

**PACIFIC ENERGY RESOURCES LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007**

**PACIFIC ENERGY RESOURCES LTD.  
CONSOLIDATED FINANCIAL STATEMENTS  
for the fiscal years ended December 31, 2008 and 2007**

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CONSOLIDATED FINANCIAL STATEMENTS  
for the fiscal years ended December 31, 2008 and 2007**

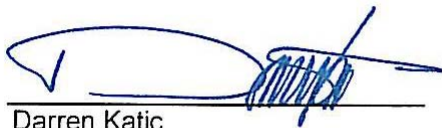
**MANAGEMENT'S REPORT TO THE SHAREHOLDERS**

The preparation of the accompanying financial statements in accordance with accounting principles generally accepted in Canada is the responsibility of management.

Management is responsible for the integrity and objectivity of the financial statements. Where necessary, the financial statements include estimates, which are based on management's informed judgments. Management has established systems of internal control, which are designed to provide reasonable assurance those assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors has reviewed the financial statements with management and the auditors and has approved the financial statements.

MEYERS NORRIS PENNY LLP are independent auditors ratified by Pacific Energy Resources Ltd.'s shareholders. The auditors have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express an opinion on the fairness of the presentation of the financial statements in accordance with Canadian generally accepted accounting principles.



Darren Katic  
President



Gerry Tywoniuk  
Sr. VP & Chief Financial Officer

Date: March 31, 2009

## INDEPENDENT AUDITORS' REPORT

To the Shareholders of  
Pacific Energy Resources, Ltd.

We have audited the accompanying consolidated balance sheet of Pacific Energy Resources Ltd. as at December 31, 2008 and 2007, and the related consolidated statements of operations, accumulated deficit and comprehensive loss, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of Pacific Energy Resources Ltd. as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "Meyers Norris Penny LLP". The signature is written in a cursive, flowing style.

Calgary, Alberta  
March 23, 2008

Chartered Accountants

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS)

**ASSETS**

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
		<b>(Restated) (Note 2)</b>
<b>CURRENT ASSETS</b>		
Cash	\$ 1,319	\$ 7,245
Restricted cash	1,100	1,302
Accounts receivable	3,519	14,196
Derivative asset (Note 13)	23,557	-
Other receivables	240	568
Inventory	4,271	8,556
Assets held for sale (Note 16)	-	46,318
Prepays and other current assets	<u>3,050</u>	<u>7,387</u>
Total current assets	37,056	85,572
<b>LONG-TERM ASSETS</b>		
Performance bonds and deposits	5,846	4,946
Investments - abandonment (Note 4)	106,180	94,483
Equity investment (Note 5)	11,763	13,626
Petroleum and natural gas properties and equipment (Note 6)	<u>375,525</u>	<u>493,244</u>
Total long-term assets	499,314	606,299
Total assets	<u>\$ 536,370</u>	<u>\$ 691,871</u>

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

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS)  
(Continued)

**LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)**

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
		<b>(Restated) (Note 2)</b>
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 36,217	\$ 32,596
Accrued interest	12,771	4,148
Due to related parties (Note 7)	76	61
Notes payable, current portion (Note 8)	468,472	-
Derivative liability, current portion (Note 13)	-	34,247
Liabilities held for sale (Note 16)	-	18,957
Other liabilities	6,933	-
Total current liabilities	524,469	90,009
<b>LONG-TERM LIABILITIES</b>		
Notes payable, net of current portion (Note 8)	33,253	433,871
Asset retirement obligation (Note 9)	60,756	56,306
Derivative liability, net of current portion (Note 13)	-	55,251
Other liabilities	-	6,169
Total long-term liabilities	94,009	551,597
Non-controlling interests related to net assets held for sale (Note 8 and 16)	-	7,755
Economic dependence and going concern (Note 1)		
Commitments and contingencies (Note 14)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 11)	21	19
Subscriptions and subscriptions receipts (Note 11)	-	9,308
Contributed surplus (Note 11)	11,791	5,452
Warrants (Note 11)	38,730	24,117
Additional paid in capital (Note 11)	239,876	207,429
Accumulated other comprehensive income (loss)	20,794	(82,716)
Deficit	(393,320)	(121,099)
Total shareholders' equity (deficit)	(82,108)	42,510
Total liabilities and shareholders' equity (deficit)	\$ 536,370	\$ 691,871

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

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATION**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS  
EXCEPT PER SHARE AMOUNTS)

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<u><b>2008</b></u>	<u><b>2007</b></u>
<b>REVENUES</b>		
Oil and gas production revenue	\$ 226,245	\$ 84,257
Royalties	(49,457)	(15,320)
Realized loss on derivatives (Note 13)	(42,440)	(10,693)
Interest and dividends	5,919	2,916
Loss from equity investment (Note 5)	(1,863)	(321)
Other revenue	137	326
	<u>138,541</u>	<u>61,165</u>
<b>EXPENSES</b>		
Production	96,868	53,212
Transportation	4,581	2,359
General and administrative	15,170	10,147
Stock compensation (Note 11)	6,339	3,468
Liquidated damages (Note 11)	4,080	6,050
Interest - cash	65,101	34,532
Interest - non-cash - paid in kind (Note 8)	42,389	8,269
Interest - accretion of discounts and amortization of deferred financing costs	10,084	11,630
Interest - accelerated expensing of accretion and amortization of deferred financing costs (Note 8)	48,398	-
General exploration	2,125	11,056
Depreciation, depletion and amortization	35,601	14,482
Impairment (Note 17)	131,407	-
	<u>462,143</u>	<u>155,205</u>
<b>LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAX</b>	(323,602)	(94,040)
Income tax expense (Note 10)	-	-
<b>LOSS FROM CONTINUING OPERATIONS</b>	<u>(323,602)</u>	<u>(94,040)</u>
Loss from discontinued operations, net of tax (Note 16)	(8,260)	(4,709)
Gain from sale of discontinued operations, net of tax (Note 16)	74,254	-
	<u>65,994</u>	<u>(4,709)</u>
<b>NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX</b>	<u>65,994</u>	<u>(4,709)</u>
<b>NET LOSS</b>	<u>\$ (257,608)</u>	<u>\$ (98,749)</u>
Basic and diluted loss per share from continuing operations	\$ (1.59)	\$ (0.67)
Basic income (loss) per share from discontinued operations	0.32	(0.03)
Diluted income (loss) per share from discontinued operations	0.21	(0.03)
Basic and diluted loss per share (Note 12)	<u>\$ (1.27)</u>	<u>\$ (0.70)</u>

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

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICIT,**  
**COMPREHENSIVE LOSS AND ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS)

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
 <b><u>CONSOLIDATED STATEMENT OF ACCUMULATED DEFICIT</u></b>		
ACCUMULATED DEFICIT, BEGINNING OF YEAR	\$ (121,099)	\$ (22,350)
Net loss	(257,608)	(98,749)
Warrant modification per incentive offering (Note 11)	(14,613)	-
ACCUMULATED DEFICIT, END OF YEAR	\$ (393,320)	\$ (121,099)
 <b><u>CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)</u></b>		
NET LOSS	\$ (257,608)	\$ (98,749)
Other comprehensive income (loss), being unrealized hedging gains (losses)	103,510	(82,716)
COMPREHENSIVE LOSS	\$ (154,098)	\$ (181,465)
 <b><u>CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</u></b>		
ACCUMULATED OTHER COMPREHENSIVE LOSS, BEGINNING OF YEAR	\$ (82,716)	\$ -
Unrealized hedging gains (losses)	103,510	(82,716)
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), END OF YEAR	\$ 20,794	\$ (82,716)

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

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS)

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss from continuing operations	\$ (323,602)	\$ (94,040)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation, depletion and amortization	35,601	14,482
Impairment	131,407	-
Interest - accelerating expensing of discounts and loan cost	48,398	-
Non cash interest paid in kind	42,389	8,269
Interest - accretion of discounts and amortization of deferred financing costs	8,151	11,630
Deferred income taxes	-	25
Non cash interest and dividend income	(5,731)	(3,014)
Non cash financing expenses	-	8,881
Stock compensation expense	6,339	3,468
Liquidated damages	4,080	6,050
Loss from equity investment	1,863	321
Changes in operating assets and liabilities:		
Restricted cash	202	(1,986)
Receivables	10,936	2,963
Derivative receivable	(2,581)	2,772
Inventory	(1,842)	5,032
Prepaid expenses and other current assets	291	1,457
Accounts payable and accrued liabilities	11,994	10,465
Other liabilities	123	1,065
Due to related parties	15	55
Net Cash Used In Operating Activities from Continuing Operations	<u>(31,967)</u>	<u>(22,105)</u>
Net Cash Provided By Discontinued Operations	<u>13,924</u>	<u>11,353</u>
Net Cash Used In Operating Activities	<u>(18,043)</u>	<u>(10,752)</u>

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

**PACIFIC ENERGY RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Under Creditor Protection as of March 9, 2009 - Note 18)  
(STATED IN US DOLLARS AND THOUSANDS)  
(Continued)

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Petroleum and natural gas property expenditures	(38,364)	(18,946)
Cash paid for restricted and short-term investments	(7,002)	(6,085)
Business acquisitions	-	(444,013)
<b>Net Cash Used In Investing Activities</b>		
From Continuing Operations	(45,366)	(469,044)
Proceeds on sale of assets	127,693	-
Cash paid to non-controlling interest	(6,387)	-
Cash paid to terminate crude oil sales hedges	(29,678)	-
Petroleum and natural gas property expenditures	(240)	(2,358)
<b>Net Cash Provided by Investing Activities</b>		
From Discontinued Operations	91,388	(2,358)
<b>Net Cash Provided By (Used In) Investing Activities</b>	46,022	(471,402)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Cash received for common shares issued	19,129	75,967
Cash received for notes payable issued	12,785	438,546
Payments on notes payable	(45,163)	(40,000)
<b>Net Cash Provided By (Used In) Financing Activities</b>		
From Continuing Operations	(13,249)	474,513
<b>Net Cash Used In Financing Activities</b>		
Used In Discontinued Operations	(20,656)	(114)
<b>Net Cash Provided By (Used In) Financing Activities</b>	(33,905)	474,399
<b>NET CHANGE IN CASH</b>	(5,926)	(7,755)
<b>CASH, BEGINNING OF YEAR</b>	7,245	15,000
<b>CASH, END OF YEAR</b>	\$ 1,319	\$ 7,245
<b>Supplementary cash flow information</b>		
Interest paid	\$ 35,627	\$ 23,405

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

**NOTES TO THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**  
FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007

*(All amounts in thousands unless otherwise specified)*

**1. NATURE AND CONTINUANCE OF OPERATIONS**

Pacific Energy Resources Ltd. (“Company” or “PERL”) was incorporated under the laws of the province of British Columbia, Canada, and in February 2005, the Company domesticated under the laws of the State of Delaware, United States.

In March 2007, the Company acquired certain assets in the Beta oil field (the “Beta Unit”) located offshore California, including Platforms Eureka, Elly and Ellen and 100% of the stock of San Pedro Bay Pipe Line Company.

In June 2007, the Company formed Pacific Energy Alaska Holdings, LLC, which in August 2007 acquired 100% of the membership interests in Forest Alaska Operating LLC, which was renamed Pacific Energy Alaska Operating LLC, 50% of the outstanding shares of Cook Inlet Pipe Line Company, and other related oil and gas assets in Alaska.

In July 2008, the Company sold its L.A. Basin and San Joaquin Basin onshore California assets (Note 16).

The Company and its wholly-owned subsidiaries’ (collectively referred to as the “Company”) principal activities are acquisition, development and exploitation of established producing oil and natural gas properties in the Western United States and Alaska.

***Economic dependence and going concern***

The Company’s primary sources of borrowings are pursuant to credit agreements with affiliates of The Goldman Sachs Group, Inc. (“Goldman”) and Silver Point Finance LLC (“Silver Point”). These affiliates are also significant owners of common shares and warrants. An affiliate of The Goldman Sachs Group, Inc. is the counterparty for the Company’s commodity swaps. The credit and swap agreements contain covenants and restrictions, including a requirement that all cash receipts are to be deposited into lockboxes and require the Company to obtain Goldman or Silver Point approval for the disbursement of funds out of the lockboxes.

Prior to the execution of Forbearance Agreements on December 19, 2008, the Company was not in compliance with all covenants under these agreements, and accordingly all amounts due under the credit agreements were classified as current liabilities as of December 31, 2008. Following the expiry of the forbearance agreements on February 17, 2009 and being unable to reach an extension agreement with its lenders, the Company and its subsidiaries filed petitions for reorganization under chapter 11 on March 9, 2009 to facilitate access to an immediate source of liquidity, the DIP Facility, as it works to restructure its debt. Goldman and Silver Point are the lenders under the DIP Facility.

The DIP Financing (see Note 18 – Subsequent Events) combined with the Company’s operating revenue is expected to provide sufficient liquidity to fund working capital, meet ongoing obligations and ensure that normal operations continue without interruption during its restructuring. The DIP credit facility matures no later than September 10, 2009. The DIP credit facility requires the Company to operate within a specified budget for operating and capital expenditures. Other than returning three additional wells to production at the Beta Unit, the capital expenditures budget provides only for maintenance and regulatory-related projects. The Company’s ability to continue operations beyond September 10, 2009, is dependent upon a reaching further agreement with Goldman and Silver Point, however no assurance can be given agreement could be reached.

**NOTES TO THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007**

*(All amounts in thousands unless otherwise specified)*

**Contributing factors**

The Company completed the \$463.2 million acquisition of the Alaskan assets in August 2007, which was financed largely with debt of \$396.5 million under the Alaska first and second lien credit facilities. Subsequently, the Company raised \$81.4 million in equity in October 2007 and January 2008. As a result of being unable to raise sufficient equity to repay a portion of these loans, the Company was in default of its financial and other covenants beginning in the first quarter of 2008.

Beginning in the first quarter of 2008, the Company negotiated with its lenders to achieve a longer term solution for its credit facilities and to fund the necessary capital expenditures to execute its business plan. As a result of not yet being able to reach such a solution in the face of substantially lower oil prices, the Company agreed to Forbearance Agreements with its lenders on December 19, 2008 to provide for additional time while the Company considered its strategic options. In late December 2008, the Company engaged a restructuring advisor and hired an investment banking firm to assist it in evaluating and executing on one or more of these options. Under the terms of the Forbearance Agreements, the lenders agreed to forbear from exercising their rights and remedies against the Company and its subsidiaries with respect to defaults under the Credit Facilities. The forbearance period after extension lasted until February 17, 2009. Funding of up to \$19.5 million was made available during this period.

In summary, the bankruptcy filing was precipitated by the dramatic decrease in the market price of crude oil over the last quarter of 2008. Combined with the Company's pre-existing level of debt related to the Alaskan acquisition and poor capital market conditions, the Company's liquidity and cash flow was insufficient to operate its business and invest in its oil producing assets to increase production. Faced with these constraints, the Company and its subsidiaries filed petitions for reorganization under chapter 11 on March 9, 2009 to facilitate access to an immediate source of liquidity, the DIP Facility, as it works to restructure its debt.

**Going Concern**

These financial statements have been prepared using the same Canadian generally accepted accounting principles ("GAAP") as applied by the Company prior to the Insolvency Proceedings described in Note 18 – Subsequent Events. While the Company has filed for and been granted creditor protection, these financial statements continue to be prepared using the going concern concept, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Insolvency Proceedings provide the Company with a period of time to stabilize its operations and financial condition and develop a restructuring plan. Debtor-In-Possession ("DIP") financing has been approved by the U.S. Bankruptcy Court and is available, subject to borrowing conditions, as described in Note 18 – Subsequent Events. Management believes that these actions make the going concern basis appropriate. However, it is not possible to predict the outcome of these proceedings and, as such, realization of assets and discharge of liabilities is subject to significant uncertainty. Accordingly, substantial doubt exists as to whether the Company will be able to continue as a going concern. Further, it is not possible to predict whether the actions taken in any restructuring will result in improvements to the financial condition of the Company sufficient to allow it to continue as a going concern. If the going concern basis is not appropriate, adjustments would be necessary to the carrying amounts and/or classification of assets and liabilities, and to the expenses in these financial statements.

**NOTES TO THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**  
FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007

*(All amounts in thousands unless otherwise specified)*

The accompanying financial statements do not purport to reflect or provide for the consequences of the Insolvency Proceedings. In particular, such financial statements do not purport to show: (a) as to assets, their realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-petition liabilities, the amounts that may be allowed for claims or contingencies, or the status and priority thereof; (c) as to shareholders accounts, the effect of any changes that may be made in the capitalization of the Company; or (d) as to operations, the effect of any changes that may be made in the Company's business.

While the Company is under creditor protection, it will make adjustments to the financial statements to isolate assets, liabilities, revenues, and expenses related to the reorganization and restructuring activities so as to distinguish these events and transactions from those associated with the ongoing operation of the business. Further, claims allowed arising under the Insolvency Proceedings may be recorded as liabilities and presented separately on the consolidated balance sheets. If a restructuring occurs and there is substantial realignment of the equity and non-equity interests in the Company, the Company will be required, under Canadian GAAP, to adopt "fresh start" reporting. Under fresh start reporting, the Company would undertake a comprehensive re-evaluation of its assets and liabilities based on the reorganization value as established and confirmed in the Plan. The financial statements do not present any adjustments that may be required during the period that the Company remains under creditor protection, or that may be required under fresh start reporting.

In accordance with Canadian GAAP appropriate for a going concern, petroleum and natural gas properties and equipment is carried at cost less accumulated depreciation, depletion and amortization and any impairment losses and they are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The series of events that led the Company to the Insolvency Proceedings and the events since then triggered impairment tests for its petroleum and natural gas properties and equipment. The Company made assumptions, such as oil prices, capital costs and operating costs in estimating the future cash flows expected from the use of its assets. There can be no assurance that expected future cash flows will be realized or will be sufficient to recover the carrying amount of long-lived assets.

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The Insolvency Proceedings materially affect the degree of uncertainty associated with the measurement of many amounts in the financial statements. More specifically, the proceedings could impact the recoverability tests and fair value assumptions used in the impairment test of petroleum and natural gas properties and equipment.

In light of the Insolvency Proceedings, current oil prices and current capital market conditions, it is unlikely that the Company's existing common shares will have any material value following the approval of a restructuring.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The consolidated financial statements include the accounts of Pacific Energy Resources Ltd. and its subsidiaries, and are presented in accordance with Canadian GAAP. The Company is in the business of exploration, development and production of crude oil and natural gas in Alaska and California.

**NOTES TO THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**  
FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007

*(All amounts in thousands unless otherwise specified)*

These financial statements include the accounts of the Company and its wholly-owned subsidiaries Petrocal Acquisition Corporation (“PAC”), Careros Acquisition Corporation (“CAC”) and its wholly-owned subsidiaries Careros Energy, Inc. (“CEI”) and Gotland Oil, Inc. (“GOI”), San Pedro Bay Pipe Line Company (“SPBPC”) (from date of acquisition), and Pacific Energy Alaska Holdings, LLC (“PEAH”) and Pacific Energy

Alaska Operating, LLC (“PEAO”) (from date of acquisition), all of which are incorporated or organized under the laws of the State of Delaware, except for GOI, which is incorporated under the laws of the State of Texas, SPBPC, which is incorporated under the laws of the State of California, and PEAH and PEAO, which were formed under the laws of the State of Alaska. All intercompany accounts and transactions have been eliminated in consolidation.

***Comparative Figures***

The Company has adjusted the December 31, 2007 audited financial statements to segregate the assets, liabilities, revenues and expenses of discontinued operations (Note 16).

The Company has adjusted the audited results of operations for the period ended December 31, 2007 for comparative purposes to segregate interest expense between cash and non-cash interest expense.

The Company has reclassified certain 2007 comparative figures to conform with the financial statement presentation adopted in the 2008 financial statements.

***Restatement***

The Company restated its December 31, 2007 comparative cash and restricted cash balances reported in its amended March 31, 2008 interim financial statements. The previously reported cash balance of \$8,547 (excluding discontinued operations) has been restated as cash of \$7,245 and restricted cash of \$1,302. Previously no restricted cash was reported. The previously reported accounts receivable balance of \$13,353 (excluding discontinued operations) has been restated as accounts receivable of \$14,196, due to a reclassification of \$843 between accounts receivable and other receivables. The previously reported other receivables balance of \$1,411 (excluding discontinued operations) has been restated as other receivables of \$568.

***Cash and Cash Equivalents***

For purposes of the statement of cash flows, the Company considers all unrestricted highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

***Cash – Restricted***

The Company’s credit agreements require that revenue from its Beta Unit and Alaska operations be deposited into lockboxes. Disbursements from these lockboxes require lender approval and accordingly such cash balances are restricted

***Accounts Receivable***

Trade accounts receivable are recorded at the invoiced amount. The Company does not have any off-balance sheet credit exposure to its customers. The Company assesses credit risk and allowance for

**NOTES TO THE ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**  
FOR THE FISCAL YEARS ENDED DECEMBER 31, 2008 AND 2007

*(All amounts in thousands unless otherwise specified)*

doubtful accounts on a customer-specific basis and its historical experience was only minor credit losses on the sale of oil and gas. For the year ended December 31, 2008, the Company did not have an allowance for doubtful accounts because all accounts were considered collectible. For the year ended December 31, 2007, the Company recorded an allowance for doubtful accounts of \$149.

***Inventory***

Crude oil inventory is valued at the lower of average cost or net realizable value on a first-in, first-out basis.

***Investments - Abandonment***

Investments – abandonment are made up of time deposits, money market accounts and marketable debt securities, which are considered to be held to maturity investments and recorded at amortized cost.

***Equity Investment***

The Company utilizes the equity method of accounting for investments subject to significant influence. Under this method, investments are initially recorded at cost and adjusted thereafter to include the Company's pro rata share of post-acquisition earnings. Any dividends received or receivable from the investee would reduce the carrying value of the investment.

***Petroleum and Natural Gas Properties and Equipment***

The Company uses the successful efforts method to account for its petroleum and natural gas properties. Lease acquisition costs are amortized on a straight-line basis over their lease term prior to the discovery of proved producing reserves. Geological and geophysical costs are expensed in the period in which they are incurred and costs of drilling an unsuccessful well are expensed when it becomes known the well did not result in a discovery of proved reserves or where one year has elapsed since the completion of drilling and near-term efforts to establish proved reserves are not foreseeable, intended, or in the Company's control. All other costs of exploring and developing for proved reserves become capitalized petroleum and natural gas properties.

Capitalized proved producing petroleum and natural gas properties, including related property and equipment, are depleted on a unit-of-production basis using the Company's working interest share of proved petroleum and natural gas reserves, before royalties. Unproved properties are not subject to depletion. Petroleum and natural gas properties are recorded at cost less accumulated amortization and depletion.

Petroleum and natural gas properties and property and equipment are assessed periodically for potential impairment to ensure that the carrying value of the properties on the balance sheet is recoverable. If a property's carrying value exceeds the estimated sum of undiscounted future cash flows resulting from its use and eventual disposition, its value is impaired. The property is then assigned a fair value equal to its estimated discounted future cash flows and the excess carrying value is charged to amortization and depletion expense. The factors used to determine fair value include, but are not limited to, estimates of reserves, future commodity prices, future production estimates, anticipated capital expenditures, and a discount rate commensurate with the risk associated with the realizing the expected cash flows projected. For the year end 2008 impairment charge, the Company used a risk adjusted present value (at a 15% discount rate) of its proved and probable reserves, using forecast prices, to determine its estimated

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discounted future cash flows. The resulting impairment charge was \$126.1 million. The impairment charge is principally the result of lower crude oil prices.

Given the complexities associated with oil and gas reserve estimates and the history of price volatility in the oil and natural gas markets, events may arise that will require the Company to record an impairment of petroleum and natural gas properties and there can be no assurance that such impairments will not be required in the future nor that they will not be material.

Equipment is stated at cost. Depreciation is provided for using the straight-line method over the useful lives of the assets as follows:

<u>Asset Category</u>	<u>Years</u>
Computer equipment and software	4
Office equipment	10
Pipeline equipment	15
Vehicles	5
Other	10

***Joint Interests***

Certain of the Company's exploitation, development and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

***Income Taxes***

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus future taxes. Future taxes are recognized for differences between the bases of assets and liabilities for financial statement purposes and income tax purposes.

The Company accounts for future tax assets and liabilities attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases, and these assets and liabilities are measured using tax rates expected to apply in the years in which those temporary differences are expected to be settled. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and the net asset is recognized. The Company was recorded a valuation allowance for 100% of its future tax assets at December 31, 2008 and 2007.

***Asset Retirement Obligations***

The Company's asset retirement obligations relate primarily to retirement obligations associated with tangible assets, such as well-sites and associated facilities. The fair value of an asset retirement obligation ("ARO") is recognized in the period in which it is incurred and when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted

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on a unit-of-production basis over the life of the associated proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to the net loss in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted costs also result in an increase or decrease to the ARO. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the accreted liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's statement of operations at that time.

***Revenue Recognition***

Revenues associated with sales of crude oil and natural gas are recognized when title passes to the customer, net of discounts and allowances, as applicable. Revenues from crude oil and natural gas production from properties in which the Company has an interest with other producers are recognized on the basis of the Company's net working interest.

***Production and Mineral Taxes***

Costs paid by the Company to non-mineral interest owners based on production of petroleum and natural gas are recognized when the product is produced.

***Transportation and Selling Costs***

Costs paid by the Company for the transportation and selling of petroleum and natural gas products are recognized when the product is delivered and the services are provided.

***Stock-Based Compensation***

Stock-based compensation expense is based on the estimated fair value of options granted at the time of the grant. The fair value is recognized in current earnings as stock-based compensation expense with a corresponding increase in contributed surplus over the vesting period of the options. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that unvested options are cancelled, previously recognized compensation expense associated with such stock options is reversed.

***Foreign Currency Translation***

All monetary assets and liabilities expressed in foreign currencies are translated at rates of exchange in effect at the end of the year. All other assets and liabilities are translated at the rates prevailing at the dates the assets were acquired or liabilities incurred. Revenue and expenses are translated at the average exchange rate for the period. The resulting foreign currency translation gains and losses are included in the determination of net loss.

***Deferred Financing Costs***

Financing fees and other costs related to the long-term debt are deferred and amortized over the term of the related debt using the effective interest rate method. Deferred financing costs are netted on the

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balance sheet against long-term debt. During the year ended December 31, 2008, the long-term portion of notes payable to affiliates of Goldman and Silver Point were reclassified as a current liability instead of as a long-term liability. As a result of this reclassification, deferred financing costs were written off and accretion of the discounts on the notes was accelerated, resulting in a charge of \$48.4 million in order to bring the notes payable up to their face value (Note 8).

***Measurement Uncertainty***

The timely preparation of the consolidated financial statements in conformity with GAAP requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly actual results may differ from estimated amounts as future events occur.

Amounts recorded for depreciation, depletion and amortization, asset retirement costs and obligations, and impairment calculations are based on estimates of petroleum and natural gas reserves, retirement costs and date. By their nature, these estimates including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the consolidated financial statements of future periods could be material. Tax interpretations, regulations and legislation in the various jurisdictions in which the Company and its subsidiaries operate are subject to change. As such, income taxes are subject to measurement uncertainty.

***Financial Instruments***

Financial instruments and derivatives CICA Handbook Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair-value or cost-based measures under different circumstances. All financial instruments must be classified as one of the following five categories, loans and receivables, held-to-maturity investments; held-for-trading instruments; available-for-sale financial assets; or other financial liabilities. All financial instruments, with the exception of loans and receivables, held-to-maturity investments and other financial liabilities, are reported on the balance sheet date at fair value. Subsequent measurement and changes in fair value will depend on their initial classification. Transaction costs are included in the initial carrying amount of financial instruments except, for held-for-trading items, which are expensed as incurred.

Financial assets and liabilities “held-for-trading” are subsequently measured at fair value, with changes in fair value recognized in net income. Financial assets “available-for-sale” are subsequently measured at fair value, with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets “held-to-maturity”, “loans and receivables”, “financial liabilities” and “other financial liabilities” are subsequently amortized using the effective interest rate method.

Cash and cash equivalents, and performance bonds are classified as “held-for-trading” and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable and certain other assets that are financial instruments are classified as “loans and receivables”. Investments – abandonment are classified as “held to maturity”. The Company’s equity investment is classified as “available for sale”. Accounts payable and accrued liabilities, other long-term obligations and current and long-term debt are classified as “other financial liabilities”. The Company

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capitalizes long-term debt transaction costs, premiums and discounts. These costs are capitalized within long-term debt and amortized using the effective interest rate method.

Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading” unless they are designed for hedge accounting.

***Comprehensive Income and Equity***

Section 1530 provides for a new statement of comprehensive income and establishes accumulated other comprehensive income (AOCI) as a separate component of shareholders’ equity. The statement of comprehensive income reflects the changes in AOCI.

***Derivative Financial Instruments***

In conducting its business, the Company uses various instruments, including forward contracts, options, and swaps, to manage its risks from fluctuations in commodity prices. All such instruments are used only to manage risk and not for trading purposes.

The Company recognizes and measures derivative instruments embedded in host contracts.

The Company designates each derivative instrument as either a hedging instrument or non-hedge derivative:

- (a) A hedging instrument is designated as either:
  - (i) a fair value hedge of a recognized asset or liability or,
  - (ii) a cash flow hedge of either:
    - (a) a specific firm commitment or anticipated transaction or
    - (b) the variable future cash flows arising from a recognized asset or liability

At the inception of a hedge, the Company documents the relationship between the hedging instrument and the hedged item, including the method of assessing retrospective and prospective hedge effectiveness. At the end of each period, the Company assesses whether the hedging instrument has been highly effective in offsetting changes in fair values or cash flows of the hedged item and measures the amount of any hedge ineffectiveness. The Company also assesses whether the hedging instrument is expected to be highly effective in the future.

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A hedging instrument is recorded on the consolidated balance sheet at fair value. Payments or receipts on a hedging instrument that is determined to be highly effective as a hedge are recognized concurrently with the hedged item. Subsequent changes in the value of a fair value hedge are recognized in earnings concurrently with the hedged item. For a cash flow hedge, the effective portion of changes in fair value is recognized in other comprehensive income (loss) and is subsequently transferred to earnings concurrently with the hedged item, whereas the portion of the changes in fair value that is not effective at offsetting the hedged exposure is recognized in earnings.

If a hedging instrument ceases to be highly effective as a hedge, is de-designated as a hedging instrument or is settled prior to maturity, then the Company ceases hedge accounting prospectively for that instrument; for a cash flow hedge, the gain or loss deferred to that date remains in accumulated other comprehensive income (loss) and is transferred to earnings concurrently with the hedged item. Subsequent changes in the fair value of that derivative instrument are recognized in earnings.

If the hedged item is sold, extinguished or matures prior to the termination of the related hedging instrument, or if it is probable that an anticipated transaction will not occur in the originally specified time frame, then the gain or loss deferred to that date for the related hedging instrument is immediately transferred from accumulated other comprehensive income (loss) to earnings.

Hedge gains or losses that were recognized in other comprehensive income (loss) are added to the initial carrying amount of a non-financial asset or non-financial liability when:

- (i) an anticipated transaction for a non-financial asset or non-financial liability becomes a specific firm commitment for which fair value hedge accounting is applied or
  - (ii) a cash flow hedge of an anticipated transaction subsequently results in the recognition of the non-financial asset or non-financial liability.
- (b) A non-hedge derivative instrument is recorded on the consolidated balance sheet at fair value and subsequent changes in fair value are recorded in earnings.

The Company applies settlement date accounting to the purchases and sales of financial assets. Settlement date accounting implies the recognition of an asset on the day it is received by the Company and the recognition of the disposal of an asset on the day that it is delivered by the Company. Any gain or loss on disposal is also recognized on that day.

***Per Share Amounts***

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated based on the treasury stock method, which assumes that any proceeds obtained on the exercise of options or warrants would be used to purchase common shares at the average price during the period.

***Changes in Accounting Policy***

Effective January 1, 2008 the Company adopted CICA Handbook section 3031 – Inventories which replaces corresponding section 3030 and establishes new standards for the measurement and disclosure of inventories. The new section prescribes that inventories should be measured at the lower of cost and net realizable value and provides guidance on the determination of cost. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

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The Company has adopted EIC 172, which requires the recognition of previously unrecognized tax loss carry forwards consequent to the recording of unrealized gains in other comprehensive income.

The Company has adopted CICA 1535, for capital disclosures. This section established standards for disclosing information about an entity's capital and how it is managed.

The Company has adopted CICA 3862 and 3863, for financial instrument disclosures. The new disclosure standard increases the Company's disclosure regarding the nature and extent of the risks associated with financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

***Future Accounting Changes***

The Company will adopt the new standard CICA 3064, Goodwill and Intangible Assets for its fiscal year beginning January 1, 2009. This section replaces CICA 3062, Goodwill and Intangible Assets and CICA 3450 Research and Development Costs. The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in CICA 3062. The Company does not anticipate that the adoption of the new section will have a material effect on the Company's financial statements.

In January 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") over a five-year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-accountable enterprises to use IFRS. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. For the Company, the transition date will be effective January 1, 2011 and will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. A detailed analysis of the difference between IFRS and the Company's accounting policies, as well as an assessment of the impact of various alternatives, is to be conducted in 2009. Changes in accounting policies are likely and may materially impact the Company's consolidated financial statements.

**3. BUSINESS ACQUISITIONS**

All business acquisitions have been accounted for using the purchase method, whereby the excess of the purchase price over the estimated fair value of identifiable tangible and intangible net assets acquired is recorded as goodwill. No goodwill has been recognized by the Company for its acquisitions in 2007.

***Alaska Property***

In August 2007, the Company, through PEAH, acquired the Alaska oil and gas properties and operations of Forest Oil Corporation ("FOC"), including 100% of the membership interests in its wholly-owned subsidiary, Forest Alaska Operating LLC, and a 50% interest in Cook Inlet Pipe Line Company ("CIPL"), for \$400.0 million in cash, the issuance of 10.0 million shares of the Company's common stock to FOC and a seven year accreting note to FOC with an initial value of \$29.3 million. The acquisition of these assets and operations provided the Company with the ability to expand its operational base outside of Southern California and was in line with its business strategy of acquiring oil and gas operations that have

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redevelopment and exploitation potential. The cash portion of the purchase price was funded from a \$425.0 million credit facility from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point (Note 8). Of the 10.0 million shares of the Company's common stock issued, 5.5 million shares, along with the shares of CIPL stock representing the 50% interest, were held in escrow pending regulatory approval of the transfer of the CIPL shares from their current owner to PEAH. Regulatory approval to become an operator of certain properties and transfer of the shares of CIPL stock was obtained in February 2008.

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The Company has included the Alaska results of operation in its statement of operations from August 2007 forward.

The acquisition was recorded as follows:

Assets Acquired:	
Petroleum and natural gas properties, and equipment	\$ 443,021
Accounts receivable	14,878
Inventory	12,611
CIPL stock	13,946
Other assets	6,069
	<u>490,525</u>
Liabilities Assumed:	
Operating liabilities (including asset retirement obligations of \$10,243)	(28,217)
	<u>\$ 462,308</u>
Payment for Net Assets Acquired:	
Long-term debt	\$ 396,470
Long-term debt - Forest Oil Corporation	29,250
Issuance of 10,000 shares of PERL common stock	24,630
Cash	11,958
	<u>\$ 462,308</u>

***Beta Unit***

In March 2007, the Company completed its acquisition of the Beta Unit from Aera Energy LLC (a Shell-Exxon Mobil joint venture), SWEPI, LP (a Shell subsidiary) and Noble Energy, Inc. As a result of this acquisition, the Company was able to expand its operations in Southern California. The acquisition agreements required the Company to deposit \$90.0 million in U.S. Treasury notes in a supplemental bond decommissioning trust account for abandonment and decommissioning purposes, provide an operating offshore bond of \$1.5 million, a working interest owner offshore bond of \$0.3 million, a payment of \$6.9 million when certain production levels are met as defined in the purchase agreements with each of the sellers, and a new lease agreement with Mineral Management Services (“MMS”) of the United States Department of the Interior. The payment of \$6.9 million was discounted to \$5.6 million and included in the payment for net assets. As of December 31, 2008 the payment was due and payable as defined in the purchase agreements, and had an unpaid balance of \$1.5 million. The acquisition was partially financed from a November 2006 credit facility from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC (Note 8).

The Company has included the Beta Unit’s results of operations in its statement of operations from March 2007 forward.

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The acquisition was recorded as follows (in thousands):

Assets Acquired:	
Petroleum and natural gas properties, and equipment	\$ 53,813
Other assets	25
	<u>53,838</u>
Liabilities Assumed:	
Asset retirement obligations	(43,210)
	<u>\$ 10,628</u>
Payment for Net Assets Acquired:	
Long-term debt, production notes	\$ 5,605
Cash	5,023
	<u>\$ 10,628</u>

**4. INVESTMENTS – ABANDONMENT**

The cost and fair value of investments – abandonment are classified as held-to-maturity and were recorded as follows at December 31, 2008 and 2007:

	<b>December 31, 2008</b>		
	<b>Amortized Cost</b>	<b>Unrealized Holding Gain (Loss)</b>	<b>Fair Value</b>
U.S. Treasury Notes	\$ 97,782	\$ 259	\$ 98,041
Certificates of deposit	10	-	10
Money market accounts	8,388	-	8,388
Balance at December 31, 2008	<u>\$ 106,180</u>	<u>\$ 259</u>	<u>\$ 106,439</u>

	<b>December 31, 2007</b>		
	<b>Amortized Cost</b>	<b>Unrealized Holding Gain (Loss)</b>	<b>Fair Value</b>
U.S. Treasury Notes	\$ 91,730	\$ 1,252	\$ 92,982
Certificates of deposit	378	-	378
Money market accounts	2,375	-	2,375
Balance at December 31, 2007	<u>\$ 94,483</u>	<u>\$ 1,252</u>	<u>\$ 95,735</u>

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**5. EQUITY INVESTMENT**

The Company's equity investment consists of its 50% interest in CIPL, which operates a pipeline in Alaska for the Company and other operators. For the years ended December 31, 2008 and 2007, the Company incurred fees from CIPL of \$4.1 million and \$4.7 million, respectively to transport oil on the Company's behalf. As of December 31, 2008 and 2007, the balance owed for these fees is \$2.8 million and \$1.9 million, respectively. The Company's investment in CIPL exceeds the book basis by \$1.9 million.

Summary financial information for CIPL as of December 31, 2008 and 2007 and for the year then ended is as follows:

	<u>December 31, 2008</u> <u>(unaudited)</u>	<u>December 31, 2007</u> <u>(unaudited)</u>
Current assets	\$ 23,099	\$ 24,512
Long-term assets	38,523	37,591
Total Assets	<u>\$ 61,622</u>	<u>\$ 62,103</u>
Current liabilities	\$ 2,230	\$ 736
Long-term liabilities	39,712	37,961
Stockholders' equity	19,680	23,406
Total Liabilities and Stockholders' Equity	<u>\$ 61,622</u>	<u>\$ 62,103</u>
Net income (loss) for the year ended	<u>\$ (3,726)</u>	<u>\$ 66</u>

The Company's share of CIPL's net income (loss) was (\$1.9) million and (\$0.3) million for the years ended December 31, 2008 and 2007, respectively.

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**6. PETROLEUM AND NATURAL GAS PROPERTIES AND EQUIPMENT**

The asset categories of petroleum and natural gas properties and equipment at December 31, 2008 and December 31, 2007 were as follows:

	<b>December 31, 2008</b>		
	<b>Cost</b>	<b>Accumulated Depletion, Depreciation and Accretion</b>	<b>Net Book Value</b>
<b>Petroleum and Natural Gas Properties:</b>			
Proved properties including lease and well equipment	\$ 506,186	\$ 167,388	\$ 338,798
In process of development	28,459	-	28,459
Unproved properties	2,677	-	2,677
<b>Total Petroleum and Natural Gas Properties</b>	<b>537,322</b>	<b>167,388</b>	<b>369,934</b>
<b>Equipment:</b>			
Vehicles	122	49	73
Office equipment and software	1,032	293	739
Pipeline equipment	5,290	550	4,740
Other	45	6	39
<b>Total Equipment</b>	<b>6,489</b>	<b>898</b>	<b>5,591</b>
	<b>\$ 543,811</b>	<b>\$ 168,286</b>	<b>\$ 375,525</b>

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	<b>December 31, 2007</b>		
	<b>Cost</b>	<b>Accumulated Depletion, Depreciation and Accretion</b>	<b>Net Book Value</b>
<b>Petroleum and Natural Gas Properties:</b>			
Proved properties including lease and well equipment	\$ 486,698	\$ 11,455	\$ 475,243
In process of development	2,773	-	2,773
Unproved properties	10,896	-	10,896
<b>Total Petroleum and Natural Gas Properties</b>	<b>500,367</b>	<b>11,455</b>	<b>488,912</b>
<b>Equipment:</b>			
Office equipment and software	372	24	348
Pipeline equipment	4,195	233	3,962
Other	24	2	22
<b>Total Equipment</b>	<b>4,591</b>	<b>259</b>	<b>4,332</b>
	<b>\$ 504,958</b>	<b>\$ 11,714</b>	<b>\$ 493,244</b>

Included in petroleum and natural gas properties and equipment at December 31, 2008 and December 31, 2007 are undeveloped properties and work in progress totaling \$31.1 million and \$13.7 million respectively for each year, which are not subject to depletion and depreciation.

At December 31, 2008, the Company's \$126.1 million impairment charge was reflected in accumulated depletion for proved properties.

The detail above excludes discontinued operations at December 31, 2007, which were sold in July 2008 (Note 16).

***Joint Interests***

At December 31, 2008, PEOA owed a subsidiary of Chevron Corporation \$18.1 million. Chevron continues to bill the Company for the Company's share of the monthly costs of operating the properties. Chevron's interest is effectively secured by the Company's production and by the working interest in the jointly-owned properties in Alaska. Beginning in the fourth quarter of 2008, Chevron exercised its right to take the Company's share of production to offset against amounts owed. To date, Chevron has not taken any other action to foreclose on the Company's working interest.

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**7. RELATED PARTY TRANSACTIONS**

The transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

- a) As of December 31, 2008 and December 31, 2007, the Company owed \$76 and \$61 respectively, to a related party for amounts incurred by the related party on the Company's behalf. These amounts are non-interest bearing and due on normal trade terms.
- b) During the year ended December 31, 2007, the Company incurred legal costs of approximately \$385 with a law firm owned in part, until October 31, 2007, by one of the Company's directors. A balance of approximately \$22 was owed at December 31, 2007.

**8. NOTES PAYABLE**

<u>Description</u>	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Notes Payable to Goldman Sachs and Silver Point:		
Beta senior secured	\$ 33,138	\$ 65,000
Alaska first lien	111,274	108,000
Alaska second lien	323,060	285,269
Face value of notes payable to		
Goldman Sachs and Silver Point	467,472	458,269
Forest Oil Corporation zero coupon note payable	33,253	29,976
Unsecured shareholder loan	1,000	-
Total face value of notes payable	501,725	488,245
Unaccreted discounts	-	(27,097)
Unamortized deferred financing costs	-	(27,277)
Carrying value of notes payable	501,725	433,871
Current portion of notes payable	(468,472)	-
Long-term portion of notes payable	\$ 33,253	\$ 433,871

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The 2007 and 2008 activity of notes payable was as follows:

	<b>Notes Payable</b>		<b>Equity</b>
	<b>Face Value</b>	<b>Carrying Value</b>	<b>Component Fair Value<sup>(A)</sup></b>
Balance at December 31, 2006	\$ 48,916	\$ 30,865	\$ 10,668
Proceeds	491,104	459,286	31,818
Payments	(40,114)	(40,114)	-
Less deferred financing costs	-	(29,235)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	8,995	13,069	-
Balance at December 31, 2007	508,901	433,871	42,486
Proceeds	12,785	12,785	-
Payments	(65,819)	(65,819)	-
Interest - non-cash - paid in kind	42,389	42,389	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	3,469	30,101	-
Accelerated expensing of discounts and loan costs	-	48,398	-
Balance at December 31, 2008	<u>\$ 501,725</u>	<u>\$ 501,725</u>	<u>\$ 42,486</u>

(A) In connection with the credit agreements executed with affiliates of Goldman Sachs and Silver Point, the Company issued warrants. Accordingly, the notes payable were recorded at a discount and a portion of the proceeds received was allocated to "Warrants" in shareholders' equity, which amounts are shown in the table above as "Equity Component - Fair Value".

In the first quarter of 2008, unaccreted discount and unamortized deferred financing costs related to the Goldman and Silver Point notes payable were written off in the amount of \$48.4 million, as a result of classifying the entire note balance in current liabilities, in order to bring the carrying value up to face value.

The detail above excludes discontinued operations at December 31, 2007, which operations were sold in July 2008 (Note 16).

The future annual principal payments for all notes are as follows:

<b>Year Ended December 31</b>	<b>Amount</b>
2009	\$ 468,472
2010	-
2011	-
2012	-
2013	-
2014 and thereafter	33,253
	<u>\$ 501,725</u>

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***Forbearance Agreements***

On December 19, 2008, the Company entered into forbearance and amendment agreements (collectively, as further amended in January and February 2009, the “Forbearance Agreements”) to each of its secured credit facilities (see Alaska Acquisition Financing and Beta Unit Financing below). Pursuant to the Forbearance Agreements, the Company revised various terms of these secured credit facilities, and the lenders and hedge provider agreed to forbear temporarily from exercising their rights and remedies against the Company and its subsidiaries with respect to certain specified existing and anticipated defaults under the credit facilities and hedge agreements, subject to certain conditions.

The Forbearance Agreements included a commitment for \$19.5 million in additional funding under the SSC Credit Facility (see Beta Unit Financing). The Company agreed to pay a 1.0% per annum fee on the unused portion.

In connection with the Forbearance Agreements, the Company agreed to a number of additional covenants, including the requirement to prepare and comply with an interim forbearance budget.

The forbearance period expired February 17, 2009, at which time the Company was out of compliance with a variety of the affirmative and negative covenants under the SSC Credit Facility and the Alaska credit facilities (also described below). Being unable to reach agreement with the secured lenders to further extend the forbearance period or revise the SSC Credit Facility and the Alaska credit facilities, the Company filed bankruptcy and entered into the DIP Facility described in Note 18 – Subsequent Events.

***Alaska Acquisition Financing***

**First and Second Lien Credit Agreements**

To fund the Company’s acquisition of the Alaska oil and gas properties and operations of FOC, PEO and PEAH, the Company borrowed an aggregate of \$425.0 million from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC. Of this amount, \$108.0 million was borrowed pursuant to a \$120.0 million first lien credit agreement that is secured by substantially all of the assets of PEO and PEAH. The unused portion of the commitment was terminated on December 19, 2008. The other \$317.0 million was borrowed pursuant to a second lien credit agreement and is secured by substantially all of the Company’s assets in Alaska and California.

Until the Forbearance Agreement effective date of December 19, 2008, loans under the first lien credit agreement bore interest at an annual rate equal to LIBOR plus 2.25% payable monthly. Default interest was an additional 2.0% beginning March 22, 2008 and accrued but unpaid default interest was capitalized to the loan balance on September 30, 2008. All interest due on October 31, 2008 and November 30, 2008 was added to the outstanding principal balance on December 19, 2008. Subsequent to December 19, 2008, loans under the first lien credit agreement bore interest at an annual rate equal to LIBOR (with a minimum of 4.0%) plus 4.0% and default interest of an additional 2.0%, both payable at the end of the forbearance period, with additional non-cash interest of 10.25% that was added to the outstanding principal balance on the last day of each month.

Interest on the second lien credit agreement consisted of cash interest at an annual rate equal to LIBOR plus 6.5% (which increased to LIBOR plus 8.5% on February 24, 2008 and to LIBOR plus 10.5% on August 24, 2008) payable on the last day of each month until December 19, 2008 and non-cash interest at an annual rate of 8.0% that is added to the outstanding principal amount of the loan under the second lien

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credit agreement on the last day of each month. This loan also has default interest of 2.0% per annum beginning March 22, 2008. Beginning December 19, 2008, the LIBOR minimum is 4.0%. Accrued but unpaid default interest was capitalized to the loan balance on September 30, 2008. Accrued interest payable in cash due on October 31, 2008 and November 30, 2008 was also added to the loan balance on December 19, 2008. Interest payable in cash due on or after December 31, 2008 was due at the expiration of the Forbearance Agreement.

The balance outstanding at December 31, 2008 on the first lien credit agreement was \$111.3 million and on the second lien credit agreement was \$323.1 million. Except for certain mandatory prepayment events and except for weekly prepayments required beginning February 2, 2009 from funds, if any, in the collateral (lockbox) account in excess of \$0.25 million, the Alaska first lien credit agreement did not require principal payments until maturity of the loan on February 24, 2009. The Alaska first lien loan was not repaid on that date. Except for certain mandatory prepayment events, the Alaska second lien credit agreement does not require principal payments until maturity of the loans on February 24, 2012. Given the existence of various defaults under the Alaska credit facilities, the lenders had the right to accelerate the maturity date and exercise other remedies under the Alaska second lien credit agreement.

The Alaska second lien loan, B-1 tranche, is subject to a penalty for any voluntary prepayment prior to February 24, 2010 in an amount equal to the excess of the present value of the amount prepaid plus all required interest on such amount through February 24, 2010, over the amount prepaid. The B-1 tranche totaled \$233.5 million at December 31, 2008.

In addition to interest payable on the outstanding advances on the first lien and second lien credit agreements, each lender received its proportionate share of:

- a. An aggregate 5.0% overriding royalty interest in the Company's Alaska oil and gas properties acquired from FOC and an aggregate 2.0% overriding royalty interest in the Company's L.A. Basin properties (which were sold in July 2008) and Beta Unit properties. The Company records the monthly royalty payments as expense;
- b. 4.75 million shares of the Company's common stock issued at closing, with an additional 2.06 million shares of PERL's common stock issued in January 2008. The fair market value of these shares of \$16.1 million was treated as a discount on the debt and was expensed through accretion over the life of the loans, until such accretion was accelerated in the first quarter of 2008 when the Alaska credit facilities were reclassified as current liabilities; and
- c. A closing fee of \$6.3 million paid at closing, a structuring fee of \$12.7 million paid at closing, \$0.5 million in administrative and documentation fees payable annually so long as any portion of the B-2 tranche of the second lien credit agreement remains outstanding; and a conversion fee payable on February 24, 2009 in an amount equal to 2.5% of the aggregate principal amount, if any, outstanding under the first lien and second lien credit agreements on that date. These fees were recorded as deferred financing charges and were amortized and expensed as additional interest over the life of the debt, until such amortization was accelerated in the first quarter of 2008 when the Alaska credit facilities were reclassified as a current liability. The continuing fees are expensed as incurred. The conversion fee totaled \$10.7 million and became payable on February 24, 2009. At December 31, 2008, the likelihood of the Company incurring a liability relating to the conversion fee was high, therefore an expense was recorded in the financial statements at December 31, 2008.
- d. Liquidated damage payments of \$9.7 million in 2008 under the first lien credit agreement for failing to syndicate the first lien loan by February 15, 2008.

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The lenders received a first priority lien on all of the Company's Alaska assets and, with respect to the Alaska second lien credit agreement, a second priority lien on the California assets at the closing date, but excluding the assets of CAC, CEI and GOI. At December 31, 2008, the net book value of the assets securing the Alaska first and second lien loans was \$348.7 million and \$536.4 million respectively. The first lien and second lien credit agreements required a lockbox mechanism whereby all of PEAO's and PEAH's production revenue cash receipts were deposited.

On March 11, 2009, an aggregate of \$98.4 million (including accrued but unpaid interest and conversion fee on the first lien credit agreement) was paid to the lenders using funds obtained under the DIP Facility, and the Alaska first lien credit facility was terminated. Immediately prior to this termination, certain Alaska oil sales hedging contracts were terminated and, together with cash on hand, \$15.9 million of the Alaska first lien loan was repaid. In addition, prior to the termination of the Alaska first lien loan, the Company repaid \$4.0 million of the Alaska first lien loan in 2009 from cash receipts.

The Alaska second lien credit facility remains outstanding and continues to accrue interest at the default rate. As of March 30, 2009, we were out of compliance with a variety of the Alaska second lien credit agreement's affirmative and negative covenants. The lenders have not granted a formal waiver or amendment of the terms of the Alaska second lien credit agreement. However, the lenders are parties to the DIP Facility, consented to the priming of our obligations the Alaska second lien credit agreement, and are subject to the initial automatic stay issued by the bankruptcy court.

The 2007 and 2008 activity of the Alaska credit agreements was as follows:

	<b>Liability Component</b>		<b>Equity</b>
	<b>Face Value</b>	<b>Carrying Value</b>	<b>Component Fair Value<sup>(A)</sup></b>
Balance at December 31, 2006	\$ -	\$ -	\$ -
Proceeds	425,000	408,862	16,138
Payments	(40,000)	(40,000)	-
Less deferred financing costs	-	(27,594)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	8,269	18,527	-
Balance at December 31, 2007	393,269	359,795	16,138
Interest - non-cash - paid in kind	41,065	41,065	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	-	5,977	-
Accelerated expensing of discounts and loan costs	-	27,497	-
Balance at December 31, 2008	<u>\$ 434,334</u>	<u>\$ 434,334</u>	<u>\$ 16,138</u>

(A) In connection with the credit agreements executed with affiliates of Goldman Sachs and Silver Point, the Company issued warrants. Accordingly, the notes payable were recorded at a discount and a portion of the proceeds received was allocated to "Warrants" in shareholders' equity, which amounts are shown in the table above as "Equity Component - Fair Value".

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**Seller Note**

In connection with the Company's acquisition of the Alaska oil and gas properties and operations from FOC (Note 3), the Company issued FOC a senior subordinated accreting note with an initial accreting value of \$29.2 million. Immediately after the Company's issuance of the note, the payoff amount increased to \$31.7 million and, unless paid earlier, continues to increase on July 31 of each year until the maturity date of July 31, 2014, at which time the accreted balance would be \$60.8 million. The Company records accretion each year on the effective interest rate method. The note balance at December 31, 2008 and 2007 was \$33.3 million and \$30.0 million, respectively.

Obligations under the note are guaranteed by PEAO, PEAH and any of the Company's future subsidiaries that guarantee any of the Company's other indebtedness. In July 2008, CAC, CEI and GOI each signed counterpart agreements guaranteeing the obligations under then note. After the later to occur of August 27, 2010 and the senior indebtedness being paid in full, unless otherwise contractually prohibited, each of PAC and SPBPC must also guarantee obligations under the note.

***Beta Unit Financing***

In November 2006, the Company entered into a \$100.0 million senior secured Credit and Guaranty Agreement ("SSC Credit Facility") with an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC. An initial and only drawing of \$65.0 million was made at that date, and the balance of the commitment expired on December 31, 2007.

Interest on the SSC Credit Facility accrued at an annual rate equal to the greater of 12.75% or the adjusted Eurodollar Rate plus 7.75% and was due monthly in arrears, except that interest accruing and otherwise coming due during the forbearance period was due at the end of that period. The interest rate was increased by an additional 3.00% upon the occurrence and during the continuance of an event of default, including during the forbearance period. The applicable interest rate was 12.75% plus 3.00% default interest at December 31, 2008.

Principal payments due monthly were equal to 90.0% of Adjusted Net Cash Flow (100% during periods of default) as defined in the agreement, although no such principal payments were payable under this formula through December 31, 2008. Effective February 2, 2009, the Company agreed that amounts in the restricted account (described below) in excess of \$500,000 or such other amount as was determined by the administrator would be used weekly to pay down the additional loans made during the period of the Forbearance Agreement and then to pay down other obligations under the SSC Credit Facility.

The SSC Credit Facility required a lockbox mechanism whereby all of the Company's and its subsidiaries' (excluding CAC, CEI, GOI, PEAH and PEAO) production revenue cash receipts were deposited. The Company facilitated the payment of operating and production expenses through requests to an affiliate of the Goldman Sachs Group, Inc. to advance funds to make the required payments. The SSC Credit Facility contained restrictions as to the type and amount of expenses which may be incurred.

In addition to interest on the outstanding advances on the SSC Credit Facility, each lender received its proportionate share of:

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- 1) Upon payment of the debt in full an aggregate 6.5% overriding royalty interest in any properties outside of Wyoming, and an aggregate 6.0% net profits interest in any properties in Wyoming, that are acquired or earned while the debt is outstanding. The granting of the 6.5% overriding royalty on the Company's onshore California properties was accelerated to July 2008 on the sale of those properties. No other such properties were acquired therefore no other royalties were granted. The Company would have recorded any such monthly royalty payments as an expense;
- 2) Upon the earlier of payment of the debt in full or December 2010, a 5.5% overriding royalty interest in the Beta Unit properties. The granting of this additional overriding royalty was accelerated to July 2008 on sale of the Company's onshore California properties. The Company records the monthly royalty payment on the Beta Unit as an expense;
- 3) Issued warrants to purchase 25.45 million shares of the Company's common stock exercisable at CAD \$1.42 (U.S. \$1.44). The warrants expire November 30, 2011 and contain anti-dilution provisions. The Company valued the warrants using the Black-Scholes option pricing model at \$22.2 million, treated them as a discount of the debt and expensed the discount as interest through accretion over the life of the debt, until such accretion was accelerated in the first quarter of 2008 when the SSC Credit Facility was reclassified as a current liability;
- 4) A funding fee of \$0.7 million was paid at closing, a 1.0% fee was payable for any funds borrowed after closing and a commitment fee of \$5.0 million was paid in 2007. These fees were recorded as deferred financing charges and were amortized and expensed as additional interest over the life of the debt, until such amortization was accelerated in the first quarter of 2008 when the SSC Credit Facility was reclassified as a current liability. The continuing fees were expensed as incurred; and
- 5) A facility fee of 1.0% per annum on the unused commitment balance paid quarterly until the unused commitment expired on December 31, 2007. The Company expensed the facility fee as incurred.

The lenders received a first priority lien on substantially all of the Company's assets at the closing date, including the Beta Unit but not the Alaska assets nor the assets of CAC, CEI and GOI, and by a pledge of all of the issued and outstanding capital stock of all of the Company's wholly-owned subsidiaries, except CEI and GOI were not added to the pledge until July 2008. At Dec. 31, 2008, the net book value of the assets securing the SSC Credit Facility was \$187.7 million.

The SSC Credit Facility provided for certain financial statement, environmental reporting and other affirmative and negative covenants, including current ratio, debt to EBITDA ratio and collateral coverage ratios. The Company was also required to enter into certain oil and gas production hedging contracts as determined by the lenders. The Company was in breach of certain financial and other covenants and entered into Forbearance Agreements (which amended certain provisions of the SSC Credit Agreement as well) on December 19, 2008.

As required by GAAP, the Company separated the liability and equity components of the SSC Credit Facility. The Company determined the fair value of the liability component of the SSC Credit Facility by calculating the present value of the associated cash flows using a discount rate that reflected its underlying rate of borrowing. The Company determined the fair value of warrants at the issue date of the SSC Credit Facility using the Black-Scholes pricing model. The resulting pro rata fair values of the liability and equity components of the SSC Credit Facility and warrants were \$46.4 million and \$18.6 million (Note 11), respectively. The liability was to accrete to \$65.0 million over the term of the SSC Credit Facility through the recording of an interest expense until the SSC Credit Facility was paid in full; this accretion was accelerated when the SSC Credit Facility was reclassified to current liabilities in the first quarter of 2008.

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On March 11, 2009, an aggregate of \$44.2 million (including interest, unpaid expenses and a \$3.8 million make-whole payment) was paid to the lenders using funds obtained under the DIP Facility, and the SSC Credit Facility was terminated. The SSC Credit Facility would otherwise have matured November 29, 2010, but given the existence of various defaults, the lenders had the right to accelerate the maturity date and exercise other remedies under the SSC Credit Facility. The prepayment penalty (make-whole payment) resulted from the repayment prior to November 30, 2009 in an amount equal to the unpaid scheduled interest payments on the prepaid principal amounts calculated through November 30, 2009.

Prior to the termination of the SSC Credit Facility:

- During the period December 19, 2008 through the February 17, 2009 expiration of the Forbearance Agreement, the Company received \$1.2 million of discretionary advances in 2008, \$10.6 million of additional loans in 2008, and \$5.9 million of additional loans in 2009, all under the terms of the Forbearance Agreement; in addition, accrued interest of \$0.6 million was capitalized to the loan balance on December 19, 2008; and
- Subsequent to the expiration of the Forbearance Agreement, the Company received an additional \$1.4 million of advances and repaid \$3.1 million.

The 2007 and 2008 activity of the SSC Credit Facility was as follows:

	<b>Liability Component</b>		<b>Equity</b>
	<b>Face Value</b>	<b>Carrying Value</b>	<b>Component</b>
			<b>Fair Value<sup>(A)</sup></b>
Balance at December 31, 2006	\$ 28,146	\$ 18,378	\$ 2,913
Proceeds	36,854	21,174	15,680
Less deferred financing costs	-	(1,641)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	-	6,188	-
Balance at December 31, 2007	65,000	44,099	18,593
Proceeds	11,785	11,785	-
Payments	(45,163)	(45,163)	-
Interest - non-cash - paid in kind	1,325	1,325	-
Accretion of discounts and amortization of deferred financing costs	191	191	-
Accelerated expensing of discounts and loan costs	-	20,901	-
Balance at December 31, 2008	<u>\$ 33,138</u>	<u>\$ 33,138</u>	<u>\$ 18,593</u>

(A) In connection with the credit agreements executed with affiliates of Goldman Sachs and Silver Point, the Company issued warrants. Accordingly, the notes payable were recorded at a discount and a portion of the proceeds received was allocated to "Warrants" in shareholders' equity, which amounts are shown in the table above as "Equity Component - Fair Value".

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***Unsecured Shareholder Loan***

The Company received a \$1.0 million unsecured loan from Bateman and Co. (“Bateman”) on April 4, 2008 for use as working capital. On February 10, 2009, the Company and Bateman modified the agreement to (i) increase the interest rate to LIBOR plus 18.5% per annum beginning February 1, 2009, such interest to be capitalized to the principal outstanding at the end of each calendar month, (ii) modify the maturity date to the earlier of February 10, 2012 or 91 days after the payment of the SSC Credit Facility and the Alaska credit facilities and (iii) to allow for, at Bateman’s option, conversion of all or any portion of principal balance to common stock of the Company. The principal balance will convert at a rate of \$0.073 per dollar being converted into common stock.

**9. ASSET RETIREMENT OBLIGATIONS**

The following table summarizes the changes in the Company’s abandonment obligations during 2007 and 2008:

	<u>Asset Retirement Obligation</u>	<u>Asset Retirement Receivable</u>	<u>Net Amount</u>
Balance at December 31, 2006	\$ 1,655	\$ 585	\$ 1,070
Acquisitions	53,453	-	53,453
Retirements	(142)	-	(142)
Accretion	3,060	45	3,015
Transferred to assets/liabilities held for sale	(1,720)	(630)	(1,090)
Balance at December 31, 2007	56,306	-	56,306
Accretion	4,450	-	4,450
Balance at December 31, 2008	<u>\$ 60,756</u>	<u>\$ -</u>	<u>\$ 60,756</u>

The Corporation estimates the total undiscounted amount of cash flows required to settle its ARO is \$176.1 million and \$185.0 million at December 31, 2008 and 2007 respectively, which will be incurred between 2010 and 2024. The nominal annual rate used to discount future cash flows was 9.67%.

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**10. INCOME TAXES**

The reconciliation of provision for income taxes at the effective federal statutory rate is as follows:

	<u>2008</u>	<u>2007</u>
Federal statutory rate (34%)	\$ (87,587)	\$ (33,575)
Increase (decrease) in taxes resulting from:		
State income tax, net of federal benefit (8.84%)	(12,664)	(5,761)
Miscellaneous	(8,605)	-
Permanent differences	1,730	2,462
Other differences	-	268
Change in valuation allowance	107,126	36,606
Income tax expense	<u>\$ -</u>	<u>\$ -</u>

The Company's approximate net operating loss ("NOL") and other carryforwards for federal and primarily California income tax purpose as of December 31, 2008 are as follows:

	<u>Federal</u>	<u>State</u>
Net operating loss	\$ 203,908	\$ 205,440
Statutory depletion	\$ 2,546	\$ 1,843

The expiration dates for the Company's NOL carryforwards as of December 31, 2008 are as follows:

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<u>Expiration date</u>	<u>Amount Federal NOL</u>	<u>Amount State NOL</u>
1/31/2013 - 1/31/2016	\$ -	\$ 3,910
12/31/2017	-	21,658
1/31/2017 - 6/30/2019	-	2,893
12/31/2019	-	54,355
12/31/2020	-	14,133
1/31/2020 - 6/30/2027	31,684	-
12/31/2027	88,032	38,436
12/31/2028	84,192	70,055
	<u>\$ 203,908</u>	<u>\$ 205,440</u>

The Company's net operating loss ("NOL") carryforwards are available to reduce future years' taxable income, are subject to limitation as to use, and expire through 2028. The statutory depletion carryforwards can be utilized over an indefinite period.

The ability of the Company to utilize NOL carryforwards and other tax attributes to reduce future federal and state taxable income and federal and state income tax of the Company are subject to various limitations under the Internal Revenue Code of the 1986, as amended (which many states conform with). The utilization of such carryforwards may be limited upon the occurrence of certain ownership changes, including issuance or exercise of rights to acquire stock, the purchase or sale of stock by 5% stockholders, as defined in the Treasury regulations, and the offering of stock by the Company during any three-year period resulting in an aggregate change of more than 50% in the beneficial ownership of the Company.

In the event of an ownership change (as defined for income tax purposes), Section 382 of the Code imposes an annual limitation on the amount of a corporation's taxable income that can be offset by these carryforwards. The limitation is generally equal to the product of (i) the fair market value of the equity of the company multiplied by (ii) a percentage approximately equivalent to the yield on long-term tax exempt bonds during the month in which an ownership change occurs. Certain NOLs acquired through various acquisitions are also subject to limitations.

Future equity transactions by the Company, by 5% stockholders (including relatively small transactions and transactions beyond the Company's control) or subsequent to the bankruptcy filing in March 2009 could cause an ownership change and therefore a limitation on the annual utilization of NOLs could cause the NOLs to expire unused.

A summary of temporary differences giving rise to future income tax asset is as follows:

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	<u>2008</u>	<u>2007</u>
Future tax assets:		
Stock-based compensation	\$ 4,934	\$ 2,219
Tax basis in excess of book	54,851	-
Net operating losses	88,628	51,786
Asset retirement obligation	4,741	1,485
Hedging losses	-	1,718
Loan fees and accretion	11,854	-
Unconsolidates subsidiary loss	950	-
Statutory depletion	1,091	2,715
	<u>167,049</u>	<u>59,923</u>
Less future tax liabilities:		
Asset retirement receivable	-	251
Book basis of petroleum and natural gas properties in excess of tax	7,604	14,135
Prepaid expenses	1,008	1,604
	<u>8,612</u>	<u>15,990</u>
Less valuation allowance	158,437	43,933
Net future tax asset	<u>\$ -</u>	<u>\$ -</u>

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**11. SHAREHOLDERS' EQUITY**

	Number of Shares	Number of Warrants	Share Capital	Subscriptions	Contributed Surplus	Warrants	Additional Paid In Capital	Accumulated Other Comprehensive Loss	Deficit	Total
Balance at December 31, 2006	77,599	37,723	\$ -	\$ 61,127	\$ 1,984	\$ 6,797	\$ 39,531	\$ -	\$ (22,350)	\$ 87,097
Net loss	-	-	-	-	-	-	-	-	(98,749)	(98,749)
Unrealized hedging losses	-	-	-	-	-	-	-	(82,716)	-	(82,716)
Subscription shares issued	-	-	-	(61,127)	-	-	-	-	-	(61,127)
Warrants issued	-	53,804	-	-	-	17,320	-	-	-	17,320
Warrants exercised	2,068	(2,068)	-	-	-	-	3,332	-	-	3,332
Shares issued for acquisitions	10,000	-	1	-	-	-	24,630	-	-	24,631
Shares issued for debt	4,750	-	1	-	-	-	11,255	-	-	11,256
Shares issued for deferred financing costs	3,097	-	-	4,882	-	-	7,000	-	-	11,882
Shares issued for liquidated damages	648	-	-	4,426	-	-	1,624	-	-	6,050
Stock options exercised	31	-	-	-	3,468	-	27	-	-	27
Common stock issued	88,450	-	-	-	-	-	120,030	-	-	123,507
Balance at December 31, 2007	186,643	89,459	\$ -	\$ 9,308	\$ 5,452	\$ 24,117	\$ 207,429	\$ (82,716)	\$ (121,099)	\$ 42,510
Net loss	-	-	-	-	-	-	-	-	(257,608)	(257,608)
Unrealized hedging losses	-	-	-	-	-	-	-	103,510	-	103,510
Warrants issued	-	12,516	-	-	-	14,613	-	-	(14,613)	-
Warrants expired	-	(790)	-	-	-	-	-	-	-	-
Warrants exercised	12,171	(12,171)	2	-	-	-	19,059	-	-	19,061
Shares issued for deferred financing costs	2,063	-	-	(4,882)	-	-	4,882	-	-	-
Shares issued for liquidated damages	4,592	-	-	(4,426)	-	-	8,506	-	-	4,080
Stock compensation	-	-	-	-	6,339	-	-	-	-	6,339
Balance at December 31, 2008	205,469	89,014	\$ -	\$ -	\$ 11,791	\$ 38,730	\$ 239,876	\$ 20,794	\$ (393,320)	\$ (82,108)

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**11. SHAREHOLDERS' EQUITY (continued)**

*Authorized Shares*

The company has authorized 50.0 million preferred shares with a par value of \$0.01. The company has authorized 500.0 million common shares with a par value of \$0.0001 per share.

*Subscription Receipts*

On August 27, 2007, in connection with credit agreements with an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC (the "lenders") for the acquisition of the Alaska assets, the Company agreed to issue additional shares of the Company's common stock as incentives for the lenders based on the Company's equity raise in October 2007. Accordingly, 2.06 million additional shares, which were valued at the date of the Alaska acquisition, were issued in January 2008. The Company had recorded subscription receipts of \$4.88 million at December 31, 2007 in relation to these shares.

*Liquidated Damages*

The registration rights agreements the Company entered into in connection with the equity and debt financings relating to the Beta Unit acquisition required the Company to, among other things, register for resale the common stock and shares underlying warrants issued in those financings and to maintain the effectiveness of the registration statement for an extended period of time. Because the Company's acquisition of the Alaska assets on August 27, 2007 necessitated that it include in the registration statement audited financial information regarding the Alaska assets, which information was unavailable at that time, the Company did not meet the August 29, 2007 filing deadline for the registration statement.

The Company initially was subject to liquidated damages assessments of 1.0% (capped at 10.0%) of the number of shares of common stock issued in the equity financing related to the Beta Unit acquisition and still held by the original holders as of the end of each 30 days of non-compliance, subject to pro ration for partial months. The shares of common stock and warrants related to the equity financing for the Beta Unit acquisition were not issued and outstanding until March 2007, when the Beta Unit acquisition closed. The Company is not obligated to repurchase either the shares or the warrants that were issued in the equity financing.

The Company filed the registration statement with the U.S. Securities and Exchange Commission in February 2008. However, the Company's dispositions of assets in July 2008 necessitated further extensive revisions to the financial and other information contained in the registration statement, and the registration statement was not finalized or declared effective. However, effective February 20, 2008, when the Company's shares that were trading under the symbol PFE.S became PFE-listed shares, non-affiliate holders of those shares became able to trade them without further restriction and therefore were no longer entitled to receive further liquidated damages shares, and affiliate holders became able to trade them subject to compliance with Rule 144 under the Securities Act of 1933 or another registration exemption and therefore continued to receive liquidated damages shares until June 2008 (the tenth month of non-compliance). Accordingly, the Company recorded liquidated damages of \$6.1 million in 2007 and \$4.1 million in 2008. The total number of shares issued for liquidated damages was 5.2 million. The liquidated damages expense represents the fair value of the underlying shares that the Company issued.

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**Stock Options**

The Company has a stock-based compensation plan that grants employees options to purchase common shares of the Company. Option exercise prices are the market price for the common shares on the date the options were issued. Options granted under the plan have varying vesting schedules, but are generally fully exercisable after three years and expire five years after the date granted.

The following tables summarize the information about options to purchase common shares during the fiscal years ended December 31, 2008 and December 31, 2007:

	December 31, 2008		December 31, 2007	
	Number of Options (in thousands)	Weighted Average Exercise Price per Share (Canadian dollars)	Number of Options (in thousands)	Weighted Average Exercise Price per Share (Canadian dollars)
Outstanding, beginning of period	12,002	\$ 2.06	5,160	\$ 1.15
Granted during the period	9,042	1.16	7,068	1.16
Expired during the period	(100)	0.84	-	-
Exercised during the period	-	-	(31)	0.84
Forfeited during the period	(878)	1.99	(195)	1.99
Outstanding, end of period	20,066	1.69	12,002	2.06
Exercisable, end of period	7,947	\$ 1.76	4,389	\$ 1.22

The following table summarizes information about the Company's outstanding stock options at December 31, 2008:

Options Outstanding			Options Exercisable		
Exercise Price (Canadian dollars)	Number of Options (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (Canadian dollars)	Number of Options (in thousands)	Weighted Average Exercise Price (Canadian dollars)
\$0.15 to \$0.18	2,050	4.85	\$ 0.18	-	-
\$0.84	3,069	1.85	0.84	3,069	0.84
\$1.18	215	4.35	1.18	-	-
\$1.40 to \$1.90	8,642	3.37	1.50	2,160	1.64
\$2.45 to \$2.50	1,110	2.26	2.48	539	2.49
\$3.00	4,980	3.36	3.00	2,179	3.00
	20,066	3.24	\$ 1.69	7,947	\$ 1.76

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The following table summarizes information about the Company's outstanding stock options at December 31, 2007:

<b>Options Outstanding</b>			<b>Options Exercisable</b>		
<b>Exercise Price</b> <b>(Canadian dollars)</b>	<b>Number of Options</b> <b>(in thousands)</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Weighted Average Exercise Price</b> <b>(Canadian dollars)</b>	<b>Number of Options</b> <b>(in thousands)</b>	<b>Weighted Average Exercise Price</b> <b>(Canadian dollars)</b>
\$0.84	3,069	2.92	\$ 0.84	2,111	\$ 0.84
\$0.84	100	0.92	0.84	68	0.84
\$1.40 to \$1.60	1,910	2.50	1.55	1,910	1.55
\$1.73 to \$3.00	6,923	4.20	2.75	300	1.93
	<u>12,002</u>	<u>3.50</u>	<u>\$ 2.06</u>	<u>4,389</u>	<u>\$ 1.22</u>

A Black-Scholes option pricing model, with the following weighted-average assumptions, was used to estimate the fair value of options on the date of the grant, for the inclusion as stock-based compensation expense:

	<u>2008</u>	<u>2007</u>
Risk free interest rate (%)	2.3 - 3.6 %	3.9 - 4.7 %
Expected lives (years)	3 - 5	3 - 5
Expected volatility (%)	75 - 88 %	87 - 94 %
Dividend per share	\$ -	\$ -

The grant date weighted-average fair value of options granted during 2008 and 2007 was CAD\$0.81 and CAD\$1.83 per option, respectively.

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**Warrants**

The following table summarizes information about the Company's outstanding warrants at December 31, 2008:

Warrants Outstanding			Warrants Exercisable		
Exercise Price (Canadian dollars)	Number of Warrants (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (Canadian dollars)	Number of Warrants (in thousands)	Weighted Average Exercise Price (Canadian dollars)
\$1.50 to \$1.70	31,162	1.03	\$ 1.65	31,162	\$ 1.65
\$1.40 to \$1.42	28,599	2.72	1.40	28,599	1.40
\$2.65	16,263	0.30	2.65	16,263	2.65
\$1.63 to \$1.95	819	0.92	1.79	819	1.79
\$2.50	12,171	4.05	2.50	12,171	2.50
	<u>89,014</u>	<u>1.85</u>	<u>\$ 1.88</u>	<u>89,014</u>	<u>\$ 1.88</u>

The following table summarizes information about the Company's outstanding warrants at December 31, 2007:

Warrants Outstanding			Warrants Exercisable		
Exercise Price (Canadian dollars)	Number of Warrants (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (Canadian dollars)	Number of Warrants (in thousands)	Weighted Average Exercise Price (Canadian dollars)
\$1.50 to \$1.70	43,332	2.00	\$ 1.67	43,332	\$ 1.67
\$0.90 U.S.	790	0.92	\$0.90 U.S.	790	\$0.90 U.S.
\$1.42	28,255	3.72	1.42	28,255	1.42
\$2.65	16,263	1.30	2.65	16,263	2.65
\$1.63 to \$1.95	819	1.92	1.79	819	1.79
	<u>89,459</u>	<u>2.40</u>	<u>\$ 1.76</u>	<u>89,459</u>	<u>\$ 1.76</u>

Effective January 18, 2008, the Company completed an incentive warrant offering pursuant to which 12,171 shares of common stock at a price of CAD\$1.70/share were issued to warrant holders upon exercise of their previously issued subscriber warrants for aggregate gross proceeds of CAD\$20.7 million. The initial subscriber warrants were issued in private placements conducted between November 2006 and January 2007 and had expiration dates of November 15, 2009 (as to 8,718 shares), December 28, 2009 (as to 3,278 shares) and January 25, 2010 (as to 176 shares).

On the same date, as incentive for the exercise of the subscriber warrants, the Company issued to the warrant holders five-year incentive warrants to purchase up to an aggregate of 12,171 shares of common stock at an exercise price of CAD\$2.50 per share. The incentive warrants were valued at \$14.6 million and

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charged to deficit. The fair value of the incentive warrants was estimated on the issuance date using the Black-Scholes valuation model with the following assumptions:

Risk-free interest rate	2.64%
Expected volatility	101.72%
Expected life (in years)	5.0

The incentive warrants contain customary anti-dilution provisions for stock splits, stock dividends and the like. The incentive warrants also contain a provision that limits the exercise of the warrants to the extent necessary to ensure that, following the exercise, the holder, together with any person acting jointly or in concert with the holder with respect to the voting of our voting securities, does not directly or indirectly own or exercise control or discretion over the voting of securities representing 19.99% or more of the Company's issued and outstanding voting securities.

The terms of the incentive warrant offering provide that if the Company completes a subsequent equity or debt offering during an 18-month adjustment period at a subscription price below CAD\$1.70, then each participant in the incentive warrant offering will be entitled to receive a number of shares of the Company's common stock (inclusive of the shares issued to the participant upon exercise of the subscriber warrant in the incentive warrant offering) equal to the aggregate exercise price the participant paid to exercise the subscriber warrant divided by the lowest equity offering price or convertible debt conversion price we receive in subsequent offerings made during the adjustment period.

In connection with the incentive warrant offering, the Company paid an aggregate cash advisory fee of CAD\$0.8 million, representing 4.0% of the aggregate proceeds of the incentive warrant offering.

***Anti-Dilution Protection on Lender Warrants***

In connection with the SSC Credit Facility, the Company issued to the secured lenders warrants to purchase up to 25.5 million shares of common stock at a per share exercise price of CAD\$1.42. The lender warrants were subject to vesting based upon amounts borrowed under the SSC Facility and ultimately vested as to an aggregate of 23.6 million shares prior to termination of the SSC Facility on March 11, 2009. The lender warrants contain anti-dilution provisions that provide for weighted average adjustments to the exercise price and number of shares of common stock underlying the lender warrants if the Company issues stock, options (other than under the Company's Amended and Restated 2006 Share Option Plan) or convertible securities for consideration per share less than the exercise price of the lender warrants.

Warrant adjustments, resulting from the issue of penalty shares relating to liquidated damages, of 0.3 million shares have been included in the warrants outstanding at December 31, 2008. However, these adjustments are subject to stock exchange approval that has not been applied for or obtained in light of the pending delisting of the Company's common stock from the TSX stock exchange. Due to the insolvency proceedings that the Company entered into on March 9, 2009, it is unlikely that the above warrants will be issued.

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**12. PER SHARE AMOUNTS**

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the periods. Diluted per share amounts reflect the potential dilution that could occur if stock options or warrants to purchase common shares were exercised and converted to common shares. The treasury stock method of calculating diluted per share amounts is used whereby any proceeds from the exercise of stock options or warrants plus unamortized stock-based compensation that are in the money assume to be used to purchase common shares of the Company at average market price during the period. Basic and diluted weighted average outstanding shares are the same as the Company has net losses.

The outstanding share options including unvested shares and convertible debentures did not have a dilutive effect on earnings (loss) per share in any of the periods presented.

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Basic Weighted Average Shares Outstanding	203,697	140,632
Diluted Weighted Average Shares Outstanding	314,549	297,150

**13. FINANCIAL INSTRUMENTS**

The Company holds various forms of financial instruments. The nature of these instruments and its operations expose the Company to market risk, credit risk and liquidity risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors has the overall responsibility for the establishment and oversight of the Company's risk management framework. To date, the Board has not established formal policies to set risk limits and to control and monitor these risks in relation to market conditions.

*Market risk*

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign currency exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks, while maximizing returns to the Company.

*a) Commodity price risk*

Due to the volatility of commodity prices the Company is potentially exposed to adverse consequences in the event of declining prices. The Company may enter into oil and natural gas contracts in order to protect its cash flow on future sales. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of oil and natural gas.

Based on annualizing fourth quarter 2008 production levels, a \$10 per barrel change in oil prices would change revenue net of royalties (after factoring in the Company's hedge position as of December 31, 2008) by approximately \$7.8 million per year.

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As at December 31, 2008, the Company had the following contracts outstanding:

**Alaska**

Type	Volume	BPD <sup>(C)</sup>	Term	Price (\$/bbl) <sup>(A)</sup>	Type
Put	907,999	2,488	January 1 - December 31, 2009	\$ 67.21	Financial

<sup>(A)</sup> Put price based on WTI

<sup>(C)</sup> Barrels per day

These put options were terminated on March 6, 2009 as described in Note 18.

**Beta**

Type	Volume	BPD	Term	Sales Contract Price (\$/bbl) <sup>(B)</sup>	Purchase Contract Price (\$/bbl) <sup>(B)</sup>	Type
Swap	260,512	714	January 1 - December 31, 2009	\$ 57.30	\$ 43.50	Financial
Swap	232,400	637	January 1 - December 31, 2010	\$ 57.30	\$ 53.25	Financial
Swap	207,460	568	January 1 - December 31, 2011	\$ 57.10	\$ 57.10	Financial
Swap	110,633	519	January 1 - July 31, 2012	\$ 56.90	\$ 56.90	Financial

<sup>(B)</sup> Swap price based on Midway Sunset. Since sales and purchases offset, the Company no longer has commodity price protection. The difference between the sales price and the purchase price will be received over the period indicated.

At December 31, 2008, the derivative liabilities on the consolidated balance sheet reflect a \$0 balance. At December 31, 2007, the derivative liabilities on the consolidated balance sheet reflect the net unrealized loss position of \$89.5 million for contracts outstanding at that date (current liability of \$34.3 million, and long-term liability of \$55.3 million).

The derivative assets on the consolidated balance sheet reflect a \$23.6 million and \$0 balance at December 31, 2008 and 2007, respectively.

For the year ended December 31, 2008, the total unrealized loss, which arose as a result of discontinued operations, was \$12.1 million on the consolidated statement of operations and \$20.8 million gain on the statement of accumulated deficit and comprehensive loss. For the year ended December 31, 2007, the total unrealized loss was \$6.8 million on the consolidated statement of operations and \$82.7 million on the statement of accumulated deficit and comprehensive loss. The financial impact on the settlement of contracts during 2008 and 2007 was realized losses of \$42.4 million and \$10.7 million, respectively.

The company terminated commodity swaps and the related hedge accounting for contracts related to the L.A. Basin onshore California production asset sale. The termination resulted in a payment of \$29.7 million to an affiliate of the Goldman Sachs Group Inc. from the proceeds of the sale of these assets in July 2008.

*b) Foreign currency exchange risk*

All of the Company's petroleum and natural gas sales and expenses and monetary assets and liabilities are denominated in United States dollars, and are not impacted by the exchange rate

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between United States dollars and a foreign currency. The Company's common shares are however traded on the TSX stock exchange and the Company's net proceeds from the issuance of any new shares in Canada would be impacted by the foreign currency exchange rate between the Canadian dollar and the United States dollar. As of December 31, 2008, the Company did not have any commitments to issue new shares other than pursuant to outstanding options, warrants, and convertible note (see Note 18). As a consequence of the March 11, 2009 bankruptcy filing, the TSX suspended trading in the Company's common shares and has announced its intentions to delist the shares.

*c) Interest rate risk*

The Company's credit facilities are subject to floating rates and are, therefore, exposed to fluctuations in the market rate of interest. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates.

Until LIBOR reaches 4.0%, a fluctuation in interest rates of 1.0% would have no effect on interest expense based on the outstanding floating rate debt as of December 31, 2008. Once LIBOR reaches above 4.0%, a fluctuation in interest rates of 1.0% would change interest expense by \$0.6 million per year based on the outstanding floating rate debt as of December 31, 2008.

For the year ended December 31, 2008, interest charges on secured credit facilities aggregated to \$79.8 million, reflecting an effective interest rate of 17.8%. For the year ended December 31, 2007, interest charges on the secured credit facilities aggregated to \$31.6 million, reflecting an effective interest rate of 15.1%. The 2008 interest amount excludes \$6.0 million covenant violation waiver fee and \$20.4 million consisting of \$9.7 million in fees for the failure to syndicate the Alaska loans and accrual in 2008 of a \$10.7 million conversion fee on the balance of the Alaska credit facility expected to be outstanding on February 24, 2009.

*Credit risk*

The Company maintains its cash accounts primarily with a large, national bank. The total cash balances are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to \$0.1 million per bank (\$0.25 million through December 31, 2009). The Company's cash balances on deposit in bank accounts at December 31, 2008 exceeded the balance insured by the FDIC in the aggregate amount of \$2.3 million. Given the current economic environment and risks in the banking industry, there is risk that these deposits may not be readily available or may not be covered by insurance.

Substantially all of the accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and, therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, credit-worthy counterparties. Receivables related to the sale of the Company's petroleum and natural gas production are from major oil and gas companies or refining companies. The Company has limited sales outlets due to the pipeline configuration in California, and due to the high transportation costs of alternative outlets in Alaska. These revenues are normally collected by the twentieth day of the month following delivery. The Company did not experience any credit losses in the collection of its accounts receivable for the year ending December 31, 2008. The Company had two customers that make up 81.0% and 19.0% of the accounts receivable balance at December 31, 2008. Each of the above customer balances have been outstanding for less than thirty

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days at December 31, 2008. The Company had two customers that make up 56.0% and 26.0% of the accounts receivable balance at December 31, 2007.

Liquidity risk

Liquidity risk would occur if the Company is not able to meet its financial obligations as they come due. See Note 18 – Subsequent Events – Insolvency Proceedings.

Fair values of financial instruments

	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Interest Income/ (Expense)</u>	<u>Other (Expense)</u>
<b>Financial Assets</b>				
Loans and receivables:				
Accounts receivable	\$ 3,519	\$ 3,519		
Derivative asset	23,557	23,557		
Other receivables	240	240		
Held to maturity:				
Performance Bonds	5,846	5,846	254 <sup>(1)</sup>	
Investments	106,180	106,439	5,478 <sup>(1)</sup>	(3)
<b>Financial Liabilities</b>				
Other financial liabilities:				
Accounts payable and accrued liabilities	36,217	36,217		
Due to related party	76	76		
Notes payable	501,725	indeterminable <sup>(2)</sup>	(42,389) <sup>(3)</sup>	(59,739) <sup>(4)</sup>
Other liabilities	6,933	6,933		

- <sup>(1)</sup> Included in interest income in the statement of income and comprehensive income. Included as non cash interest and dividend income on the statement of cash flows.
- <sup>(2)</sup> Due to the Company's financial condition at December 31, 2008, and due to higher credit spreads in the debt capital markets generally, the Company believes the carrying value of its debt exceeds its fair value. There is no readily-determinable basis for determining this fair value.
- <sup>(3)</sup> Included in interest and other financing charges on short term/long term debt in the statement of income and comprehensive income. The non-cash interest expense relating to accretion of premiums, discounts or transaction costs that are netted against these liabilities are included in non-cash paid in kind interest in the statement of cash flows.
- <sup>(4)</sup> Included in interest and other financing charges on short term/long term debt in the statement of income and comprehensive income. The amortization of financing fees related to this liability is included in amortization of deferred finance charges in the statement of cash flows.

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**14. COMMITMENTS AND CONTINGENCIES**

*Contractual Obligations:*

**Operating Leases**

The Company has non-cancelable operating leases for its office facilities. The leases have scheduled increases, require the Company to pay its share of operating costs, and expire from 2009 to 2012. The leases include options to extend the terms of the leases for three to five years.

Future minimum payments under operating leases for the next five years total \$2.2 million, and are as follows:

<u>Year Ended December 31</u>	<u>Amount</u>
2009	\$ 829
2010	701
2011	493
2012	180
2013	-
	<u>\$ 2,203</u>

**Drilling Commitments**

The Company shares interests in various oil and gas properties with other companies. The Company may be required to provide funds for drilling and completion costs related to these oil and gas properties. At December 31, 2008 the Company had no material drilling commitments.

**15. CAPITAL DISCLOSURES**

The Insolvency Proceedings (see Note 18 – Subsequent Events) have significantly affected the Company’s ability to manage its capital structure in the near term. The DIP Financing (see Note 18 – Subsequent events) combined with the Company’s operating revenue is expected to provide sufficient liquidity to fund working capital, meet ongoing obligations and ensure that normal operations continue without interruption during its restructuring.

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**16. DISCONTINUED OPERATIONS**

In July 2008, the Company sold its L.A. Basin onshore California assets and its San Joaquin Basin onshore assets for net proceeds of \$127.5 million, in order to pay down a portion of its debt.

The following tables present financial information related to operations held for sale until the July 2008 closing dates, as well as the proceeds and gain on sale.

**Income Statement**

	<b>For the Year Ended</b>	
	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
REVENUES		
Oil and gas production revenue	\$ 18,586	\$ 20,947
Royalties	(3,969)	(4,520)
Unrealized gain (loss) on derivatives	(12,121)	(6,782)
Realized gain (loss) on derivatives	(2,806)	(1,073)
Interest and dividends	28	93
Other revenue	5	1,583
	(277)	10,248
EXPENSES		
Production	3,427	5,465
Interest - cash	790	2,108
Interest - non-cash	1,933	3,409
General exploration	-	1,060
Depreciation, depletion and amortization	1,833	2,915
	7,983	14,957
INCOME (LOSS) BEFORE INCOME TAX	(8,260)	(4,709)
Income tax expense	-	-
NET INCOME (LOSS)	\$ (8,260)	\$ (4,709)

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**Balance Sheet**

	<b>December 31, 2007</b>	
<b>ASSETS</b>		
Cash	\$	2,134
Accounts receivable		2,582
Other receivables		991
Prepays and other current assets		102
Performance bonds and deposits		646
Asset retirement receivable		630
Petroleum and natural gas properties and equipment		39,233
		46,318
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities		1,300
Notes payable (see below)		15,725
Asset retirement obligation		1,720
Derivative liability		18,099
Other liabilities		212
		37,056
Non-controlling interest		7,755
		44,811
<b>NET INVESTMENT</b>	<b>\$</b>	<b>1,507</b>

**Laurus Master Fund Ltd. Note Payable**

In June 2006, the Company's wholly-owned subsidiary, CAC, entered into a securities purchase agreement, with Laurus for proceeds of \$21.0 million evidenced by the Laurus Master Fund Ltd. note payable. The note was paid in full in 2008 upon the sale of the Company's San Joaquin Basin assets.

The 2007 and 2008 activity of the Laurus Note was as follows:

	<b>Liability Component</b>		<b>Equity Component (Non-Controlling Interest)</b>
	<b>Face Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Balance at December 31, 2006	\$ 20,770	\$ 12,486	\$ 7,755
Payments	(114)	(114)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	-	3,353	-
Balance at December 31, 2007	20,656	15,725	7,755
Payments	(20,656)	(15,725)	(7,755)
Balance at December 31, 2008	\$ -	\$ -	\$ -

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**Proceeds on Sale and Gain on Sale**

The net sales proceeds were \$127,506, being the gross sales proceeds of \$135,000 less customary purchase price adjustments of \$7,494 (being principally cash flow from the effective date to the closing date). The net sales proceeds were used as follows:

Partial repayment of SSC Credit Facility	\$	44,972
Repayment of Laurus Master Fund Ltd. note payable		18,037
Termination of commodity swaps		29,678
Laurus Master Fund Ltd. share of proceeds		6,387
Payment of closing costs		1,222
Addition to working capital		27,210
Total use of net sales proceeds	\$	<u>127,506</u>

The gain on sale was calculated as follows:

Net proceeds	\$	127,506
Net book value of net assets sold		(38,590)
Costs of sale		(4,127)
Realization of accumulated other comprehensive loss on hedge termination		(10,535)
Gain on sale of discontinued operations		<u>74,254</u>
Provision for income tax		-
Gain on sale of discontinued operations - net of tax	\$	<u>74,254</u>

**Indemnification Relating to Sale of Assets**

The sale agreements require the Company and its subsidiaries that sold the assets to Occidental Petroleum Corporation (“OXY”) to indemnify OXY against certain claims made by OXY within 18 months following the closing dates. The claims must relate to either breaches of sellers’ representations, warranties and covenants under the sale agreements or certain other liabilities relating to the assets and operations sold. Each individual claim is subject to a threshold of \$100,000 or \$50,000 under the L.A. Basin or San Joaquin Basin sale agreement, respectively. Also, OXY may not make an individual claim unless the aggregate amount of all claims exceeds a threshold of \$1,000,000 or \$350,000 under the L.A. Basin or San Joaquin Basin sale agreement, respectively. If the aggregate threshold is met under one of the sale agreements, then the sellers would be obligated to pay only claim amounts that exceed the aggregate threshold but do not exceed 35% of the sale price.

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**17. IMPAIRMENT**

The Company incurred impairment charges of approximately \$131.4 million for the year ended December 31, 2008. Included in the impairment is \$126.1 million related to certain PEO petroleum and natural gas properties' net book value exceeding the future cash flows. The impairment charge is principally the result of lower crude oil prices. The company also recorded impairment of unproved properties of \$0.3 million related to the expiration of certain PEO exploration leases.

In addition, the Company recorded a write down of oil inventories of \$5.3 million as the market value of oil inventory was lower than its carrying value at December 31, 2008.

**18. SUBSEQUENT EVENTS**

*Insolvency Proceedings*

On March 9, 2009, the Company and its wholly-owned subsidiaries filed with the U.S. Bankruptcy Court for the District of Delaware ("Bankruptcy Court") voluntary petitions for reorganization under chapter 11 of the United States Bankruptcy Code ("Chapter 11"). On March 10, 2009, the Bankruptcy Court entered an interim order (1) approving senior secured superpriority postpetition financing (see "*DIP Facility*" below), (2) authorizing use of cash collateral, (3) granting liens and providing superpriority administrative expense status, (4) granting adequate protection, (5) modifying automatic stay, and (6) scheduling a final hearing. A final hearing on the DIP Facility and other matters is scheduled for April 8, 2009. Under the interim order, the Company received customary authority from the Bankruptcy Court to enable it to continue operating its business in the ordinary course of business. The DIP financing combined with the Company's operating revenue is expected to provide sufficient liquidity to fund working capital, meet ongoing obligations and ensure that normal operations continue without interruption during its restructuring.

In addition to obtaining bankruptcy protection in the U.S. on March 10, 2009, the Company obtained protection in Canada under the *Companies' Creditors Arrangement Act* (Canada) (the "CCAA") on March 12, 2009. The initial protection period under the CCAA is scheduled to expire April 9, 2009. CCAA protection will also stay creditors, suppliers and others from enforcing any rights against the Company. The initial order granted on March 12, 2009 by the Supreme Court of British Columbia ("BCSC") granted CCAA protection for an initial period expiring April 9, 2009 to be extended thereafter as the BCSC deems appropriate. If by April 9, 2009, the Company has not filed a restructuring plan or obtained an extension of the CCAA protection, creditors and others will no longer be stayed from enforcing their rights against the Company. While under CCAA protection, the Company's management remains responsible for day-to-day operations. The BCSC has appointed Todd McMahon Inc. as a monitor, who will be responsible for monitoring the course and conduct of the U.S. proceedings as well as ongoing operations and reporting to the BCSC.

The Chapter 11 and CCAA protection are collectively referred to as the "Insolvency Proceedings."

*DIP Financing*

The Company entered into a debtor-in-possession financing pursuant to a \$186.6 million Senior Secured Super Priority Priming Debtor in Possession Credit and Guaranty Agreement ("*DIP Facility*") with an entity affiliated with The Goldman Sachs Group, Inc. and five entities affiliated with Silver Point Finance, LLC. Under the DIP Facility, the Company, PEAH and PEO are borrowers, and the

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Company and all of its wholly-owned subsidiaries are guarantors. The DIP Facility is secured by a superpriority lien on substantially all of the Company's assets and a pledge of all the issued and outstanding capital stock of each of the Company's wholly-owned subsidiaries, which lien is junior only to certain permitted prior liens.

The DIP Facility includes an initial \$3.0 million funded on March 11, 2009 and up to an additional \$41.0 million that may also be funded under a new revolving facility ("Revolving Facility"), plus refinancing through two new short-term loans of \$44.2 million ("PERL Term Facility") and \$98.4 million ("PEAO Term Facility") covering the remaining obligations that were outstanding under the SSC Credit Facility and the Alaska first lien credit facility, which credit facilities were terminated upon entry into the DIP Facility. The Alaska second lien credit facility remains outstanding. The maturity date of the DIP Facility is the earliest to occur of (i) September 10, 2009, (ii) the effective date of the borrowers' reorganization plan, (iii) the date on which the borrowers have consummated a sale or sales of substantially all of the borrowers' assets pursuant to bankruptcy court and lender approval, and (iv) the date of termination of the lenders' obligations to make loans or permit existing loans to remain outstanding pursuant to the event of default provisions of the DIP Facility.

Non-default interest on outstanding advances under the DIP Facility accrues at an annual rate equal to 10.5% plus the greater of 4.0% and the adjusted Eurodollar rate, computed on the basis of a 360-day year for the actual number of days elapsed. A portion of the interest on each loan accrues at an annual rate equal to 4.0% and is payable in cash on each monthly payment date. The remaining portion of interest on each loan is to be compounded into the outstanding principal amount of the loans on each monthly payment date. The interest rate is increased by an additional 2.0% upon the occurrence and during the continuance of an event of default as defined in the DIP Facility.

The DIP Facility requires a lockbox mechanism whereby all of the cash revenues and cash receipts of the Company and its wholly-owned subsidiaries are swept daily into two collateral accounts – one account for PEO and PEAH ("PEAO Collateral Account") controlled by Silver Point Finance, LLC as collateral agent and the other account for us and our wholly-owned subsidiaries other than PEO and PEAH ("PERL Collateral Account") controlled by an affiliate of The Goldman Sachs Group, Inc. as collateral agent. The borrowers request permission from the collateral agents to pay expenses in accordance with the budget established under the DIP Facility.

All good collected amounts in excess of \$0.25 million or such greater amount as may be determined from time to time by the holders of 66-2/3% of the loan exposure under the DIP Facility ("Required Lenders") (after accounting for outstanding checks) are applied by the collateral agents to prepay the principal outstanding on the loans under the DIP Facility on the first business day of each week as follows:

- each prepayment made by the collateral agent from the PEO Collateral Account is applied first to prepay the Revolving Facility; second to prepay the PEO Term Facility; third to prepay obligations under the Alaska second lien credit agreement; and fourth to prepay the PERL Term Facility; and
- each prepayment made by the collateral agent from the PERL Collateral Account is applied first to prepay the Revolving Facility; second to prepay the PERL Term Facility; third to prepay obligations under the Alaska second lien credit agreement; and fourth to prepay the PEO Term Facility.

In addition to the prepayments to be effectuated by the collateral agents, the borrowers are required to

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make prepayments with the proceeds of any non-ordinary course sales of collateral and the proceeds of casualty or property insurance. The borrowers may make voluntary prepayments without premium or penalty in increments of at least \$1.0 million in principal amount plus interest.

The DIP Facility contains customary events of default, representations, warranties and covenants for a loan of this type, as well as the following covenants:

- use of proceeds from the DIP Facility and use of other cash from other sources is limited to permitted purposes and amounts approved by the Required Lenders, as described in the budget required to be filed with the bankruptcy court;
- the Company was required to assume the pre-petition oil and gas production hedging contract with an affiliate of The Goldman Sachs Group, Inc. relating to the Company's Beta Unit operations and is prohibited from entering into other hedging contracts;
- the Company and its subsidiaries are prohibited, subject to certain limited exceptions, from forming or acquiring additional subsidiaries or business entities, merging or consolidating with or into other business entities, selling assets or properties outside the ordinary course of business, and issuing additional capital stock or securities convertible into or exercisable for capital stock (other than upon conversion or exercise of outstanding derivative securities);
- the Company and its subsidiaries are prohibited from incurring additional indebtedness or liens, except for certain limited permitted indebtedness and liens;
- the Company is required to engage various professionals, including a chief restructuring officer, investment banker and business broker, and provide numerous reports, financial statements and other information to the lenders, administrative agent and hedge provider;
- the borrowers are prohibited from allowing the aggregate volume of production to vary more than a certain percentage from the amount shown in our budget or as otherwise agreed to by the Required Lenders; and
- the borrowers are prohibited from paying any expenses or disbursements other than those set forth in the budget, plus a permitted percentage variance on budgeted expenses or disbursements.

In addition to interest on the outstanding advances under the DIP Facility, each lender will receive its proportionate share of:

- a commitment fee equal to 0.75% times the actual daily amount by which the aggregate commitments under the DIP Facility exceed the sum of the outstanding amount of all loans under the DIP Facility, which is due and payable monthly in arrears on the last business day of each month, commencing March 31, 2009, and on the maturity date; and
- a facility payment of \$1.0 million, which accrues interest at the effective interest rate under the DIP Facility from March 11, 2009 through the maturity date, and is due and payable to the administrative agent on the maturity date unless the borrowers elect to make the facility payment earlier.

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***Termination of Put Options***

On March 6, 2009, the Alaska put options described in Note 13 above were terminated by the hedge provider in accordance with the default provisions of the hedge agreement. Proceeds to the Company were \$13.7 million, which were applied to reduce the Alaska first lien loan amount accordingly.

***Seller Note***

Our bankruptcy filing on March 11, 2009 resulted in the automatic acceleration of the maturity date of the note (see Note 8). The accelerated amount is \$35.5 million. However, the automatic stay provisions of the bankruptcy code and the subordination provisions in the note prevent the holder of the note from taking action to collect on the note. The note continues to accrue interest at a rate of 13% per annum from the date of acceleration.

***Unsecured Shareholder Loan***

The Company received a \$1.0 million unsecured loan from Bateman and Co. (“Bateman”) on April 4, 2008 for use as working capital. On February 10, 2009, the Company and Bateman modified the agreement to (i) increase the interest rate to LIBOR plus 18.5% per annum beginning February 1, 2009, such interest to be capitalized to the principal outstanding at the end of each calendar month, (ii) modify the maturity date to the earlier of February 10, 2012 or 91 days after the payment of the SSC Credit Facility and the Alaska credit facilities and (iii) to allow for, at Bateman’s option, conversion of all or any portion of principal balance to common stock of the Company. The principal balance will convert at a rate of \$0.073 per dollar being converted into common stock.

***Anti-Dilution Protection on Lender Warrants***

The Company estimates that through March 11, 2009, the anti-dilution provisions required adjustments to increase the aggregate number of shares underlying the lender warrants by approximately 1.4 million shares and to decrease the exercise price of the lender warrants to approximately CAD\$1.344 per share. Through December 31, 2008, the adjustment amount was 0.3 million shares. However, these adjustments have not been made as these adjustments are subject to stock exchange approval that has not been applied for or obtained in light of the pending delisting of the Company’s common stock from the TSX stock exchange. Due to the insolvency proceedings that the Company entered into on March 9, 2009, it is unlikely that the above warrants will be issued.