MARINER ENERGY INC
Form 10-Q
August 06, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-32747

MARINER ENERGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	**86-0460233**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

One BriarLake Plaza, Suite 2000
2000 West Sam Houston Parkway South
Houston, Texas 77042
(Address of principal executive offices and zip code)
(713) 954-5500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of July 31, 2010, there were 103,137,493 shares issued and outstanding of the issuer s common stock, par value $0.0001 per share.

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PART I

Item 1. Unaudited Condensed Consolidated Financial Statements

MARINER ENERGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands, except share data)

	June 30, 2010	December 31, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,656	$ 8,919
Receivables, net of allowances of $1,024 and $3,408 as of June 30, 2010 and December 31, 2009, respectively	135,486	148,725
Insurance receivables	7,681	8,452
Derivative financial instruments	25,792	2,239
Intangible assets	12,676	22,615
Prepaid expenses and other	27,126	11,667
Deferred income tax		9,704
Total current assets	216,417	212,321
Property and Equipment:		
Proved oil and gas properties, full cost method	5,420,608	5,117,273
Unproved properties, not subject to amortization	439,604	292,237
Total oil and gas properties	5,860,212	5,409,510
Other property and equipment	56,202	55,695
Accumulated depreciation, depletion and amortization:		
Proved oil and gas properties	(3,059,123)	(2,884,411)
Other property and equipment	(10,039)	(8,235)
Total accumulated depreciation, depletion and amortization	(3,069,162)	(2,892,646)
Total property and equipment, net	2,847,252	2,572,559
Derivative Financial Instruments	19,154	902
Deferred Income Tax		12,491
Other Assets, net of amortization	83,772	68,932
TOTAL ASSETS	$ 3,166,595	$ 2,867,205
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 8,805	$ 3,579
Accrued liabilities	139,923	137,206
Accrued capital costs	139,404	140,941
Deferred income tax	6,447	
Abandonment liability	86,799	54,915
Accrued interest	8,171	8,262

Derivative financial instruments	7,606	27,708
Total current liabilities	397,155	372,611
Long-Term Liabilities:		
Abandonment liability	308,443	362,972
Deferred income tax	10,306	
Derivative financial instruments		15,017
Long-term debt	1,458,564	1,194,850
Other long-term liabilities	35,475	38,800
Total long-term liabilities	1,812,788	1,611,639
Commitments and Contingencies (see Note 9)		
Stockholders Equity:		
Preferred stock, $.0001 par value; 20,000,000 shares authorized, no shares issued and outstanding at June 30, 2010 and December 31, 2009		
Common stock, $.0001 par value; 180,000,000 shares authorized, 103,140,173 shares issued and outstanding at June 30, 2010; 180,000,000 shares authorized, 101,806,825 shares issued and outstanding at December 31, 2009	10	10
Additional paid-in capital	1,266,081	1,257,526
Accumulated other comprehensive income (loss)	22,220	(25,955)
Accumulated deficit	(331,659)	(348,626)
Total stockholders equity	956,652	882,955
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 3,166,595	$ 2,867,205

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

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MARINER ENERGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In thousands except share data)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Revenues:				
Natural gas	$ 92,414	$ 142,363	$ 209,926	$ 295,701
Oil	96,496	78,954	192,135	139,879
Natural gas liquids	20,166	8,193	47,826	14,662
Other revenues	1,696	2,460	3,998	25,064
Total revenues	210,772	231,970	453,885	475,306
Costs and Expenses:				
Lease operating expense	59,710	47,092	112,653	100,491
Severance and ad valorem taxes	6,101	3,730	13,020	7,262
Transportation expense	4,401	4,575	10,090	9,159
General and administrative expense	23,859	21,122	51,439	38,533
Depreciation, depletion and amortization	94,127	100,282	194,630	195,087
Full cost ceiling test impairment				704,731
Other miscellaneous expense	807	2,758	3,496	10,767
Total costs and expenses	189,005	179,559	385,328	1,066,030
OPERATING INCOME (LOSS)	21,767	52,411	68,557	(590,724)
Other Income (Expense):				
Interest income	634	302	769	387
Interest expense, net of amounts capitalized	(19,885)	(16,972)	(40,348)	(31,374)
Income (Loss) Before Taxes	2,516	35,741	28,978	(621,711)
(Provision) Benefit for Income Taxes	(812)	(18,528)	(12,011)	214,806
NET INCOME (LOSS)	$ 1,704	$ 17,213	$ 16,967	$ (406,905)
Net Income (Loss) per share:				
Basic	$ 0.02	$ 0.19	$ 0.17	$ (4.50)
Diluted	$ 0.02	$ 0.19	$ 0.17	$ (4.50)
Weighted average shares outstanding:				
Basic	101,371,705	91,798,761	101,182,367	90,339,810
Diluted	102,631,715	92,152,933	102,362,050	90,339,810

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

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MARINER ENERGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)
(In thousands)
For the six months ended June 30, 2010 and 2009

	Common Stock	Stock Amount	Additional Paid-In-Capital	Accumulated Other Comprehensive Income/ (Loss)	Accumulated Deficit	Total Stockholders Equity
Balance at December 31, 2009	101,807	$ 10	$ 1,257,526	$ (25,955)	$ (348,626)	$ 882,955
Common shares issued restricted stock	1,616					
Treasury stock bought and cancelled on same day	(292)		(5,656)			(5,656)
Forfeiture of restricted stock	(12)					
Share-based compensation			13,971			13,971
Stock options exercised	21		240			240
Comprehensive income:						
Net income					16,967	16,967
Change in fair value of derivative hedging instruments net of income taxes of $31,823				57,013		57,013
Hedge settlements reclassified to income net of income taxes of $(4,858)				(8,675)		(8,675)
Foreign currency translation adjustment				(163)		(163)
Total comprehensive income				48,175	16,967	65,142
Balance at June 30, 2010	103,140	$ 10	$ 1,266,081	$ 22,220	$ (331,659)	$ 956,652

	Common Stock	Stock Amount	Additional Paid-In-Capital	Accumulated Other Comprehensive Income/ (Loss)	Accumulated Deficit	Total Stockholders Equity

Balance at December 31, 2008	88,846	$	9	$ 1,071,347	$	78,181	$	(29,217)	$	1,120,320
Common shares issued equity offering	11,500		1	159,673						159,674
Common shares issued restricted stock	1,689									
Treasury stock bought and cancelled on same day	(167)			(1,891)						(1,891)
Forfeiture of restricted stock	(20)									
Share-based compensation				14,143						14,143
Stock options exercised				5						5
Comprehensive loss:										
Net loss								(406,905)		(406,905)
Change in fair value of derivative hedging instruments net of income taxes of $26,725						46,876				46,876
Hedge settlements reclassified to income net of income taxes of $(48,138)						(86,063)				(86,063)
Total comprehensive loss						(39,187)		(406,905)		(446,092)
Balance at June 30, 2009	101,848	$	10	$ 1,243,277	$	38,994	$	(436,122)	$	846,159

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

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MARINER ENERGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In thousands)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating Activities:		
Net income (loss)	$ 16,967	$ (406,905)
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income tax	12,011	(214,806)
Depreciation, depletion and amortization	194,630	195,087
Ineffectiveness of derivative instruments	(1,620)	3
Full cost ceiling test impairment		704,731
Share-based compensation	11,840	12,208
Derivative financial instruments		(10,269)
Other	2,312	483
Changes in operating assets and liabilities:		
Receivables	13,378	66,302
Insurance receivables	771	4,347
Cash from liquidation of hedges		20,519
Prepaid expenses and other	(34,199)	(9,053)
Intangible assets	939	1,001
Accounts payable and accrued liabilities	(18,796)	(25,917)
Net cash provided by operating activities	198,233	337,731
Investing Activities:		
Acquisitions and additions to oil and gas properties	(455,049)	(318,625)
Additions to other property and equipment	(507)	(616)
Net cash used in investing activities	(455,556)	(319,241)
Financing Activities:		
Credit facility borrowings	456,000	261,221
Credit facility repayments	(193,000)	(691,221)
Repurchase of stock	(5,656)	(1,891)
Debt redetermination costs	(1,524)	(2,300)
Debt offering costs		(5,282)
Proceeds from equity offering		160,138
Proceeds from debt issuance		291,279
Proceeds from exercise of stock options	240	5
Net cash provided by financing activities	256,060	11,949
(Decrease) Increase in Cash and Cash Equivalents	(1,263)	30,439
Cash and Cash Equivalents at Beginning of Period	8,919	3,209
Cash and Cash Equivalents at End of Period	$ 7,656	$ 33,648

Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest (net of amount capitalized)	$ 35,737	$ 28,765

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

MARINER ENERGY, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Summary of Significant Accounting Policies

Operations Mariner Energy, Inc. (Mariner or the Company) is an independent oil and gas exploration, development and production company with principal operations in the Permian Basin, Gulf Coast and in the Gulf of Mexico, both shelf and deepwater. Unless otherwise indicated, references to Mariner , the Company , we , our , ours us refer to Mariner Energy, Inc. and its subsidiaries collectively.

Interim Financial Statements The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in conformity with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of a normal and recurring nature) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the entire year. These unaudited condensed consolidated financial statements included herein should be read in conjunction with the Financial Statements and Notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

Use of Estimates The preparation of the condensed consolidated financial statements in conformity with 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 financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Company s most significant financial estimates are based on remaining proved natural gas and oil reserves. Estimates of proved reserves are key components of Mariner s depletion rate for natural gas and oil properties, its unevaluated properties and its full cost ceiling test. In addition, estimates are used in computing taxes, preparing accruals of operating costs and production revenues, asset retirement obligations, fair value and effectiveness of derivative instruments and fair value of stock options and the related compensation expense. Because of the inherent nature of the estimation process, actual results could differ materially from these estimates.

Principles of Consolidation Mariner s condensed consolidated financial statements as of and for the period ended June 30, 2010 and consolidated financial statements as of and for the period ended December 31, 2009 include its accounts and the accounts of its subsidiaries. All inter-company balances and transactions have been eliminated.

Income Taxes The Company s provision for taxes includes both federal and state taxes. The Company records its federal income taxes using an asset and liability approach which results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the book carrying amounts and the tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be recovered.

The Company had no uncertain tax positions during the six months ended June 30, 2010 or for the year ended December 31, 2009.

Recent Accounting Pronouncements In July 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance which requires an entity to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, an entity is required to disclose credit quality indicators, past due information, and modifications of its financing receivables. These disclosures are intended to help financial statement users assess an entity s credit risk exposures and evaluate the adequacy of its allowance for credit losses. The guidance is effective for interim and annual reporting periods ending on or after December 15, 2010. The Company is currently evaluating the potential impact of adopting the guidance.

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Mariner will begin complying with the disclosure requirements in its annual report on Form 10-K for the year ended December 31, 2010.

In April 2010, the FASB issued authoritative guidance which provides clarification that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trade should not be considered to contain a condition that is not a market, performance or service condition. Therefore, the award would be classified as an equity award if it otherwise qualifies as equity. The guidance is effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company is currently evaluating the potential impact of adopting the guidance.

In February 2010, the FASB issued authoritative guidance which requires additional information to be disclosed principally in respect of Level 3 fair value measurements and transfers to and from Level 1 and Level 2 measurements. In addition, enhanced disclosure is required concerning inputs and valuation techniques used to determine Level 2 and Level 3 fair value measurements. The guidance is generally effective for interim and annual reporting periods beginning after December 15, 2009; however, the requirements to disclose separately purchases, sales, issuances, and settlements in the Level 3 reconciliation are effective for fiscal years beginning after December 15, 2010 (and for interim periods within such years). The Company adopted the standard effective January 1, 2010. The adoption did not have a material impact on the Company s consolidated financial position, cash flows or results of operations.

2. Acquisitions and Dispositions

Onshore Acquisition On December 31, 2009, Mariner acquired the reorganized subsidiaries and operations of Edge Petroleum Corporation (Edge). The assets acquired consist primarily of (i) estimated proved reserves, (ii) undeveloped oil and gas property, primarily in Texas and New Mexico, (iii) exploration assets in the form of seismic data, and (iv) certain tax attributes of the acquired subsidiaries. The effective date of the acquisition was June 30, 2009 and the purchase price was $260.0 million, less adjustments which resulted in a net purchase price as of December 31, 2009 of approximately $213.6 million, subject to final adjustments. Mariner financed the net purchase price by borrowing under its secured revolving credit facility.

Pro Forma Financial Information: The unaudited pro forma information set forth below gives effect to the acquisition of the reorganized Edge subsidiaries as if it had been consummated as of the beginning of the applicable period. The unaudited pro forma information has been derived from the historical Consolidated Financial Statements of the Company and of Edge. The unaudited pro forma information is for illustrative purposes only. The financial results may have been different had each of the acquired Edge subsidiaries been an independent company and had the companies always been combined. No reliance should be placed on the pro forma financial information as being indicative of the historical results that would have been achieved had the acquisition occurred in the past or the future financial results that the Company will achieve after the acquisition.

	For the Three Months	For the Six Months
	Ended June 30, 2009 (In thousands, except per share amounts)	
Pro Forma:		
Revenue	$244,123	$ 511,944
Net income (loss) available to common stockholders	$ 8,238	$ (491,113)
Basic income (loss) per share	$ 0.09	$ (5.44)
Diluted income (loss) per share	$ 0.09	$ (5.44)

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3. Long-Term Debt

As of June 30, 2010 and December 31, 2009, the Company s long-term debt was as follows:

	June 30, 2010	December 31, 2009
	(In thousands)	
Bank credit facility	$ 568,000	$ 305,000
7 1/2% Senior Notes, due April 15, 2013, net of discount	298,410	298,125
8% Senior Notes, due May 15, 2017	300,000	300,000
11 3/4% Senior Notes, due June 30, 2016, net of discount	292,154	291,725
Total long-term debt	$ 1,458,564	$ 1,194,850

Bank Credit Facility The Company has a secured revolving credit facility with a group of banks pursuant to an amended and restated credit agreement dated March 2, 2006, as further amended. The credit facility matures January 31, 2012 and is subject to a borrowing base which is redetermined periodically. The outstanding principal balance of loans under the credit facility may not exceed the borrowing base. The most recent borrowing base redetermination concluded in April 2010 when the credit facility was amended to:

Increase the borrowing base by $150.0 million to $950.0 million until the next redetermination under the credit agreement,

Reschedule the regular periodic borrowing base redeterminations to begin in February and August of each year,

Give the lenders an option to redetermine the borrowing base upon termination of hedge contracts with more than six months remaining in their original nominal term,

Increase the maximum permitted ratio of total debt to EBITDA (as defined in the credit agreement) to 3.5 to 1.0 from 2.5 to 1.0, and

Give Mariner optionality to issue before January 1, 2011 up to $400.0 million in additional unsecured debt with a non-default interest rate of up to 13% per annum (plus a maximum default rate of 3%) and a scheduled maturity date no earlier than March 2, 2015. Upon closing such a debt issuance, the borrowing base automatically would reduce by 25% of the aggregate principal amount of the debt issued until otherwise redetermined under the credit agreement.

As of June 30, 2010, maximum credit availability under the facility was $1.0 billion, including up to $50.0 million in letters of credit, subject to a borrowing base of $950.0 million. As of June 30, 2010, there were $568.0 million in advances outstanding under the credit facility and four letters of credit outstanding totaling $4.7 million, of which $4.2 million is required for plugging and abandonment obligations at certain of the Company s offshore fields. As of June 30, 2010, after accounting for the $4.7 million of letters of credit, the Company had $377.3 million available to borrow under the credit facility.

Borrowings under the bank credit facility bear interest at either a LIBOR-based rate or a prime-based rate, at the Company s option, plus a specified margin. At June 30, 2010, when borrowings at both LIBOR and prime-based rates were outstanding, the blended interest rate was 2.92% on all amounts borrowed. During the six months ended June 30, 2010, the commitment fee on unused capacity was 0.5% per annum. Commitment fees are included in Accrued interest in the Condensed Consolidated Balance Sheets in Item 1 of Part I of this Quarterly Report.

The credit facility subjects the Company to various restrictive covenants and contains other usual and customary terms and conditions, including limits on additional debt, cash dividends and other restricted payments, liens, investments, asset dispositions, mergers and speculative hedging. Financial covenants under the credit facility require the Company to, among other things:

maintain a ratio of consolidated current assets plus the unused borrowing base to consolidated current liabilities of not less than 1.0 to 1.0; and maintain a ratio of total debt to EBITDA (as defined in the credit agreement) of not more than 3.5 to 1.0.

The Company was in compliance with these covenants as of June 30, 2010 when the ratio of consolidated current assets plus the unused borrowing base to consolidated current liabilities was 1.92 to 1.0 and the ratio of total debt to EBITDA was 2.6 to 1.0.

The Company s payment and performance of its obligations under the credit facility (including any obligations under commodity and interest rate hedges entered into with facility lenders) are secured by liens upon substantially all of the assets of the Company and its subsidiaries, except its Canadian subsidiary, and guaranteed by its subsidiaries, other than Mariner Energy Resources, Inc. which is a co-borrower, and its Canadian subsidiary.

Senior Notes In 2009, the Company sold and issued $300.0 million aggregate principal amount of its $11^3/_4$% senior notes due 2016 (the $11^3/_4$% Notes). In 2007, the Company sold and issued $300.0 million aggregate principal amount of its 8% senior notes due 2017 (the 8% Notes). In 2006, the Company sold and issued $300.0 million aggregate principal amount of its $7^1/_2$% senior notes due 2013 (the $7^1/_2$% Notes and together with the $11^3/_4$% Notes and the 8% Notes, the Notes). The Notes are governed by indentures that are substantially identical for each series. The Notes are senior unsecured obligations of the Company. The $11^3/_4$% Notes mature on June 30, 2016 with interest payable on June 30 and December 30 of each year beginning December 30, 2009. The 8% Notes mature on May 15, 2017 with interest payable on May 15 and November 15 of each year. The $7^1/_2$% Notes mature on April 15, 2013 with interest payable on April 15 and October 15 of each year. There is no sinking fund for the Notes. The Company and its restricted subsidiaries are subject to certain financial and non-financial covenants under each of the indentures governing the Notes. The Company was in compliance with the financial covenants under the Notes as of June 30, 2010.

Capitalized Interest For the three-month periods ended June 30, 2010 and 2009, capitalized interest totaled $6.2 million and $3.0 million, respectively. For the six-month periods ended June 30, 2010 and 2009, capitalized interest totaled $11.5 million and $5.2 million, respectively.

4. Stockholders Equity

Common Stock Offering On June 10, 2009, the Company sold and issued 11.5 million shares of its common stock, par value $.0001 per share, at a public offering price of $14.50 per share in an underwritten offering registered under the 1933 Act. The total sold included 1.5 million shares issued upon full exercise of the underwriters overallotment option. Net offering proceeds, after deducting underwriters discounts and estimated offering expenses but before giving effect to the underwriters reimbursement of up to $0.5 million for offering expenses, were approximately $159.2 million. The Company used net offering proceeds to repay debt under its bank credit facility.

5. Oil and Gas Properties

The Company s oil and gas properties are accounted for using the full cost method of accounting. All direct costs and certain indirect costs associated with the acquisition, exploration and development of oil and gas properties are capitalized, including eligible general and administrative costs (G&A). G&A costs associated with production, operations, marketing and general corporate activities are expensed as incurred. These capitalized costs, coupled with the Company s estimated asset retirement obligations recorded in accordance with accounting for asset retirement and environmental obligations under GAAP, are included in the amortization base and amortized to expense using the unit-of-production method. Amortization is calculated based on estimated proved oil and gas reserves. Proceeds from the sale or disposition of oil and gas properties are applied to reduce net capitalized costs unless the sale or disposition causes a significant change in the relationship between costs and the estimated value of proved reserves. For the three-month periods ended June 30, 2010 and 2009, capitalized G&A totaled $7.2 million and $5.3 million, respectively. For the six-month periods ended June 30, 2010 and 2009, capitalized G&A totaled $13.8 million and $10.3 million, respectively.

Capitalized costs (net of accumulated depreciation, depletion and amortization and deferred income taxes) of proved oil and gas properties are subject to a full cost ceiling limitation. The ceiling limits these costs to an amount equal to the present value, discounted at 10%, of estimated future net cash flows from estimated proved reserves less estimated future operating and development costs, abandonment costs (net of salvage value) and estimated related future income taxes. In accordance with SEC rules, the natural gas and oil prices used to calculate the full cost ceiling limitation for periods ending on or after December 31, 2009 are the 12-month average prices, calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12-month period prior to the end of the reporting period, unless prices are defined by contractual arrangements. Prices are adjusted for basis or location differentials. Price is held constant over the life of the reserves. The Company uses derivative financial instruments that qualify for cash flow hedge accounting under GAAP to hedge against the volatility of oil and natural gas prices. In accordance with SEC guidelines, Mariner includes estimated future cash flows from its hedging program in the ceiling test calculation. If net capitalized costs related to proved properties exceed the ceiling limit, the excess is impaired and recorded in the Condensed Consolidated Statement of Operations.

At June 30, 2010 and June 30, 2009 the ceiling limit exceeded the net capitalized costs of the Company s proved oil and gas properties and no impairment was recorded. The ceiling limit of its proved reserves at June 30, 2010 was calculated based upon 12-month average prices of $4.10 per Mcf for gas and $75.76 per barrel for oil, calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12-month period prior to the end of the reporting period, unless prices are defined by contractual arrangements. Prices are adjusted for basis or location differentials. The ceiling limit of its proved reserves at June 30, 2009 was calculated based upon quoted market prices of $3.89 per Mcf for gas and $70.00 per barrel for oil. The Company may be required to recognize non-cash impairment charges in future reporting periods if average 12-month market prices for oil and natural gas were to decline. At June 30, 2010, the Company had 78,168,919 MMbtus of natural gas and 4,476,544 Bbls of oil of future production hedged.

6. Accrual for Future Abandonment Liabilities

In accordance with accounting for asset retirement and environmental obligations under GAAP, the Company records the fair value of a liability for the legal obligation to retire an asset in the period in which it is incurred with the corresponding cost capitalized by increasing the carrying amount of the related long-lived asset. Upon adoption, the Company recorded an asset retirement obligation to reflect the Company s legal obligations related to future plugging and abandonment of its oil and natural gas wells. The liability is accreted to its then present value each period, and the capitalized cost is depreciated over the useful life of the related asset. If the liability is settled for an amount other than the recorded amount, the difference is recognized in proved oil and gas properties.

To estimate the fair value of an asset retirement obligation, the Company employs a present value technique, which reflects certain assumptions, including its credit-adjusted risk-free interest rate, the estimated settlement date of the liability and the estimated current cost to settle the liability. Changes in timing or to the original estimate of cash flows will result in changes to the carrying amount of the liability.

The following roll forward is provided as a reconciliation of the beginning and ending aggregate carrying amounts of the asset retirement obligation:

		(In thousands)
Abandonment liability as of January 1, 2010 (1)	$	417,887
Liabilities incurred		1,092
Liabilities settled		(26,111)
Accretion expense		18,113
Revisions to previous estimates		(15,739)
Abandonment liability as of June 30, 2010 (2)	$	395,242

(1) Includes $54.9 million classified as a

current liability at January 1, 2010.

(2) Includes $86.8 million classified as a current liability at June 30, 2010.

7. Share-Based Compensation

Applicable Plans In May 2009, the Company s stockholders approved the Mariner Energy, Inc. Third Amended and Restated Stock Incentive Plan (the Stock Incentive Plan) in which the Company s directors, employees and consultants are eligible to participate. Awards of up to an aggregate 12,500,000 shares of the Company s common stock may be made under the Stock Incentive Plan in the form of incentive stock options, non-

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qualified stock options or restricted stock. Restricted common stock and non-qualified stock options are outstanding under the Stock Incentive Plan. Options to purchase the Company s common stock granted to certain employees in connection with a March 2006 merger transaction also are outstanding but are not governed by the Stock Incentive Plan (Rollover Options).

Plan Activity The Company recorded total compensation expense related to restricted stock and stock options of $7.1 million and $7.3 million for the three-month periods ended June 30, 2010 and 2009, respectively and $14.0 million and $14.1 million for the six-month periods ended June 30, 2010 and 2009, respectively. Unrecognized compensation expense at June 30, 2010 for the unvested portion of restricted stock granted under the Stock Incentive Plan was $53.4 million and for unvested options was $0.

Share-based compensation, including restricted stock and options under each of the Company s plans, for the periods reflected was as follows:

	Three Months		Six Months	
	Ended June 30,			
	2010	2009	2010	2009
	(In thousands)			
Share-based compensation included in:				
General and administrative expense	$ 5,949	$ 6,284	$ 11,840	$ 12,208
Oil and natural gas properties under full cost method	1,131	1,081	2,131	1,935
Total share-based compensation	$ 7,080	$ 7,365	$ 13,971	$ 14,143

Share-based compensation charged to earnings for the periods reflected was as follows:

	Three Months		Six Months	
	Ended June 30,			
	2010	2009	2010	2009
	(In thousands)			
Charged to earnings	$ 5,949	$ 6,284	$ 11,840	$ 12,208
Tax benefit	(2,308)	(2,269)	(4,594)	(4,358)
	$ 3,641	$ 4,015	$ 7,246	$ 7,850

The following table presents a summary of stock option activity under the Stock Incentive Plan and under Rollover Options for the six months ended June 30, 2010:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1) (In thousands)
Outstanding at January 1, 2010	644,160	$ 13.88	$ 4,896
Granted			
Exercised	(20,860)	11.52	(208)
Forfeited	(1,600)	14.00	(12)
Outstanding and exercisable at June 30, 2010	621,700	13.96	$ 4,676

(1) Based upon the difference between the closing price per share of Mariner s common stock on June 30, 2010 of $21.48 and the option exercise price of in-the-money options.

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A summary of the activity for unvested restricted stock awards under the Stock Incentive Plan as of June 30, 2010 and 2009, respectively, and changes during the six-month periods then ended is as follows:

	Restricted Shares under Stock Incentive Plan June 30,	
	2010	**2009**
Total unvested shares at beginning of period: January 1	3,660,265	2,697,926
Shares granted (1)	1,616,254	1,689,342
Shares vested	(931,612)	(562,798)
Shares forfeited (2)	(11,776)	(20,426)
Total unvested shares at end of period: June 30	4,333,131	3,804,044
Available for future grant as options or restricted stock	5,759,936	7,028,732

(1) Includes 121,022 shares granted during the three months ended June 30, 2010 and 4,741 shares granted during the six months ended June 30, 2009 under the Stock Incentive Plan s 2008 Long-Term Performance-Based Restricted Stock Program discussed below.

(2) Includes 4,741 shares forfeited in each of the six months ended June 30, 2010 and 2009 under the Stock Incentive Plan s 2008 Long-Term Performance-Based Restricted Stock Program.

The following table summarizes the status under the provisions for accounting for stock compensation under GAAP of the Company s restricted stock, including long-term performance based restricted stock, at June 30, 2010 and the changes during the six months then ended:

	Equity Instruments (thousands)	Weighted Average Fair Value	Aggregate Intrinsic Value ($ thousands)	Weighted Average Remaining Contractual Life (Years)
Unvested at January 1, 2010	3,660,265	$ 21.51	$ 78,734	
Granted	1,616,254	15.22	24,598	
Vested	(931,612)	17.60	(16,401)	
Forfeited	(11,776)	15.34	(181)	
Unvested at June 30, 2010	4,333,131	20.02	$ 86,750	6.09

Long-Term Performance-Based Restricted Stock Program In June 2008, Mariner s board of directors adopted a Long-Term Performance-Based Restricted Stock Program (the Program) under the Stock Incentive Plan. Shares of restricted common stock subject to the Program were granted in 2008, 2009 and 2010. Vesting of these shares is contingent, begins upon satisfaction of specified thresholds of $38.00 and $46.00 for the market price per share of Mariner s common stock, and continues in installments over five to seven years thereafter, assuming, in most instances, continued employment by Mariner. The fair value of restricted stock grants made under the Program is estimated using a Monte Carlo simulation. For the three months and six months ended June 30, 2010, stock-based compensation expense related to these restricted stock grants totaled $2.1 million and $4.4 million, respectively.

Weighted average fair values and valuation assumptions used to value Program grants for the quarter ended June 30, 2010 are as follows:

	Quarter Ended June 30, 2010
Weighted average fair value of grants	$ 16.02
Expected volatility	60.24%
Risk-free interest rate	4.20%
Dividend yield	0.00%
Expected life	10 years

Expected volatility is calculated based on the average historical stock price volatility of Mariner and a peer group as of June 30, 2010. The peer group consisted of the following seven independent oil and gas exploration and production companies: ATP Oil & Gas Corporation, Callon Petroleum Co., Energy Partners, Ltd., McMoRan Exploration Co., Plains Exploration & Production Company, Stone Energy Corporation and W&T Offshore, Inc.

The risk-free interest rate is determined at the grant date and is based on 10-year, zero-coupon government bonds with maturity equal to the contractual term of the awards, converted to a continuously compounded rate. The expected life is based upon the contractual terms of the restricted stock grants under the Program.

8. Derivative Financial Instruments and Hedging Activities

The energy markets historically have been very volatile, and Mariner expects oil and gas prices will be subject to wide fluctuations in the future. In an effort to reduce the effects of the volatility of the price of oil and natural gas on the Company s operations, management has elected to hedge oil and natural gas prices from time to time through the use of commodity price swap agreements and costless collars. While the use of these hedging arrangements limits the downside risk of adverse price movements, it also limits future gains from favorable movements. In addition, forward price curves and estimates of future volatility are used to assess and measure the ineffectiveness of the Company s open contracts at the end of each period.

For derivative contracts that are designated and qualify as cash flow hedges pursuant to accounting for derivatives and hedging under GAAP, the portion of the gain or loss on the derivative instrument that is effective in offsetting the variable cash flows associated with the hedged forecasted transaction is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings (e.g., in revenues when the hedged transactions are commodity sales). The remaining gain or loss on the derivative contract in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffective portion) is recognized in earnings during the current period. The Company currently does not exclude any component of the derivative contracts gain or loss from the assessment of hedge effectiveness.

On January 29, 2009, the Company liquidated crude oil fixed price swaps that previously had been designated as cash flow hedges for accounting purposes in respect of 977,000 barrels of crude oil in exchange for a cash payment to Mariner of $10.0 million and installment payments of $13.5 million to be paid monthly to Mariner through 2009. On April 16, 2009, the Company received a $10.5 million cash settlement on the hedges that were settled in monthly installments at January 29, 2009. Since, at the time of liquidation, the forecasted sales of crude oil volumes were still expected to occur, the accumulated losses through January 29, 2009 on the related derivative contracts remained in accumulated other comprehensive income. These accumulated losses were reclassified to oil revenues throughout 2009 as the physical transactions occurred. Additionally, all changes in the value of these derivative contracts subsequent to January 29, 2009 were also reclassified monthly from accumulated other comprehensive income to current period oil revenues. The table below reflects these reclassifications for the three months and six months ended June 30, 2009.

Derivative gains and losses are recorded by commodity type in oil and gas revenues in the Condensed Consolidated Statements of Operations. The effects on the Company s oil and gas revenues from its hedging activities were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(In thousands)			
Cash Gain on Settlements (1)	$ 13,798	$ 63,547	$ 11,913	$ 121,004
Reclassification of Liquidated Swaps (2)		6,677		13,200
(Loss) Gain on Hedge Ineffectiveness (3)	(838)	176	1,620	(3)
Total	$ 12,960	$ 70,400	$ 13,533	$ 134,201

(1) Designated as cash flow hedges pursuant

to accounting for derivatives and hedging under GAAP.

(2) Net gain realized in 2009 on liquidated crude oil fixed price swaps that do not qualify for hedge accounting.

(3) Unrealized (loss) gain recognized in natural gas revenue related to the ineffective portion of open contracts designated as cash flow hedges that are not eligible for deferral under GAAP due primarily to the basis differentials between the contract price and the indexed price at the point of sale.

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As of June 30, 2010, the Company had the following hedge contracts outstanding:

Fixed Price Swaps	Quantity	Weighted Average Fixed Price		Fair Value Asset/(Liability) (In thousands)	
Natural Gas (MMbtus)					
July 1 December 31, 2010	20,600,274	$	5.56	$	15,297
January 1 December 31, 2011	29,389,843	$	5.79		13,430
January 1 December 31, 2012	22,338,802	$	6.11		9,267
January 1 December 31, 2013	5,840,000	$	6.76		4,795
Crude Oil (Bbls)					
July 1 December 31, 2010	1,595,280	$	73.64		(5,179)
January 1 December 31, 2011	1,978,364	$	79.33		(275)
January 1 December 31, 2012	494,100	$	80.76		(199)
January 1 December 31, 2013	408,800	$	82.81		204
Total				$	37,340

The Company has reviewed the financial strength of its counterparties and believes the credit risk associated with these swaps to be minimal. Hedges with counterparties that are lenders under the Company s bank credit facility are secured under the bank credit facility.

For derivative instruments that are not designated as a hedge for accounting purposes, all realized and unrealized gains and losses are recognized in the consolidated statement of operations during the current period. This will result in non-cash gains or losses being reported in Mariner s operating results.

As of June 30, 2010, the Company expects to realize within the next 12 months a net gain of approximately $18.2 million resulting from hedging activities that are currently recorded in accumulated other comprehensive income. The net hedging gain is expected to be realized as a decrease of $8.0 million to oil revenues and an increase of $26.2 million to natural gas revenues.

Additional Disclosures about Derivative Instruments and Hedging Activities

At June 30, 2010 and December 31, 2009, the Company had derivative financial instruments under GAAP recorded in its consolidated balance sheets as set forth below (in thousands). The fair values are recorded by netting asset and liability positions where counterparty master netting arrangements contain provisions for net settlement. See Note 12, Fair Value Measurement for information regarding the methods and assumptions used to estimate the fair values of the Company s derivative financial instruments.

Fair Value of Derivative Contracts
Asset Derivatives

	June 30, 2010 Balance sheet Location		Fair value	December 31, 2009 Balance sheet Location		Fair value
Derivatives designated as cash flow hedging contracts						
Fixed Price Swaps	Current Assets: Derivative financial instruments	$	25,792	Current Assets: Derivative financial instruments	$	2,239
	Long-Term Assets: Derivative Financial Instruments		19,154	Long-Term Assets: Derivative Financial Instruments		902
	Total:	$	44,946	Total:	$	3,141

	Fair Value of Derivative Contracts Liability Derivatives			
	June 30, 2010		December 31, 2009	
	Balance sheet Location	Fair value	Balance sheet Location	Fair value
Derivatives designated as cash flow hedging contracts				
Fixed Price Swaps	Current Liabilities: Derivative financial instruments	$ 7,606	Current Liabilities: Derivative financial instruments	$ 27,708
	Long-Term Liabilities: Derivative financial instruments		Long-Term Liabilities: Derivative financial instruments	15,017
	Total:	$ 7,606	Total:	$ 42,725

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For the three months ended June 30, 2010 and 2009, the effect on income (loss) of derivative financial instruments under GAAP was as follows (in thousands):

Derivatives designated as cash flow hedging contracts under GAAP	Amount of gain/(loss) recognized in OCI on derivative (effective portion) Second Quarter 2010	2009	Location of gain/(loss) reclassified from Accumulated OCI into income (effective portion)	Amount of gain/(loss) reclassified from Accumulated OCI into income (effective portion) Second Quarter 2010	2009	Location of gain/(loss) recognized in income on derivative (ineffective portion)	Amount of gain/(loss) recognized in income on derivative (ineffective portion) Second Quarter 2010	2009
Fixed Price Swaps	$ 28,799	$ (23,589)	Revenues-Natural Gas	$ 16,848	$ 58,668	Revenues-Natural Gas	$ (838)	$ 176
			Revenues-Crude Oil	(3,050)	4,879			
			Total	$ 13,798	$ 63,547			

Derivatives not designated as cash flow hedging contracts under GAAP	Location of gain recognized in income on derivative	Amount of gain recognized in income on derivative Second Quarter 2010	Second Quarter 2009
Fixed Price Swaps	Revenues-Crude Oil	$	$ 6,677

For the six months ended June 30, 2010 and 2009, the effect on income (loss) of derivative financial instruments under GAAP was as follows (in thousands):

Derivatives designated as cash flow hedging contracts under GAAP	Amount of gain/(loss) recognized in OCI on derivative (effective portion) Six Months Ended June 30, 2010	2009	Location of gain/(loss) reclassified from Accumulated OCI into income (effective portion)	Amount of gain/(loss) reclassified from Accumulated OCI into income (effective portion) Six Months Ended June 30, 2010	2009	Location of gain/(loss) recognized in income on derivative (ineffective portion)	Amount of gain/(loss) recognized in income on derivative (ineffective portion) Six Months Ended June 30, 2010	2009
Fixed Price Swaps	$ 88,837	$ 63,351		$ 20,357	$ 101,813	Revenues-Natural Gas	$ 1,620	$ (3)

Revenues-Natural Gas		
Revenues-Crude Oil	(8,444)	19,191
Total	$ 11,913	$ 121,004

Derivatives not designated as cash flow hedging contracts under GAAP	Location of gain recognized in income on derivative	Amount of gain recognized in income on derivative Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Fixed Price Swaps	Revenues-Crude Oil	$	$ 13,200

See Note 11, Comprehensive Income (Loss) for more information related to the Company s derivative financial instruments.

9. Commitments and Contingencies

Minimum Future Lease Payments The Company leases certain office facilities and other equipment under long-term operating lease arrangements. Minimum future lease obligations under the Company s operating leases in effect at June 30, 2010 are as follows:

	(In thousands)
2011	$ 1,898
2012	3,695
2013	3,435
2014	3,308
2015 and thereafter	13,065

Other Commitments In the ordinary course of business, the Company enters into long-term commitments to purchase seismic data and other geological information such as maps, logs and studies. The minimum annual payments under these contracts are $4.8 million in 2011.

Insurance Matters

Current Insurance Against Hurricanes

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Mariner is a member of OIL Insurance Limited (OIL), an energy industry insurance cooperative, which provides Mariner windstorm insurance coverage. During 2009, the coverage was subject to a $10.0 million per-occurrence deductible, a $250.0 million per-occurrence loss limit, and a $750.0 million industry aggregate per-event loss limit. Effective January 1, 2010, the coverage is subject to a $10.0 million per-occurrence deductible; a $150.0 million per-occurrence loss limit per member that Mariner elected to supplement with $25.0 million in additional coverage which if used, would be repayable, interest free, over five years; an annual maximum of $300.0 million per member; and a $750.0 million industry aggregate per-event loss limit. Annual industry windstorm losses of $300.0 million or less will be mutualized among all members. Annual industry windstorm losses exceeding $300.0 million will be mutualized among windstorm members in two pools, one for offshore and one for onshore, with future premiums based upon a pool s loss experience and a member s weighted percent of the pool s asset base. Mariner anticipates these changes to increase its loss retention by approximately $100.0 million for windstorm losses, which it expects to either self insure, insure through the commercial market, insure through the purchase of additional OIL coverage or a combination of these.

Mariner annually considers whether the commercial market offers supplemental or excess insurance that would, based on Mariner s historical experience, supplement its OIL coverage on a cost-effective basis. In 2010, Mariner elected to purchase insurance from the commercial market to supplement the reduced windstorm coverage offered by OIL. The supplemental insurance will provide up to an additional $78.3 million of aggregate annual coverage in respect