LINN ENERGY, LLC
Form 10-Q
November 06, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the Quarterly Period Ended September 30, 2008

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: 000-51719

LINN ENERGY, LLC
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	65-1177591 (IRS Employer Identification No.)
600 Travis, Suite 5100 Houston, Texas (Address of principal executive offices)	77002 (Zip Code)

(281) 840-4000
(Registrant's telephone number, including area code)

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 x 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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

As of October 31, 2008, there were 115,154,653 units outstanding.

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GLOSSARY OF TERMS

As commonly used in the oil and gas industry and as used in this Quarterly Report on Form 10-Q, the following terms have the following meanings:

Bbl. One stock tank barrel or 42 United States gallons liquid volume.

Bcfe. One billion cubic feet equivalent, determined using a ratio of six Mcf of gas to one Bbl of oil, condensate or natural gas liquids.

MBbls. One thousand barrels of oil or other liquid hydrocarbons.

MBbls/d. MBbls per day.

Mcf. One thousand cubic feet.

Mcfe. One thousand cubic feet equivalent, determined using the ratio of six Mcf of gas to one Bbl of oil, condensate or natural gas liquids.

Mid-Continent I. February 2007 acquisition of oil and gas properties in the Texas Panhandle from Cavallo Energy LP, acting through its general partner, Stallion Energy LLC, for a contract price of $415.0 million.

Mid-Continent II. June 2007 acquisition of oil and gas properties in the Texas Panhandle for a contract price of $90.5 million.

Mid-Continent III. August 2007 acquisition of oil and gas properties in Oklahoma, Kansas and the Texas Panhandle from Dominion Resources, Inc. for a contract price of $2.05 billion.

Mid-Continent IV. January 2008 acquisition of oil and gas properties in Oklahoma from Lamamco Drilling Company for a contract price of $552.2 million.

MMBtu. One million British thermal units.

MMcf. One million cubic feet.

MMcf/d. MMcf per day.

MMcfe. One million cubic feet equivalent, determined using a ratio of six Mcf of gas to one Bbl of oil, condensate or natural gas liquids.

MMcfe/d. MMcfe per day.

MMMBtu. One billion British thermal units.

NYMEX. The New York Mercantile Exchange.

Tcfe. One trillion cubic feet equivalent, determined using the ratio of six Mcf of gas to one Bbl of oil, condensate or natural gas liquids.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINN ENERGY, LLC
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2008 (Unaudited)	December 31, 2007
	(in thousands, except unit amounts)	
Assets		
Current assets:		
Cash and cash equivalents	$ 47,269	$ 1,441
Accounts receivable – trade, net	260,071	149,850
Derivative instruments	61,201	26,100
Other current assets, net	17,491	5,768
Total current assets	386,032	183,159
Noncurrent assets:		
Oil and gas properties and equipment (successful efforts method)	3,822,413	3,618,741
Less accumulated depreciation, depletion and amortization	(205,520)	(127,265)
	3,616,893	3,491,476
Other property and equipment	21,974	37,407
Less accumulated depreciation	(3,564)	(5,383)
	18,410	32,024
Derivative instruments	2,027	—
Goodwill	—	64,419
Other noncurrent assets, net	14,119	36,625
Noncurrent assets held for sale	58,432	—
	74,578	101,044
Total assets	$ 4,095,913	$ 3,807,703
Liabilities and Unitholders' Capital		
Current liabilities:		
Accounts payable and accrued expenses	$ 188,911	$ 223,636
Derivative instruments	20,707	6,148
Other current liabilities	8,508	12,943
Total current liabilities	218,126	242,727
Noncurrent liabilities:		
Credit facility	1,521,393	1,443,000
Senior notes, net	250,086	—
Derivative instruments	122,079	63,813
Other noncurrent liabilities	29,931	31,522
Total noncurrent liabilities	1,923,489	1,538,335
Unitholders' capital:		

115,158,483 units and 113,815,914 units issued and outstanding at September 30, 2008 and December 31, 2007, respectively		2,191,207		2,374,660
Accumulated loss		(236,909)		(348,019)
		1,954,298		2,026,641
Total liabilities and unitholders' capital	$	4,095,913	$	3,807,703

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

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LINN ENERGY, LLC

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands, except per unit amounts)			
Revenues and other:				
Oil, gas and natural gas liquid sales	$ 240,634	$ 61,318	$ 672,092	$ 117,380
Gain (loss) on oil and gas derivatives	845,818	(65,440)	(293,780)	(143,588)
Natural gas marketing revenues	4,647	2,995	11,056	7,656
Other revenues	561	924	1,682	2,056
	1,091,660	(203)	391,050	(16,496)
Expenses:				
Operating expenses	56,970	22,306	139,732	39,915
Natural gas marketing expenses	4,061	2,451	9,738	6,426
General and administrative expenses	18,695	12,657	56,093	34,850
Data license expenses			2,475	
Bad debt expenses	1,436		1,436	
Depreciation, depletion and amortization	51,727	16,825	146,210	29,295
	132,889	54,239	355,684	110,486
Other income and (expenses):				
Interest expense, net of amounts capitalized	(22,574)	(10,839)	(71,199)	(19,429)
Loss on interest rate swaps	(9,694)	(3,151)	(17,483)	(2,954)
Other, net	(3,558)	(2,422)	(8,034)	(2,944)
	(35,826)	(16,412)	(96,716)	(25,327)
Income (loss) from continuing operations before income taxes	922,945	(70,854)	(61,350)	(152,309)
Income tax provision	(1,002)	(977)	(1,047)	(5,007)
Income (loss) from continuing operations	921,943	(71,831)	(62,397)	(157,316)
Discontinued operations:				
Gain on sale of assets, net of taxes	162,442		161,120	
Income (loss) from discontinued operations, net of taxes	(1,774)	(4,391)	12,387	(3,879)
Net income (loss) from discontinued operations	160,668	(4,391)	173,507	(3,879)
Net income (loss)	$ 1,082,611	$ (76,222)	$ 111,110	$ (161,195)
Net income (loss) per unit – continuing operations:				
Units – basic	$ 8.06	$ (0.89)	$ (0.55)	$ (2.54)
Units – diluted	$ 8.05	$ (0.89)	$ (0.55)	$ (2.54)
Net income (loss) per unit – discontinued operations:				
Units – basic	$ 1.41	$ (0.05)	$ 1.52	$ (0.06)
Units – diluted	$ 1.41	$ (0.05)	$ 1.52	$ (0.06)

Net income (loss) per unit:								
Units – basic	$	9.47	$	(0.94)	$	0.97	$	(2.60)
Units – diluted	$	9.46	$	(0.94)	$	0.97	$	(2.60)
Weighted average units outstanding:								
Units – basic		114,321		69,207		114,111		58,072
Units – diluted		114,476		69,207		114,111		58,072
Class D – basic				11,792				3,974
Class D – diluted				11,792				3,974
Distributions declared per unit	$	0.63	$	0.57	$	1.89	$	1.61

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

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LINN ENERGY, LLC

CONDENSED CONSOLIDATED STATEMENTS OF UNITHOLDERS' CAPITAL

(Unaudited)

	Nine Months Ended September 30, 2008				
	Units	Unitholders' Capital	Accumulated Income (Loss)	Treasury Units (at Cost)	Total Unitholders' Capital
			(in thousands)		
Balance as of December 31, 2007	113,816	$ 2,374,660	$ (348,019)	$	$ 2,026,641
Issuance of units	1,437	23,483			23,483
Purchase of units	(95)			(1,981)	(1,981)
Cancellation of units		(1,981)		1,981	
Distributions to unitholders		(217,331)			(217,331)
Unit-based compensation expenses		12,376			12,376
Net income			111,110		111,110
Balance as of September 30, 2008	115,158	$ 2,191,207	$ (236,909)	$	$ 1,954,298

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

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LINN ENERGY, LLC

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2008	2007
	(in thousands)	
Cash flow from operating activities:		
Net income (loss)	$ 111,110	$ (161,195)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation, depletion and amortization	152,599	49,109
Unit-based compensation and unit warrant expenses	12,376	10,890
Bad debt expenses	1,436	
Amortization and write-off of deferred financing fees and other	12,271	4,108
Gain on sale of assets	(161,120)	(867)
Deferred income tax		3,359
Mark-to-market on derivatives:		
Total losses	311,263	146,542
Cash settlements	(72,416)	24,896
Cash settlements on canceled derivatives	(81,358)	
Premiums paid for derivatives	(129,520)	(257,092)
Changes in assets and liabilities:		
Increase in accounts receivable	(99,448)	(47,163)
(Increase) decrease in other assets	(3,821)	10,614
Increase (decrease) in accounts payable and accrued expenses	(14,473)	24,205
Increase in other liabilities	3,889	4,626
Net cash provided by (used in) operating activities	42,788	(187,968)
Cash flow from investing activities:		
Acquisition of oil and gas properties	(575,622)	(2,572,614)
Additions to oil and gas properties	(249,833)	(54,170)
Purchases of other property and equipment	(2,783)	(12,494)
Proceeds from sales of oil and gas properties and other property and equipment	744,133	2,974
Net cash used in investing activities	(84,105)	(2,636,304)
Cash flow from financing activities:		
Proceeds from sale and issuance of units		2,120,000
Purchase of units	(1,981)	(7,399)
Proceeds from issuance of debt	1,422,000	1,140,000
Principal payments on debt	(1,095,116)	(265,947)
Distributions to unitholders	(217,331)	(90,165)
Financing fees and other, net	(20,427)	(45,224)
Net cash provided by financing activities	87,145	2,851,265
Net increase in cash and cash equivalents	45,828	26,993
Cash and cash equivalents:		
Beginning	1,441	6,595
Ending	$ 47,269	$ 33,588

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

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LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Basis of Presentation

Linn Energy, LLC ("Linn Energy" or the "Company") is an independent oil and gas company focused on the development and acquisition of long life properties which complement its asset profile in producing basins within the United States.

The condensed consolidated financial statements at September 30, 2008, and for the three and nine months ended September 30, 2008 and 2007, are unaudited, but in the opinion of management include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results for the interim periods. Certain information and note disclosures normally included in annual financial statements prepared in accordance with United States generally accepted accounting principles ("GAAP") have been condensed or omitted under Securities and Exchange Commission ("SEC") rules and regulations, and as such this report should be read in conjunction with the financial statements and notes in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The results reported in these unaudited condensed consolidated financial statements should not necessarily be taken as indicative of results that may be expected for the entire year.

Certain amounts in the condensed consolidated financial statements and notes thereto have been reclassified to conform to the 2008 financial statement presentation. Such reclassifications include those related to the presentation of discontinued operations (see Note 2) on the condensed consolidated statements of operations.

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and revenues and expenses and the disclosure of contingent assets and liabilities to prepare these condensed consolidated financial statements in conformity with GAAP. Actual results could differ from those estimates.

The Company's Appalachian Basin and Mid Atlantic Well Service ("Mid Atlantic") operations have been classified as discontinued operations on the condensed consolidated statement of operations for all periods presented. Unless otherwise indicated, information about the statement of operations that is presented in the notes to condensed consolidated financial statements relates only to Linn Energy's continuing operations.

(2) Assets Held for Sale and Discontinued Operations

On July 1, 2008, the Company completed the sale of its interests in oil and gas properties located in the Appalachian Basin to XTO Energy, Inc. ("XTO") for a contract price of $600.0 million. Net proceeds were $568.1 million and the carrying value of net assets sold was $405.3 million, resulting in a gain on the sale of $162.8 million, which is recorded in "discontinued operations: gain on sale of assets, net of taxes" on the condensed consolidated statements of operations. The gain is subject to normal post-closing adjustments. The Company used the net proceeds from the sale to repay loans outstanding under its term loan agreement and reduce indebtedness under its credit facility (see Note 8).

In addition, in March 2008, the Company exited the drilling and service business in the Appalachian Basin provided by its wholly owned subsidiary Mid Atlantic Well Service ("Mid Atlantic"). At September 30, 2008, substantially all of the property and equipment previously held by Mid Atlantic totaling $9.2 million had been sold. During the three and nine months ended September 30, 2008, the Company recorded a loss on the sale of the Mid Atlantic assets of $0.3 million and $1.6 million, respectively, which is recorded in "discontinued operations: gain on sale of assets, net of

taxes” on the condensed consolidated statements of operations.

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LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

(Unaudited)

The following summarizes the Appalachian Basin and Mid Atlantic amounts included in income from discontinued operations on the condensed consolidated statements of operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Total revenues and other	$ (421)	$ 14,707	$ 49,564	$ 51,394
Total operating expenses	(1,549)	(13,980)	(23,779)	(39,051)
Interest expense	196	(5,774)	(13,398)	(17,246)
Income (loss) from discontinued operations	(1,774)	(5,047)	12,387	(4,903)
Income tax benefit		656		1,024
Income (loss) from discontinued operations, net of taxes	$ (1,774)	$ (4,391)	$ 12,387	$ (3,879)

The Company computed interest expense related to discontinued operations in accordance with Emerging Issues Task Force Issue No. 87-24, "Allocation of Interest to Discontinued Operations" based on debt required to be repaid as a result of the disposal transaction.

On August 15, 2008, the Company completed the sale of certain of its assets in the Verden area in Oklahoma to Laredo Petroleum, Inc. ("Laredo") for a contract price of $185.0 million, subject to closing adjustments. Net proceeds and the carrying value of net assets sold were approximately $167.5 million. The Verden assets were acquired by the Company with its acquisition of oil and gas properties from Dominion Resources, Inc. ("Dominion") in August 2007. The Company used the net proceeds from the sale to reduce indebtedness (see Note 8).

In addition, on October 9, 2008, the Company entered into an agreement to sell its deep rights in certain central Oklahoma acreage, which includes the Woodford Shale interval, for a contract price of $229.1 million, subject to closing adjustments. The sale includes no producing reserves and Linn Energy will retain the rights to the shallow portion of this acreage. The Company anticipates closing in the fourth quarter of 2008, subject to closing conditions. There can be no assurance that all of the conditions to closing will be satisfied. At September 30, 2008, the carrying value of net assets to be sold of approximately $58.1 million is included in "noncurrent assets held for sale" on the condensed consolidated balance sheet. These assets were acquired by the Company with its acquisition of oil and gas properties from Dominion in August 2007. The Company plans to use the net proceeds from the sale to reduce indebtedness (see Note 8).

(3) Acquisitions

The Company accounts for its acquisitions using the purchase method of accounting as prescribed in SFAS No. 141, "Business Combinations." On January 31, 2008, the Company completed the acquisition of certain oil and gas properties located primarily in the Mid-Continent region from Lamamco Drilling Company ("Lamamco") for a contract price of $552.2 million, subject to closing adjustments ("Mid-Continent IV"). The acquisition was financed with a combination of borrowings under the Company's credit facility and proceeds from a term loan entered into at closing (see Note 8).

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LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

(Unaudited)

The following presents the purchase accounting for the Mid-Continent IV acquisition, based on estimates of fair value:

	Mid-Continent IV (in thousands)
Cash	$ 537,124
Estimated transaction costs	635
	537,759
Fair value of liabilities assumed	4,029
Total purchase price	$ 541,788

The following presents the allocation of the purchase price for the Mid-Continent IV acquisition, based on estimates of fair value:

	Mid-Continent IV (in thousands)
Current assets	$ 1,811
Oil and gas properties	537,868
Other property and equipment	2,109
	$ 541,788

The purchase price and purchase price allocation above are based on reserve reports, published market prices and estimates by management. The most significant assumptions are related to the estimated fair values assigned to proved oil and gas properties. To estimate the fair values of these properties, the Company utilized estimates of oil and gas reserves. The Company estimated future prices to apply to the estimated reserve quantities acquired, and estimated future operating and development costs to arrive at estimates of future net revenues. The Company also reviewed comparable purchases and sales of oil and gas properties within the same regions.

The following unaudited pro forma financial information presents a summary of Linn Energy’s consolidated results of continuing operations for the three and nine months ended September 30, 2008 and 2007, assuming the Mid-Continent IV acquisition had been completed as of January 1, 2007, including adjustments to reflect the allocation of the purchase price to the acquired net assets. The pro forma financial information also assumes that the following 2007 acquisitions were completed as of January 1, 2007:

- February 1, 2007, acquisition of certain oil and gas properties and related assets in the Texas Panhandle for a contract price of $415.0 million (“Mid-Continent I”)

- June 12, 2007, acquisition of certain oil and gas properties in the Texas Panhandle for a contract price of $90.5 million (“Mid-Continent II”)

- August 31, 2007, acquisition of certain oil and gas properties in the Mid-Continent, in Oklahoma, Kansas and the Texas Panhandle for a contract price of $2.05 billion (“Mid-Continent III”)

The revenues and expenses of the Mid-Continent I, Mid-Continent II and Mid-Continent III assets are included in the consolidated results of the Company as of February 1, 2007, June 12, 2007 and

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LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

(Unaudited)

September 1, 2007, respectively. The revenues and expenses of the Mid-Continent IV assets are included in the consolidated results of the Company effective February 1, 2008. The pro forma financial information is not necessarily indicative of the results of operations if the acquisitions had been effective as of January 1, 2007. All amounts reflect continuing operations.

	Three Months Ended September 30,	Nine Months Ended September 30,	
	2007	2008	2007
	(in thousands, except per unit amounts)		
Total revenues and other	$ 81,183	$ 400,323	$ 265,758
Total operating expenses	$ 97,376	$ 360,321	$ 268,299
Loss from continuing operations	$ (51,488)	$ (61,391)	$ (96,482)
Loss from continuing operations per unit:			
Units – basic	$ (0.64)	$ (0.54)	$ (1.56)
Units – diluted	$ (0.64)	$ (0.54)	$ (1.56)
Class D – basic	$ (0.64)	$	$ (1.56)
Class D – diluted	$ (0.64)	$	$ (1.56)

(4) Goodwill

The entire goodwill balance of $64.4 million at December 31, 2007 related to the Mid-Continent III acquisition in August 2007 (see Note 3).

The following reflects the changes in the carrying amount of goodwill during the nine months ended September 30, 2008 and the year ended December 31, 2007 (in thousands):

Balance, December 31, 2006	$ —
Mid-Continent III acquisition	64,419
Balance, December 31, 2007	64,419
Purchase accounting adjustments:	
Post closing statement and other	7,935
Verden assets (1)	(19,200)
Woodford Shale assets (1)	(53,154)
Balance, September 30, 2008	$ —

(1) Represents update to preliminary purchase accounting in which amounts were allocated to unproved oil and gas properties and subsequently sold or held for sale as of September 30, 2008 (see Note 2).

(5) Unitholders' Capital

Issuance of Units

During the nine months ended September 30, 2008, the Company issued 410,000 units in connection with the termination of certain contractual obligations in the Western region (equal to a fair value of approximately $8.7 million).

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LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

(Unaudited)

During the nine months ended September 30, 2008, the Company issued 600,000 units in connection with the acquisition of certain gas properties in the Appalachian Basin (equal to a fair value of approximately $14.7 million).

Cancellation of Units

During the nine months ended September 30, 2008, the Company purchased 94,521 restricted units from employees for approximately $2.0 million in conjunction with the vesting of restricted unit awards. The proceeds were used to fund the employees' minimum payroll taxes on the awards, and the Company canceled the units.

(6) Oil and Gas Capitalized Costs

Aggregate capitalized costs related to oil and gas production activities with applicable accumulated depreciation, depletion and amortization are presented below:

	September 30, 2008	December 31, 2007
	(in thousands)	
Proved properties:		
Leasehold acquisition	$ 3,306,728	$ 3,095,400
Development	331,914	254,251
Unproved properties	95,833	156,908
Gas compression plant and pipelines	87,938	112,182
	3,822,413	3,618,741
Less accumulated depletion, depreciation and amortization	(205,520)	(127,265)
	$ 3,616,893	$ 3,491,476

(7) Business and Credit Concentrations

For the three and nine months ended September 30, 2008, the Company's four largest customers represented approximately 17%, 12%, 11% and 10% and 19%, 11%, 11% and 10%, respectively, of the Company's sales. For the three and nine months ended September 30, 2007, the Company's two largest customers represented approximately 27% and 25%, and 31% and 25%, respectively, of the Company's sales.

At September 30, 2008, three customers' trade accounts receivable from oil, gas and natural gas liquids ("NGL") sales accounted for more than 10% of the Company's total trade accounts receivable. As of September 30, 2008, trade accounts receivable from the Company's three largest customers represented approximately 19%, 14% and 10% of the Company's receivables. At December 31, 2007, three customers' trade accounts receivable from oil, gas and NGL sales accounted for more than 10% of the Company's total trade accounts receivable. As of December 31, 2007, trade accounts receivable from the Company's three largest customers represented approximately 22%, 13% and 12% of the Company's receivables.

LINN ENERGY, LLC
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

(Unaudited)

(8) Debt

At September 30, 2008 and December 31, 2007, the Company had the following debt outstanding:

	September 30, 2008	December 31, 2007
	(in thousands)	
Credit facility (1)	$ 1,521,393	$ 1,443,000
Senior notes, net (2)	250,086	—
Less current maturities	—	—
	$ 1,771,479	$ 1,443,000

(1) Variable rate of 4.39% at September 30, 2008 and 7.02% at December 31, 2007.

(2) Fixed rate of 9.875%; net of unamortized discount of approximately $5.8 million at September 30, 2008.

Credit Facility

At September 30, 2008, the Company had a $1.85 billion borrowing base under its Third Amended and Restated Credit Agreement (“Credit Facility”) with a maturity of August 2010. During the third quarter of 2008, the Company repaid $513.6 million in indebtedness under its Credit Facility with net proceeds from the sales of Appalachian Basin and Verden properties (see Note 2).

The borrowing base under the Credit Facility will be redetermined semi-annually by the lenders in their sole discretion, based on, among other things, reserve reports as prepared by reserve engineers taking into account the oil and gas prices at such time. At the Company’s election, interest on borrowings under the Credit Facility is determined by reference to either the London Interbank Offered Rate (“LIBOR”) plus an applicable margin between 1.00% and 1.75% per annum or the alternate base rate (“ABR”) plus an applicable margin between 0% and 0.25% per annum.

Certain subsidiaries of Lehman Brothers Holdings Inc. (“Lehman Holdings”), including Lehman Brothers Commodity Services Inc. (“Lehman Commodity Services”), were lenders in the Company’s Credit Facility. In September 2008 and October 2008, Lehman Holdings and Lehman Commodity Services, respectively, filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code (see Note 11). At September 30, 2008, available borrowing under the Credit Facility was $313.9 million, which includes a $6.5 million reduction in availability for outstanding letters of credit and an $8.2 million reduction for the unfunded portion of Lehman Holdings’ subsidiaries’ approximate 2.5% commitment. In October 2008, the Company replaced Lehman Holdings’ subsidiaries with another lender and Lehman Holdings’ subsidiaries no longer participate in the Company’s Credit Facility. Available borrowing under the Credit Facility was $285.2 million at October 31, 2008 which includes a $6.4 million reduction in availability for outstanding letters of credit and the restoration of the previously unavailable Lehman Holdings’ subsidiaries’ commitment.

Term Loan

On January 31, 2008, in order to fund a portion of the January 2008 acquisition of oil and gas properties in the Mid-Continent (see Note 3), the Company entered into a $400.0 million Second Lien Term Loan Agreement ("Term Loan") maturing on July 31, 2009. Interest was determined by reference to LIBOR plus an applicable margin of 5.0% for the first twelve months and 7.5% for the remaining period until maturity or a domestic bank rate plus an applicable margin of 3.5% for the first twelve months and 6.0%

for the remaining period until maturity. On June 30, 2008, the Company repaid $243.6 million in indebtedness under the Term Loan with net proceeds from the Senior Notes (see below). On July 1, 2008, the Company repaid the balance of the term loan of $156.4 million. Deferred financing fees associated with the Term Loan of approximately $1.9 million and $4.6 million were written off during the three and nine months ended September 30, 2008, respectively.

Senior Notes

On June 24, 2008, the Company entered into a purchase agreement with a group of initial purchasers ("Initial Purchasers") pursuant to which the Company agreed to issue $255.9 million in aggregate principal amount of the Company's senior notes due 2018 ("Senior Notes"). The Senior Notes were offered and sold to the Initial Purchasers and then resold to qualified institutional buyers each in transactions exempt from the registration requirements under the Securities Act of 1933, as amended ("Securities Act"). The Company used the net proceeds (after deducting the Initial Purchasers' discounts and offering expense) of approximately $243.6 million to repay loans outstanding under the Company's Term Loan (see above). In connection with the Senior Notes, the Company incurred financing fees of approximately $7.3 million, which will be amortized over the life of the Senior Notes and recorded in interest expense. The $5.9 million discount on the Senior Notes will be amortized over the life of the Senior Notes and recorded in interest expense.

The Senior Notes were issued under an Indenture dated June 27, 2008 ("Indenture"), mature on July 1, 2018 and bear interest at 9.875%. Interest is payable semi-annually beginning January 1, 2009. The Senior Notes are general unsecured senior obligations of the Company and are effectively junior in right of payment to any secured indebtedness of the Company to the extent of the collateral securing such indebtedness. Each of the Company's material subsidiaries guaranteed the Senior Notes on a senior unsecured basis. The Indenture provides that the Company may redeem: 1) on or prior to July 1, 2011, up to 35% of the aggregate principal amount of the Senior Notes at a redemption price of 109.875% of the principal amount, plus accrued and unpaid interest, 2) prior to July 1, 2013, all or part of the Senior Notes at a redemption price equal to the principal amount, plus a make whole premium (as defined in the Indenture) and accrued and unpaid interest, and 3) on or after July 1, 2013, all or part of the Senior Notes at redemption prices equal to 104.938% in 2013, 103.292% in 2014, 101.646% in 2015 and 100% in 2016 and thereafter. The Indenture also provides that, if a change of control (as defined in the Indenture) occurs, the holders have a right to require the Company to repurchase all or part of the Senior Notes at a redemption price equal to 101%, plus accrued and unpaid interest.

The Senior Notes' Indenture contains covenants that, among other things, limit the Company's ability to: (i) pay distributions on, purchase or redeem the Company's units or redeem its subordinated debt; (ii) make investments; (iii) incur or guarantee additional indebtedness or issue certain types of equity securities; (iv) create certain liens; (v) sell assets; (vi) consolidate, merge or transfer all or substantially all of the Company's assets; (vii) enter into agreements that restrict distributions or other payments from the Company's restricted subsidiaries to the Company; (viii) engage in transactions with affiliates; and (ix) create unrestricted subsidiaries.

In connection with the issuance and sale of the Senior Notes, the Company entered into a Registration Rights Agreement ("Registration Rights Agreement") with the Initial Purchasers. Under the Registration Rights Agreement, the Company agreed to use its reasonable best efforts to file with the SEC and cause to become effective a registration statement relating to an offer to issue new notes having terms substantially identical to the Senior Notes in exchange for outstanding Senior Notes. In certain circumstances, the Company may be required to file a shelf registration statement to cover resales of the Senior Notes. The Company will not be obligated to file the registration statements described above if the restrictive legend on the Senior Notes has been removed and the Senior Notes are freely tradable (in each case, other than with respect to persons that are affiliates of the Company) pursuant to Rule 144 under the Securities Act, as of the 366th day after the Senior Notes were issued. If the Company fails to satisfy its obligations under the Registration Rights Agreement, the Company may be required to pay additional interest to holders of the Senior Notes under certain circumstances.

(9) Derivatives

Commodity Derivatives

The Company sells oil, gas and NGL in the normal course of its business and utilizes derivative instruments to minimize the variability in cash flows due to price movements in oil, gas and NGL. The Company enters into derivative instruments such as swap contracts, collars and put options to economically hedge a portion of its forecasted oil, gas and NGL sales. Oil puts are also used to economically hedge NGL sales. The Company did not designate these contracts as cash flow hedges under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended, ("SFAS 133"); therefore, the changes in fair value of these instruments are recorded in current earnings. See Note 10 for additional disclosures about oil and gas commodity derivatives as required by Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157").

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The following table summarizes open positions as of September 30, 2008 and represents, as of such date, derivatives in place through December 31, 2014, on annual production volumes:

	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
Gas Positions:							
Fixed Price Swaps:							
Hedged Volume (MMMBtu)	9,936	39,586	39,566	31,901	29,662		
Average Price ($/MMBtu)	$ 8.68	$ 8.53	$ 8.20	$ 8.27	$ 8.46	$	$
Puts:							
Hedged Volume (MMMBtu)	1,766	6,960	6,960	6,960			
Average Price ($/MMBtu)	$ 8.07	$ 7.50	$ 7.50	$ 7.50	$	$	$
PEPL Puts: (1)							
Hedged Volume (MMMBtu)	964	5,334	10,634	13,259	5,934		
Average Price ($/MMBtu)	$ 7.85	$ 7.85	$ 7.85	$ 7.85	$ 7.85	$	$
Total:							
Hedged Volume (MMMBtu)	12,666	51,880	57,160	52,120	35,596		
Average Price ($/MMBtu)	$ 8.53	$ 8.32	$ 8.05	$ 8.06	$ 8.36	$	$
Oil Positions:							
Fixed Price Swaps:							
Hedged Volume (MBbls)	688	2,437	2,150	2,073	2,025	2,275	2,200
Average Price ($/Bbl)	$ 82.11	$ 90.00	$ 90.00	$ 84.22	$ 84.22	$ 84.22	$ 84.22
Puts: (2)							
Hedged Volume (MBbls)	467	1,843	2,250	2,352	500		
Average Price ($/Bbl)	$ 73.34	$ 120.00	$ 110.00	$ 69.11	$ 77.73	$	$
Collars:							
Hedged Volume (MBbls)		250	250	276	348		
Average Floor Price ($/Bbl)	$	$ 90.00	$ 90.00	$ 90.00	$ 90.00	$	$
Average Ceiling Price ($/Bbl)	$	$ 114.25	$ 112.00	$ 112.25	$ 112.35	$	$
Total:							
	1,155	4,530	4,650	4,701	2,873	2,275	2,200

Hedged Volume (MBbls)							
Average Price ($/Bbl)	$ 78.57	$ 102.21	$ 99.68	$ 77.00	$ 83.79	$ 84.22	$ 84.22
Gas Basis Differential Positions:							
PEPL Basis Swaps: (3)							
Hedged Volume (MMMBtu)	9,036	34,666	29,366	26,741	34,066		
Hedged Differential ($/MMBtu)	$ (0.95)	$ (0.95)	$ (0.95)	$ (0.95)	$ (0.95)	$	$

(1) Settle on the Panhandle Eastern Pipeline (“PEPL”) spot price of gas to hedge basis differential associated with gas production in the Mid-Continent region.

(2) The Company utilizes oil puts to hedge revenues associated with its NGL production.

(3) Represents a swap of the basis between the New York Mercantile Exchange (“NYMEX”) and the PEPL spot price of gas of $(0.95) per MMBtu for the volumes hedged.

Settled derivatives on gas production for the three and nine months ended September 30, 2008 included a volume of 12,906 MMMBtu and 38,064 MMMBtu at an average contract price of $8.53 and $8.47, respectively. Settled derivatives on oil and NGL production for the three and nine months ended September 30, 2008 included a volume of 1,013 MBbls and 3,151 MBbls at an average contract price of $78.07 and $77.56, respectively. The gas derivatives are settled based on the closing NYMEX future price of gas or on the published PEPL spot price of gas on the settlement date, which occurs on the third day
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preceding the production month. The oil transactions are settled based on the average month's daily NYMEX price of light oil and settlement occurs on the final day of the production month.

By using derivative instruments to economically hedge exposures to changes in commodity prices, the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk. The Company minimizes the credit risk in derivative instruments by 1) limiting its exposure to any single counterparty, 2) entering into derivative instruments only with counterparties that are also lenders in the Company's Credit Facility, each of which currently meet the Company's minimum credit quality standard, and 3) monitoring the creditworthiness of the Company's counterparties on an ongoing basis. See Note 11 for details about canceled commodity contracts with Lehman Commodity Services.

Interest Rate Swaps

The Company has entered into interest rate swap agreements based on LIBOR to minimize the effect of fluctuations in interest rates. If LIBOR is lower than the fixed rate in the contract, the Company is required to pay the counterparties the difference, and conversely, the counterparties are required to pay the Company if LIBOR is higher than the fixed rate in the contract. The Company did not designate the interest rate swap agreements as cash flow hedges under SFAS No. 133; therefore, the changes in fair value of these instruments are recorded in current earnings. See Note 10 for additional disclosures about interest rate swaps as required by SFAS 157.

The following presents the settlement terms of the interest rate swaps:

	Year 2008	Year 2009	Year 2010	Year 2011 (1)
		(dollars in thousands)		
Notional Amount	$ 1,212,000	$ 1,212,000	$ 1,212,000	$ 1,212,000
Fixed Rate	4.20%	5.06%	5.06%	5.06%

(1) Represents interest rate swaps that settle in January 2011.

Outstanding Notional Amounts

The following presents the outstanding notional amounts and maximum number of months outstanding of derivative instruments:

	September 30, 2008	December 31, 2007
Outstanding notional amounts of gas contracts (MMMBtu)	209,422	275,769
Maximum number of months gas contracts outstanding	51	59
Outstanding notional amounts of oil contracts (MBbls)	22,383	16,214
Maximum number of months oil contracts outstanding	75	72
Outstanding notional amount of interest rate swaps (in thousands)	$ 1,212,000	$ 1,212,000

Maximum number of months interest rate swaps outstanding	27	36

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Balance Sheet Presentation

The Company's commodity derivatives and interest rate swap derivatives are presented on a net basis in "derivative instruments" on the condensed consolidated balance sheets. The following summarizes the fair value of derivatives outstanding on a gross basis:

	September 30, 2008	December 31, 2007
	(in thousands)	
Assets:		
Commodity derivatives	$ 299,128	$ 246,124
Interest rate swaps	179	2,548
	$ 299,307	$ 248,672
Liabilities:		
Commodity derivatives	$ 341,126	$ 260,058
Interest rate swaps	37,739	32,475
	$ 378,865	$ 292,533

The Company's counterparties are participants in its Credit Facility (see Note 8) which is secured by the Company's oil and gas reserves; therefore, the Company is not required to post any collateral. The Company does not require collateral from the counterparties. The maximum amount of loss due to credit risk, based on the gross fair value of financial instruments that the Company would incur if its counterparties failed completely to perform according to the terms of the contracts was approximately $8.4 million at September 30, 2008. In accordance with the Company's standard practice, its commodity and interest rate swap derivatives are subject to counterparty netting under the agreements governing such derivatives and therefore the risk of such loss is mitigated at September 30, 2008.

Gain (Loss) on Derivatives

Gains and losses on derivatives are reported on the condensed consolidated statements of operations in "gain (loss) on oil and gas derivatives" and "loss on interest rate swaps" and include realized and unrealized gains (losses). Realized gains (losses), excluding canceled commodity derivatives, represent amounts related to the settlement of derivative instruments, and for commodity derivatives, are aligned with the underlying production. Unrealized gains (losses) represent the change in fair value of the derivative instruments and are non-cash items. The following presents the Company's reported gains and losses on derivative instruments:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
Realized gains (losses):				
Commodity derivatives	$ (28,270)	$ 10,756	$ (62,289)	$ 24,649
Canceled commodity derivatives	(13,161)		(81,358)	
Interest rate swaps	(5,817)	647	(11,479)	729
	$ (47,248)	$ 11,403	$ (155,126)	$ 25,378
Unrealized gains (losses):				

Commodity derivatives (1)	$ 887,249	$ (76,196)	$ (150,133)	$ (168,237)
Interest rate swaps	(3,877)	(3,798)	(6,004)	(3,683)
	$ 883,372	$ (79,994)	$ (156,137)	$ (171,920)
Total gains (losses):				
Commodity derivatives	$ 845,818	$ (65,440)	$ (293,780)	$ (143,588)
Interest rate swaps	(9,694)	(3,151)	(17,483)	(2,954)
	$ 836,124	$ (68,591)	$ (311,263)	$ (146,542)

(1) Includes a net unrealized gain of approximately $6.7 million related to canceled derivative contracts with Lehman Commodity Services (see Note 11) for the three and nine months ended September 30, 2008.

During the three and nine months ended September 30, 2008, the Company canceled (before the contract settlement date) derivative contracts on estimated future gas production resulting in realized losses of $13.2 million and $81.4 million, respectively. The future gas production under the canceled contracts primarily related to properties in the Verden area and the Appalachian Basin (see Note 2).

In addition, in September 2008, the Company canceled (before the contract settlement date) all of its commodity derivative contracts with Lehman Commodity Services as counterparty. The Company entered into contracts for substantially the same volumes at identical strike prices with another participant in its Credit Facility for a cost of approximately $67.6 million. As a result, effective September 17, 2008, Lehman Commodity Services was no longer a counterparty to any of the Company's commodity derivative contracts and the Company's overall derivative positions are unchanged. See Note 11 for details about the Company's receivable for the canceled derivative contracts from Lehman Commodity Services.

(10) Fair Value of Financial Instruments

The Company accounts for its oil and gas commodity derivatives and interest rate swaps at fair value (see Note 9) on a recurring basis. Effective January 1, 2008, the Company adopted SFAS 157 for these financial instruments. SFAS 157 defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value, and enhances disclosure requirements for fair value measurements. The impact of the adoption of SFAS 157 to the Company's results of operations was a decrease to net income by approximately $66.6 million, or $0.58 per unit, for the three months ended September 30, 2008, resulting from an assumed credit risk adjustment. The impact of the adoption was an increase to net income by approximately $21.4 million, or $0.19 per unit, for the nine months ended September 30, 2008, resulting from an assumed credit risk adjustment.

The fair value of derivative instruments is determined utilizing pricing models for significantly similar instruments. The models use a variety of techniques to arrive at fair value, including quotes and pricing analysis. Inputs to the pricing models include publicly available prices and forward curves generated from a compilation of data gathered from third parties.

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Fair Value Hierarchy

In accordance with SFAS 157, the Company has categorized its financial instruments, based on the priority of inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Financial assets and liabilities recorded on the condensed consolidated balance sheets are categorized based on the inputs to the valuation techniques as follows:

Level 1 Financial assets and liabilities for which values are based on unadjusted quoted prices for identical assets or liabilities in an active market that management has the ability to access.

Level 2 Financial assets and liabilities for which values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability (commodity derivatives and interest rate swaps).

Level 3 Financial assets and liabilities for which values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

As required by SFAS 157, when the inputs used to measure fair value fall within different levels of the hierarchy in a liquid environment, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company conducts a review of fair value hierarchy classifications on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities.

The following presents the Company's fair value hierarchy for assets and liabilities measured at fair value on a recurring basis at September 30, 2008. These items are included in "derivative instruments" on the condensed consolidated balance sheet.

	Fair Value Measurements on a Recurring Basis September 30, 2008		
	Level 2	Netting (1)	Total
		(in thousands)	
Assets:			
Commodity derivatives	$ 299,128	$ (235,900)	$ 63,228
Interest rate swaps	$ 179	$ (179)	$
Liabilities:			
Commodity derivatives	$ 341,126	$ (235,900)	$ 105,226
Interest rate swaps	$ 37,739	$ (179)	$ 37,560

(1) Represents counterparty netting under derivative netting agreements.

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(11) Commitments and Contingencies

On September 15, 2008, Lehman Holdings filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code ("Chapter 11") with the United States Bankruptcy Court for the Southern District of New York (the "Court"). On October 3, 2008, Lehman Commodity Services also filed a voluntary petition for reorganization under Chapter 11 with the Court. As of September 30, 2008, the Company had a receivable of approximately $67.6 million from Lehman Commodity Services for canceled derivative contracts (see Note 9). The Company is pursuing various legal remedies to protect its interests. Based on market expectations, at September 30, 2008, the Company estimated approximately $6.7 million of the receivable balance to be collectible. The net receivable of approximately $6.7 million is included in "other current assets, net" on the condensed consolidated balance sheet at September 30, 2008. The associated gain of approximately $67.6 million and the estimated loss of approximately $60.9 million is included in "gain (loss) on oil and gas derivatives" on the condensed consolidated statements of operations for the three and nine months ended September 30, 2008, for a net gain of approximately $6.7 million. The Company believes that the ultimate disposition of this matter will not have a material adverse effect on its business, financial position, results of operations or liquidity.

From time to time the Company is a party to various legal proceedings or is subject to industry rulings that could bring rise to claims in the ordinary course of business. The Company is not currently a party to any litigation or pending claims that it believes would have a material adverse effect on its business, financial position, results of operations or liquidity.

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(12) Earnings Per Unit

The following table summarizes the calculation of basic and diluted net income (loss) per unit:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands, except per unit amounts)			
Income (loss) from continuing operations	$ 921,943	$ (71,831)	$ (62,397)	$ (157,316)
Net income (loss) from discontinued operations	160,668	(4,391)	173,507	(3,879)
Net income (loss)	$ 1,082,611	$ (76,222)	$ 111,110	$ (161,195)
Weighted average units outstanding:				
Basic units outstanding	114,321	69,207	114,111	58,072
Dilutive effect of unit equivalents	155			
Diluted units outstanding	114,476	69,207	114,111	58,072
Weighted average Class D units outstanding: (1)				
Basic Class D units outstanding		11,792		3,974
Dilutive effect of unit equivalents				
Diluted Class D units outstanding		11,792		3,974
Net income (loss) per unit – continuing operations:				
Units – basic	$ 8.06	$ (0.89)	$ (0.55)	$ (2.54)
Units – diluted	$ 8.05	$ (0.89)	$ (0.55)	$ (2.54)
Class D units – basic (1)	$	$ (0.89)	$	$ (2.54)
Class D units – diluted (1)	$	$ (0.89)	$	$ (2.54)
Net income (loss) per unit – discontinued operations:				
Units – basic	$ 1.41	$ (0.05)	$ 1.52	$ (0.06)
Units – diluted	$ 1.41	$ (0.05)	$ 1.52	$ (0.06)
Class D units – basic (1)	$	$ (0.05)	$	$ (0.06)
Class D units – diluted (1)	$	$ (0.05)	$	$ (0.06)
Net income (loss) per unit:				
Units – basic	$ 9.47	$ (0.94)	$ 0.97	$ (2.60)
Units – diluted	$ 9.46	$ (0.94)		