

TARGA RESOURCES, INC.
AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2009

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CONFIDENTIAL

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As generally used in the energy industry and in these Audited Financial Statements, the identified terms have the following meanings:

| | |
|--------|-------------------------------|
| NGL(s) | Natural Gas Liquid(s) |
| MMBtu | Million British thermal units |
| Bbl | barrels |

Price Index Definitions

| | |
|---------|---|
| IF-WAHA | Inside FERC Gas Market Report, West Texas Waha |
| NY-HH | New York Mercantile Exchange (NYMEX), Henry Hub |
| NY-WTI | NYMEX, West Texas Intermediate Crude Oil |

Report of Independent Registered Public Accounting Firm

To the Stockholder and Board of Directors of Targa Resources, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of comprehensive income, of changes in owners' equity and of cash flows present fairly, in all material respects, the financial position of Targa Resources, Inc. and its subsidiaries (the "Company") at December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As disclosed in Note 3 in the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests effective January 1, 2009.

/s/PricewaterhouseCoopers LLP

Houston, Texas
March 3, 2010

TARGA RESOURCES, INC.
CONSOLIDATED BALANCE SHEETS

| | December 31, | |
|---|----------------------|-------------|
| | 2009 | 2008 |
| | (In millions) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 252.4 | \$ 362.8 |
| Trade receivables, net of allowances of \$8.0 million and \$9.4 million | 404.3 | 303.9 |
| Inventory | 39.4 | 68.5 |
| Assets from risk management activities | 32.9 | 112.3 |
| Other current assets | 16.0 | 9.6 |
| Total current assets | 745.0 | 857.1 |
| Property, plant and equipment, at cost | 3,193.3 | 3,093.3 |
| Accumulated depreciation | (645.2) | (475.9) |
| Property, plant and equipment, net | 2,548.1 | 2,617.4 |
| Long-term assets from risk management activities | 13.8 | 89.8 |
| Investment in debt obligations of Targa Resources Investments Inc. | 70.9 | 11.0 |
| Other assets | 57.7 | 73.3 |
| Total assets | \$ 3,435.5 | \$ 3,648.6 |
| LIABILITIES AND OWNERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 206.6 | \$ 153.8 |
| Accrued liabilities | 305.2 | 253.4 |
| Current maturities of debt | 12.5 | 12.5 |
| Liabilities from risk management activities | 29.2 | 11.7 |
| Deferred income taxes | 1.4 | 36.2 |
| Total current liabilities | 554.9 | 467.6 |
| Long-term debt, less current maturities | 1,208.1 | 1,552.4 |
| Long-term liabilities from risk management activities | 43.8 | 9.7 |
| Deferred income taxes | 71.2 | 40.0 |
| Other long-term liabilities | 63.1 | 49.7 |
| Commitments and contingencies (see Note 16) | | |
| Owners' equity: | | |
| Targa Resources, Inc. stockholder's equity: | | |
| Common stock (\$0.001 par value, 1,000 shares authorized, issued, and outstanding at December 31, 2009 and 2008, collateral for Targa Resources Investments Inc. debt, see Note 11) | - | - |
| Additional paid-in capital | 419.9 | 420.1 |
| Retained earnings | 163.2 | 127.6 |
| Accumulated other comprehensive income (loss) | (15.6) | 31.9 |
| Total Targa Resources, Inc. stockholder's equity | 567.5 | 579.6 |
| Noncontrolling interest in subsidiaries | 926.9 | 949.6 |
| Total owners' equity | 1,494.4 | 1,529.2 |
| Total liabilities and owners' equity | \$ 3,435.5 | \$ 3,648.6 |

See notes to consolidated financial statements

TARGA RESOURCES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

| | <u>Year Ended December 31,</u> | |
|--|--------------------------------|----------------|
| | <u>2009</u> | <u>2008</u> |
| | (In millions) | |
| Revenues | \$ 4,536.5 | \$ 7,998.9 |
| Costs and expenses: | | |
| Product purchases | 3,791.6 | 7,218.5 |
| Operating expenses | 235.0 | 275.2 |
| Depreciation and amortization expenses | 170.3 | 160.9 |
| General and administrative expenses | 120.2 | 95.9 |
| Other (see Note 20) | <u>2.0</u> | <u>13.4</u> |
| | <u>4,319.1</u> | <u>7,763.9</u> |
| Income from operations | 217.4 | 235.0 |
| Other income (expense): | | |
| Interest expense, net | (98.7) | (102.0) |
| Equity in earnings of unconsolidated investments | 5.0 | 14.0 |
| Gain (loss) on debt repurchases (See Note 11) | (1.5) | 13.1 |
| Loss on early debt extinguishment (See Note 11) | (14.8) | - |
| Gain on insurance claims (see Note 12) | - | 18.5 |
| Gain (loss) on mark-to-market derivative instruments | 0.3 | (1.3) |
| Other income | <u>1.2</u> | <u>-</u> |
| Income before income taxes | 108.9 | 177.3 |
| Income tax expense: | | |
| Current | (1.4) | (1.2) |
| Deferred | <u>(22.1)</u> | <u>(26.1)</u> |
| | <u>(23.5)</u> | <u>(27.3)</u> |
| Net income | 85.4 | 150.0 |
| Less: Net income attributable to noncontrolling interest | <u>49.8</u> | <u>97.1</u> |
| Net income attributable to Targa Resources, Inc. | <u>\$ 35.6</u> | <u>\$ 52.9</u> |

See notes to consolidated financial statements

TARGA RESOURCES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2009 | 2008 |
| | (In millions) | |
| Net income | \$ 85.4 | \$ 150.0 |
| Other comprehensive income (loss): | | |
| Commodity hedging contracts: | | |
| Change in fair value | (49.6) | 110.9 |
| Reclassification adjustment for settled periods | (39.5) | 40.4 |
| Interest rate swaps: | | |
| Change in fair value | (7.2) | (5.0) |
| Reclassification adjustment for settled periods | 8.8 | 0.7 |
| Change in fair value of available for sale securities | 13.9 | (6.7) |
| Foreign currency translation adjustment | - | (1.8) |
| Related income taxes | 26.1 | (50.5) |
| Other comprehensive income (loss) | (47.5) | 88.0 |
| Comprehensive income | 37.9 | 238.0 |
| Net income attributable to noncontrolling interest | 49.8 | 97.1 |
| Other comprehensive income (loss) attributable to noncontrolling interest: | | |
| Commodity hedging contracts: | | |
| Change in fair value | (54.7) | 95.5 |
| Reclassification adjustment for settled periods | (30.2) | 24.7 |
| Interest rate swaps: | | |
| Change in fair value | (0.1) | (14.0) |
| Reclassification adjustment for settled periods | 6.9 | 2.0 |
| Other comprehensive income (loss) attributable to noncontrolling interest | (78.1) | 108.2 |
| Comprehensive income (loss) attributable to noncontrolling interest | (28.3) | 205.3 |
| Comprehensive income attributable to Targa Resources, Inc. | \$ 66.2 | \$ 32.7 |

See notes to consolidated financial statements

TARGA RESOURCES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN OWNERS' EQUITY

| | Additional | Retained | Accumulated | Noncontrolling | Total |
|--|-----------------|-----------------|----------------------|-----------------|-------------------|
| | Paid-in | | Other | | |
| | <u>Capital</u> | <u>Earnings</u> | <u>Income (Loss)</u> | <u>Interest</u> | |
| | (In millions) | | | | |
| Balance, December 31, 2007 | \$ 473.8 | \$ 74.7 | \$ (56.1) | \$ 815.1 | \$ 1,307.5 |
| VESCO Acquisition | - | - | - | 41.9 | 41.9 |
| Distribution of property | - | - | - | (14.8) | (14.8) |
| Contributions | - | - | - | 0.3 | 0.3 |
| Distributions | (53.9) | - | - | (98.5) | (152.4) |
| Amortization of equity awards | 1.2 | - | - | 0.3 | 1.5 |
| Tax expense on vesting of common stock | (1.0) | - | - | - | (1.0) |
| Other comprehensive income | - | - | 88.0 | 108.2 | 196.2 |
| Net income | - | 52.9 | - | 97.1 | 150.0 |
| Balance, December 31, 2008 | \$ 420.1 | \$ 127.6 | \$ 31.9 | \$ 949.6 | \$ 1,529.2 |
| Contributions | - | - | - | 103.8 | 103.8 |
| Distributions | (0.2) | - | - | (98.5) | (98.7) |
| Amortization of equity awards | 0.4 | - | - | 0.3 | 0.7 |
| Tax expense on vesting of common stock | (0.4) | - | - | - | (0.4) |
| Other comprehensive loss | - | - | (47.5) | (78.1) | (125.6) |
| Net income | - | 35.6 | - | 49.8 | 85.4 |
| Balance, December 31, 2009 | <u>\$ 419.9</u> | <u>\$ 163.2</u> | <u>\$ (15.6)</u> | <u>\$ 926.9</u> | <u>\$ 1,494.4</u> |

See notes to consolidated financial statements

TARGA RESOURCES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | <u>Year Ended December 31,</u> | |
|--|--------------------------------|-----------------|
| | <u>2009</u> | <u>2008</u> |
| | (In millions) | |
| Cash flows from operating activities | | |
| Net income | \$ 85.4 | \$ 150.0 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization in interest expense | 6.2 | 8.4 |
| Interest income on paid-in-kind investment | (3.4) | (1.0) |
| Amortization in general and other administrative expense | 0.7 | 1.5 |
| Depreciation and amortization expense | 168.8 | 160.9 |
| Accretion of asset retirement obligations | 2.9 | 1.9 |
| Deferred income tax expense | 22.1 | 26.1 |
| Equity in earnings of unconsolidated investments, net of distributions | - | (9.4) |
| Risk management activities | 40.3 | (64.5) |
| Loss (gain) on sale of assets | 0.1 | (5.9) |
| Loss (gain) on debt repurchases | 1.5 | (13.1) |
| Loss on early debt extinguishment | 14.8 | - |
| Gain on property damage insurance settlement (See Note 12) | - | (18.5) |
| Asset impairment charges | 1.5 | 5.1 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and other assets | (139.9) | 601.7 |
| Inventory | 19.3 | 72.8 |
| Accounts payable and other liabilities | 122.0 | (516.8) |
| Net cash provided by operating activities | <u>342.3</u> | <u>399.2</u> |
| Cash flows from investing activities | | |
| Outlays for property, plant and equipment | (99.4) | (132.3) |
| Acquisitions, net of cash acquired | - | (124.9) |
| Proceeds from property insurance | 38.8 | 48.3 |
| Investment in debt obligations of Targa Resources Investments Inc. | (39.3) | (16.4) |
| Other | 1.3 | 2.2 |
| Net cash used in investing activities | <u>(98.6)</u> | <u>(223.1)</u> |
| Cash flows from financing activities | | |
| Repayments of senior secured debt | (460.0) | (12.5) |
| Borrowings (repayments) under senior secured credit facility | (95.9) | 95.9 |
| Senior secured credit facility of the Partnership: | | |
| Borrowings | 569.2 | 185.3 |
| Repayments | (577.7) | (323.8) |
| Repurchases of senior notes of the Partnership | (18.9) | (26.8) |
| Proceeds from issuance of senior notes of the Partnership | 237.4 | 250.0 |
| Distributions to noncontrolling interest | (98.5) | (98.5) |
| Contributions from noncontrolling interest | 103.8 | 0.3 |
| Distribution to Targa Resources Investments Inc. | (0.2) | (53.9) |
| Costs incurred in connection with financing arrangements | (13.3) | (7.2) |
| Net cash provided by (used in) financing activities | <u>(354.1)</u> | <u>8.8</u> |
| Net change in cash and cash equivalents | (110.4) | 184.9 |
| Cash and cash equivalents, beginning of period | <u>362.8</u> | <u>177.9</u> |
| Cash and cash equivalents, end of period | <u>\$ 252.4</u> | <u>\$ 362.8</u> |

See notes to consolidated financial statements

TARGA RESOURCES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Except as noted within the context of each footnote disclosure, the dollar amounts presented in the tabular data within these footnote disclosures are stated in millions of dollars.

Note 1—Organization and Operations

Organization and Operations

Targa Resources, Inc. is a Delaware corporation formed on February 26, 2004. Unless the context requires otherwise, references to “we”, “us”, “our”, “the Company” or “Targa” are intended to mean the consolidated business and operations of Targa Resources, Inc.

We are a second-tier, wholly owned subsidiary of our parent holding company, Targa Resources Investments Inc. (“Targa Investments”). The only significant asset of Targa Investments is its ownership of 100% of the outstanding capital stock of an intermediate holding company, whose sole asset is its ownership of 100% of our outstanding capital stock, which consists of one thousand shares of common stock.

Basis of Presentation

The accompanying financial statements and related notes present our consolidated financial position as of December 31, 2009 and 2008, and the results of our operations, cash flows and changes in owners’ equity for the years ended December 31, 2009 and 2008.

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). All significant intercompany balances and transactions have been eliminated. Certain reclassifications have been made to the previous years to conform to the 2009 presentation. These reclassifications do not affect net income.

We currently own approximately 33.9% of Targa Resources Partners LP (the “Partnership”), including our 2% general partner interest. Targa Resources GP LLC (“TRGP”), the general partner of the Partnership, is wholly owned by us. The Partnership is consolidated within our financial statements under the presumption, as well as presence, of general partner control in accordance with GAAP.

The noncontrolling interest in our consolidated balance sheets consists primarily of the investment by partners other than Targa Resources, Inc., including those partners’ share of the net income, distributions and accumulated other comprehensive income (loss) of the Partnership. Noncontrolling interest in net income on our consolidated statements of operations consists primarily of those partners’ share of the net income of the Partnership.

In preparing the accompanying consolidated financial statements, the Company has reviewed, as determined necessary by the Company, events that have occurred after December 31, 2009, up until the issuance of the financial statements, which occurred on March 3, 2010. See Notes 5, 8, 11, 13 and 16.

Note 2—Out of Period Adjustments

During 2009, we recorded adjustments related to prior periods which decreased our income before income taxes for 2009 by \$5.4 million. The adjustments consisted of \$7.2 million related to debt issue costs that should have been expensed during 2007 and \$1.8 million of revenue which should have been recorded during 2006.

Had these adjustments been previously recorded in their appropriate periods, net income attributable to Targa for the year ended December 31, 2009 would have increased by \$3.4 million.

After evaluating the quantitative and qualitative aspects of these errors, we concluded that our previously issued financial statements were not materially misstated and the effect of recognizing these adjustments in the 2009 financial statements were not material to the 2009 results of operations, financial position, or cash flows.

Note 3—Accounting Policies and Related Matters

Asset retirement obligations (“AROs”) are legal obligations associated with the retirement of tangible long-lived assets that result from the asset’s acquisition, construction, development and/or normal operation. An ARO is initially measured at its estimated fair value. Upon initial recognition of an ARO, we record an increase to the carrying amount of the related long-lived asset and an offsetting ARO liability. The consolidated cost of the asset and the capitalized asset retirement obligation is depreciated using the straight-line method over the period during which the long-lived asset is expected to provide benefits. After the initial period of ARO recognition, the ARO will change as a result of either the passage of time or revisions to the original estimates of either the amounts of estimated cash flows or their timing.

Changes due to the passage of time increase the carrying amount of the liability because there are fewer periods remaining from the initial measurement date until the settlement date; therefore, the present values of the discounted future settlement amount increases. These changes are recorded as a period cost called accretion expense. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows shall be recognized as an increase or a decrease in the carrying amount of the liability for an asset retirement obligation and the related asset retirement cost capitalized as part of the carrying amount of the related long-lived asset. Upon settlement, AROs will be extinguished by us at either the recorded amount or we will recognize a gain or loss on the difference between the recorded amount and the actual settlement cost.

Cash and Cash Equivalents. Cash and cash equivalents include all cash on hand, demand deposits, and investments with original maturities of three months or less. We consider cash equivalents to include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. As of December 31, 2009 and 2008, accrued liabilities included approximately \$9.9 million and \$10.5 million of outstanding checks that were reclassified from cash and cash equivalents.

Comprehensive Income. Comprehensive income includes net income and other comprehensive income (“OCI”), which includes unrealized gains and losses on derivative instruments that are designated as hedges, and currency translation adjustments.

Concentration of Credit Risk. Financial instruments which potentially subject us to concentrations of credit risk consist primarily of trade accounts receivable and commodity derivative instruments.

Trade Accounts Receivable. We extend credit to customers and other parties in the normal course of business. We have established various procedures to manage our credit exposure, including initial credit approvals, credit limits and terms, letters of credit, and rights of offset. We also use prepayments and guarantees to limit credit risk to ensure that our established credit criteria are met.

Estimated losses on accounts receivable are provided through an allowance for doubtful accounts. In evaluating the level of established reserves, we make judgments regarding each party’s ability to make required payments, economic events and other factors. As the financial condition of any party changes, circumstances develop or additional information becomes available, adjustments to an allowance for doubtful accounts may be required.

The following table presents the activity of our allowance for doubtful accounts for the periods indicated:

| | Year Ended December 31, | |
|--------------------------------|--------------------------------|---------------|
| | 2009 | 2008 |
| Balance at beginning of period | \$ 9.4 | \$ 1.1 |
| Additions | - | 8.3 |
| Deductions | (1.3) | - |
| Write-offs | (0.1) | - |
| Balance at end of period | <u>\$ 8.0</u> | <u>\$ 9.4</u> |

Significant Commercial Relationships. The following table lists the percentage of our consolidated sales and purchases with customers and suppliers which accounted for more than 10% of our consolidated revenues and consolidated product purchases for the periods indicated:

| | <u>Year Ended December 31,</u> | |
|---------------------------------------|--------------------------------|-------------|
| | <u>2009</u> | <u>2008</u> |
| % of consolidated revenues: | | |
| Chevron Phillips Chemical Company LLC | 15% | 19% |
| % of consolidated product purchases: | | |
| Louis Dreyfus Energy Services L.P. | 11% | 9% |

Consolidation Policy. We evaluate our financial interests in business enterprises to determine if they represent variable interest entities where we are the primary beneficiary. If such criteria are met, we consolidate the financial statements of such businesses with those of our own. Our consolidated financial statements include our accounts and those of our majority-owned subsidiaries in which we have a controlling interest.

We follow the equity method of accounting if our ownership interest is between 20% and 50% and we exercise significant influence over the operating and financial policies of the investee.

Debt Issue Costs. Costs incurred in connection with the issuance of long-term debt are deferred and charged to interest expense over the term of the related debt.

Environmental Liabilities. Liabilities for loss contingencies, including environmental remediation costs arising from claims, assessments, litigation, fines, and penalties and other sources are charged to expense when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. See Note 16.

Gas Processing Imbalances. Quantities of natural gas and/or NGLs over-delivered or under-delivered related to certain gas plant operational balancing agreements are recorded monthly as inventory or as a payable using weighted average prices at the time the imbalance was created. Monthly, inventory imbalances receivable are valued at the lower of cost or market, inventory imbalances payable are valued at replacement cost. These imbalances are settled either by current cash-out settlements or by adjusting future receipts or deliveries of natural gas or NGLs.

Income Taxes. We account for income taxes using the asset and liability method of accounting for deferred income taxes and provide deferred income taxes for all significant temporary differences.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax payable and related tax expense together with assessing temporary differences resulting from differing treatment of certain items, such as depreciation, for tax and accounting purposes. These differences can result in deferred tax assets and liabilities, which are included within our consolidated balance sheets.

We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that it is more likely than not (a likelihood of more than 50%) that some portion or all of the deferred tax assets will not be realized, we establish a valuation allowance. Any change in the valuation allowance would impact our income tax provision and net income in the period in which such a determination is made. We consider all available evidence, both positive and negative, to determine whether, based on the weight of the evidence, a valuation allowance is needed. Evidence used includes information about our current financial position and our results of operations for the current and preceding years, as well as all currently available information about future years, including our anticipated future performance, the reversal of deferred tax liabilities and tax planning strategies.

We believe future sources of taxable income, reversing temporary differences and other tax planning strategies will be sufficient to realize assets for which no reserve has been established.

Inventory. Our product inventories consist primarily of NGLs. Most product inventories turn over monthly, but some inventory, primarily propane, is held during the year to meet anticipated heating season requirements of our customers. Product inventories are valued at the lower of cost or market using the average cost method.

Investments in Debt Securities. Investments in debt securities that we have the positive intent and ability to hold to maturity are classified as “held-to-maturity” and reported at cost, adjusted for amortization or accretion of premiums or discounts.

Securities not classified as held-to-maturity are classified as “available-for-sale” and are recorded at fair value. The fair value of our available-for-sale securities is based on quoted market prices. In instances where quoted market prices are not available, fair values are based on indicative valuations provided by a bank. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are reported as accumulated other comprehensive income or loss which is a separate component of consolidated owners’ equity, and the annual change in such gains and losses are reported as other comprehensive income. Realized gains and losses on the sale of available-for-sale securities are recorded on the trade date and are determined using the specific identification method.

A transfer of securities between categories is recorded at fair value on the date of transfer.

Discounts or premiums are accreted or amortized to interest income using the effective interest method over the expected terms of the related security.

Investment securities are evaluated for impairment when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Noncontrolling Interest. Noncontrolling interest represents third party ownership in the net assets of our consolidated subsidiaries. For financial reporting purposes, the assets and liabilities of our majority owned subsidiaries are consolidated with any third party investors’ interest shown as noncontrolling interest. In the statements of operations, noncontrolling interest reflects the allocation of joint venture earnings to third party investors. Distributions to and contributions from noncontrolling interest represent cash payments to and cash contributions from such third party investors.

Price Risk Management (Hedging). We have designated certain contracts that meet the definition of a derivative as normal purchases and normal sales, which are not accounted for as derivatives. All derivative instruments not qualifying for the normal purchases and normal sales exception are recorded on the balance sheets at fair value. If a derivative does not qualify as a hedge or is not designated as a hedge, the gain or loss on the derivative is recognized currently in earnings. If a derivative qualifies for hedge accounting and is designated as a cash flow hedge, the effective portion of the unrealized gain or loss on the derivative is deferred in accumulated OCI, a component of owners’ equity, and reclassified to earnings when the forecasted transaction occurs. Cash flows from a derivative instrument designated as a hedge are classified in the same category as the cash flows from the item being hedged.

Our policy is to formally document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking the hedge. This process includes specific identification of the hedging instrument and the hedged item, the nature of the risk being hedged and the manner in which the hedging instrument’s effectiveness will be assessed. At the inception of the hedge and on an ongoing basis, we assess whether the derivatives used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. Hedge ineffectiveness is measured on a quarterly basis. Any ineffective portion of the unrealized gain or loss is reclassified to earnings in the current period.

The relationship between the hedging instrument and the hedged item must be highly effective in achieving the offset of changes in cash flows attributable to the hedged risk both at the inception of the contract and on an ongoing basis. Hedge accounting is discontinued prospectively when a hedge instrument is terminated or ceases to be highly effective. Gains and losses deferred in OCI related to cash flow hedges for which hedge accounting has been discontinued remain deferred until the forecasted transaction occurs. If it is no longer probable that a hedged forecasted transaction will occur, deferred gains or losses on the hedging instrument are reclassified to earnings immediately. See Notes 7, 14, and 17.

Product Exchanges. Exchanges of NGL products between parties are executed to satisfy timing and logistical needs of the parties. Volumes received and delivered under exchange agreements are recorded as inventory. If the locations of receipt and delivery are in different markets, a price differential may be billed or owed. The price differential is recorded as either accounts receivable or accrued liabilities.

Property, Plant and Equipment. Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated service lives of our functional asset groups are as follows:

| <u>Asset Group</u> | <u>Range of Years</u> |
|--|-----------------------|
| Natural gas gathering systems and processing facilities | 5 to 20 |
| Fractionation, terminalling and natural gas liquids storage facilities | 5 to 25 |
| Transportation assets | 10 to 25 |
| Other property and equipment | 3 to 25 |

Expenditures for maintenance and repairs are expensed as incurred. Expenditures to refurbish assets that extend the useful lives or prevent environmental contamination are capitalized and depreciated over the remaining useful life of the asset or major asset component.

Our determination of the useful lives of property, plant and equipment requires us to make various assumptions, including the supply of and demand for hydrocarbons in the markets served by our assets, normal wear and tear of the facilities, and the extent and frequency of maintenance programs.

We capitalize certain costs directly related to the construction of assets, including internal labor costs, interest and engineering costs. Upon disposition or retirement of property, plant and equipment, any gain or loss is charged to operations.

We evaluate the recoverability of our property, plant and equipment when events or circumstances such as economic obsolescence, the business climate, legal and other factors indicate we may not recover the carrying amount of the assets. Asset recoverability is measured by comparing the carrying value of the asset with the asset's expected future undiscounted cash flows. These cash flow estimates require us to make projections and assumptions for many years into the future for pricing, demand, competition, operating cost and other factors. If the carrying amount exceeds the expected future undiscounted cash flows we recognize an impairment loss to write down the carrying amount of the asset to its fair value as determined by quoted market prices in active markets or present value techniques if quotes are unavailable. The determination of the fair value using present value techniques requires us to make projections and assumptions regarding the probability of a range of outcomes and the rates of interest used in the present value calculations. Any changes we make to these projections and assumptions could result in significant revisions to our evaluation of recoverability of our property, plant and equipment and the recognition of an impairment loss in our consolidated statements of operations.

Revenue Recognition. Our primary types of sales and service activities reported as operating revenues include:

- sales of natural gas, NGLs and condensate;
- natural gas processing, from which we generate revenues through the compression, gathering, treating, and processing of natural gas; and
- NGL fractionation, terminalling and storage, transportation and treating.

We recognize revenues when all of the following criteria are met: (1) persuasive evidence of an exchange arrangement exists, if applicable, (2) delivery has occurred or services have been rendered, (3) the price is fixed or determinable and (4) collectability is reasonably assured.

For processing services, we receive either fees or a percentage of commodities as payment for these services, depending on the type of contract. Under percent-of-proceeds contracts, we receive either an agreed upon percentage of the actual proceeds that we receive from our sales of the residue natural gas and NGLs or an agreed upon percentage based on index related prices for the natural gas and NGLs. Percent-of-value and percent-of-liquids contracts are variations on this arrangement. Under keep-whole contracts, we keep the NGLs extracted and return the processed natural gas or value of the natural gas to the producer. Natural gas or NGLs that we receive for services or purchase for resale are in turn sold and recognized in accordance with the criteria outlined above. Under fee-based contracts, we receive a fee based on throughput volumes.

We generally report revenues gross in our consolidated statements of operations. Except for fee-based contracts, we act as the principal in the transactions where we receive commodities, take title to the natural gas and NGLs, and incur the risks and rewards of ownership.

During 2009, we reclassified NGL marketing fractionation and other service fees to revenues that were originally recorded in product purchase costs. The reclassification increased revenues and product purchases for 2008 \$28.7 million. This reclassification had no impact on our income from operations, net income, financial position or cash flows and we concluded that our previously issued financial statements were not materially misstated.

Share-Based Compensation. We award share-based compensation to employees and directors in the form of restricted stock, stock options and performance unit awards. Compensation expense on restricted stock and stock options is measured by the fair value of the award at the date of grant. Compensation expense on performance unit awards is initially measured by the fair value of the award at the date of grant, and remeasured subsequently at each reporting date through the settlement period. Compensation expense is recognized in general and administrative expense over the requisite service period of each award. See Note 13.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Estimates and judgments are based on information available at the time such estimates and judgments are made. Adjustments made with respect to the use of these estimates and judgments often relate to information not previously available. Uncertainties with respect to such estimates and judgments are inherent in the preparation of financial statements. Estimates and judgments are used in, among other things, (1) estimating unbilled revenues and operating and general and administrative costs, (2) developing fair value assumptions, including estimates of future cash flows and discount rates, (3) analyzing long-lived assets for possible impairment, (4) estimating the useful lives of assets and (5) determining amounts to accrue for contingencies, guarantees and indemnifications. Actual results could differ materially from estimated amounts.

Note 4—Inventory

Due to fluctuating commodity prices for natural gas liquids, we occasionally recognize lower of cost or market adjustments when the carrying values of our inventories exceeds their net realizable value. These non-cash adjustments are charged to product purchases within operating costs and expenses in the period they are recognized, with the related cash impact in the subsequent period.

Note 5—Partnership Units and Related Matters

Initial Public Offering. On February 14, 2007, the initial public offering (“IPO”) of 19,320,000 common units representing limited partner interests in the Partnership was completed. The Partnership used net proceeds from this offering of \$377.5 million and \$294.5 million in borrowings under its credit facility to retire \$665.7 million of affiliate debt owed to us. In return for our contribution of our North Texas assets to the Partnership in connection with the IPO, we received a 2% general partner interest, incentive distribution rights and a limited partner interest in the Partnership represented by 11,528,231 subordinated units. These units were subordinated to the common units with respect to distribution rights, until May 19, 2009, at which time under the terms of the Partnership’s amended and restated partnership agreement, all of our subordinated units converted to common units on a one-for-one basis.

Secondary Public Offering. On October 24, 2007, the Partnership completed the purchase of our ownership interests in the natural gas gathering and processing assets associated with the San Angelo Operating Unit System located in the Permian Basin (the “SAOU System”) and the Louisiana Operating Unit System located in Southwest Louisiana (the “LOU System”). The total value of the transaction was approximately \$730.2 million. Concurrent with the acquisition, the Partnership sold 13,500,000 common units representing limited partnership interests at a price of \$26.87 per common unit (\$25.796 per common unit after the underwriting discount). Total consideration paid by the Partnership to us consisted of cash of approximately \$722.5 million and 312,246 general partner units issued to us.

On November 20, 2007, the underwriters exercised their option to purchase an additional 1,800,000 common units at the same \$26.87 price per the Partnership’s common unit. The net proceeds from the underwriters exercise were used to reduce borrowings under the Partnership credit facility by approximately \$47.0 million. In addition, we contributed \$1.0 million to the Partnership to maintain our 2% general partner interest.

Sale of Downstream Business. On September 24, 2009, the Partnership acquired our interests in Targa Downstream GP LLC, Targa LSNG GP LLC, Targa Downstream LP and Targa LSNG LP (collectively, the “Downstream Business”) for \$530 million. Consideration to us comprised \$397.5 million in cash and the

issuance to us of 174,033 general partner units and 8,527,615 common units. The form of the transaction reflected in the Partnership's consolidated financial statements was:

- We contributed the Downstream Business to the Partnership.
 - Prior to the contribution, the Downstream Business' affiliate indebtedness payable to us totaled \$817.3 million, inclusive of \$223.0 million of accrued interest.
 - Immediately prior to, and in contemplation of, the contribution, \$287.3 million of the Downstream Business' affiliated indebtedness was settled through a separate capital contribution from us.
 - On the contribution date, the Downstream Business' affiliate indebtedness payable to us was \$530 million.
- The Partnership repaid the affiliate indebtedness with: (i) \$397.5 million in cash; (ii) 174,033 in general partner units with an agreed-upon value of \$2.7 million; and (iii) 8,527,615 in common units with an agreed-upon value of \$129.8 million.

The sale of the Downstream Business has been accounted for as a transfer of net assets between entities under common control.

As part of the transaction, we agreed to provide distribution support to the Partnership in the form of a reduction in the reimbursement for general and administrative expense allocated to the Partnership if necessary (or make a payment to the Partnership, if needed) for a 1.0 times distribution coverage ratio, at the current distribution level of \$0.5175 per limited partner unit, subject to maximum support of \$8.0 million in any quarter. The distribution support is in effect for the nine-quarter period beginning with the fourth quarter of 2009 and continuing through the fourth quarter of 2011.

Public Offering of Common Units. On August 12, 2009, the Partnership completed a unit offering under its shelf registration statement of 6,900,000 common units representing limited partner interests in the Partnership at a price of \$15.70 per common unit. Net proceeds of the offering were \$105.3 million, after deducting underwriting discounts, commissions and estimated offering expenses, and including the general partner's proportionate capital contribution of \$2.2 million. The Partnership used substantially all of the proceeds to repay \$103.5 million of outstanding borrowings under its senior secured revolving credit facility.

Cash Distributions. In accordance with the Partnership's partnership agreement, the Partnership must distribute all of its available cash, as defined in the partnership agreement, within 45 days following the end of each calendar quarter. Distributions will generally be made 98% to the common unitholders and 2% to the general partner, subject to the payment of incentive distributions to the extent that certain target levels of cash distributions are achieved.

Under the quarterly incentive distribution provisions, generally the Partnership's general partner is entitled to 13% of amounts distributed in excess of \$0.3881 per unit, 23% of the amounts distributed in excess of \$0.4219 per unit and 48% of amounts distributed in excess of \$0.50625 per unit. No incentive distributions were paid to us as part of our general partner interest prior to the fourth quarter of 2007. To the extent there is sufficient available cash, the holders of common units are entitled to receive the minimum quarterly distribution of \$0.3375 per unit, plus arrearages, prior to any distribution of available cash to the holders of subordinated units.

The following table shows the amount of the Partnership's cash distributions declared and paid in the years ended December 31, 2009 and 2008.

| <u>Date Paid</u> | <u>For the Three Months Ended</u> | <u>Distributions Paid</u> | | | | <u>Total</u> | <u>Distributions per limited partner unit</u> |
|--|-----------------------------------|---------------------------|---------------------|------------------------|-----------|--------------|---|
| | | <u>Limited Partners</u> | | <u>General Partner</u> | | | |
| | | <u>Common</u> | <u>Subordinated</u> | <u>Incentive</u> | <u>2%</u> | | |
| (In millions, except per unit amounts) | | | | | | | |
| 2009 | | | | | | | |
| November 14, 2009 | September 30, 2009 | \$ 31.9 | \$ - | \$ 2.6 | \$ 0.7 | \$ 35.2 | \$ 0.5175 |
| August 14, 2009 | June 30, 2009 | 23.9 | - | 2.0 | 0.5 | 26.4 | 0.5175 |
| May 15, 2009 | March 31, 2009 | 18.0 | 5.9 | 1.9 | 0.5 | 26.3 | 0.5175 |
| February 13, 2009 | December 31, 2008 | 18.0 | 6.0 | 1.9 | 0.5 | 26.4 | 0.5175 |
| 2008 | | | | | | | |
| November 14, 2008 | September 30, 2008 | \$ 17.9 | \$ 6.0 | \$ 1.9 | \$ 0.5 | \$ 26.3 | \$ 0.5175 |
| August 14, 2008 | June 30, 2008 | 17.8 | 5.9 | 1.7 | 0.5 | 25.9 | 0.5125 |
| May 15, 2008 | March 31, 2008 | 14.5 | 4.8 | 0.2 | 0.4 | 19.9 | 0.4175 |
| February 14, 2008 | December 31, 2007 | 13.8 | 4.6 | 0.1 | 0.4 | 18.9 | 0.3975 |

Subsequent Events.

On January 19, 2010, the Partnership completed a public offering of 5,500,000 common units representing limited partner interests in the Partnership ("common units") under its existing shelf registration statement on Form S-3 at a price of \$23.14 per common unit (\$22.17 per common unit, net of underwriting discounts), providing net proceeds of \$121.9 million. Pursuant to the exercise of the underwriters' overallotment option, the Partnership sold an additional 825,000 common units at \$23.14 per common unit, providing net proceeds of \$18.3 million. The partnership used the net proceeds from the offering for general partnership purposes, which included reducing borrowings under its senior secured credit facility.

On February 12, 2010, we paid a cash distribution of \$0.5175 per limited partner unit, to unitholders of record on February 3, 2010, for the three months ended December 31, 2009. The total distribution paid was \$38.8 million, with \$24.8 million paid to the Partnership's common unitholders and \$10.4 million, \$0.8 million and \$2.8 million paid to us in respect of our common units, general partner interest and incentive distribution rights.

Note 6—Property, Plant and Equipment

Property, plant and equipment and accumulated depreciation were as follows at the dates indicated:

| | <u>December 31,</u> | |
|---|---------------------|-------------------|
| | <u>2009</u> | <u>2008</u> |
| Natural gas gathering systems | \$ 1,578.0 | \$ 1,513.6 |
| Processing and fractionation facilities | 956.0 | 911.4 |
| Terminalling and natural gas liquids storage facilities | 246.6 | 234.3 |
| Transportation assets | 271.6 | 264.6 |
| Other property and equipment | 66.2 | 63.1 |
| Land | 52.7 | 52.2 |
| Construction in progress | <u>22.2</u> | <u>54.1</u> |
| | 3,193.3 | 3,093.3 |
| Accumulated depreciation | <u>(645.2)</u> | <u>(475.9)</u> |
| | <u>\$ 2,548.1</u> | <u>\$ 2,617.4</u> |

Note 7—Fair Value Measurements

We account for the fair value of our financial assets and liabilities using the three-tier fair value hierarchy, which prioritizes the significant inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Our derivative instruments consist of financially settled commodity and interest rate swap and option contracts and fixed price commodity contracts with certain customers. We determine the value of our derivative contracts utilizing a discounted cash flow model for swaps and a standard option pricing model for options, based on inputs that are either readily available in public markets. We have consistently applied these valuation techniques in all periods presented and believe we have obtained the most accurate information available for the types of derivative contracts we hold. We have categorized the inputs for these contracts as Level 2 or Level 3.

The following tables set forth, by level within the fair value hierarchy, our financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008. These financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value assets and liabilities and their placement within the fair value hierarchy levels.

| As of December 31, 2009 | Total | Level 1 | Level 2 | Level 3 |
|---|--------------|----------------|----------------|----------------|
| Assets from commodity derivative contracts | \$ 43.3 | \$ - | \$ 43.3 | \$ - |
| Assets from interest rate derivatives | 2.1 | - | 2.1 | - |
| Total assets | \$ 45.4 | \$ - | \$ 45.4 | \$ - |
| Liabilities from commodity derivative contracts | \$ 59.8 | \$ - | \$ 46.1 | \$ 13.7 |
| Liabilities from interest rate derivatives | 12.7 | - | 12.7 | - |
| Total liabilities | \$ 72.5 | \$ - | \$ 58.8 | \$ 13.7 |
| | | | | |
| As of December 31, 2008 | Total | Level 1 | Level 2 | Level 3 |
| Assets from commodity derivative contracts | \$ 202.1 | \$ - | \$ 53.9 | \$ 148.2 |
| Securities available for sale (1) | 9.7 | - | - | 9.7 |
| Total assets | \$ 211.8 | \$ - | \$ 53.9 | \$ 157.9 |
| Liabilities from commodity derivative contracts | \$ 3.9 | \$ - | \$ 3.9 | \$ - |
| Liabilities from interest rate derivatives | 17.5 | - | 17.5 | - |
| Total liabilities | \$ 21.4 | \$ - | \$ 21.4 | \$ - |

The following table sets forth a reconciliation of the changes in the fair value of our financial instruments classified as Level 3 in the fair value hierarchy:

| | Derivatives Contracts | Available For Sale Securities (1) | Total |
|---|----------------------------------|--|--------------|
| Balance, December 31, 2007 | \$ (124.2) | \$ - | \$ (124.2) |
| Unrealized gains (losses) included in OCI | 149.6 | (6.7) | 142.9 |
| Purchases | 3.3 | 16.4 | 19.7 |
| Terminations | 77.8 | - | 77.8 |
| Settlements | 41.7 | - | 41.7 |
| Balance, December 31, 2008 | \$ 148.2 | \$ 9.7 | \$ 157.9 |
| Unrealized gains (losses) included in OCI | (57.1) | 14.9 | (42.2) |
| Purchases | - | 39.3 | 39.3 |
| Settlements | (35.0) | - | (35.0) |
| Transfers out of Level 3 (2) (3) | (69.8) | (63.9) | (133.7) |
| Balance, December 31, 2009 | \$ (13.7) | \$ - | \$ (13.7) |

- (1) We have investments in Targa Investments' debt obligations. In December 2009, we reclassified these debt obligations from an investment in an available-for-sale security to a held-to-maturity security. Held-to-maturity securities are recorded at amortized cost and, therefore, no longer included in the recurring fair value disclosures above. See Note 8.

- (2) During 2009, we reclassified certain of our NGL derivative contracts from Level 3 (unobservable inputs in which little or no market data exists) to Level 2 as we were able to obtain directly observable inputs other than quoted prices in active markets.
- (3) Transfer of available-for-sale security excludes \$3.7 million in accumulated amortized discount and \$3.4 million in fair value of paid in kind of interest.

Held-to-maturity securities are recorded at amortized cost and, therefore, no longer included in the recurring fair value disclosures above; however, the transfer from available-for-sale to held-to-maturity was made at fair value. This nonrecurring measurement was determined using transaction pricing at year-end based upon quotes obtained from 3rd parties willing to transact in a principal-to-principal market. As such, the inputs to the fair value of the securities are classified as Level 2 and the held-to-maturity investment measured at fair value on a nonrecurring basis was \$70.9 million.

Note 8—Investment in Debt Obligations of Targa Investments

In 2009, we made additional investments in Targa Investments' outstanding variable rate indebtedness ("Holdco Notes"), acquiring an additional \$67.7 million in par value for \$42.7 million, including interest taken in-kind of \$3.4 million. As of December 31, 2009 we held \$88.7 million in par value debt with an amortized cost of \$63.7 million and an unrealized gain on the investment of \$7.2 million. The stated maturity date of the indebtedness is February 9, 2015, and as of December 31, 2009, the variable rate was 5.2%. We had previously classified this investment as an available-for-sale security as our intent to hold the investment to maturity was not certain. As of December 31, 2009, we evaluated our classification and management determined that it has the intent and ability to hold the debt securities to maturity and, therefore, reclassified the investment as a held-to-maturity security. Investments transferred from available-for-sale into the held-to-maturity category are done so at fair value with any unrealized amounts in other comprehensive income at the time of transfer recognized over the term of the notes. The investment was transferred into the held-to-maturity category at a fair value of \$70.9 million, a \$17.8 million discount to par value, which will be amortized into interest income over the term of the notes. Additionally, the \$7.2 million unrealized gain on the investment recorded in accumulated other comprehensive income will be recognized to interest income over the term of the notes.

Subsequent Event. In January 2010, we purchased an additional \$164.2 million in face value of the Holdco Notes for \$131.4 million. See Note 11. The purchase price will be recorded as an addition to the unamortized cost basis and the \$32.8 million discount will be amortized over the term of the notes.

Note 9—Investment in Unconsolidated Affiliates

As of December 31, 2009 and 2008, our unconsolidated investment consisted of a 38.75% ownership interest in Gulf Coast Fractionators LP ("GCF"), a venture that fractionates natural gas liquids on the Gulf Coast. As of December 31, 2009 and 2008, our investment in GCF was \$18.5 million.

Our equity in the net assets of GCF exceeded our acquisition date investment account by \$5.2 million. This amount is being amortized over the estimated remaining life of the net assets on a straight-line basis, and is included as a component of our equity in earnings of unconsolidated investments.

Prior to July 31, 2008 our unconsolidated investments also included a 22.9% ownership interest in Venice Energy Services Company, LLC ("VESCO"), a venture that operates a natural gas liquids processing and extraction facility. On July 31, 2008, we acquired an additional 53.9% interest, giving us effective control. We have consolidated the operations of VESCO in our financial results effective August 1, 2008.

The following table shows our equity earnings and cash distributions with respect to our unconsolidated investment for the years indicated:

| | <u>December 31,</u> | |
|------------------------|---------------------|----------------|
| | <u>2009</u> | <u>2008</u> |
| Equity in earnings of: | | |
| VESCO (1) (2) | \$ - | \$ 10.1 |
| GCF | <u>5.0</u> | <u>3.9</u> |
| | <u>\$ 5.0</u> | <u>\$ 14.0</u> |
| Cash distributions: | | |
| GCF | <u>\$ 5.0</u> | <u>\$ 4.6</u> |

(1) Includes our equity earnings through July 31, 2008.

(2) Includes business interruption insurance claims of \$4.1 million for 2008.

Note 10—Asset Retirement Obligations

Our asset retirement obligations are included in our consolidated balance sheets as a component of other long-term liabilities. The changes in our aggregate asset retirement obligations are as follows:

| | <u>Year Ended December 31,</u> | |
|----------------------------------|--------------------------------|----------------|
| | <u>2009</u> | <u>2008</u> |
| Beginning of period | \$ 34.0 | \$ 12.6 |
| Liabilities incurred (1) | - | 16.9 |
| Liabilities settled | - | (0.2) |
| Change in cash flow estimate (2) | (2.8) | 2.8 |
| Accretion expense | <u>2.9</u> | <u>1.9</u> |
| End of period | <u>\$ 34.1</u> | <u>\$ 34.0</u> |

(1) The entire amount relates to our consolidation of VESCO.

(2) The change in cash flow estimate is primarily from a reassessment of abandonment cost estimates for our offshore gathering systems.

Note 11—Debt Obligations

Consolidated debt obligations consisted of the following as of the dates indicated:

| | <u>December 31,</u> | |
|---|---------------------|-------------------|
| | <u>2009</u> | <u>2008</u> |
| Long-term debt: | | |
| Obligations of Targa: | | |
| Senior secured term loan facility, variable rate, due October 2012 | \$ 62.2 | \$ 522.2 |
| Senior unsecured notes, 8½% fixed rate, due November 2013 | 250.0 | 250.0 |
| Senior secured revolving credit facility, variable rate, due October 2011 | - | 95.9 |
| Obligations of the Partnership: (1) | | |
| Senior secured revolving credit facility, variable rate, due February 2012 | 479.2 | 487.7 |
| Senior unsecured notes, 8¼% fixed rate, due July 2016 | 209.1 | 209.1 |
| Senior unsecured notes, 11¼% fixed rate, due July 2017 (2) | 220.1 | - |
| Total debt | 1,220.6 | 1,564.9 |
| Current maturities of debt | (12.5) | (12.5) |
| Total long-term debt | <u>\$ 1,208.1</u> | <u>\$ 1,552.4</u> |
| Irrevocable standby letters of credit: | | |
| Letters of credit outstanding under senior secured synthetic letter of credit facility (3) | \$ 48.7 | \$ 114.0 |
| Letters of credit outstanding under senior secured revolving credit facility of the Partnership | 69.2 | 9.7 |
| | <u>\$ 117.9</u> | <u>\$ 123.7</u> |

- (1) We consolidate the debt of the Partnership with that of our own; however, we do not have the obligation to make interest payments or debt payments with respect to the debt of the Partnership.
- (2) The carrying amount of the notes includes \$11.2 million of unamortized original issue discount as of December 31, 2009.
- (3) The \$50 million senior secured synthetic letter of credit facility terminates in October 2012. As of December 31, 2009, we had \$1.3 million available under this facility.

Information Regarding Variable Interest Rates Paid

The following table shows the range of interest rates paid and weighted average interest rate paid on our variable-rate debt obligations during 2009:

| | <u>Range of interest rates paid</u> | <u>Weighted average interest rate paid</u> |
|---|---|--|
| Senior secured term loan facility | 2.2% to 6.0% | 3.5% |
| Senior secured revolving credit facility | 2.1% to 3.5% | 3.1% |
| Senior secured revolving credit facility of the Partnership | 1.2% to 4.5% | 1.7% |

Consolidated Debt Maturity Table

The following table presents the scheduled maturities of principal amounts of our consolidated debt obligations:

| | <u>Targa</u> | <u>Partnership</u> | <u>Total</u> |
|----------------|-----------------|--------------------|-------------------|
| 2010 | \$ 12.5 | \$ - | \$ 12.5 |
| 2011 | 12.5 | - | 12.5 |
| 2012 | 37.2 | 479.2 | 516.4 |
| 2013 | 250.0 | - | 250.0 |
| Thereafter (1) | - | 429.2 | 429.2 |
| | <u>\$ 312.2</u> | <u>\$ 908.4</u> | <u>\$ 1,220.6</u> |

- (1) Due 2016 and 2017.

Description of Debt Obligations

Obligations of Targa

Senior Secured Credit Agreement

(See subsequent event disclosure within this Note 11 for the impact of our refinancing of the senior secured credit facility.)

Our senior secured credit agreement (the “credit agreement”) provides senior secured financing of \$2,500 million, consisting of:

- \$1,250 million senior secured term loan facility;
- \$700 million senior secured asset sale bridge loan facility;
- \$250 million senior secured revolving credit facility (the “credit facility”); and
- \$300 million senior secured synthetic letter of credit facility.

The entire amount of our credit facility is available for letters of credit and includes a limited borrowing capacity for borrowings on same-day notice referred to as swing line loans.

We may increase the commitments under our credit facility in an aggregate amount up to \$400 million, subject to the satisfaction of certain conditions.

Borrowings under the credit agreement, other than the senior secured synthetic letter of credit facility, will bear interest at a rate equal to an applicable margin plus, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Credit Suisse and (2) the federal funds rate plus 0.5% or (b) LIBOR as determined by reference to the costs of funds for dollar deposits for the interest period relevant to such borrowing adjusted for certain statutory reserves.

We are required to pay a facility fee, quarterly in arrears, to the lenders under the senior secured synthetic letter of credit facility equal to (i) 2.00% of the amount on deposit in the designated deposit account plus (ii) the administrative cost incurred by the deposit account agent for such quarterly period. In addition, we are required to pay a commitment fee equal to 0.375% of the currently unutilized commitments thereunder.

The senior secured credit agreement requires us to prepay loans outstanding under the senior secured term loan facility, subject to certain exceptions, with:

- 50% of our annual excess cash flow (which percentage will be reduced to 25% if our total leverage ratio is no more than 4.00 to 1.00 and to 0% if our total leverage ratio is no more than 3.00 to 1.00);
- 100% of the net cash proceeds of all non-ordinary course asset sales, transfers, or other dispositions of property, subject to certain exceptions;
- 100% of the net cash proceeds of any incurrence of debt, other than debt permitted under the senior secured credit agreement.

We are required to repay the term loan facility in quarterly principal amounts of 0.25% of the original principal amount, with the remaining amount payable October 31, 2012.

Principal amounts outstanding under our credit facility are due and payable in full on October 31, 2011. As of December 31, 2009, we had availability under this facility of \$239.8 million, after giving effect to the Lehman Commercial Paper Inc. (“Lehman Paper”) default. In October 2008, Lehman Paper, a lender under our credit facility, defaulted on a borrowing request. As a result of the default, we believe the availability under the facility has been effectively reduced by \$10.2 million.

All obligations under the credit agreement and certain secured hedging arrangements are unconditionally guaranteed, subject to certain exceptions, by each of our existing and future domestic restricted subsidiaries, referred to, collectively, as the guarantors. We have pledged the following assets, subject to certain exceptions, as collateral:

- the capital stock and other equity interests held by us or any guarantor (except that we will not pledge more than 65% of the voting stock and other voting equity interests of any foreign subsidiary); and
- a security interest in, and mortgages on, our and our guarantors' tangible and intangible assets.

The credit agreement contains a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to incur additional indebtedness (including guarantees and hedging obligations) or issue preferred stock; create liens on assets; enter into sale and leaseback transactions; engage in mergers or consolidations; sell assets; pay dividends and make distributions or repurchase capital stock and other equity interests; make investments, loans or advances; make capital expenditures; repay, redeem or repurchase certain indebtedness; make certain acquisitions; engage in certain transactions with affiliates; amend certain debt and other material agreements; change our lines of business; and impose certain restrictions on restricted subsidiaries that are not guarantors, including restrictions on the ability of such subsidiaries that are not guarantors to pay dividends.

The credit agreement requires us to maintain certain specified maximum total leverage ratios and certain specified minimum interest coverage ratios. In each case we are required to comply with certain limitations, including minimum cash consideration requirements.

During the third quarter of 2009, we repaid substantially all of our senior secured term loan facility and recognized a \$14.8 million loss on early debt extinguishment consisting of the write-off of debt issue costs related to the facility.

During the third quarter of 2009, we elected to reduce the commitments under the senior secured synthetic letter of credit facility from \$300.0 million to \$50.0 million.

8½% Senior Notes Due 2013

In December, 2007, we filed a registration statement on Form S-4/A in which we offered to exchange up to \$250.0 million of our outstanding 8½% senior notes due 2013 ("the Notes") for new notes. The terms of the new notes were substantially identical to the outstanding notes, except that we registered the new notes under the Securities Act of 1933. The exchange of outstanding notes for new notes was completed in January 2008.

The Notes:

- are our unsecured senior obligations;
- rank *pari passu* in right of payment with all our existing and future senior indebtedness, including indebtedness under our credit agreement;
- are effectively subordinated to all our secured indebtedness to the extent of the value of the collateral securing such indebtedness, including indebtedness under the senior secured credit facilities;
- are structurally subordinated to all existing and future claims of creditors (including trade creditors) and holders of preferred stock of our subsidiaries that do not guarantee the Notes;
- rank senior in right of payment to any of our future subordinated indebtedness;
- are guaranteed on a senior unsecured basis by the subsidiary guarantors that guarantee the senior secured credit facilities; and

Interest on the Notes accrues at the rate of 8½% per annum and is payable in cash semi-annually in arrears on May 1 and November 1.

On or after November 1, 2009, we may redeem all or a part of the Notes at the redemption prices set forth below (expressed as percentages of principal amount) plus accrued and unpaid interest and liquidated damages, if any, on the Notes redeemed, if redeemed during the twelve-month period beginning on November 1 of each year indicated below:

| <u>Year</u> | <u>Percentage</u> |
|---------------------|-------------------|
| 2009 | 104.250% |
| 2010 | 102.125% |
| 2011 and thereafter | 100.000% |

Compliance with Debt Covenants

As of December 31, 2009, we were in compliance with the covenants contained in our various debt agreements.

Obligations of The Partnership

Credit Agreement

On February 14, 2007, the Partnership entered into a credit agreement which provided for a five-year \$500 million credit facility with a syndicate of financial institutions. On October 24, 2007, the Partnership entered into the First Amendment to Credit Agreement which allowed it to request commitments under the credit agreement, as supplemented and amended, up to \$1 billion. The Partnership currently has \$977.5 million committed under the senior secured credit facility. In October 2008, Lehman Bank defaulted on a borrowing request under the Partnership's senior secured credit facility. Lehman's commitment under the facility is \$19 million and is currently unfunded which effectively reduces the Partnership's total commitments under its credit facility by \$19 million.

The credit facility bears interest at the Partnership's option, at the higher of the lender's prime rate or the federal funds rate plus 0.5%, plus an applicable margin ranging from 0% to 1.25% dependent on the Partnership's total leverage ratio, or LIBOR plus an applicable margin ranging from 1.0% to 2.25% dependent on the Partnership's total leverage ratio. The Partnership's credit facility is secured by substantially all of its assets. As of December 31, 2009, the Partnership had approximately \$479.2 million of borrowings outstanding under its senior secured credit facility and approximately \$69.2 million of outstanding letters of credit.

The Partnership's senior secured credit facility restricts its ability to make distributions of available cash to unitholders if a default or an event of default (as defined in the Partnership's senior secured credit facility) has occurred and is continuing. The senior secured credit facility requires the Partnership to maintain a leverage ratio (the ratio of consolidated indebtedness to its consolidated EBITDA, as defined in the senior secured credit facility) of less than or equal to 5.50 to 1.00 and a senior secured indebtedness ratio (the ratio of senior secured indebtedness to consolidated EBITDA, as defined in the senior secured credit facility) of less than or equal to 4.50 to 1.00, each subject to certain adjustments. The senior secured credit facility also requires the Partnership to maintain an interest coverage ratio (the ratio of its consolidated EBITDA to its consolidated interest expense, as defined in the senior secured credit facility) of greater than or equal to 2.25 to 1.00 determined as of the last day of each quarter for the four-fiscal quarter period ending on the date of determination, as well as upon the occurrence of certain events, including the incurrence of additional permitted indebtedness. In conjunction with a material acquisition, the Partnership has the option to increase the leverage ratio to 6.00 to 1.00 and to increase the senior secured indebtedness ratio to 5.00 to 1.00 for a period of up to a year.

The credit facility matures on February 14, 2012, at which time all unpaid principal and interest is due.

8¼% Senior Notes due 2016

On June 18, 2008, the Partnership completed the private placement under Rule 144A and Regulation S of the Securities Act of 1933 of \$250 million in aggregate principal amount of 8¼% senior notes due 2016 (the "8¼% Notes"). The 8¼% Notes:

- are the Partnership's unsecured senior obligations;
- rank *pari passu* in right of payment with its existing and future senior indebtedness, including indebtedness under the Partnership's credit facility;
- are senior in right of payment to any of the Partnership's future subordinated indebtedness; and
- are unconditionally guaranteed by the Partnership.

The 8¼% Notes are effectively subordinated to all secured indebtedness under the Partnership's credit agreement, which is secured by substantially all of its assets, to the extent of the value of the collateral securing that indebtedness.

Interest on the 8¼% Notes accrues at the rate of 8¼% per annum and is payable semi-annually in arrears on January 1 and July 1, commencing on January 1, 2009.

At any time prior to July 1, 2011, the Partnership may redeem up to 35% of the aggregate principal amount of the 8¼% Notes with the net cash proceeds of one or more equity offerings by the Partnership at a redemption price of 108.25% of the principal amount, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date provided that:

- (1) at least 65% of the aggregate principal amount of the 8¼% Notes (excluding 8¼% Notes held by the Partnership) remains outstanding immediately after the occurrence of such redemption; and
- (2) the redemption occurs within 90 days of the date of the closing of such equity offering.

At any time prior to July 1, 2012, the Partnership may also redeem all or a part of the 8¼% Notes at a redemption price equal to 100% of the principal amount of the 8¼% Notes redeemed plus the applicable premium as defined in the indenture agreement as of, and accrued and unpaid interest and liquidated damages, if any, to the date of redemption.

On or after July 1, 2012, the Partnership may redeem all or a part of the 8¼% Notes at the redemption prices set forth below (expressed as percentages of principal amount) plus accrued and unpaid interest and liquidated damages, if any, on the 8¼% Notes redeemed, if redeemed during the twelve-month period beginning on July 1 of each year indicated below:

| <u>Year</u> | <u>Percentage</u> |
|---------------------|-------------------|
| 2012 | 104.125% |
| 2013 | 102.063% |
| 2014 and thereafter | 100.000% |

During 2008, the Partnership repurchased \$40.9 million face value of its outstanding 8¼% Notes in open market transactions at an aggregate purchase price of \$28.3 million, including \$1.5 million of accrued interest. The Partnership recognized a gain on the debt repurchases of \$13.1 million associated with the purchased notes. The repurchased 8¼% Notes were retired and are not eligible for re-issue at a later date.

11¼% Senior Notes due 2017

On July 6, 2009, the Partnership completed the private placement under Rule 144A and Regulation S of the Securities Act of 1933 of \$250 million in aggregate principal amount of 11¼% senior notes due 2017 (the "11¼% Notes"). The 11¼% Notes were issued at 94.973% of the face amount, resulting in gross proceeds of \$237.4 million. The 11¼% Notes:

- are the Partnership's unsecured senior obligations;
- rank *pari passu* in right of payment with its existing and future senior indebtedness, including indebtedness under the Partnership's senior secured revolving credit facility;
- are senior in right of payment to any of the Partnership's future subordinated indebtedness; and
- are unconditionally guaranteed by the Partnership.

The 11¼% Notes are effectively subordinated to all indebtedness under the Partnership's credit agreement, which is secured by substantially all of its assets, to the extent of the value of the collateral securing that indebtedness.

Interest on the 11¼% Notes accrues at the rate of 11¼% per annum and is payable semi-annually in arrears on January 15 and July 15, commencing on January 15, 2010.

At any time prior to July 15, 2012, the Partnership may redeem up to 35% of the aggregate principal amount of the 11¼% Notes with the net cash proceeds of certain equity offerings by the Partnership at a redemption price of 111.25% of the principal amount, plus accrued and unpaid interest to the redemption date, provided that:

- (1) at least 65% of the aggregate principal amount of the 11¼% Notes (excluding 11¼% Notes held by the Partnership) remains outstanding immediately after the occurrence of such redemption; and

(2) the redemption occurs within 90 days of the date of the closing of such equity offering.

At any time prior to July 15, 2013, the Partnership may also redeem all or a part of the 11¼% Notes at a redemption price equal to 100% of the principal amount of the 11¼% Notes redeemed plus the applicable premium as defined in the indenture as of, and accrued and unpaid interest to, the date of redemption.

On or after July 15, 2013, the Partnership may redeem all or a part of the 11¼% Notes at the redemption prices set forth below (expressed as percentages of principal amount) plus accrued and unpaid interest on the 11¼% Notes redeemed, if redeemed during the twelve-month period beginning on July 15 of each year indicated below:

| <u>Year</u> | <u>Percentage</u> |
|---------------------|-------------------|
| 2013 | 105.625% |
| 2014 | 102.813% |
| 2015 and thereafter | 100.000% |

The 11¼% Notes are subject to a registration rights agreement dated as of July 6, 2009. Under the registration rights agreement, the Partnership is required to file by July 7, 2010 a registration statement with respect to any 11¼% Notes that are not freely transferable without volume restrictions by holders of the 11¼% Notes that are not affiliates of ours. If the Partnership fails to do so, additional interest will accrue on the principal amount of the 11¼% Notes. The Partnership has determined that the payment of additional interest is not probable. As a result, the Partnership has not recorded a liability for any contingent obligation. Any subsequent accruals of a liability or payments made under this registration rights agreement will be charged to earnings as interest expense in the period they are recognized or paid.

During 2009, the Partnership repurchased \$18.7 million face value of its outstanding 11¼% Notes in open market transactions at an aggregated purchase price of \$18.9 million plus accrued interest of \$0.3 million. The Partnership recognized a loss on the debt repurchases of \$1.5 million, including \$0.4 million in debt issue costs associated with the repurchased notes. The repurchased 11¼% Notes were retired and are not eligible for re-issue at a later date.

Compliance with Debt Covenants

As of December 31, 2009, the Partnership was in compliance with the covenants contained in its various debt agreements.

Holdco Loan Facility of Targa Investments

During 2007, Targa Investments borrowed \$450.0 million under a newly arranged credit agreement. The net proceeds of \$445.1 million (after payment of debt issuance costs) were used to pay a dividend on Targa Investments' preferred stock. See Note 8.

Principal amounts outstanding under the credit agreement are due and payable in full on February 9, 2015. In connection with the agreement, Targa Investments pledged its indirect 100% ownership of our capital stock as collateral for amounts due under the agreement. Neither we, nor any of our subsidiaries, guaranty Targa Investments' obligations under the credit agreement, our assets are not pledged as collateral under the credit agreement, nor do we have an obligation to repay the amounts borrowed under the credit agreement.

On March 7, 2008, we made a cash distribution of \$50.0 million to Targa Investments. Targa Investments used the proceeds to retire \$62.5 million of its outstanding borrowings under this credit agreement.

Subsequent event

On January 5, 2010, we entered into a new senior secured credit facility with a syndicate of financial institutions consisting of a \$100 million revolving credit facility due 2014 and a \$500 million term loan due 2016. There was no initial funding on the revolving credit line. The proceeds of the term loan were used to:

- complete the cash tender offer and consent solicitation for all \$250.0 million of our outstanding 8 ½% senior notes due 2013;
- repay the outstanding balance of \$62.2 million on our existing senior secured term loan due 2012;

- purchase \$164.2 million in face value of the Holdco Notes for \$131.4 million. (See Note 8.); and,
- fund working capital and pay fees and expenses to the new credit facility.

Note 12—Insurance Claims

We recognize income from business interruption insurance in our consolidated statements of operations in the period that a proof of loss is executed and submitted to the insurers for payment. The following table summarizes our income recognition of business interruption insurance for the periods indicated:

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2009 | 2008 |
| Included in revenues (1) | \$ 21.5 | \$ 32.9 |
| Included in equity in earnings of unconsolidated investments | - | 4.1 |

(1) Includes \$2.0 million and \$1.3 million for 2009 and 2008 in non-hurricane business interruption proceeds.

Hurricanes Gustav and Ike

Certain of our Louisiana and Texas facilities sustained damage and had disruptions to their operations during the 2008 hurricane season from two Gulf Coast hurricanes—Gustav and Ike. As of December 31, 2008, we recorded a \$19.3 million loss provision (net of estimated insurance reimbursements) related to the hurricanes. During 2009, the estimate was reduced by \$3.7 million. During 2009, expenditures related to the hurricanes included \$33.7 million for previously accrued repair costs and \$7.5 million capitalized as improvements.

Hurricanes Katrina and Rita

Katrina and Rita affected certain of our Gulf Coast facilities in 2005. Our final purchase price allocation for the DMS acquisition in October 2005 included an \$81.1 million receivable for insurance claims related to property damage caused by Katrina and Rita. During 2008, our cumulative receipts exceeded such amount, and we recognized a gain of \$18.5 million. During 2009, expenditures related to these hurricanes included \$0.3 million capitalized as improvements. The insurance claim process is now complete with respect to Katrina and Rita for property damage and business interruption insurance.

Note 13—Stock and Other Compensation Plans

Stock Option Plans

Under Targa Investments' 2005 Incentive Compensation Plan ("the Plan"), options to purchase a fixed number of shares of its stock may be granted to our employees, directors and consultants. Generally, options granted under the Plan have a vesting period of four years and remain exercisable for ten years from the date of grant.

The fair value of each option granted was estimated on the date of grant using a Black-Scholes option pricing model, which incorporates various assumptions for 2008, including (i) expected term of the options of ten years, (ii) a risk-free interest rate of 3.6%, (iii) expected dividend yield of 0%, and (iv) expected stock price volatility on Targa Investments' common stock of 25.5%. Our selection of the risk-free interest rate was based on published yields for United States government securities with comparable terms. Because Targa Investments is a non-public company, its expected stock price volatility was estimated based upon the historical price volatility of the Dow Jones MidCap Pipelines Index over a period equal to the expected average term of the options granted. The calculated fair value of options granted during the year ended December 31, 2008 was \$1.48 per share.

The following table shows stock option activity for the periods indicated:

| | <u>Number of Options</u> | <u>Weighted Average Exercise Price</u> | <u>Weighted Average Remaining Contractual Term (in years)</u> |
|---|------------------------------|--|---|
| Outstanding at December 31, 2007 | 5,062,080 | \$ 7.80 | |
| Granted | 180,000 | 3.59 | |
| Exercised | (368,113) | 2.41 | |
| Repurchased | (77,601) | 7.80 | |
| Forfeited | <u>(51,736)</u> | 7.80 | |
| Outstanding at December 31, 2008 | <u>4,744,630</u> | 8.06 | |
| Exercised | <u>(214,870)</u> | 1.41 | |
| Outstanding at December 31, 2009 | <u>4,529,760</u> | 8.38 | 5.98 |
| Exercisable at December 31, 2009 | <u>4,363,098</u> | 8.51 | 5.91 |

We recognized compensation expense associated with stock options of \$0.1 million and \$0.2 million during 2009 and 2008. As of December 31, 2009, we expect to incur an additional \$0.1 million of expense related to non-vested stock options over a weighted average period of approximately two years. The total intrinsic value of options exercised during 2009 was less than \$0.1 million.

Non-vested (Restricted) Common Stock

Restricted stock awards entitle recipients to exchange restricted common shares for unrestricted common shares (at no cost to them) once the defined vesting period expires, subject to certain forfeiture provisions. The restrictions on the non-vested shares generally lapse four years from the date of grant.

The following table provides a summary of Targa Investments' non-vested restricted common stock awards for the periods indicated:

| | <u>Year Ended December 31,</u> | |
|--|--------------------------------|------------------|
| | <u>2009</u> | <u>2008</u> |
| Outstanding at beginning of period | 1,249,116 | 5,467,154 |
| Granted | - | 20,000 |
| Vested | (1,198,085) | (4,163,020) |
| Forfeited | <u>-</u> | <u>(75,018)</u> |
| Outstanding at end of period | <u>51,031</u> | <u>1,249,116</u> |
| Weighted average grant date fair value per share | <u>\$ 1.67</u> | <u>\$ 1.19</u> |

The total fair value of non-vested restricted common shares that vested during 2009 was \$1.4 million. We recognized \$0.3 million and \$1.0 million of compensation expense associated with the vesting of restricted stock during 2009 and 2008. As of December 31, 2009, we expect to incur an additional \$0.1 million of expense related to non-vested shares issued to our employees, over a weighted average period of approximately two years.

Non-Employee Director Grants and Incentive Plan related to the Partnership's Common Units

In 2007, Targa Investments adopted a Long-Term Incentive Plan ("LTIP") for employees, consultants and directors of the general partner and its affiliates who perform services for Targa Investments or its affiliates. The LTIP provides for the grant of cash-settled performance units, which are linked to the performance of the Partnership's common units and may include distribution equivalent rights ("DERs"). The LTIP is administered by the compensation committee of the board of directors of Targa Investments. Subject to applicable vesting criteria, a DER entitles the grantee to a cash payment equal to cash distributions paid on an outstanding common unit.

Grants outstanding under Targa Investments' LTIP were 275,400 under the 2007 program, 135,800 under the 2008 program, 534,900 units under the 2009 program and 90,403 units under the 2010 program. During

2009, there were forfeitures under the LTIP of 12,025 units. Grants under the 2007, 2008, 2009 and 2010 programs are payable in August 2010, July 2011, June 2012 and June 2013. Each vested performance unit will entitle the grantee to a cash payment equal to the then value of a Partnership common unit, including DERs. Vesting of performance units is based on the total return per common unit of the Partnership through the end of the performance period, relative to the total return of a defined peer group.

Because the performance units require cash settlement, they have been accounted for as liabilities. The fair value of a performance unit is the sum of: (i) the closing price of a Partnership common unit on the reporting date; (ii) the fair value of an at-the-money call option on a performance unit with a grant date equal to the reporting date and an expiration date equal to the last day of the performance period; and (iii) estimated DERs. The fair value of the call options was estimated using a Black-Scholes option pricing model with a dividend yield of 8.5%, and with risk-free rates and volatilities of 0.3% and 42% under the 2007 program, 0.8% and 61% under the 2008 program, 1.4% and 61% under the 2009 program and 1.4% and 52% under the 2010 program.

At December 31, 2009, the aggregate fair value of performance units expected to vest was \$23.5 million. During 2009 and 2008, we recognized compensation expense of \$10.5 million and \$0.1 million related to the performance units. The remaining recognition period for the unrecognized compensation cost is approximately three and a half years.

During 2009 and 2008, Targa Resources GP LLC, the general partner of the Partnership, also made equity-based awards of 32,000 and 16,000 restricted common units of the Partnership (4,000 and 2,000 restricted common units of the Partnership to each of the Partnership's and Targa Investments' non-management directors) under its ("Incentive Plan"). The awards will settle with the delivery of common units and are subject to three-year vesting, without a performance condition, and will vest ratably on each anniversary of the grant date. During 2009 and 2008, we recognized compensation expense of \$0.3 million related to these awards. We estimate that the remaining fair value of \$0.2 million will be recognized in expense over approximately two years. As of December 31, 2009 there were 41,993 unvested restricted common units outstanding under this plan.

The following table summarizes our unit-based awards for each of the periods indicated (in units and dollars):

| | Year Ended |
|--|---------------------------------|
| | <u>December 31, 2009</u> |
| Outstanding at beginning of period | 26,664 |
| Granted | 32,000 |
| Vested | <u>(16,671)</u> |
| Outstanding at end of period | <u>41,993</u> |
| Weighted average grant date fair value per share | <u>\$ 12.88</u> |

Subsequent Event. On January 22, 2010, TRGP made equity-based awards of 2,250 restricted common units (15,750 total restricted common units) of the Partnership to each of the Partnership's and Targa Investments' non-management directors under the Incentive Plan. The awards will settle with the delivery of common units and are subject to three year vesting, without a performance condition, and will vest ratably on each anniversary of the grant date.

Other Compensation Plans

We have a 401(k) plan whereby we match 100% of up to 5% of an employee's contribution (subject to certain limitations in the plan). We also contribute an amount equal to 3% of each employee's eligible compensation to the plan as a retirement contribution and may make additional contributions at our sole discretion. All Targa contributions are made 100% in cash. We made contributions to the 401(k) plan totaling \$3.7 million and \$8.4 million during 2009 and 2008.

Note 14—Derivative Instruments and Hedging Activities

Our principal market risks are our exposure to changes in commodity prices, particularly to the prices of natural gas and NGLs and changes in interest rates.

Commodity Price Risk. A majority of our revenues from our natural gas gathering and processing business are derived from percent-of-proceeds contracts under which we receive a portion of the natural gas and/or NGLs, or equity volumes, as payment for services. The prices of natural gas and NGLs are subject to market fluctuations in response to changes in supply, demand, market uncertainty and a variety of additional factors

beyond our control. We monitor these risks and enter into commodity derivative transactions designed to mitigate the impact of commodity price fluctuations on our business. Cash flows from a derivative instrument designated as a hedge are classified in the same category as the cash flows from the item being hedged.

The primary purpose of our commodity risk management activities is to hedge our exposure to commodity price risk and reduce fluctuations in our operating cash flow despite fluctuations in commodity prices. In an effort to reduce the variability of our cash flows, as of December 31, 2009, we have hedged the commodity price associated with a significant portion of our expected natural gas, NGL and condensate equity volumes for the years 2010 through 2013 by entering into derivative financial instruments including swaps and purchased puts (or floors). The percentages of our expected equity volumes that are hedged decrease over time. With swaps, we typically receive an agreed upon fixed price for a specified notional quantity of natural gas or NGL and we pay the hedge counterparty a floating price for that same quantity based upon published index prices. Since we receive from our customers substantially the same floating index price from the sale of the underlying physical commodity, these transactions are designed to effectively lock-in the agreed fixed price in advance for the volumes hedged. In order to avoid having a greater volume hedged than our actual equity volumes, we typically limit our use of swaps to hedge the prices of less than our expected natural gas and NGL equity volumes. We utilize purchased puts (or floors) to hedge additional expected equity commodity volumes without creating volumetric risk. Our commodity hedges may expose us to the risk of financial loss in certain circumstances. Our hedging arrangements provide us protection on the hedged volumes if market prices decline below the prices at which these hedges are set. If market prices rise above the prices at which we have hedged, we will receive less revenue on the hedged volumes than we would receive in the absence of hedges.

We have tailored our hedges to generally match the NGL product composition and the NGL and natural gas delivery points to those of our physical equity volumes. Our NGL hedges cover baskets of ethane, propane, normal butane, isobutane and natural gasoline based upon our expected equity NGL composition. We believe this strategy avoids uncorrelated risks resulting from employing hedges on crude oil or other petroleum products as “proxy” hedges of NGL prices. Additionally, our NGL hedges are based on published index prices for delivery at Mont Belvieu and our natural gas hedges are based on published index prices for delivery at Columbia Gulf, Houston Ship Channel, Permian Basin, Mid-Continent and Waha, which closely approximate our actual NGL and natural gas delivery points. We hedge a portion of our condensate sales using crude oil hedges that are based on the NYMEX futures contracts for West Texas Intermediate light, sweet crude. At December 31, 2009, the notional volumes of our commodity hedges were:

| <u>Commodity</u> | <u>Instrument</u> | <u>Unit</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> |
|------------------|-------------------|-------------|-------------|-------------|-------------|-------------|
| Natural Gas | Swaps | MMBtu/d | 35,694 | 28,500 | 19,500 | 8,000 |
| NGL | Swaps | Bbl/d | 8,958 | 6,100 | 3,950 | - |
| NGL | Floors | Bbl/d | - | 253 | 294 | - |
| Condensate | Swaps | Bbl/d | 851 | 750 | 400 | 400 |

Interest Rate Risk. We are exposed to changes in interest rates, primarily as a result of our variable rate borrowings under the Partnership’s credit facility. To the extent that interest rates increase, our interest expense for our revolving debt will also increase. As of December 31, 2009, we had outstanding variable rate borrowings of \$62.2 million and the Partnership had outstanding variable rate borrowings of \$479.2 million. In an effort to reduce the variability of our cash flows, we have entered into several interest rate swap and interest rate basis swap agreements. Under these agreements, which are accounted for as cash flow hedges, the base interest rate on the specified notional amount of our variable rate debt is effectively fixed for the term of each agreement and ineffectiveness is required to be measured each reporting period. The fair values of the interest rate swap agreements, which are adjusted regularly, have been aggregated by counterparty for classification in our consolidated balance sheets. Accordingly, unrealized gains and losses relating to the interest rate swaps are recorded in OCI until the interest expense on the related debt is recognized in earnings.

Credit Risk. Our credit exposure related to commodity derivative instruments is represented by the fair value of contracts with a net positive fair value to us at the reporting date. At such times, these outstanding instruments expose us to credit loss in the event of nonperformance by the counterparties to the agreements. Should the creditworthiness of one or more of our counterparties decline, our ability to mitigate nonperformance risk is limited to a counterparty agreeing to either a voluntary termination and subsequent cash settlement or a novation of the derivative contract to a third party. In the event of a counterparty default, we may sustain a loss and our cash receipts could be negatively impacted.

As of December 31, 2009, affiliates of Goldman Sachs and Bank of America (“BofA”) accounted for 93% and 5% of our counterparty credit exposure related to commodity derivative instruments. Goldman Sachs and BofA are major financial institutions, each possessing investment grade credit ratings, based upon minimum credit ratings assigned by Standard & Poor’s Ratings Services.

The following schedules reflect the fair values of derivative instruments in our financial statements:

| | <u>Asset Derivatives</u> | | | | <u>Liability Derivatives</u> | | | |
|---|-------------------------------|-------------------------|-----------------|-------------------------------|------------------------------|----------------|--|--|
| | <u>Balance Sheet Location</u> | <u>Fair Value as of</u> | | <u>Balance Sheet Location</u> | <u>Fair Value as of</u> | | | |
| | | <u>December 31,</u> | | | <u>December 31,</u> | | | |
| | | <u>2009</u> | <u>2008</u> | | <u>2009</u> | <u>2008</u> | | |
| <u>Derivatives designated as hedging instruments</u> | | | | | | | | |
| Commodity contracts | Current assets | \$ 31.6 | \$ 108.7 | Current liabilities | \$ 20.7 | \$ - | | |
| | Long-term assets | 11.7 | 89.8 | Long-term liabilities | 39.1 | 0.1 | | |
| Interest rate contracts | Current assets | 0.2 | - | Current liabilities | 8.0 | 8.0 | | |
| | Long-term assets | 1.9 | - | Long-term liabilities | 4.7 | 9.6 | | |
| Total derivatives designated as hedging instruments | | <u>45.4</u> | <u>198.5</u> | | <u>72.5</u> | <u>17.7</u> | | |
| <u>Derivatives not designated as hedging instruments</u> | | | | | | | | |
| Commodity contracts | Current assets | 1.1 | 3.6 | Current liabilities | 0.5 | 3.7 | | |
| | Long-term assets | 0.2 | - | Long-term liabilities | - | - | | |
| Interest rate contracts | Current assets | - | - | Current liabilities | - | - | | |
| | Long-term assets | - | - | Long-term liabilities | - | - | | |
| Total derivatives not designated as hedging instruments | | <u>1.3</u> | <u>3.6</u> | | <u>0.5</u> | <u>3.7</u> | | |
| Total derivatives | | <u>\$ 46.7</u> | <u>\$ 202.1</u> | | <u>\$ 73.0</u> | <u>\$ 21.4</u> | | |

The fair value of derivative instruments, depending on the type of instrument, was determined by the use of present value methods or standard option valuation models with assumptions about commodity prices based on those observed in underlying markets. These contracts may expose us to the risk of financial loss in certain circumstances. Our hedging arrangements provide us protection on the hedged volumes if prices decline below the prices at which these hedges are set. If prices rise above the prices at which we have hedged, we will receive less revenue on the hedged volumes than we would receive in the absence of hedges.

Our earnings are also affected by use of the mark-to-market method of accounting for derivative financial instruments that do not qualify for hedge accounting or that have not been designated as hedges. The changes in fair value of these instruments are recorded on the balance sheets and through earnings (i.e., using the "mark-to-market" method) rather than being deferred until the anticipated transaction affects earnings. The use of mark-to-market accounting for financial instruments can cause non-cash earnings volatility due to changes in the underlying commodity price indices. During 2009 and 2008, we recorded mark-to-market gains (losses) of \$0.3 million and (\$1.3) million.

The following table reflects the gain (loss) recognized in OCI on our consolidated balance sheets:

| <u>Derivatives in Cash Flow Hedging Relationships</u> | <u>Gain (Loss)</u> | |
|---|--|-----------------|
| | <u>Recognized in OCI on</u> | |
| | <u>Derivatives (Effective Portion)</u> | |
| | <u>Year Ended December 31,</u> | |
| | <u>2009</u> | <u>2008</u> |
| Interest rate contracts | \$ (7.3) | \$ (19.0) |
| Commodity contracts | (104.3) | 206.4 |
| | <u>\$ (111.6)</u> | <u>\$ 187.4</u> |

The following tables reflect amounts reclassified from OCI to revenues and expense:

| Location of Gain (Loss) Reclassified from OCI into Income | Amount of Gain (Loss) Reclassified from OCI into Income (Ineffective Portion) | |
|--|--|-------------|
| | Year Ended December 31, | |
| | 2009 | 2008 |
| | 2009 | 2008 |
| Revenues | \$ (0.3) | \$ - |

| Location of Gain (Loss) Reclassified from OCI into Income | Amount of Gain (Loss) Reclassified from OCI into Income (Effective Portion) | |
|--|--|-------------|
| | Year Ended December 31, | |
| | 2009 | 2008 |
| | 2009 | 2008 |
| Interest expense, net | \$ (15.7) | \$ (2.7) |
| Revenues | 69.7 | (65.1) |
| | \$ 54.0 | \$ (67.8) |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivatives | Amount of Gain (Loss) Recognized in Income on Derivatives | |
|--|--|--|-------------|
| | | Year Ended December 31, | |
| | | 2009 | 2008 |
| | | 2009 | 2008 |
| Commodity contracts | Other income (expense) | \$ 0.3 | \$ (1.3) |

As of December 31, 2009, OCI included \$29.4 million (\$18.3 million, net of tax) of unrealized net losses on commodity hedges and \$3.1 million (\$1.9 million, net of tax) of unrealized net losses on interest rate hedges.

As of December 31, 2008, OCI included \$59.6 million (\$39.3 million, net of tax) of unrealized net gains on commodity hedges, and \$4.7 million (\$3.1 million, net of tax) of unrealized net losses on interest rate hedges.

During 2009 and 2008 deferred net gains/(losses) on commodity hedges of \$69.7 million and (\$65.1) million were reclassified from OCI to revenues, and deferred net losses on interest rate hedges of (\$15.7) million and (\$2.7) million were reclassified from OCI to interest expense. During 2009 there were \$0.3 million in adjustments for ineffectiveness losses. During 2008, there were no adjustments for hedge ineffectiveness.

As of December 31, 2009, \$40.6 million (\$25.2 million, net of tax) of deferred net losses on commodity hedges and \$7.4 million (4.6 million, net of tax) of deferred net losses on interest rate hedges recorded in OCI are expected to be reclassified to revenues during the next twelve months.

In May 2008, Targa and the Partnership entered into certain NGL derivative contracts with Lehman Brothers Commodity Services Inc. ("Lehman"). Due to Lehman's bankruptcy filing, it is unlikely that we will receive full or partial payment of any amounts that may become owed to us under these contracts. Accordingly, Targa and the Partnership discontinued hedge accounting treatment for these contracts in July, 2008. Deferred losses of \$0.2 million and \$0.3 million will be reclassified from OCI to revenues during 2011 and 2012 when the forecasted transactions related to these contracts are expected to occur. Subsequent to the discontinuation of hedge accounting treatment, Targa and the Partnership recognized an aggregate non-cash loss on mark-to-market derivatives of \$1.3 million to adjust the fair value of the Lehman derivative contracts to zero. In October 2008, Targa and the Partnership terminated the Lehman derivative contracts.

In July 2008, the Partnership paid \$87.4 million to terminate certain out-of-the-money natural gas and NGL commodity swaps. Prior to the terminations, these swaps were designated as hedges. Deferred losses of \$27.9 million will be reclassified from OCI as a non-cash reduction of revenue during 2010 when the hedged forecasted sales transactions occurs. During 2009 and 2008, deferred losses of \$38.8 million and \$20.8 million related to the terminated swaps, were reclassified from OCI as a non-cash reduction to revenue. The Partnership also entered into new natural gas and NGL commodity swaps at then current market prices that match the production volumes of the terminated swaps through 2010.

In connection with the transfer of assets to the Partnership in October 2007 (see Note 5), we de-designated and settled for cash of approximately \$24.2 million derivative financial instruments designated as hedges of forecasted sales of NGLs through 2011. During 2009 and 2008, we reclassified deferred net losses of \$6.7 million and \$9.9 million related to these derivatives from OCI to revenues. During the years ended December 31, 2010 and 2011, we will reclassify additional deferred net losses of \$1.8 million and \$0.2 million, from OCI to revenues with respect to the de-designated hedges.

Interest Rate Swaps

In October 2009, we made payments of \$3.2 million to terminate all of our interest rate swaps and recognized a loss of \$0.4 million.

As of December 31, 2009, the Partnership had \$479.2 million outstanding under its senior secured revolving credit facility, with interest accruing at a base rate plus an applicable margin. In order to mitigate the risk of changes in cash flows attributable to changes in market interest rates the Partnership entered into interest rate swaps and interest rate basis swaps that effectively fix the base rate on \$300 million in borrowings as shown below:

| <u>Period</u> | <u>Fixed Rate</u> | <u>Notional Amount</u> | <u>Fair Value</u> |
|-------------------|-------------------|------------------------|-------------------|
| 2010 | 3.67% | \$300 million | \$ (7.8) |
| 2011 | 3.52% | 300 million | (5.1) |
| 2012 | 3.40% | 300 million | (0.6) |
| 2013 | 3.39% | 300 million | 1.6 |
| 01/01 - 4/24/2014 | 3.39% | 300 million | 1.3 |
| | | | <u>\$ (10.6)</u> |

The Partnership has designated all interest rate swaps and interest rate basis swaps as cash flow hedges of variable rate interest payments on borrowings under its senior secured revolving credit facility.

See Note 7 and Note 17 for additional disclosures related to derivative instruments and hedging activity.

Note 15—Income Taxes

Our provisions for income taxes for the periods indicated are as follows:

| | <u>Year Ended December 31,</u> | |
|------------------|--------------------------------|----------------|
| | <u>2009</u> | <u>2008</u> |
| Current expense | \$ 1.4 | \$ 1.2 |
| Deferred expense | <u>22.1</u> | <u>26.1</u> |
| | <u>\$ 23.5</u> | <u>\$ 27.3</u> |

Our deferred income tax assets and liabilities at December 31, 2009 and 2008 consist of differences related to the timing of recognition of certain types of costs as follows:

| | December 31, | |
|--|---------------------|------------------|
| | 2009 | 2008 |
| Deferred tax assets: | | |
| Net operating loss | \$ 58.7 | \$ 71.7 |
| Commodity hedging contracts and other | 6.3 | - |
| Tax credits | 16.8 | 16.8 |
| | <u>81.8</u> | <u>88.5</u> |
| Deferred tax liabilities: | | |
| Investments (1) | (132.8) | (125.9) |
| Commodity hedging contracts and other | (21.6) | (38.8) |
| | <u>(154.4)</u> | <u>(164.7)</u> |
| Net deferred tax liability | <u>\$ (72.6)</u> | <u>\$ (76.2)</u> |
| Federal | \$ (81.1) | \$ (85.8) |
| Foreign | 0.5 | 0.4 |
| State | 8.0 | 9.2 |
| | <u>\$ (72.6)</u> | <u>\$ (76.2)</u> |
| Balance sheet classification of deferred tax assets (liabilities): | | |
| Current asset | \$ - | \$ - |
| Long-term asset | - | - |
| Current liability | (1.4) | (36.2) |
| Long-term liability | (71.2) | (40.0) |
| | <u>\$ (72.6)</u> | <u>\$ (76.2)</u> |

(1) Our deferred tax liability attributable to investments reflects the differences between the book and tax carrying values of the assets and liabilities of our wholly-owned partnerships and equity method investments.

As of December 31, 2009, for federal income tax purposes, we had carryforwards of approximately \$203.4 million of regular tax net operating losses (“NOL”) and \$78.5 million of alternative minimum tax NOL. The NOL carryforwards expire in 2029.

Set forth below is reconciliation between our income tax provision (benefit) computed at the United States statutory rate on income before income taxes and the income tax provision in the accompanying consolidated statements of operations for the periods indicated:

| | Year Ended December 31, | |
|---|--------------------------------|----------------|
| | 2009 | 2008 |
| U.S. federal income tax provision at statutory rate | \$ 38.1 | \$ 61.8 |
| State income taxes | 1.6 | 0.9 |
| Attributable to Noncontrolling Interest | (17.4) | (34.3) |
| Other | 1.2 | (1.1) |
| Income tax provision | <u>\$ 23.5</u> | <u>\$ 27.3</u> |

During 2009 and 2008, no uncertain tax positions were identified. We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material adverse effect on our financial condition, results of operations or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

We are a member of a group that files a consolidated tax return with the federal government as well as several states. We share tax expense and liability with our parent corporation, Targa Investments, based on our relative contributions to consolidated income tax expense and liability. There has been no change in the method of allocation for the years presented in these financial statements.

Note 16—Commitments and Contingencies

Certain property and equipment is leased under non-cancelable leases that require fixed monthly rental payments and expire at various dates through 2099. Transportation contracts require us to make payments for capacity and expire at various dates through 2013. Surface and underground access for gathering, processing, and distribution assets that are located on property not owned by us is obtained through right-of-way agreements, which require annual rental payments and expire at various dates through 2099. Future non-cancelable commitments related to certain contractual obligations are presented below:

| | Payments Due by Period | | | | | | |
|-----------------------------------|------------------------|----------------|----------------|----------------|---------------|---------------|----------------|
| | Total | 2010 | 2011 | 2012 | 2013 | 2014 | Thereafter |
| Operating lease obligations (1) | \$ 55.2 | \$ 11.1 | \$ 8.7 | \$ 8.2 | \$ 5.6 | \$ 4.8 | \$ 16.8 |
| Capacity payments (2) | 12.4 | 5.1 | 3.6 | 2.6 | 1.1 | - | - |
| Right-of-way | 18.6 | 1.2 | 1.2 | 1.1 | 1.1 | 0.9 | 13.1 |
| Capital Projects | 33.4 | 17.2 | 14.7 | 0.5 | 0.5 | 0.5 | - |
| Other contractual obligations (3) | 1.3 | 0.6 | 0.6 | 0.1 | - | - | - |
| | <u>\$ 120.9</u> | <u>\$ 35.2</u> | <u>\$ 28.8</u> | <u>\$ 12.5</u> | <u>\$ 8.3</u> | <u>\$ 6.2</u> | <u>\$ 29.9</u> |

(1) Include minimum lease payment obligations associated with gas processing plant site leases, railcar leases, and office space leases.

(2) Consist of capacity payments for firm transportation contracts.

(3) Primarily consist of information technology contractual obligations.

Total expenses related to operating leases, right-of-way and capacity payments were \$13.7 million, \$2.0 million and \$9.6 million for 2009 and \$14.7 million, \$3.1 million and \$6.7 million for 2008.

Environmental

For environmental matters, we record liabilities when remedial efforts are probable and the costs can be reasonably estimated. Environmental reserves do not reflect management's assessment of the insurance coverage that may be applicable to the matters at issue. Management has assessed each of the matters based on current information and made a judgment concerning its potential outcome, considering the nature of the claim, the amount and nature of damages sought and the probability of success.

Our environmental liability at December 31, 2009 and 2008 was \$3.2 million and \$3.8 million. Our December 31, 2009 liability consisted of \$0.2 million for gathering system leaks, \$1.5 million for ground water assessment and remediation, and \$1.5 million for the gas processing plant environmental violations.

In May 2007, the New Mexico Environment Department ("NMED") alleged air emissions violations at the Eunice, Monument and Saunders gas processing plants operated by Targa Midstream Services Limited Partnership and owned by Versado Gas Processors, LLC ("Versado"), which were identified in the course of an inspection of the Eunice plant conducted by the NMED in August 2005.

Subsequent event. In January 2010, Versado settled the alleged violations with NMED for a penalty of approximately \$1.5 million. As part of the settlement, Versado agreed to install two acid gas injection wells, additional emission control equipment and monitoring equipment, the cost of which we estimate to be approximately \$33.4 million.

Legal Proceedings

We are a party to various legal proceedings and/or regulatory proceedings and certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against us. We believe all such matters are without merit or involve amounts which, if resolved unfavorably, would not have a material effect on our financial position, results of operations, or cash flows, except for the items more fully described below.

On December 8, 2005, WTG Gas Processing ("WTG") filed suit in the 333rd District Court of Harris County, Texas against several defendants, including Targa Resources, Inc. and three other Targa entities and private equity funds affiliated with Warburg Pincus LLC, seeking damages from the defendants. The suit alleges that Targa and private equity funds affiliated with Warburg Pincus LLC, along with ConocoPhillips Company ("ConocoPhillips") and Morgan Stanley, tortiously interfered with (i) a contract WTG claims to have had to purchase the SAOU System from ConocoPhillips and (ii) prospective business relations of WTG. WTG claims the alleged interference resulted from Targa's competition to purchase the ConocoPhillips' assets and its

successful acquisition of those assets in 2004. On October 2, 2007, the District Court granted defendants' motions for summary judgment on all of WTG's claims. WTG's motion to reconsider and for a new trial was overruled. On January 2, 2008, WTG filed a notice of appeal. On February 3, 2009, the parties presented oral arguments to the 14th Court of Appeals in Houston Texas.

Subsequent event. On February 23, 2010, the 14th Court of Appeals affirmed the District Court's final judgment in favor of defendants in its entirety. We have agreed to indemnify the Partnership for any claim or liability arising out of the WTG suit.

Note 17—Related-Party Transactions

Relationships with Warburg Pincus LLC

Warburg Pincus LLC beneficially owns approximately 74% of the outstanding voting stock of our parent. Warburg Pincus LLC is able to elect members of our board of directors, appoint new management and approve any action requiring the approval of our stockholder, including amendment of our certificate of incorporation and mergers or sales of substantially all of our assets. The directors elected by Warburg Pincus LLC will be able to make decisions affecting our capital structure, including decisions to issue additional capital stock, implement stock repurchase programs and declare dividends.

Chansoo Joung and Peter Kagan, two of our directors, are Managing Directors of Warburg Pincus LLC and are also directors of Broad Oak Energy, Inc. ("Broad Oak") from whom we buy natural gas and NGL products. Affiliates of Warburg Pincus LLC own a controlling interest in Broad Oak. We purchased \$9.7 million and \$4.8 million of product from Broad Oak during 2009 and 2008. These transactions were at market prices consistent with similar transactions with nonaffiliated entities.

Relationship with Maritech Resources, Inc.

William D. Sullivan, one of the directors of the General Partner of the Partnership, is also a director of Tetra Technologies, Inc. ("Tetra"). Maritech Resources, Inc. ("Maritech") is a subsidiary of Tetra. We purchased \$1.8 million and \$6.0 million of product from Maritech during 2009 and 2008. These transactions were at market prices consistent with similar transactions with nonaffiliated entities.

Relationships with Bank of America

Equity

An affiliate of BofA holds a non-voting equity interest in the general partner of Warburg Pincus Private Equity VIII, L.P. and Warburg Pincus Private Equity IX, L.P., the principal shareholders of Targa Investments.

Financial Services

BofA is a lender and an agent under our existing senior secured credit facilities. Additionally, BofA is a lender and an administrative agent under the Partnership's senior secured credit facility.

Hedging Arrangements

We have previously entered into various commodity derivative transactions with BofA. As of December 31, 2009, we have no open positions with BofA. For the years ended December 31, 2009 and 2008 we received from (paid to) BofA \$24.2 million and (\$30.3) million in commodity derivative settlements.

The Partnership had the following open commodity derivatives with BofA as of December 31, 2009:

| <u>Period</u> | <u>Commodity</u> | <u>Daily Volumes</u> | <u>Average Price</u> | <u>Index</u> |
|---------------------|------------------|----------------------|----------------------|--------------|
| Jan 2010 - Dec 2010 | Natural Gas | 3,289 MMBtu | \$ 7.39 per MMBtu | IF-WAHA |
| Jan 2010 - Jun 2010 | Natural Gas | 663 MMBtu | 8.16 per MMBtu | NY-HH |
| Jan 2010 - Dec 2010 | Condensate | 181 Bbl | 69.28 per Bbl | NY-WTI |

As of December 31, 2009 the fair value of these Partnership open positions was an asset of \$0.9 million. During 2009 and 2008 the Partnership received from (paid to) BofA \$25.4 million and (\$9.1) million in commodity derivative settlements.

Commercial Relationships

In April 2004, we entered into a base agreement for the purchase and sale of natural gas with Entergy-Koch Trading, LP, pursuant to which Entergy-Koch Trading, LP typically purchases natural gas for fuel at its affiliated cogeneration facility in Lake Charles. On November 1, 2004, BofA acquired Entergy-Koch Trading, LP and became a successor to this agreement. Pricing terms under the agreement are governed by reference to specified index prices plus a premium. For the years 2009 and 2008, we had product sales to BofA, which are included in revenues, of \$36.7 million and \$97.0 million. For the same periods, we had natural gas and NGL product purchases of \$1.0 million and \$5.1 million from BofA.

Transactions with Unconsolidated Affiliates

For the years indicated, our natural gas and NGL sales and purchases with our unconsolidated affiliates were:

| | <u>Year Ended December 31,</u> | |
|--|--------------------------------|-----------------|
| | <u>2009</u> | <u>2008</u> |
| <u>Included in revenues</u> | | |
| GCF | \$ 0.2 | \$ 0.5 |
| VESCO (1) | - | <u>0.7</u> |
| | <u>\$ 0.2</u> | <u>\$ 1.2</u> |
| <u>Included in costs and expenses</u> | | |
| GCF | \$ 1.4 | \$ 3.5 |
| VESCO (1) | - | <u>178.1</u> |
| | <u>\$ 1.4</u> | <u>\$ 181.6</u> |

(1) For 2008, our commercial transactions with VESCO are reflected through July 31, 2008. As a result of acquiring an additional ownership in VESCO, they are no longer considered an unconsolidated affiliate and we have consolidated the operations of VESCO in our financial results with effect from August 1, 2008.

These transactions were at market prices consistent with similar transactions with nonaffiliated entities.

Note 18—Fair Value of Financial Instruments

The estimated fair values of our assets and liabilities classified as financial instruments have been determined using available market information and valuation methodologies described below. Considerable judgment is required in interpreting market data to develop the estimates of fair value. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

The carrying value of our and the Partnership's credit facilities approximates their fair values, as the interest rates are based on prevailing market rates. The fair value of the senior secured term loan facility and the senior unsecured notes are based on quoted market prices based on trades of such debt.

The carrying values of items comprising current assets and current liabilities approximate fair values due to the short-term maturities of these instruments. Derivative financial instruments included in our financial statements are stated at fair value. The carrying amounts and fair values of our other financial instruments are as follows as of the dates indicated:

| | As of December 31, | | | |
|--|----------------------------|-----------------------|----------------------------|-----------------------|
| | 2009 | | 2008 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Senior secured term loan facility | \$ 62.2 | \$ 61.9 | \$ 522.2 | \$ 331.6 |
| Senior unsecured notes, 8½% fixed rate (1) | 250.0 | 259.2 | 250.0 | 134.4 |
| Senior unsecured notes of the Partnership, 8¼% fixed rate | 209.1 | 206.5 | 209.1 | 128.3 |
| Senior unsecured notes of the Partnership, 11¼% fixed rate (2) | 220.1 | 253.5 | - | - |

- (1) The fair value as of December 31, 2009 represents the value of the last trade of the year which occurred on December 9, 2009. On January 5, 2010 we paid \$264.7 million to complete a cash tender offer for all outstanding aggregate principal amount plus accrued interest of \$3.8 million.
- (2) The carrying amount of the notes includes \$11.2 million of unamortized original issue discount as of December 31, 2009.

Note 19—Supplemental Cash Flow Information

Supplemental cash flow information was as follows for the periods indicated:

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2009 | 2008 |
| Cash: | | |
| Interest paid | \$ 69.7 | \$ 93.7 |
| Income taxes paid (received) | (0.1) | 1.6 |
| Business interruption insurance receipts | 19.2 | 15.9 |
| Non-cash: | | |
| Inventory line-fill transferred to property, plant and equipment | 9.8 | - |
| Like-kind exchange of property, plant and equipment | - | 5.8 |
| Settlement of Partnership notes | - | 14.1 |
| Distribution of property to noncontrolling interest | - | 14.8 |

Note 20—Other Operating Income

Our other operating (income) expense consists of the following items for the periods indicated:

| | Year Ended December 31, | |
|--|--------------------------------|----------------|
| | 2009 | 2008 |
| Abandoned project costs | \$ 5.6 | \$ - |
| Casualty loss adjustment (see Note 12) | (3.7) | 19.3 |
| Loss (gain) on sale of assets (1) | 0.1 | (5.9) |
| | <u>\$ 2.0</u> | <u>\$ 13.4</u> |

- (1) For 2008, \$5.8 million of the gain on sale of assets was due to a like-kind exchange. See Note 19.

Note 21—Significant Risks and Uncertainties

Nature of Operations in Midstream Energy Industry

We operate in the midstream energy industry. Our business activities include gathering, transporting, processing, fractionating and storing natural gas, NGLs and crude oil. Our results of operations, cash flows and financial condition may be affected by (i) changes in the commodity prices of these hydrocarbon products and (ii) changes in the relative price levels among these hydrocarbon products. In general, the prices of natural gas, NGLs, condensate and other hydrocarbon products are subject to fluctuations in response to changes in supply, market uncertainty and a variety of additional factors that are beyond our control.

Our profitability could be impacted by a decline in the volume of natural gas, NGLs and condensate transported, gathered or processed at our facilities. A material decrease in natural gas or crude oil production or crude oil refining, as a result of depressed commodity prices, a decrease in exploration and development activities or otherwise, could result in a decline in the volume of natural gas, NGLs and condensate handled by our facilities. A reduction in demand for NGL products by the petrochemical, refining or heating industries, whether because of (i) general economic conditions, (ii) reduced demand by consumers for the end products made with NGL products, (iii) increased competition from petroleum-based products due to the pricing differences, (iv) adverse weather conditions, (v) government regulations affecting commodity prices and production levels of hydrocarbons or the content of motor gasoline or (vi) other reasons, could also adversely affect our results of operations, cash flows and financial position.

Credit Risk due to Industry Concentrations

A substantial portion of our revenues are derived from companies in the domestic natural gas, NGL and petrochemical industries. This concentration could impact our overall exposure to credit risk since these customers may be impacted by similar economic or other conditions. To help reduce our credit risk, we evaluate our counterparties' financial condition and, where appropriate, negotiate netting agreements. We generally do not require collateral for our accounts receivable; however, in certain circumstances we will call for prepayment, require automatic debit agreements or obtain collateral to minimize our potential exposure to defaults.

Counterparty Risk with Respect to Financial Instruments

Where we are exposed to credit risk in our financial instrument transactions, we analyze the counterparty's financial condition prior to entering into an agreement, establish credit and/or margin limits and monitor the appropriateness of these limits on an ongoing basis. Generally, we do not require collateral and we do not anticipate nonperformance by our counterparties.

We have master netting agreements with most of our hedge counterparties. These netting agreements allow us to net settle asset and liability positions with the same counterparties. As of December 31, 2009, we had \$7.4 million in liabilities to offset the default risk of counterparties with which we also had asset positions of \$25.9 million as of that date.

Casualties and Other Risks

We maintain coverage in various insurance programs, which provide us with property damage, business interruption and other coverages which are customary for the nature and scope of our operations. The financial impact of storm events such as Hurricanes Katrina and Rita, and more recently Hurricanes Gustav and Ike, as well as the current economic environment, have affected many insurance carriers, and may affect their ability to meet their obligation or trigger limitations in certain insurance coverages. At present, there is no indication of any of our insurance carriers being unable or unwilling to meet its coverage obligations.

We believe that we maintain adequate insurance coverage, although insurance will not cover every type of interruption that might occur. As a result of insurance market conditions, premiums and deductibles for certain insurance policies have increased substantially, and in some instances, certain insurance may become unavailable, or available for only reduced amounts of coverage. As a result, we may not be able to renew existing insurance policies or procure other desirable insurance on commercially reasonable terms, if at all.

If we were to incur a significant liability for which we were not fully insured, it could have a material impact on our consolidated financial position and results of operations. In addition, the proceeds of any such insurance may not be paid in a timely manner and may be insufficient if such an event were to occur. Any event that interrupts the revenues generated by our consolidated operations, or which causes us to make significant expenditures not covered by insurance, could reduce our ability to meet our obligations under various agreements with our lenders.