November 2013 and we have received proceeds of \$985 million through June 2014, including \$20 million received in May 2014, after customary purchase price adjustments and escrow account settlements. In January 2013, we entered into an agreement to sell all of our oil and natural gas properties located in South Texas, excluding our Eagle Ford oil properties, for \$325 million in cash. This transaction closed in February 2013 and we received proceeds of \$321 million, after customary purchase price adjustments. We used the proceeds from these property divestitures to reduce our debt. These property divestitures affect the comparability of the results of our operations between the three and six months ended June 30, 2014 and the three and six months ended June 30, 2013 presented herein.

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RESULTS OF OPERATIONS

For the three and six months ended June 30, 2014, we recognized net losses of \$83 million and \$104 million, respectively, compared to net earnings of \$33 million and a net loss of \$35 million for the three and six months ended June 30, 2013, respectively. Adjusted EBITDA, which is a measure used by management, securities analysts, and investors that consists of net earnings (loss) before interest expense, income taxes, depreciation, depletion, and amortization, as well as other items including ceiling test write-downs and unrealized gains and losses on derivative instruments, was \$31 million and \$66 million for the three and six months ended June 30, 2014, respectively, compared to \$88 million and \$182 million for the three and six months ended June 30, 2013, respectively. The decreases in EBITDA in the 2014 periods as compared to the 2013 periods were primarily due to the property divestitures referenced above under “Recent Events.” Adjusted EBITDA is a performance measure not calculated in accordance with generally accepted accounting principles (“GAAP”). See “Reconciliation of Non-GAAP Measure” at the end of this Item 2 for a reconciliation of Adjusted EBITDA to our reported net earnings (loss), the most directly comparable financial measure calculated and presented in accordance with GAAP.

Management’s analysis of the individual components of the changes in our quarterly and year-to-date results follows.

Oil, Natural Gas, and Natural Gas Liquids Volumes, Revenues, and Prices

Oil, natural gas, and natural gas liquids sales volumes, revenues, and per unit price realizations for the three and six months ended June 30, 2014 and 2013 are set forth in the table below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Sales volumes:				
Oil (MBbls)	292	601	618	1,160
Natural gas (MMcf)	6,216	11,406	12,654	25,738
NGLs (MBbls)	182	694	360	1,392
Totals (MMcfe)	9,060	19,176	18,522	41,050
Revenues (in thousands):				
Oil	\$28,107	\$56,316	\$58,439	\$110,278
Natural gas	26,545	41,161	54,716	83,819
NGLs	5,454	19,309	11,408	40,731
Totals	\$60,106	\$116,786	\$124,563	\$234,828
Per unit price realizations:				
Oil (\$/Bbl)	\$96.26	\$93.70	\$94.56	\$