

PAA NATURAL GAS STORAGE LP

Form 10-Q

November 05, 2010

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2010

OR

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

Commission file number: 1-34722

PAA Natural Gas Storage, L.P.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

27-1679071

(I.R.S. Employer
Identification No.)

333 Clay Street, Suite 1500, Houston, Texas

(Address of principal executive offices)

77002

(Zip Code)

(713) 646-4100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

As of November 2, 2010, there were 31,586,405 common units outstanding. The common units trade on the New York Stock Exchange under the ticker symbol PNG.

**PAA NATURAL GAS STORAGE, L.P. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION
Item 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
PAA Natural Gas Storage, L.P. and Subsidiaries
Condensed Consolidated Balance Sheets
(unaudited)
(in thousands, except units)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	\$ 429	\$ 3,124
Accounts receivable	8,023	6,439
Natural gas imbalance receivables	400	400
Other current assets	6,492	2,280
Total current assets	15,344	12,243
Property and equipment		
Property and equipment	873,038	816,267
Less: Accumulated depreciation, depletion and amortization	(11,682)	(3,004)
Property and equipment, net	861,356	813,263
Other assets		
Base gas	37,498	27,927
Goodwill and intangibles, net	47,880	46,974
Total other assets, net	85,378	74,901
Total assets	\$ 962,078	\$ 900,407
LIABILITIES, PARTNERS CAPITAL AND MEMBERS CAPITAL		
Current liabilities		
Accounts payable and accrued liabilities	\$ 10,591	\$ 14,034
Natural gas imbalance payables	400	400
Accrued income and other taxes	707	1,610
Total current liabilities	11,698	16,044
Long-term liabilities		
Note payable to PAA		450,523
Long-term debt under credit facility	221,500	
Other long-term liabilities	94	1,096
Total long-term liabilities	221,594	451,619
Total liabilities	233,292	467,663
Commitments and contingencies (Note 5)		

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Partners' capital and members' capital			
Common unitholders (31,586,405 units issued and outstanding at September 30, 2010)		478,323	
Subordinated unitholders (25,434,351 units issued and outstanding at September 30, 2010)		238,262	
General partner		12,604	
Members' capital			432,744
Accumulated other comprehensive loss		(403)	
Total partners' capital and members' capital		728,786	432,744
Total liabilities, partners' capital and members' capital	\$	962,078	\$ 900,407

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

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PAA Natural Gas Storage, L.P. and Subsidiaries
Condensed Consolidated Statements of Operations
(unaudited)
(in thousands, except per unit data)

	Successor	Predecessor	Successor	Predecessor
	September	July 1, 2009	September	January 1,
	3, 2009	through	3, 2009	2009
	through	September	through	through
	September	September	September	September
	30,	2, 2009	30,	2, 2009
	2010	30, 2009	2010	30, 2009
	(See Note 1)	(See Note 1)	(See Note 1)	(See Note 1)
Revenues				
Firm storage services	\$ 23,773	\$ 6,020	\$ 11,977	\$ 66,057
Hub services	689	343	482	3,625
Other	621	7	1	1,764
Total revenues	25,083	6,370	12,460	71,446
Costs and expenses				
Storage related costs	5,101	1,002	2,124	16,624
Other operating costs (except those shown below)	1,720	896	1,252	5,144
Fuel expense	611	171	40	1,665
General and administrative expenses	3,409	1,383	781	11,163
Depreciation, depletion and amortization	3,867	770	1,887	10,323
Total costs and expenses	14,708	4,222	6,084	44,919
Operating income	10,375	2,148	6,376	26,527
Other income/(expense)				
Interest expense, net of capitalized interest	(749)	(1,140)	(676)	(6,540)
Interest income	1		13	2
Income tax expense			(119)	
Gain on interest rate swaps				336
Other income (expense)	(7)	(2)	(1)	(17)
Net income	\$ 9,620	\$ 1,006	\$ 5,593	\$ 19,975
	\$ 1,006	\$ 15,518		

Calculation of Limited Partner Interest in Net Income: ⁽¹⁾

Net income	\$ 9,620	n/a	n/a	\$ 14,547	n/a	n/a
Less general partner interest in net income	192	n/a	n/a	291	n/a	n/a
Limited partner interest in net income	\$ 9,428	n/a	n/a	\$ 14,256	n/a	n/a

Net income per limited partner unit (basic and diluted) ⁽¹⁾

Common and Series A subordinated units ⁽²⁾	\$ 0.21	n/a	n/a	\$ 0.32	n/a	n/a
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Limited partner units outstanding ⁽¹⁾

Common and Series A subordinated units ⁽²⁾ (Basic)	44,520	n/a	n/a	44,902	n/a	n/a
Common and Series A subordinated units ⁽²⁾ (Diluted)	44,525	n/a	n/a	44,907	n/a	n/a

⁽¹⁾ Reflective of general and limited partner interest in net income since closing of the Partnership's initial public offering. See Note 8, Net Income per Limited Partner Unit.

⁽²⁾ Excludes Series B subordinated units. See Note 8, Net Income per Limited Partner Unit.

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

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PAA Natural Gas Storage, L.P. and Subsidiaries
Condensed Consolidated Statement of Changes in Partners Capital and Members Capital
(unaudited)
(in thousands)

	Members Capital	Common	Partners Capital Limited Partners Subordinated		General Partner	Accumulated Other Comprehensive Loss	Total
			Series A	Series B			
Balance at December 31, 2009	\$ 432,744	\$	\$	\$	\$	\$	\$ 432,744
Net income attributable to the period from January 1, 2010 through May 4, 2010	5,428						5,428
Extinguishment of related party note payable to PAA	16,375						16,375
Contribution of net assets to PAA Natural Gas Storage, L.P.	(454,547)	205,422	158,088	78,888	12,149		
Issuance of common units to public, net of offering and other costs		268,161					268,161
Modification of subordinated units			(22,903)	22,903			
Equity compensation expense		222			359		581
Modification of LTIP awards		1,181					1,181
Net income attributable to the period from May 5, 2010 through September 30, 2010		10,024	4,232		291		14,547
Distributions to unitholders		(6,677)	(2,946)		(196)		(9,819)
Distribution equivalent right payments		(10)					(10)
Contribution from general partner					1		1
Net deferred loss on cash flow hedges						(403)	(403)
	\$	\$ 478,323	\$ 136,471	\$ 101,791	\$ 12,604	\$ (403)	\$ 728,786

**Balance at
September 30, 2010**

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

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PAA Natural Gas Storage, L.P. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(unaudited)
(in thousands)

	Successor September 3, 2009	Predecessor January 1, 2009
	Nine Months Ended September 30, 2010	through September 30, 2009
	(See Note 1)	through September 2, 2009 (See Note 1)
Cash flows from operating activities		
Net income	\$ 19,975	\$ 1,006
Adjustments to reconcile to cash flow from operations		\$ 15,518
Depreciation, depletion and amortization	10,323	770
Non-cash change in fair market value of derivative instruments	(370)	(336)
Non-cash interest expense on borrowings from parent, net	5,081	
Change in assets and liabilities		
Accounts receivable and other assets	(5,882)	954
Accounts payable and accrued liabilities	3,099	2,021
Net cash provided by operating activities	32,226	4,415
		22,603
Cash flows from investing activities		
Additions to property and equipment	(58,550)	(8,365)
Cash paid for base gas	(9,488)	(4,367)
Other investing activities	80	14,002
Net cash provided by (used in) investing activities	(67,958)	1,270
		(58,561)
Cash flows from financing activities		
Repayments on term loan agreement		(25,214)
Borrowings on revolving credit facility	256,900	59,400
Repayments of borrowings on revolving credit facility	(35,400)	(29,900)
Borrowings from parent	24,000	
Repayment of borrowings from parent	(468,363)	
Net proceeds from issuance of common units	268,161	
Costs incurred in connection with financing arrangements	(2,433)	(4,639)
Contribution from general partner	1	
Distributions paid to limited partners	(9,623)	
Distributions paid to general partner	(196)	
Distribution equivalent right payments	(10)	
Contributions from members		8,500

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Distributions to members				(8,500)
Net cash provided by (used in) financing activities	33,037	(25,214)		23,636
Net decrease in cash and cash equivalents	(2,695)	(19,529)		(12,322)
Cash and cash equivalents				
Beginning of period	3,124	20,328		32,650
End of period	\$ 429	\$ 799	\$	20,328
Cash paid for interest, net of amounts capitalized	\$ 1,448	\$	\$	2,298
Cash paid for income taxes	\$	\$	\$	795
Non-cash items				
Change in non-cash asset purchases included in accounts payable	\$ (6,855)	\$ (3,761)	\$	1,534
Non-cash interest capitalized on borrowings from parent	\$ 5,130	\$ 1,140	\$	

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

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PAA Natural Gas Storage, L.P. and Subsidiaries
Notes to the Condensed Consolidated Financial Statements
(unaudited)

1. Organization, Nature of Operations and Basis of Presentation

PAA Natural Gas Storage, L.P. (the Partnership or PNG) is a Delaware limited partnership formed on January 15, 2010 to own the natural gas storage business of Plains All American Pipeline, L.P. (PAA). The Partnership is a fee-based, growth-oriented partnership engaged in the ownership, acquisition, development, operation and commercial management of natural gas storage facilities. We currently own and operate two natural gas storage facilities located in Louisiana and Michigan.

Our Pine Prairie facility is a recently constructed, high-deliverability salt cavern natural gas storage complex located in Evangeline Parish, Louisiana. As of September 30, 2010, Pine Prairie had a total working gas storage capacity of approximately 24.0 billion cubic feet (Bcf) in three caverns. Our Bluewater facility is a depleted reservoir natural gas storage complex located approximately 50 miles from Detroit in St. Clair County, Michigan. As of September 30, 2010, Bluewater had a total working gas storage capacity of approximately 26 Bcf in two depleted reservoirs.

As further discussed in Note 6, on May 5, 2010, the Partnership completed its initial public offering (IPO) pursuant to which PAA sold an approximate 23.0% limited partner interest in the Partnership to the public. Immediately prior to the closing of the IPO on May 5, 2010, PAA and certain of its consolidated subsidiaries contributed 100.0% of the equity interests in PAA Natural Gas Storage, LLC (PNGS), the predecessor of the Partnership, and its subsidiaries to the Partnership. For periods prior to our initial public offering, the accompanying condensed consolidated financial statements of PNGS reflect the predecessor financial statements of the Partnership, which are based on the historical ownership percentages of PAA and its subsidiaries in the PNGS operations that were contributed to the Partnership in conjunction with the IPO. Prior to the IPO, the financial statements of the Partnership consisted of total assets of \$1,000 and the Partnership had not conducted any activity since its formation on January 15, 2010. The accompanying condensed consolidated financial statements, to the extent they relate to periods prior to the IPO, have been prepared from the separate financial records maintained by PNGS or its predecessor, as applicable, and may not necessarily be indicative of the actual results of operations that might have occurred if the Partnership had operated separately during those periods. As of September 30, 2010, PAA owned approximately 77.0% of the equity interests in the Partnership including our 2.0% general partner interest and limited partner interests consisting of 18,106,529 common units, 11,934,351 Series A subordinated units and 13,500,000 Series B subordinated units.

On September 3, 2009, PAA became the sole owner of PNGS by acquiring Vulcan Capital's 50.0% interest in PNGS (PAA Ownership Transaction) for an aggregate purchase price of \$215.0 million. Although PNGS continued as the same legal entity after the PAA Ownership Transaction, all of its assets and liabilities were adjusted to fair value at the time of the transaction in accordance with push-down accounting requirements. The remeasurement of PNGS's assets and liabilities to fair value resulted in changes in carrying value for certain of PNGS's assets and liabilities. The changes in carrying value are summarized as follows (in thousands):

PP&E, net	\$ 153,800
Base gas	(38,338)
Goodwill	(61,398)
Other long term assets	(4,546)
	\$ 49,518

As a result of the push-down accounting requirements applied in conjunction with the PAA Ownership Transaction, the financial information of PNGS for periods preceding (designated as Predecessor) and succeeding (designated as Successor) the PAA Ownership Transaction have been prepared under two different cost bases of accounting. Where applicable, a vertical line separates financial information for periods preceding and succeeding the PAA Ownership Transaction to highlight the fact that such information was prepared under different bases of

accounting.

The accompanying condensed consolidated interim financial statements should be read in conjunction with the Partnership's final prospectus dated April 29, 2010 (the "Final Prospectus") included in our Registration Statement on Form S-1, as amended (SEC File No. 333-164492). These financial statements have been prepared in accordance with the instructions for interim reporting as prescribed by the Securities and Exchange Commission (the "SEC"). All adjustments (consisting only of normal recurring adjustments) that in the opinion of management were necessary for a fair statement of the results for interim periods have been reflected. The condensed balance sheet data as of December 31, 2009 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the three and nine months ended September 30, 2010 should not be taken as indicative of results to be expected for the full year.

The accompanying condensed consolidated financial statements include the accounts of PNG and its subsidiaries, all of which are wholly owned. All significant intercompany transactions have been eliminated.

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As used in this document, the terms we, us, our and similar terms refer to the Partnership and its subsidiaries including its predecessors, where applicable, unless the context indicates otherwise.

Other Current Assets

During the quarter ended June 30, 2010, we purchased approximately 1 Bcf of natural gas for approximately \$4.6 million for use in the dewatering of our Pine Prairie facility. This gas, which was acquired for operational purposes, is reflected as a component of other current assets in our accompanying condensed consolidated balance sheet as of September 30, 2010. We anticipate that this gas will be sold during the fourth quarter of 2010. In July 2010, we entered into derivative instruments, which were designated as cash flow hedges, to manage our exposure to changes in natural gas prices associated with this anticipated sale.

2. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued guidance that requires an enterprise to perform an analysis to determine whether the enterprise's variable interest(s) provide a controlling financial interest in a variable interest entity (VIE). This analysis identifies the primary beneficiary of a VIE as the enterprise that has (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (ii) the obligation to absorb losses of the entity, or the right to receive benefits from the entity, that could potentially be significant to the VIE. This guidance also (i) requires such assessments to be ongoing, (ii) amends certain guidance for determining whether an entity is a VIE and (iii) enhances disclosures that will provide users of financial statements with more transparent information regarding an enterprise's involvement in a VIE. We adopted this guidance as of January 1, 2010. Our adoption did not have any material impact on our financial position, results of operations or cash flows.

In January 2010, the FASB issued guidance to enhance disclosures related to the existing fair value hierarchy disclosure requirements. A fair value measurement is designated as Level 1, 2 or 3 within the hierarchy based on the nature of the inputs used in the valuation process. Level 1 measurements generally reflect quoted market prices in active markets for identical assets or liabilities, Level 2 measurements generally reflect the use of significant observable inputs and Level 3 measurements typically utilize significant unobservable inputs. This new guidance requires additional disclosures regarding transfers into and out of Level 1 and Level 2 measurements and requires a gross presentation of activities within the Level 3 roll forward. This guidance was effective for the first interim or annual reporting period beginning after December 15, 2009, except for the gross presentation of the Level 3 roll forward, which is required for annual reporting periods beginning after December 15, 2010 and for interim reporting periods within those years. We adopted the guidance relating to Level 1 and Level 2 measurements as of January 1, 2010. Our adoption did not have any material impact on our financial position, results of operations or cash flows. We will adopt the guidance relating to Level 3 measurements on January 1, 2011. We do not expect that adoption of this guidance will have any material impact on our financial position, results of operations, or cash flows.

3. Derivative Instruments and Risk Management Activities

From time to time, we may utilize derivative instruments to (i) manage our price exposure associated with anticipated purchases or sales of natural gas, (ii) economically hedge the value of our natural gas storage facilities and (iii) manage our exposure to interest rate risk. 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 hedges. This process includes specific identification of the hedging instrument and the hedged transaction, the nature of the risk being hedged and how the hedging instrument's effectiveness will be assessed. Both at the inception of a hedge and on an ongoing basis, we assess whether the derivatives used in such hedging transactions are highly effective in offsetting changes in cash flows of hedged items. FASB guidance requires us to recognize changes in the fair value of derivative instruments currently in earnings unless the derivatives meet specific cash flow hedge accounting requirements, in which case the effective portion of changes in the fair value of cash flow hedges are deferred in accumulated other comprehensive income (AOCI) and reclassified into earnings when the underlying hedged transaction affects earnings.

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Commodity Price Risk Hedging

We use derivative financial instruments to hedge the following commodity risks inherent in our business:

Anticipated Purchases and Sales of Natural Gas Our gas storage facilities require minimum levels of base gas to operate. For our natural gas storage facilities that are under construction, we anticipate purchasing base gas in future periods as construction is completed. We use derivatives to hedge such anticipated purchases of natural gas. As of September 30, 2010, we have a long futures position of approximately 1 Bcf consisting of NYMEX futures and a long call option position of approximately 0.7 Bcf. Such positions were entered into during the first quarter of 2010. Additionally, we use derivatives to hedge anticipated sales of operational gas when that gas is no longer needed for cavern development purposes. As of September 30, 2010, we have a short futures position of approximately 1 Bcf consisting of NYMEX futures. Such positions were entered into during the third quarter of 2010. As of September 30, 2010, all of our outstanding derivatives entered into for purposes of hedging anticipated purchases and sales of natural gas have been designated as cash flow hedges.

Interest Rate Risk Hedging

Prior to the PAA Ownership Transaction, we had previously entered into a series of interest rate swap agreements that were designated as cash flow hedges. These interest rate swaps were utilized to mitigate exposure to changes in cash flows associated with variable rate interest payments on certain debt obligations. In conjunction with the PAA Ownership Transaction, all of the associated debt obligations were settled and all of these interest rate swap agreements were terminated. Subsequent to the PAA Ownership Transaction, we have not entered into any additional interest rate swap agreements.

Summary of Financial Statement Impact

Derivatives that qualify for hedge accounting are designated as cash flow hedges. Changes in fair value for the effective portion of the hedges are deferred to AOCI and recognized in earnings in the periods during which the underlying hedged transaction impacts earnings. Derivatives that do not qualify for hedge accounting and the ineffective portion of cash flow hedges are recognized in earnings each period. Cash settlements associated with our derivative activities are reflected as operating cash flows in our consolidated statements of cash flows.

We recognized realized losses of approximately \$0.8 million, of which approximately \$0.4 million was incurred during the nine months ended September 30, 2010, associated with a natural gas calendar spread position, which was closed in June 2010 and did not qualify for hedge accounting. Such losses are reflected as a component of other revenues in our accompanying condensed consolidated statements of operations. During the three and nine months ended September 30, 2009, we did not have any derivative positions that did not qualify for hedge accounting.

Our earnings were not impacted by derivatives that were classified as cash flow hedges during the three and nine months ended September 30, 2010.

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A summary of the impact of our derivative activities in cash flow hedging relationships recognized in earnings for the periods July 1, 2009 through September 2, 2009 and January 1, 2009 through September 2, 2009 is as follows (in thousands):

		July 1, 2009 through September 2, 2009		
		Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)(1)	Amount of Gain/(Loss) Recognized in Income on Derivatives (Ineffective Portion)(2)	Total
Interest Rate Derivatives	Location of Gain/(Loss)			
	Interest expense	\$(2,081)	\$	\$(2,081)

		January 1, 2009 through September 2, 2009		
		Amount of Gain/(Loss) Reclassified from AOCI into Income (Effective Portion)(1)	Amount of Gain/(Loss) Recognized in Income on Derivatives (Ineffective Portion)(2)	Total
Interest Rate Derivatives	Location of Gain/(Loss)			
	Interest expense	\$(6,613)	\$	\$(6,613)
	Gain on interest rate swaps		336	336
Total		\$(6,613)	\$ 336	\$(6,277)

(1) Amounts represent derivative gains and losses that were reclassified from AOCI to earnings during the period to

coincide with the earnings impact of the respective hedged transaction.

- (2) Amounts represent the ineffective portion of the fair value of our cash flow hedges that were recognized in earnings during the period.

The following table summarizes the derivative assets and liabilities on our condensed consolidated balance sheet on a gross basis as of September 30, 2010 (in thousands):

	Asset Derivatives Balance Sheet		Liability Derivatives Balance Sheet	
	Location	Fair Value	Location	Fair Value
Commodity derivatives designated as hedging instruments	Accounts payable and accrued liabilities	\$ 1,007	Accounts payable and accrued liabilities	\$ (1,411)

The following table summarizes the derivative assets and liabilities on our condensed consolidated balance sheet on a gross basis as of December 31, 2009 (in thousands):

	Asset Derivatives Balance Sheet		Liability Derivatives Balance Sheet	
	Location	Fair Value	Location	Fair Value
Commodity derivatives not designated as hedging instruments	Accounts payable and Accrued liabilities	\$ 37	Accounts payable and Accrued liabilities	\$ (407)

As of September 30, 2010, there was a net loss of approximately \$0.4 million deferred in AOCI (no amounts were deferred in AOCI as of December 31, 2009). The deferred loss in AOCI is expected to be reclassified to future earnings contemporaneously with the earnings recognition of the underlying hedged transactions. The underlying hedged transactions are for anticipated base gas purchases and anticipated sales of operational gas. As we account for base gas as a long-term asset, which is not subject to depreciation, amounts related to base gas will not be reclassified to future earnings until such gas is sold or in the event an impairment charge is recognized in the future. Approximately \$1.4 million of deferred loss as of September 30, 2010 is associated with anticipated base gas purchases. We expect to reclassify the \$1.0 million deferred gain as of September 30, 2010, associated with anticipated sales of operational gas, into earnings during the fourth quarter of 2010. Amounts deferred are based on market prices as of September 30, 2010, thus actual amounts to be reclassified will differ and could vary materially as a result of changes in market conditions. During 2010 and 2009, no amounts were reclassified from AOCI to earnings as a result of anticipated hedge transactions that were no longer considered to be probable of occurring.

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Our accounting policy is to offset fair value amounts associated with derivatives executed with the same counterparty when a master netting agreement exists. As of September 30, 2010 and December 31, 2009, we did not have an obligation to pay or a right to receive cash collateral associated with our derivatives. At September 30, 2010 and December 31, 2009, none of our outstanding derivatives contained credit-risk related contingent features that would result in a material adverse impact upon a change in our credit ratings.

ASC 820, Fair Value Measurements and Disclosures, requires enhanced disclosures about assets and liabilities carried at fair value. As defined in ASC 820, fair value is the price that would be received from selling an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The determination of fair value incorporates various factors. These factors include not only the credit standing of the counterparties involved and the impact of credit enhancements, but also the impact of potential nonperformance risk on our liabilities. As of September 30, 2010 and December 31, 2009, all of our derivatives consisted of exchange-traded instruments within active markets. We therefore consider all of our derivatives as of September 30, 2010 and December 31, 2009 to be Level 1 fair value measurements.

4. Debt

In April 2010, subject to consummation of our initial public offering, we entered into a three-year, \$400.0 million senior unsecured revolving credit facility that matures in May 2013. This credit facility, which bears interest based on LIBOR plus an applicable margin (approximately 2.8% in the aggregate as of September 30, 2010) determined based on funded debt-to-EBITDA levels (as defined in the credit agreement), may be expanded to \$600.0 million, subject to additional lender commitments and with approval of the administrative agent for the credit facility.

This credit facility restricts, among other things, the Partnership's ability to make distributions of available cash to unitholders if any default or event of default, as defined in the credit agreement, exists or would result therefrom. In addition, the credit facility contains restrictive covenants, including those that restrict our ability to incur additional indebtedness, engage in certain transactions with affiliates, grant (or permit to exist) liens or enter into certain restricted contracts, make any material change to the nature of our business, make a disposition of all or substantially all of our assets or enter into a merger, consolidate, liquidate, wind up or dissolve. Also, the credit facility contains certain financial covenants which, among other things, requires us to maintain a debt-to-EBITDA coverage ratio that will not be greater than 4.75 to 1.00 on outstanding debt (5.50 to 1.00 on all outstanding debt during an acquisition period) and also requires that we maintain an interest-to-EBITDA coverage ratio that will not be less than 3.00 to 1.00, as such terms are defined in the credit agreement. As of September 30, 2010, we were in compliance with the covenants contained in our credit agreement.

We incurred approximately \$2.4 million of costs, reflected as a component of goodwill and intangibles, net in our accompanying condensed consolidated balance sheet as of September 30, 2010, in connection with the establishment of our senior unsecured revolving credit facility. Such costs were capitalized and will be amortized over the term of the credit facility using the straight-line method of amortization. Amortization of debt issuance costs is reflected as a component of depreciation, depletion and amortization expenses in our accompanying condensed consolidated statements of operations. At September 30, 2010, we estimate that the carrying value of outstanding borrowings under our credit facility approximates fair value as interest rates reflect current market rates.

Our credit facility includes the ability to issue letters of credit. As of September 30, 2010, we had no outstanding letters of credit.

As of December 31, 2009, approximately \$450.5 million was outstanding on a related party note payable to PAA, which was entered into in conjunction with the PAA Ownership Transaction. The note accrued interest and was payable in kind, at a rate of 6.5%. As discussed in Note 6, net proceeds of the IPO, along with borrowings under the new credit facility, were used to repay approximately \$468.4 million of the related party note, which included additional borrowings and interest accrued through May 5, 2010. The remaining balance of approximately \$16.4 million was extinguished and treated as a capital contribution by PAA as part of PAA's initial investment in the Partnership.

Capitalized interest for the three and nine months ended September 30, 2010, was \$1.0 million and \$6.5 million, respectively, and \$1.3 million, \$3.3 million and \$10.2 million for the periods September 3, 2009 through September 30, 2009, July 1, 2009 through September 2, 2009 and January 1, 2009 through September 2, 2009, respectively.

5. Commitments and Contingencies

Environmental

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We may experience releases of natural gas, brine, crude oil or other contaminants into the environment, or discover past releases that were previously unidentified. Although we maintain an inspection program designed to prevent and, as applicable, to detect and address such releases promptly, damages and liabilities incurred due to any such releases from our assets may substantially affect our business. As of September 30, 2010, we have not identified any such material obligations.

A natural gas storage facility, associated pipeline header system and gas handling and compression facilities may suffer damage as a result of an accident, natural disaster or terrorist activity. These hazards can cause personal injury and loss of life, severe damage to or destruction of property, base gas, or equipment, pollution or environmental damage, or suspension of operations. We maintain insurance under PAA's insurance program, of various types that we consider adequate to cover our operations and properties. Such insurance covers our assets in amounts management considers reasonable. The insurance policies are subject to deductibles that we consider reasonable and not excessive. Our insurance does not cover every potential risk associated with operating natural gas storage facilities, associated pipeline header systems, and gas handling and compression facilities. The overall trend in the insurance industry appears to be a contraction in the breadth and depth of available coverage, while costs, deductibles and retention levels have increased. Absent a material favorable change in the insurance markets, we expect this trend to continue as we continue to grow and expand. Accordingly, we may elect to self-insure more of our activities or incorporate higher retention in our insurance arrangements.

The occurrence of a significant event not fully insured, indemnified or reserved against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect our operations and financial condition. We believe we are adequately insured for public liability and property damage to others with respect to our operations. With respect to all of our coverage, we may not be able to maintain adequate insurance in the future at rates we consider reasonable. In addition, although we believe that we have established adequate reserves to the extent that such risks are not insured, costs incurred in excess of these reserves may be higher and may potentially have a material adverse effect on our financial condition, results of operations or cash flows.

Litigation

We, in the ordinary course of business, are a claimant and/or a defendant in various legal proceedings. To the extent we are able to assess the likelihood of a negative outcome for these proceedings, our assessments of such likelihood range from remote to probable. If we determine that a negative outcome is probable and the amount of loss is reasonably estimable, we accrue the estimated amount. We do not believe that the outcome of these legal proceedings, individually or in the aggregate, will have a materially adverse effect on our financial condition, results of operations or cash flows.

6. Partners Capital and Distributions***Initial Public Offering***

As discussed in Note 1, immediately prior to the closing of the IPO on May 5, 2010, PAA and its subsidiaries contributed 98.0% of the equity interests in PNGS to the Partnership in exchange for certain limited partner interests. In addition, PNGS GP LLC, the general partner of the Partnership and a subsidiary of PAA, contributed 2.0% of the equity interests in PNGS to the Partnership in exchange for a 2.0% general partner interest in the Partnership as well as all of our incentive distribution rights, which entitle our general partner to increasing percentages of the cash we distribute in excess of \$0.3375 per quarter.

On May 5, 2010, the Partnership issued approximately 13.5 million common units to the public, which included approximately 1.8 million common units issued pursuant to the full exercise of the underwriters' over-allotment option, through an underwritten initial public offering representing an approximate 23.0% limited partner interest in us. Upon closing of the initial public offering and after giving effect to the exercise of the underwriters' over-allotment option, PAA and its subsidiaries retained an approximate 77.0% equity interest in the Partnership, consisting of approximately 18.1 million common units, approximately 13.9 million Series A subordinated units, 11.5 million Series B subordinated units and a 2.0% general partner interest in us. Total proceeds of the initial public offering were approximately \$289.8 million. After deducting underwriting discounts and commissions and direct offering expenses, net proceeds of the offering were approximately \$268.2 million. Net proceeds of the offering, along with \$200.0 million of borrowings under the Partnership's new \$400.0 million senior unsecured revolving credit facility,

were used to repay intercompany indebtedness owed to PAA. The remaining balance of the intercompany indebtedness owed to PAA of approximately \$16.4 million was extinguished and treated as a capital contribution and part of PAA's initial investment in the Partnership.

Outstanding Units

From the closing of our initial public offering on May 5, 2010 through September 30, 2010, changes in our issued and outstanding common, Series A subordinated and Series B subordinated units were as follows:

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		Subordinated		
	Common	Series A	Series B	Total
Balance, May 5, 2010				
Initial public offering	31,584,529	13,934,351	11,500,000	57,018,880
Modification of subordinated units		(2,000,000)	2,000,000	
Vesting of LTIP awards	1,876			1,876
Balance, September 30, 2010				
	31,586,405	11,934,351	13,500,000	57,020,756

Modification of subordinated units

In August 2010, our general partner amended and restated the Amended and Restated Agreement of Limited Partnership of the Partnership (the Second Amended and Restated Agreement) to increase our distribution coverage and growth profile of our common and Series A subordinated units and improve our posture with respect to potential acquisitions. The Second Amended and Restated Agreement reduced the number of Series A subordinated units held by PAA by 2.0 million units and increased the number of Series B subordinated units held by PAA by an equivalent amount. The Second Amended and Restated Agreement also established two additional tranches of Series B subordinated units. We accounted for this transaction as an exchange between entities under common control and accordingly, we reclassified approximately \$22.9 million, the book value of 2.0 million Series A subordinated units at the time of the transaction, from the Series A subordinated unit limited partner capital account to the Series B subordinated unit limited partner capital account in our accompanying condensed consolidated statement of changes in partners' capital and members' capital.

Series A subordinated units

All of our Series A subordinated units are owned by PAA. The principal difference between our common units and Series A subordinated units is that in any quarter during the subordination period, holders of the Series A subordinated units are not entitled to receive any distribution until the common units have received the minimum quarterly distribution plus any arrearages in the payment of the minimum quarterly distribution from prior quarters. Series A subordinated units will not accrue arrearages.

At any time on or after June 30, 2013, the subordination period for the Series A subordinated units will end on the first business day following the quarter in respect of which we have, for each of three consecutive, non-overlapping four quarter periods (i) generated from distributable cash flow at least \$1.35 (the minimum quarterly distribution on an annualized basis) on the weighted average number of outstanding common units and Series A subordinated units on a fully diluted basis, plus the corresponding distribution on our general partner's 2.0% interest and (ii) paid from available cash at least \$1.35 on all outstanding common units and Series A subordinated units, plus the corresponding distribution on our general partner's 2.0% interest. Additionally, at any time on or after June 30, 2011, if we have, for a period of four consecutive quarters (i) generated from distributable cash flow at least \$0.5063 per quarter (150.0% of the minimum quarterly distribution, which is approximately \$2.03 on an annualized basis) on the weighted average number of outstanding common units and Series A subordinated units on a fully diluted basis, plus the corresponding distributions on our general partner's 2.0% interest and the related distributions on the incentive distribution rights and (ii) paid from available cash at least \$0.5063 per quarter (150.0% of the minimum quarterly distribution, which is approximately \$2.03 on an annualized basis) on all outstanding common units and Series A subordinated units, plus the corresponding distribution on our general partner's 2.0% interest and the related distributions on the incentive distribution rights, the subordination period will end.

In addition, the subordination period will end upon the removal of our general partner other than for cause, if the units held by our general partner and its affiliates are not voted in favor of such removal.

When the subordination period ends, all Series A subordinated units will convert into common units on a one-for-one basis, and all common units thereafter will no longer be entitled to arrearages.

Series B subordinated units

All of our Series B subordinated units are owned by PAA. The Series B subordinated units will not be entitled to participate in our quarterly distributions until they convert into Series A subordinated units or common units.

The Series B subordinated units will convert into Series A subordinated units upon satisfaction of the following operational and financial conditions:

2,600,000 Series B subordinated units will convert into Series A subordinated units on a one-for-one basis if (a) the aggregate amount of working gas storage capacity at Pine Prairie that has been placed into service totals at least 29.6 Bcf,

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(b) we generate distributable cash flow for two consecutive quarters sufficient to pay a quarterly distribution of at least \$0.36 per unit (representing an annualized distribution of \$1.44 per unit) on the weighted average number of outstanding common units and Series A subordinated units and all of such Series B subordinated units and (c) we make a quarterly distribution of available cash of at least \$0.36 per quarter for two consecutive quarters on all outstanding common units and Series A subordinated units and the corresponding distributions on our general partner's 2.0% interest and the related distributions on the incentive distribution rights;

2,833,333 Series B subordinated units will convert into Series A subordinated units on a one-for-one basis if (a) the aggregate amount of working gas storage capacity at Pine Prairie that has been placed into service totals at least 35.6 Bcf, (b) we generate distributable cash flow for two consecutive quarters sufficient to pay a quarterly distribution of at least \$0.3825 per unit (representing an annualized distribution of \$1.53 per unit) on the weighted average number of outstanding common units and Series A subordinated units and all of such Series B subordinated units and, if any, the Series B subordinated units described in the prior bullet, and (c) we make a quarterly distribution of available cash of at least \$0.3825 per quarter for two consecutive quarters on all outstanding common units and Series A subordinated units and the corresponding distributions on our general partner's 2.0% interest and the related distributions on the incentive distribution rights;

2,066,667 Series B subordinated units will convert into Series A subordinated units on a one-for-one basis if (a) the aggregate amount of working gas storage capacity at Pine Prairie that has been placed into service totals at least 41.6 Bcf, (b) we generate distributable cash flow for two consecutive quarters sufficient to pay a quarterly distribution of at least \$0.4075 per unit (representing an annualized distribution of \$1.63 per unit) on the weighted average number of outstanding common units and Series A subordinated units and all of such Series B subordinated units and, if any, the Series B subordinated units described in the prior two bullets, and (c) we make a quarterly distribution of available cash of at least \$0.4075 per quarter for two consecutive quarters on all outstanding common units and Series A subordinated units and the corresponding distributions on our general partner's 2.0% interest and the related distributions on the incentive distribution rights;

3,000,000 Series B subordinated units will convert into Series A subordinated units on a one-for-one basis if (a) the aggregate amount of working gas storage capacity at Pine Prairie that has been placed into service totals at least 48 Bcf, (b) we generate distributable cash flow for two consecutive quarters sufficient to pay a quarterly distribution of at least \$0.4275 per unit (representing an annualized distribution of \$1.71 per unit) on the weighted average number of outstanding common units and Series A subordinated units and all of such Series B subordinated units and, if any, the Series B subordinated units described in the prior three bullets, and (c) we make a quarterly distribution of available cash of at least \$0.4275 per quarter for two consecutive quarters on all outstanding common units and Series A subordinated units and the corresponding distributions on our general partner's 2.0% interest and the related distributions on the incentive distribution rights; and

3,000,000 Series B subordinated units will convert into Series A subordinated units on a one-for-one basis if (a) the aggregate amount of working gas storage capacity at Pine Prairie that has been placed into service totals at least 48 Bcf, (b) we generate distributable cash flow for two consecutive quarters sufficient to pay a quarterly distribution of at least \$0.45 per unit (representing an annualized distribution of \$1.80 per unit) on the weighted average number of outstanding common units and Series A subordinated units and all of such Series B subordinated units and, if any, the Series B subordinated units described in the prior four bullets, and (c) we make a quarterly distribution of available cash of at least \$0.45 per quarter for two consecutive quarters on all outstanding common units and Series A subordinated units and the corresponding distributions on our general partner's 2.0% interest and the related distributions on the

incentive distribution rights.

Before giving effect to the Second Amended and Restated Agreement, there were 4,600,000, 3,833,333 and 3,066,667 Series B subordinated units included in first, second and third tranches of Series B subordinated units, respectively.

Our general partner will determine whether the in-service operational requirements set forth above have been satisfied. To the extent that the operational tests described above are satisfied prior to or during the two-quarter period applicable to the financial tests described above, the holder of the Series B subordinated units subject to conversion will be entitled to receive the quarterly distribution payable with respect to the second quarter of such two-quarter period. In all other circumstances, where the operational tests are satisfied following the two-quarter period applicable to the financial tests, the holder of the Series B subordinated units subject to conversion will be entitled to receive any distribution payable following the satisfaction of such operational tests.

Any Series B subordinated units that remain outstanding as of December 31, 2018 will automatically be cancelled.

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Following conversion of any Series B subordinated units into Series A subordinated units, such converted Series B subordinated units will further convert into common units (together with any other outstanding Series A subordinated units) to the extent that the tests for conversion of the Series A subordinated units are satisfied. In determining whether such conversion tests have been satisfied, the Series B subordinated units that have converted into Series A subordinated units will be treated as Series A subordinated units from and after the date of their conversion into Series A subordinated units.

If at the time the above operational and financial tests are satisfied, the subordination period has already ended and all outstanding Series A subordinated units have converted into common units, the Series B subordinated units will instead convert directly into common units on a one-for-one basis and participate in the quarterly distribution payable to common units.

Distributions

Our partnership agreement requires that, within 45 days subsequent to the end of each quarter, beginning with the quarter ended June 30, 2010, we will distribute all of our available cash, as defined in our partnership agreement, to unitholders of record on the applicable record date.

Our partnership agreement requires that we distribute all of our available cash each quarter in the following manner:

first, 98.0% to the holders of common units and 2.0% to our general partner, until each common unit has received the minimum quarterly distribution of \$0.3375, plus any arrearages from prior quarters; and

second, 98.0% to the holders of Series A subordinated units and 2.0% to our general partner, until each Series A subordinated unit has received the minimum quarterly distribution of \$0.3375.

If cash distributions to our unitholders exceed \$0.3375 per common unit and Series A subordinated unit in any quarter, our general partner will receive, in addition to distributions on its 2.0% general partner interest, incentive distributions in increasing percentages, up to 48.0%, of the cash we distribute in excess of that amount as follows:

	Total Quarterly Distributions per Common Unit and Series A Subordinated Unit	Marginal Percentage Interest in Distributions	
		Unitholders	General Partner
Minimum quarterly distribution	\$ 0.3375	98.0%	2.0%
First target distribution	above \$0.3375 up to \$0.37125	85.0%	15.0%
Second target distribution	above \$0.37125 up to \$0.50625	75.0%	25.0%
Thereafter	above \$0.50625	50.0%	50.0%

Our general partner has the right, at any time when there are no Series A subordinated units outstanding and it has received incentive distributions at the highest level to which it is entitled (48.0%) for each of the prior four consecutive fiscal quarters, to reset the initial target distribution levels at higher levels based on our cash distributions at the time of the exercise of the reset election.

The following table details the distributions subsequent to our initial public offering (in millions, except per unit amounts):

Date Declared	Date Paid or To Be Paid	Distributions Paid				Total	Distributions per limited partner unit
		Series A		General Partner			
		Units	Units	Incentive	2%		
October 12, 2010	November 12, 2010 ⁽¹⁾	\$ 10.7	\$ 4.0	\$	\$ 0.3	\$ 15.0	\$ 0.3375
July 13, 2010	August 13, 2010 ⁽²⁾	\$ 6.7	\$ 2.9	\$	\$ 0.2	\$ 9.8	\$ 0.2114

- (1) Payable to unitholders of record on November 2, 2010, for the period July 1, 2010 through September 30, 2010.
- (2) Amount represents a quarterly distribution of \$0.3375 per unit prorated from the May 5, 2010 closing date of the IPO through June 30, 2010.

7. Comprehensive Income

Comprehensive income includes net income and all other non-owner changes in equity. Components of comprehensive income (loss) are presented below (in thousands):

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	Successor September 3, 2009		Predecessor July 1, 2009		Successor September 3, 2009		Predecessor January 1, 2009	
	Three Months Ended September 30, 2010		through September 2, 2009		Nine Months Ended September 30, 2010		through September 2, 2009	
	(See Note 1)		(See Note 1)		(See Note 1)		(See Note 1)	
Net income	\$ 9,620	\$ 1,006	\$ 5,593	\$ 19,975	\$ 1,006	\$ 15,518		
Net derivative gain/(loss) on cash flow hedges	(44)		(627)	(403)		1,990		
Total comprehensive income	\$ 9,576	\$ 1,006	\$ 4,966	\$ 19,572	\$ 1,006	\$ 17,508		

8. Net Income per Limited Partner Unit

Basic and diluted net income per unit is determined by dividing each class of limited partners' interest in net income by the weighted average number of limited partner units for such class outstanding during the period. Pursuant to FASB guidance, the limited partners' interest in net income is calculated by first reducing net income by the distribution pertaining to the current period's net income, which is to be paid in the subsequent quarter (including the incentive distribution right in excess of the 2.0% general partner interest). Then, the remaining undistributed earnings or excess distributions over earnings, if any, are allocated to the general partner and limited partner interests in accordance with the contractual terms of the partnership agreement. Diluted earnings per limited partner unit, where applicable, reflects the potential dilution that could occur if securities or other agreements to issue additional units of a limited partner class, such as phantom unit awards, were exercised, settled or converted into such units.

The following table sets forth the computation of basic and diluted earnings per limited partner unit for the three months ended September 30, 2010 and the period from May 5, 2010 (the closing of our initial public offering) through September 30, 2010 (amounts in thousands, except per unit data):

	Three Months Ended September 30, 2010		May 5, 2010 through September 30, 2010	
Net income	\$ 9,620	\$ 14,547		
Less: General partner's incentive distribution paid (1)				
Less: General partner 2.0% ownership	192	291		
Net income available to limited partners	\$ 9,428	\$ 14,256		
Numerator for basic and diluted earnings per limited partner unit: Allocation of net income amongst limited partner interests:				
Net income allocable to common units	\$ 6,686	\$ 10,024		
Net income allocable to Series A subordinated units	2,742	4,232		

Net income allocable to Series B subordinated units (2)

Net income available to limited partners	\$	9,428	\$	14,256
Denominator:				
Basic weighted average number of limited partner units outstanding:				
(2)(3)(4)				
Common units		31,586		31,585
Series A subordinated units		12,934		13,317
Series B subordinated units		12,500		12,117
Diluted weighted average number of limited partner units outstanding:				
(2)(3)(4)				
Common units		31,591		31,590
Series A subordinated units		12,934		13,317
Series B subordinated units		12,500		12,117
Basic and diluted net income per limited partner unit: (2)(3)(4)				
Common units	\$	0.21	\$	0.32
Series A subordinated units	\$	0.21	\$	0.32
Series B subordinated units	\$		\$	

(1) Based on the amount of the distribution declared per common and Series A subordinated limited partner units related to earnings for the applicable periods, our general partner was not entitled to receive any incentive distributions for such periods.

(2) As of September 30, 2010, our Series B subordinated units were not entitled to participate in our earnings, losses or distributions in accordance with

the terms of our
partnership
agreement as
necessary
performance
conditions have
not been
satisfied. As a

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result, no earnings were allocated to the Series B subordinated units in our determination of basic and diluted net income per limited partner unit.

- (3) Substantially all of our LTIP awards (described in Note 9), which are equity classified awards, contain provisions whereby vesting occurs only upon the satisfaction of a performance condition. None of the performance conditions on such awards had been satisfied as of September 30, 2010. As such, our outstanding LTIP awards as of September 30, 2010 did not have a material impact in our determination of diluted net income per limited partner unit.

- (4) The conversion of (i) our Series A subordinated units to common units and (ii) our Series B subordinated units to Series A subordinated units or common units is subject to certain performance conditions. None of these performance conditions had been satisfied as of September 30, 2010 therefore, there is no dilutive impact of such units in our determination of diluted net income per limited partner unit.

Table of Contents**9. Equity Compensation Plans****Long Term Incentive Plan (LTIP)**

On April 27, 2010, PNGS GP LLC, the general partner of the Partnership, adopted the PAA Natural Gas Storage, L.P. 2010 Long Term Incentive Plan (the 2010 LTIP Plan) for the employees, directors and consultants of our general partner and its affiliates, including PAA, who perform services on our behalf. The 2010 LTIP Plan consists of restricted units, phantom units, unit options, unit appreciation rights and unit awards. The 2010 LTIP Plan limits the number of common units that may be delivered pursuant to awards under the plan to 3,000,000 units.

During the second quarter of 2010, 658,500 phantom units were granted under the 2010 LTIP Plan to directors, officers and other employees, a portion of which were granted upon conversion of outstanding awards denominated in common units of PAA. Of this total, (i) 30,000 phantom units will vest annually in 25.0% increments and have an automatic re-grant feature such that as they vest, an equivalent amount is granted; (ii) 326,000 phantom units will vest in one-third increments upon the later of (a) the May 2012 distribution date and the date we pay a quarterly distribution of at least \$0.3875, (b) the May 2013 distribution date and the date we pay a quarterly distribution of at least \$0.4500, and (c) the May 2014 distribution date and the date we pay a quarterly distribution of at least \$0.4750; and (iii) 302,500 phantom units will vest in 25.0% increments in connection with the conversion of our Series A subordinated units and the conversion of each of the first three tranches of our Series B subordinated units. Distribution equivalent rights were also awarded with respect to 342,500 of the phantom unit grants.

In November 2010, our Board of Directors approved the modification (subject to agreement by the individual award recipients) of 302,500 LTIP awards originally granted in the second quarter of 2010 to more closely align the vesting of these awards to the conversion of our Series B subordinated units as a result of the modification of our subordinated units in August 2010 (see Note 6). Such awards now vest in 20% increments in connection with the conversion of our Series A subordinated units and the conversion of each of the first four tranches of our Series B subordinated units.

Our LTIP activity for awards issued under the 2010 LTIP Plan is summarized in the following table (in thousands, except per unit data):

	Units	Weighted Average Grant Date Fair Value per Unit
Outstanding, May 5, 2010		\$
Granted (1)	661	19.72
Vested	(2)	19.72
Cancelled or forfeited		
Outstanding, September 30, 2010	659	\$ 19.72

(1) Includes 645,000 equity classified awards and 13,500 liability classified awards.

Prior to our initial public offering and adoption of the 2010 LTIP Plan, certain of our officers and other individuals providing direct services on our behalf were granted LTIP awards under LTIP plans sponsored by PAA's general partner (PAA LTIP Awards). Such awards, which allow settlement in cash or PAA common units upon vesting at the

election of PAA's general partner, generally contained performance conditions based on the attainment of certain annualized PAA distribution levels or the attainment of specific PNG EBITDA levels and vested upon the later of a certain date or the attainment of such levels. In connection with the second quarter grants under the 2010 LTIP Plan, substantially all of the then outstanding liability-classified PAA LTIP awards held by PNG management were converted to equity-classified PNG LTIP awards, which resulted in a reclassification to Partners' capital of approximately \$1.2 million of compensation expense recognized on such awards through the modification date. As of September 30, 2010, we are obligated to reimburse PAA, upon vesting, for approximately 20,000 currently outstanding PAA LTIP awards. We reimbursed PAA approximately \$0.3 million and \$0.5 million for PAA LTIP awards that vested during the three and nine months ended September 30, 2010, respectively.

The fair value of our liability classified awards is calculated based on the closing price of the underlying PAA or PNG units as of each balance sheet date and adjusted for the present value of any distributions that are estimated to occur on the underlying units over the vesting period that will not be received by the award recipients. The fair value of our equity classified awards is calculated based on the closing price of our common units as of the respective grant dates and adjusted for the present value of any distributions that are estimated to occur on the underlying units over the vesting period that will not be received by the award recipient. The fair value of these awards is recognized as compensation expense over the service period. For awards with performance conditions, we recognize compensation expense only if the achievement of the performance condition is considered probable and amortize that expense over the service period. When awards with performance conditions that were not previously considered probable of occurring become probable

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of occurring, we incur additional equity compensation expense necessary to adjust the life-to-date accrued expense associated with these awards. Substantially all of our equity compensation expense is reflected as a component of general and administrative expenses in our accompanying condensed consolidated statements of operations.

Our accrued liability at September 30, 2010 related to all outstanding liability classified LTIP awards is approximately \$1.3 million. We have also recognized \$1.8 million in Partners' capital related to all outstanding equity classified LTIP awards. Compensation expense recognized on 2010 LTIP Plan awards reflects our assessment that an annualized PNG distribution of \$1.45 and the conversion of our Series A subordinated units and the first tranche of our Series B subordinated units are probable of occurring.

Class B Awards of Our General Partner

In July 2010, the Board of Directors of our general partner authorized the issuance of 165,000 Class B Units (PNGS Class B Units) of PNGS GP LLC (PNG's general partner) in order to create long term incentives for our management. The entire economic burden of the PNGS Class B Units, which are equity classified, will be borne solely by our general partner and will not impact our cash or our units outstanding. We will recognize the grant date fair value of the PNGS Class B Units as compensation expense over the service period, with such expense recognized as a capital contribution. We will not be obligated to reimburse our general partner for such costs and any distributions made on the PNGS Class B Units will not reduce the amount of cash available for distribution to our unitholders.

Approximately 98,000 PNGS Class B units were granted in July 2010 and the remaining units are reserved for future grants. The PNGS Class B Units earn the right to participate in distributions (i.e., become earned) in 25% increments 180 days following the payment by PNG of quarterly distributions that equate to annualized distribution levels of \$2.00, \$2.30, \$2.50 and \$2.70. When PNGS Class B Units become earned units, they will participate in quarterly distributions paid to our general partner in excess of \$2,500,000. In addition, 50% of the applicable earned units vest immediately upon becoming earned units and the remaining 50% vest on the fifth anniversary of the date of grant. If PNGS Class B Units become earned units after the fifth anniversary of the date of grant, 100% of such units will vest immediately upon becoming earned units. Assuming all 165,000 PNGS Class B Units were granted and earned, the maximum participation rate would be 6% of PNG's quarterly general partner distribution in excess of \$2,500,000. No expense and corresponding capital contribution were recognized during the three months ended September 30, 2010 as it was not deemed probable that any of the performance conditions necessary for the PNGS Class B Units to become earned would be met.

Awards Granted by PAA

During September 2010, PAA entered into agreements with certain officers of PAA pursuant to which these individuals were granted approximately 375,000 awards denominated in PNG common units, Series A subordinated units, and Series B Subordinated units. The awards will vest upon the completion of the service period and certain performance conditions including the conversion of PNG's Series A subordinated units into common units of PNG and the conversion of PNG's Series B subordinated units into Series A subordinated units of PNG. Upon vesting, these awards will be settled with outstanding common or Series A subordinated units of PNG currently owned by PAA. The entire economic burden of these agreements will be borne solely by PAA and will not impact our cash or our units outstanding. Since these individuals also serve as officers of PNG and PNG benefits as a result of the services they provide, we will recognize the grant date fair value of these awards as compensation expense over the service period, with such expense recognized as a capital contribution. During the three months ended September 30, 2010, we recognized approximately \$0.4 million of expense and a corresponding capital contribution associated with these awards.

Other Consolidated Equity Compensation Information

The table below summarizes the expense recognized and the value of vested awards related to our equity compensation plans (in thousands):

Three Months Ended September 30, 2010	
Liability Awards	Equity Awards

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Equity compensation expense	\$ 230	\$	441
LTIP cash settled vestings	\$ 317	\$	
Distribution equivalent right payments	\$	\$	10

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	Nine Months Ended September 30, 2010	
	Liability Awards	Equity Awards
Equity compensation expense	\$ 933	\$ 581
LTIP cash settled vestings	\$ 471	\$
Distribution equivalent right payments	\$	\$ 10

Based on the September 30, 2010 fair value measurement and probability assessment regarding future distributions, we expect to recognize approximately \$3.5 million of additional expense over the estimated service period of our outstanding awards related to the remaining unrecognized fair value. For our liability classified awards, this estimate is based on the fair value of the outstanding awards as of September 30, 2010. For our equity classified awards, this estimate is based on the grant date fair value of such awards. Actual amounts may materially differ as a result of a change in the market price of our units and/or probability assessment regarding future distributions. We estimate that the remaining fair value will be recognized in expense as shown below (in thousands):

Year	Equity Compensation Plan Fair Value Amortization(1),(2)	
2010 (3)	\$	315
2011		1,699
2012		916
2013 and thereafter		561
Total	\$	3,491

(1) Amounts do not include fair value associated with awards containing performance conditions that are not considered to be probable of occurring at September 30, 2010.

(2) Amounts do not include fair value associated with awards which are not dilutive to our limited partners

or impact cash flow available for distribution to our limited partners.

- (3) Includes equity compensation plan fair value amortization for the remaining three months of 2010.

10. Related Party Transactions

We do not directly employ any personnel to manage or operate our business. These functions are provided by employees of Plains All American GP LLC ("GP LLC"), the general partner of Plains AAP, L.P. which is the sole member of PAA GP LLC, PAA's general partner. References to PAA, unless the context otherwise requires, include GP LLC. We reimburse PAA for all direct and indirect expenses it incurs or payments it makes on our behalf and all other expenses allocable to us or otherwise incurred by PAA in connection with the operation of our business. These expenses are recorded in general and administrative expenses and other operating costs on our income statement and include salary, bonus, incentive compensation and other amounts paid to persons who perform services for us or on our behalf. We record these costs on the accrual basis in the period in which PAA's general partner incurs them. We reimburse PAA for costs related to equity-based compensation awards upon vesting of the awards. Our agreement with PAA provides that PAA will determine the expenses allocable to us in any reasonable manner determined by PAA in its sole discretion. Total costs reimbursed by us to PAA for the three and nine months ended September 30, 2010, were approximately \$4.6 million and \$16.0 million, respectively; and \$0.9 million, \$1.5 million and \$7.9 million for the periods September 3, 2009 through September 30, 2009, July 1, 2009 through September 2, 2009 and January 1, 2009 through September 2, 2009, respectively. Of these amounts approximately \$0.8 million and \$2.6 million and \$0.1 million, \$0.3 million and \$1.0 million, during the three and nine month periods ended September 30, 2010 and the periods September 3, 2009 through September 30, 2009, July 1, 2009 through September 2, 2009 and January 1, 2009 through September 2, 2009, respectively, were allocated personnel costs for shared services and the remainder consisted of direct costs that PAA paid on our behalf along with our allocation of insurance premiums for participation in PAA's insurance program. As of September 30, 2010 and December 31, 2009, PNG had a liability to PAA of approximately \$1.0 million and \$0.8 million, respectively, included in accounts payable and accrued liabilities on our accompanying condensed consolidated balance sheet.

As of September 30, 2010 and December 31, 2009, PNG's obligation for unvested equity-based compensation awards for which we are required to reimburse PAA upon vesting and settlement was approximately \$1.3 million and \$1.8 million, respectively. Approximately \$1.2 million and \$0.7 million of such amounts were reflected in accounts payable and accrued liabilities in our accompanying condensed consolidated balance sheets as of September 30, 2010 and December 31, 2009, respectively, with the remaining balances included as a component of other long-term liabilities at each respective date.

Omnibus Agreement

In conjunction with our initial public offering in May 2010, we entered into an omnibus agreement with PAA and certain of its affiliates, pursuant to which we agreed upon certain aspects of our relationship with them, including, among other things (1) the

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provision by PAA's general partner to us of certain general and administrative services and our agreement to reimburse PAA's general partner for such services, (2) the provision by PAA's general partner of such personnel as may be necessary to operate and manage our business, and our agreement to reimburse PAA's general partner for the expenses associated with such personnel, (3) certain indemnification obligations, and (4) our use of the name PAA and related marks. Under this agreement, PAA indemnifies us against certain environmental liabilities, tax matters, and title or permitting defects generally for a period of three years after the closing of our initial public offering. The environmental indemnifications are subject to a cap of \$15.0 million and require us to pay the first \$250 thousand of costs incurred. In addition, we have indemnified PAA against any losses, costs or damages incurred by PAA or its general partner that are attributable to the ownership and operation of our assets following the close of the initial public offering.

Tax Sharing Agreement

In conjunction with our initial public offering in May 2010, we entered into a tax sharing agreement with PAA, pursuant to which we and PAA agreed on the method of allocation among us and our subsidiaries, on the one hand, and PAA and its subsidiaries (other than us and our subsidiaries) on the other, of the responsibilities, liabilities and benefits relating to any taxes for which a combined return is filed for taxable periods including or beginning on May 5, 2010. Subsequent to the PAA Ownership Transaction, income tax expense allocated to us under applicable allocation methodologies has not been material.

Relationship with our general partner

Except as previously disclosed, we are not party to any material transactions with our general partner or any of its affiliates. Additionally, our general partner is not obligated to provide any direct or indirect financial assistance to us or to increase or maintain its capital investment in us.

11. Reporting Segment

We manage our operations through two operating segments, Bluewater and Pine Prairie. We have aggregated these operating segments into one reporting segment, Gas Storage. Our Chief Operating Decision Maker (our Chief Executive Officer) evaluates segment performance based on a variety of measures including adjusted EBITDA, volumes, adjusted EBITDA per thousand cubic feet (mcf) and maintenance capital investment. We have aggregated our two operating segments into one reportable segment based on the similarity of their economic and other characteristics, including the nature of services provided, methods of execution and delivery of services, types of customers served and regulatory requirements. We define adjusted EBITDA as earnings before interest expense, taxes, depreciation, depletion and amortization, equity compensation plan charges, gains and losses from derivative activities and selected items that are generally unusual or non-recurring. The measure above excludes depreciation and amortization as we believe that depreciation and amortization are largely offset by repair and maintenance capital investments. Maintenance capital consists of expenditures for the replacement of partially or fully depreciated assets in order to maintain the operating capability, service capability, and/or functionality of our existing assets.

The following table reflects certain financial data for our reporting segment for the periods indicated (in thousands):

	Successor September 3, 2009		Predecessor July 1, 2009		Successor September 3, 2009		Predecessor January 1, 2009	
	Three Months Ended September 30, 2010	through September 30, 2009	through September 2, 2009	Nine Months Ended September 30, 2010	through September 30, 2009	through September 2, 2009		
	(See Note 1)		(See Note 1)	(See Note 1)		(See Note 1)		(See Note 1)
Revenues ⁽¹⁾	\$ 25,083	\$ 6,370	\$ 12,460	\$ 71,446	\$ 6,370	\$ 46,929		
Adjusted EBITDA	\$ 14,907	\$ 3,849	\$ 8,275	\$ 37,982	\$ 3,849	\$ 28,701		

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Maintenance capital	\$	75	\$	2	\$	170	\$	292	\$	2	\$	384
Long-lived assets ⁽¹⁾ , ₍₂₎	\$	946,734	\$	872,605	\$	946,734	\$	872,605	\$		\$	
Total assets ⁽²⁾	\$	962,078	\$	881,079	\$	962,078	\$	881,079	\$		\$	

(1) We only have operations in the United States, thus no geographic data disclosure is necessary for revenues or long-lived assets.

(2) Amounts are as of September 30.

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The following table reconciles Adjusted EBITDA to consolidated net income (in thousands):

	Successor		Predecessor	Successor		Predecessor
	September		July 1, 2009	September		January 1, 2009
	3, 2009			3, 2009		
	Three	through	through	Nine	through	through
	Months	September	September	Months	September	September
	Ended			Ended		
	September			September		
	30,	30, 2009	2, 2009	30, 2010	30, 2009	2, 2009
	2010					
		(See Note 1)	(See Note 1)	(See Note 1)	(See Note 1)	(See Note 1)
Adjusted EBITDA	\$ 14,907	\$ 3,849	\$ 8,275	\$ 37,982	\$ 3,849	\$ 28,701
Selected items impacting Adjusted EBITDA:						
Equity compensation charge	(671)	(933)		(1,514)	(933)	(304)
Mark-to-market of open derivative positions				370		
Depreciation, depletion and amortization	(3,867)	(770)	(1,887)	(10,323)	(770)	(8,054)
Interest expense	(749)	(1,140)	(676)	(6,540)	(1,140)	(4,352)
Income tax expense			(119)			(473)
Net Income	\$ 9,620	\$ 1,006	\$ 5,593	\$ 19,975	\$ 1,006	\$ 15,518

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion analyzes the financial condition and results of operations of the Partnership, including periods prior to our initial public offering on May 5, 2010. Such analysis should be read in conjunction with the historical audited financial statements, and the notes thereto, included in the final prospectus dated April 29, 2010 (the Final Prospectus) included in our Registration Statement on Form S-1, as amended (SEC File No. 333-164492). For ease of reference, we refer to the historical financial results of PAA Natural Gas Storage, LLC (PNGS) prior to our initial public offering as being our historical financial results. Unless the context otherwise requires, references to we, us, our, and the Partnership are intended to mean the business and operations of PAA Natural Gas Storage, L.P. (the Partnership or PNG) and its consolidated subsidiaries since May 5, 2010. When used in the historical context (i.e. prior to May 5, 2010), these terms are intended to mean the business and operations of PNGS. Unless the context indicates otherwise, for purposes of the following discussion PAA refers to Plains All American Pipeline, L.P. (the owner of our general partner) (NYSE: PAA) and its consolidated subsidiaries and affiliates other than the Partnership and its general partner and their respective subsidiaries.

For periods prior to our initial public offering, the historical condensed consolidated financial statements included in this Quarterly Report on Form 10-Q are those of PNGS. Through the contribution of all of the equity interest of PNGS to us in connection with the closing of our initial public offering on May 5, 2010, all of the assets, liabilities and operations of PNGS were contributed directly or indirectly by PAA to the Partnership. For further discussion regarding the Partnership's initial public offering, please see Notes 1 and 6 to the condensed consolidated financial statements.

As further discussed in Note 1 to the condensed consolidated financial statements, PNGS became a wholly owned subsidiary of PAA on September 3, 2009 when PAA acquired an additional 50.0% interest in PNGS from Vulcan Capital (the PAA Ownership Transaction). Application of push-down accounting from PAA to PNGS resulted in a change in carrying value for certain assets and liabilities of PNGS. Accordingly, the following discussion refers to Predecessor and Successor periods, which relate to the accounting periods preceding and succeeding the PAA Ownership Transaction. In the presentation set forth below, the historical Predecessor and Successor periods of 2009 have been separated by a vertical line in order to highlight the fact that the financial information for such periods was prepared under two different cost bases of accounting.

Overview of Operating Results, Capital Spending and Significant Activities

In October 2010, we filed with the Federal Energy Regulatory Commission (FERC) for expansion of our Pine Prairie facility. The filing contemplates construction of an additional 32 Bcf of working gas storage capacity, including two new 12 Bcf caverns and the expansion of existing permitted capacity by 8 Bcf. Receipt of FERC approval of the proposed expansions would increase Pine Prairie's permitted capacity from 48 Bcf to 80 Bcf.

During the second quarter of 2010, we received the necessary regulatory approvals and placed our third cavern into service at our Pine Prairie facility. This 10 Bcf cavern increases the Partnership's working gas storage capacity at Pine Prairie by approximately 70.0% from 14 Bcf to 24 Bcf and increases the Partnership's aggregate working capacity by 25.0% from 40 Bcf to approximately 50 Bcf.

During the second quarter of 2010, we established a commercial optimization group. Without altering our basic commercial strategy of committing a high percentage of our storage capacity under multi-year firm storage contracts at attractive rates, our dedicated commercial marketing group will capture short-term market opportunities by leasing a portion of our owned or leased storage capacity engaging in related commercial marketing activities. Consistent with PAA's experience in marketing crude oil and refined products, we believe a dedicated commercial marketing group that has a consistent presence in our markets will enhance our ability to properly price our storage and hub service offerings and will increase our cash flow by capitalizing on volatility and inefficiencies in the natural gas markets. We will conduct these commercial activities within pre-defined risk parameters, and our general policy will be (i) to purchase natural gas only in situations where we have a market for such gas, (ii) to utilize physical natural gas inventory and financial derivatives to manage and optimize seasonal and spread risks inherent in our operations and commercial management activities and to structure our transactions so that commodity price fluctuations will not have a material adverse impact on our cash flow and (iii) not to acquire or hold natural gas, futures contracts or other derivative products for the purpose of speculating on outright commodity price changes.

Results of Operations (in thousands, except per storage capacity and monthly operating metrics data)

The tables below summarize our results of operations for the periods indicated. Due to the change in accounting basis that occurred as a result of the PAA Ownership Transaction, combining results of operations for periods in 2009 prior and subsequent to the transaction for purposes of comparison to 2010 results without making appropriate adjustments may not necessarily facilitate a

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meaningful analysis and would be inconsistent with relevant accounting and financial reporting authoritative guidance applicable to similar circumstances. As a result, we have elected to present pro forma results of operations for the three and nine month periods ended September 30, 2009 which have been prepared as if the PAA Ownership Transaction had occurred on January 1, 2009. This pro forma information should be read in conjunction with the Unaudited Pro Forma Condensed Combined Financial Statements contained in the Final Prospectus.

The pro forma information is based on assumptions that we believe are reasonable under the circumstances and are intended for illustrative purposes only. While not necessarily indicative of the results of the actual or future operations that would have been achieved had the PAA Ownership Transaction occurred on January 1, 2009, we believe this information provides a more meaningful basis of comparison for purposes of discussion of current period results as information is presented on a comparable accounting basis for complete fiscal periods. Pro forma adjustments reflected in the pro forma results for the three and nine month periods ended September 30, 2009 impacted general and administrative expenses, interest expense and depreciation, depletion and amortization. Revenues and expense categories, other than those previously noted, were not materially impacted by the change in basis and amounts on a pro forma basis for the applicable 2009 period are the summation of activity for the applicable 2009 historical periods. Further discussion of the nature of the pro forma adjustments made is included as a part of this analysis.

	Successor	Pro Forma	Successor	Predecessor	Favorable/(Unfavorable)		
	Three	Three	September	through	July 1, 2009	Variance⁽²⁾	
	Months	Months	3, 2009	September	through	\$	%
	Ended	Ended	through	September	September		
	September	September	September	2, 2009			
	30, 2010	30, 2009	30, 2009				
Revenues							
Firm Storage Services							
Reservation fees	\$ 22,487	\$ 16,854	\$ 5,638	\$ 11,216	\$ 5,633		33%
Cycling fees and fuel-in-kind	1,286	1,143	382	761	143		13%
Hub Services	689	825	343	482	(136)		-16%
Other	621	8	7	1	613		7663%
Total revenue	25,083	18,830	6,370	12,460	6,253		33%
Storage related costs							
Other operating costs (except those shown below)	(1,720)	(2,148)	(896)	(1,252)	428		20%
Fuel expense	(611)	(211)	(171)	(40)	(400)		-190%
General and administrative expenses	(3,409)	(2,474)	(1,383)	(781)	(935)		-38%
Interest income and other income (expense), net	(6)	10	(2)	12	(16)		-160%
Equity compensation expense	671	933	933				
Mark-to-market of open derivative							

positions

Adjusted EBITDA	\$	14,907	\$	11,814	\$	3,849	\$	8,275	\$	3,093	26%
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Reconciliation to net income

Depreciation, depletion and amortization		(3,867)		(2,584)		(770)		(1,887)		(1,283)	-50%
Interest expense, net of capitalized interest		(749)		(2,675)		(1,140)		(676)		1,926	72%
Income tax expense				(119)				(119)		119	100%
Equity compensation expense		(671)		(933)		(933)					
Mark-to-market of open derivative positions											
Net income	\$	9,620	\$	5,503	\$	1,006	\$	5,593	\$	4,117	75%

Operating Data:

Net revenue margin ⁽¹⁾		19,982		15,704		5,368		10,336		4,278	27%
Other operating expenses / G&A / Other		(5,075)		(3,890)		(1,519)		(2,061)		(1,185)	-30%
Adjusted EBITDA	\$	14,907	\$	11,814	\$	3,849	\$	8,275	\$	3,093	26%
Average working storage capacity (Bcf)		50.0		40.0		40.0		40.0		10.0	25%
Monthly Operating Metrics (\$/Mcf)											
Net Revenue Margin	\$	0.13	\$	0.13	\$	0.13	\$	0.13			0%
Operating expenses / G&A / Other	\$	(0.03)	\$	(0.03)	\$	(0.04)	\$	(0.03)			0%
Adjusted EBITDA	\$	0.10	\$	0.10	\$	0.09	\$	0.10			0%

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	Successor Nine Months Ended September 30, 2010	Pro Forma Nine Months Ended September 30, 2009	Successor September 3, 2009 through September 30, 2009	Predecessor January 1, 2009 through September 2, 2009	Favorable/(Unfavorable) Variance⁽²⁾	
					\$	%
Revenues						
Firm Storage Services						
Reservation fees	\$ 62,172	\$ 45,254	\$ 5,638	\$ 39,616	\$ 16,918	37%
Cycling fees and fuel-in-kind	3,885	3,415	382	3,033	470	14%
Hub Services	3,625	3,331	343	2,988	294	9%
Other	1,764	1,299	7	1,292	465	36%
Total revenue	71,446	53,299	6,370	46,929	18,147	34%
Storage related costs	(16,624)	(9,794)	(1,002)	(8,792)	(6,830)	-70%
Other operating costs (except those shown below)	(5,144)	(5,716)	(896)	(4,820)	572	10%
Fuel expense	(1,665)	(1,987)	(171)	(1,816)	322	16%
General and administrative expenses	(11,163)	(6,185)	(1,383)	(3,562)	(4,978)	-80%
Interest income and other income (expense), net	(12)	456	(2)	458	(468)	-103%
Equity compensation expense	1,514	1,237	933	304		
Mark-to-market of open derivative positions	(370)					
Adjusted EBITDA	\$ 37,982	\$ 31,310	\$ 3,849	\$ 28,701	\$ 6,672	21%
Reconciliation to net income						
Depreciation, depletion and amortization	(10,323)	(8,533)	(770)	(8,054)	(1,790)	-21%
Interest expense, net of capitalized interest	(6,540)	(8,554)	(1,140)	(4,352)	2,014	24%
Income tax expense		(473)		(473)	473	100%
Equity compensation expense	(1,514)	(1,237)	(933)	(304)		

Mark-to-market of open derivative positions		370									
Net income	\$	19,975	\$	12,513	\$	1,006	\$	15,518	\$	7,462	60%
Operating Data:											
Net revenue margin (1)		54,822		43,505		5,368		38,137		11,317	26%
Other operating expenses / G&A / Other		(16,840)		(12,195)		(1,519)		(9,436)		(4,645)	-38%
Adjusted EBITDA	\$	37,982	\$	31,310	\$	3,849	\$	28,701	\$	6,672	21%
Average working storage capacity (Bcf)		46.0		37.0		40.0		36.0		9.0	24%
Monthly Operating Metrics (\$/Mcf)											
Net Revenue Margin	\$	0.13	\$	0.13	\$	0.13	\$	0.13			0%
Operating expenses / G&A / Other	\$	(0.04)	\$	(0.04)	\$	(0.04)	\$	(0.03)			0%
Adjusted EBITDA	\$	0.09	\$	0.09	\$	0.09	\$	0.10	\$		0%

(1) Net revenue margin equals total revenues minus storage related costs

(2) Represents variance between the results of operations for the three and nine months ended September 30, 2010 and the pro forma results of operations for the same periods in 2009.

Pro Forma Adjustments

Pro forma adjustments reflected in the information above include:

An increase in general and administrative expenses of approximately \$0.3 million and \$1.2 million for the three and nine month pro forma periods ended September 30, 2009, respectively, to reflect an increase in personnel costs allocated to us from PAA as a result of an increase in services provided on our behalf.

A net increase in interest expense, net of capitalized interest of approximately \$0.9 million and \$3.1 million for the three and nine month pro forma periods ended September 30, 2009, respectively. In conjunction with the PAA Ownership Transaction amounts outstanding under our credit facilities were extinguished and replaced with a related party note payable to PAA which accrued interest at a rate of 6.5%, which was higher than historical rates of interest on our extinguished credit facilities. The increase in interest rate results in incremental interest expense in the 2009 periods on a pro forma basis. This increase was partially offset by an increase in capitalized interest.

A net decrease in depreciation, depletion and amortization expense of approximately \$0.1 million and \$0.3 million for the three and nine month pro forma periods ended September 30, 2009, respectively. Depreciation expense increased by \$0.2 million and \$0.6 million in the three and nine month pro forma periods ended September 30, 2009, respectively, due to fair value adjustments recorded in conjunction with the PAA Ownership Transaction, partially offset by a revision in estimates of useful lives. Amortization expense decreased by \$0.3 million and \$0.9 million in the three and nine month pro forma periods ended September 30, 2009, respectively, due to changes in the composition of our intangible assets, including debt issuance costs, and their associated estimated useful lives.

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The adjustments to general and administrative expenses are the only pro forma adjustment impacting Adjusted EBITDA on a pro forma basis for the 2009 pro forma periods.

Three Months Ended September 30, 2010 as Compared to the Pro Forma Three Months Ended September 30, 2009

Revenues, Volumes and Storage Related Costs. As noted in the table above, our total revenue and storage related costs increased during the three months ended September 30, 2010 (the Successor Third Quarter of 2010) when compared to the three months ended September 30, 2009 (the Pro Forma Third Quarter of 2009) on a pro forma basis. The primary reasons for such increase are the placement into service of an additional 10 Bcf of working gas storage capacity at our Pine Prairie facility in April 2010 and additional leasing of third party storage and transportation assets impacting the Successor Third Quarter of 2010 relative to the Pro Forma Third Quarter of 2009. These and other significant variances related to these periods are discussed in more detail below:

Firm storage reservation fees Firm storage reservation fee revenues increased for the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009, primarily due to the placement into service of an additional 10 Bcf of working gas capacity at our Pine Prairie facility in April 2010, which resulted in approximately \$5.1 million in incremental revenues generated by our Pine Prairie facility for the Successor Third Quarter of 2010. Revenues from firm storage reservation fees were also positively impacted by loan activities and additional revenue generating activities associated with increased amounts of leased storage and transportation capacity. See Storage related costs below.

Firm storage cycling fees and fuel-in-kind Firm storage cycling fees and fuel-in-kind revenues increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009. An increase in the period-over-period average natural gas price of approximately 24.0% in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009 increased our fuel-in-kind revenues. Such increase was offset by a lower volume of natural gas injections into our facilities during 2010 as compared to 2009 which was generally the result of warmer weather conditions increasing the market demand for natural gas that would otherwise have been injected into storage.

Hub services Hub services decreased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009. Our hub services activities are generally short-term in nature and their timing is influenced by weather, operating disruptions, import activities and other conditions that result in temporary disruptions in supply and demand. In the Successor Third Quarter of 2010, market conditions were generally less favorable for the value of hub services activities as compared to the Pro Forma Third Quarter of 2009.

Other Other revenue for each of the periods consists primarily of crude oil sales and activities associated with natural gas storage-related futures derivative positions. Crude oil sales increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009 by approximately \$0.6 million. The increase was a result of increased production in 2010 versus the prior year period. The 2010 increase in production was primarily due our completion of a new well drilled as part of our ongoing expansion efforts our Bluewater facility. No natural gas storage-related derivative financial instruments were in place during the third quarter of 2010 or 2009.

Storage related costs Storage related costs increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009 due to an increase in the amount of storage and transportation capacity leased from third parties. In addition, we experienced higher costs as a result of increased loan transactions in 2010 as compared to 2009. Further, during the Successor Third Quarter of 2010 we released a portion of our leased transportation capacity to third parties through August 2011. We recognized a loss of approximately \$0.6 million representing the portion of the reservation charges that we do not anticipate recovering over the period of the capacity release.

Other Costs and Expenses. The significant variances are discussed further below:

Operating costs Field operating costs decreased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009. The decrease is primarily related to a decrease in property tax expense attributable to a tax abatement agreement covering our Pine Prairie facility and an increase in capitalizable costs related to work performed by our employees on facility expansion efforts at our Bluewater facility.

Fuel expense Fuel expense increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009 due to increases in both the volume of fuel consumed and the market price of fuel in the 2010 period as compared to the 2009 period.

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General and administrative expenses General and administrative expenses increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009. The increase resulted from the continued expansion of our business and growth in personnel costs, including equity compensation expense and the establishment of our commercial optimization group, along with additional administrative costs associated with being a public company. Additionally, during the 2010 period we recognized approximately \$0.4 million of equity compensation expense associated with awards granted by PAA. Although we will not bear the economic burden of these awards, we benefit from the services underlying these awards.

Depreciation, depletion and amortization Depreciation, depletion and amortization expense increased in the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009. The increase resulted primarily from an increased amount of depreciable assets resulting from our internal growth projects, (including the additional 10 Bcf of storage capacity placed into service in April 2010).

Interest expense, net of capitalized interest Interest expense decreased in the Successor Third Quarter of 2010 when compared to the Pro Forma Third Quarter of 2009. The decrease principally resulted from decreases in both average debt balances outstanding and average interest rates in 2010 as compared to 2009 on a pro forma basis. Capitalized interest was approximately \$1.0 million and \$4.9 million in the 2010 historical period and the 2009 pro forma periods, respectively. Capitalized interest was impacted from the decreases in both average debt balances outstanding and average interest rates along with an increase in the in-service capacity at our Pine Prairie facility period over period.

Income tax expense As a partnership, and then as a publicly traded partnership subsequent to our IPO, we are not subject to U.S. federal income taxes, rather, the tax effect of our operations is passed through to our partners and now our unitholders. Our income tax expense consists principally of state income taxes calculated on an apportionment basis. The income tax expense is lower in the Successor Third Quarter of 2010 when compared to the Pro Forma Third Quarter of 2009 due to the combined impact of the expansion in our areas of operations outside of the applicable state, and ownership changes that resulted in our inclusion as a consolidated subsidiary of PAA.

Nine Months Ended September 30, 2010 as Compared to the Pro Forma Nine Months Ended September 30, 2009

Revenues, Volumes and Storage Related Costs. As noted in the table above, our total revenue and storage related costs increased during the nine months ended September 30, 2010 (the Successor Nine Month Period of 2010) when compared to the nine months ended September 30, 2009 (the Pro Forma Nine Month Period of 2009). The primary reasons for such increases are the placement into service of an additional 8 Bcf and 10 Bcf of working gas storage capacity at our Pine Prairie facility in April 2009 and April 2010, respectively, and additional leasing of third party storage and transportation assets impacting the Successor Nine Month Period of 2010 relative to the Pro Forma Nine Month Period of 2009. These and other significant variances related to these periods are discussed in more detail below:

Firm storage reservation fees Firm storage reservation fee revenues increased for the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009, primarily due to the placement into service of an additional 8 Bcf and 10 Bcf of working gas capacity at our Pine Prairie facility in April 2009 and April 2010, respectively, which resulted in approximately \$14.6 million in incremental revenues generated by our Pine Prairie facility for the Successor Nine Month Period of 2010. Revenues from firm storage reservation fees were also positively impacted by loan activities and additional revenue generating activities associated with increased amounts of leased storage and transportation capacity. See Storage related costs below.

Firm storage cycling fees and fuel-in-kind Firm storage cycling fees and fuel-in-kind revenues increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009. The increase was primarily driven by an increase in the period-over-period average natural gas price of approximately 19.0% in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009, which increased our fuel-in-kind revenues. Such increase was partially offset by a lower volume of natural gas injections into our facilities during the Successor Third Quarter of 2010 as compared to the Pro Forma Third Quarter of 2009 which was generally the result of warmer weather conditions increasing the market demand for natural gas that would otherwise have been injected into storage.

Hub services Hub services increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009. This increase primarily related to increased wheeling and balancing services as a result of utilizing leased transportation capacity during the 2010 Successor period to augment the service capabilities of our owned assets. See Storage related costs below. Our hub services activities are generally short-term in nature and their timing is influenced

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by weather, operating disruptions, import activities and other conditions that result in temporary disruptions in supply and demand. In the Successor Nine Month Period of 2010, market conditions were generally less favorable for the value of hub services activities as compared to the Pro Forma Nine Month Period of 2009.

Other Other revenue for each of the periods consists primarily of crude oil sales and activities associated with natural gas storage-related futures derivative positions. Crude oil sales increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009 by approximately \$0.9 million. The increase reflected higher average realized prices in 2010 versus the prior year period, combined with an increase in production in 2010. The 2010 increase in production was primarily due our completion of a new well drilled as part of our ongoing expansion efforts at our Bluewater facility. The Successor Nine Month Period of 2010 also includes losses of approximately \$0.4 million associated with changes in the fair market value of a natural gas storage related futures derivative position. No such derivative financial instruments were in place during the Pro Forma Nine Month Period of 2009. During the second quarter of 2010, we closed out these positions at a realized loss of approximately \$0.8 million.

Storage related costs Storage related costs increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009 due to an increase in the amount of storage and transportation capacity leased from third parties. In addition, we experienced higher costs as a result of increased loan transactions in 2010 as compared to 2009. Further, during the Successor Third Quarter of 2010 we released a portion of our leased transportation capacity to third parties through August 2011. We recognized a loss of approximately \$0.6 million representing the portion of the reservation charges that we do not anticipate recovering over the period of the capacity release.

Other Costs and Expenses. The significant variances are discussed further below:

Operating costs Field operating costs decreased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009. The decrease is primarily related to a decrease in property tax expense attributable to a tax abatement agreement covering our Pine Prairie facility.

Fuel expense Fuel expense decreased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009 primarily due to a decrease in fuel volumes used of approximately 16.0%. Such decrease was primarily driven by operational improvements in managing customer movements and was partially offset by increases in fuel prices in the 2010 period over the 2009 period. Additionally, the Pro Forma Nine Month Period of 2009 includes a lower of cost or market charge of approximately \$0.2 million which was recognized during the first quarter of 2009.

General and administrative expenses General and administrative expenses increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009. The increase resulted from the continued expansion of our business and growth in personnel costs, including equity compensation expense and the establishment of our commercial optimization group, along with additional administrative costs associated with being a public company. General and administrative expense for the 2010 period reflects approximately \$2.1 million associated with acquisition evaluation expenses, the start-up of our commercial optimization group and general and administrative expenses associated with our initial public offering efforts. Additionally, during the 2010 period we recognized approximately \$0.4 million of equity compensation expense associated with awards granted by PAA. Although we will not bear the economic burden of these awards, we benefit from the services underlying these awards.

Interest income and other income (expense), net Interest income and other income (expense), net for the Pro Forma Nine Month Period of 2009 was comprised primarily of interest income and ineffectiveness associated with an interest rate swap agreement. The reduction of interest income and other income (expense), net for the Successor Nine Month Period of 2010 was driven by the termination of the swap agreement in conjunction with the PAA Ownership Transaction and, following the PAA Ownership Transaction, a significant reduction in the amount of cash balances carried by us, which resulted in a decrease in interest income.

Depreciation, depletion and amortization Depreciation, depletion and amortization expense increased in the Successor Nine Month Period of 2010 as compared to the Pro Forma Nine Month Period of 2009. Depreciation increased by approximately \$1.8 million, primarily as a result of an increased amount of depreciable assets

resulting from our internal growth projects including the additional 8 Bcf and 10 Bcf of storage capacity placed into service in April 2009 and April 2010, respectively.

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Interest expense, net of capitalized interest Interest expense decreased in the Successor Nine Month Period of 2010 when compared to the Pro Forma Nine Month Period of 2009. The decrease principally resulted from decreases in both average debt balances outstanding and average interest rates in the 2010 historical period as compared to the 2009 period on a pro forma basis. Capitalized interest was approximately \$6.5 million and \$13.0 million in the 2010 historical period and the 2009 pro forma period, respectively, with decreases in both average debt balances outstanding and average interest rates as well as an increase in in-service capacity at our Pine Prairie facility period over period.

Income tax expense As a partnership, and then as a publicly traded partnership subsequent to our IPO, we are not subject to U.S. federal income taxes, rather, the tax effect of our operations is passed through to our partners and now our unitholders. Our income tax expense consists principally of state income taxes calculated on an apportionment basis. The income tax expense is lower in the Successor Nine Month Period of 2010 when compared to the Pro Forma Nine Month Period of 2009 due to the combined impact of the expansion in our areas of operations outside of the applicable state, and ownership changes that resulted in our inclusion as a consolidated subsidiary of PAA.

Outlook

The market for hub services activities softened during late 2009 and the first half of 2010, primarily due to reduced spread and basis differentials resulting from what we believe to be a combination of factors, including weather, the impact of shale gas production, and pipeline infrastructure additions. Market conditions weakened further in the third quarter with seasonal spreads, as reflected by the October 2010 to January 2011 NYMEX spread, decreasing to \$0.46 per decatherm during the third quarter of 2010, which was a five-year low.

We expect that the adverse market conditions may be temporary, but if such conditions continue, in addition to adversely affecting hub services activities, they may adversely impact lease rates our customers are willing to pay for firm storage leases for new capacity under construction and renewals of existing capacity upon expirations of existing term leases. Accordingly, although a significant portion of our existing capacity is underpinned by multi-year firm storage contracts, we will not be unaffected by adverse overall market conditions. We believe our asset base, business model, and strong financial capabilities position us to actively pursue acquisitions and to continue to execute our organic growth program, which includes the ability to construct incremental storage capacity at low costs and generate attractive economic returns. However, we can provide no assurance that our operating and financial results will not be adversely impacted, or that our acquisition and organic growth efforts will be successful. See the Risk Factors section of the Final Prospectus.

Liquidity and Capital Resources**Overview**

Our ability to finance our operations, including funding capital expenditures, making acquisitions, making cash distributions and satisfying any indebtedness obligations, will depend on our ability to generate cash in the future. Our ability to generate cash remains subject to a number of factors, some of which extend beyond our control. See Risk Factors in the Final Prospectus for further discussion regarding such risks that may affect our liquidity and capital resources.

Prior to September 3, 2009, our activities were conducted in a joint venture arrangement. Accordingly, cash flow from operations, borrowings under our Predecessor's credit facilities and contributions from equity owners were our primary sources of liquidity. On September 3, 2009, PAA became the sole owner of PNGS by acquiring Vulcan Capital's 50.0% interest in us. In conjunction with that transaction, PNGS entered into a note payable to PAA for approximately \$421.0 million. The proceeds of the note payable were used to repay amounts borrowed under our Predecessor's credit facilities and related interest rate swaps. Such credit facilities were terminated following their repayment. The note payable to PAA accrued interest, which was payable in kind, at a rate of 6.5%.

In April 2010, subject to consummation of the Partnership's initial public offering, the Partnership entered into a three-year, \$400.0 million senior unsecured revolving credit facility. This credit facility, which bears interest based on LIBOR plus an applicable margin determined based on funded debt-to-EBITDA levels, may be expanded to \$600.0 million with approval of the administrative agent for the credit facility. This credit facility restricts, among other things, the Partnership's ability to make distributions of available cash to unitholders if any default or event of default, as defined in the agreement, exists or would result therefrom. In addition, the credit facility contains

restrictive covenants, including those that restrict our ability to incur additional indebtedness, engage in transactions with affiliates, grant (or permit to exist) liens or enter into certain restricted contracts, make any material change to the nature of our business, make a disposition of all or substantially all of our assets or enter into a merger, consolidate, liquidate, wind up or dissolve. Also, the credit facility contains certain financial covenants requiring us to maintain certain financial ratios related to our

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consolidated EBITDA, consolidated interest charges and consolidated funded indebtedness, as such terms are defined in the credit agreement.

In conjunction with the closing of our initial public offering on May 5, 2010, the Partnership borrowed approximately \$200.0 million under the \$400.0 million senior unsecured revolving credit facility. These borrowings, along with the net proceeds from the initial public offering, were used to repay a portion of the note payable to PAA. The portion of the note not repaid was extinguished and treated as a capital contribution and part of PAA's investment in the Partnership. At September 30, 2010, we had \$221.5 million outstanding under this facility. The extent to which we can borrow against the remaining \$178.5 million depends on our ability to maintain various financial ratios, including a debt-to-EBITDA coverage ratio of less than 4.75 to 1.00 on outstanding debt (5.50 to 1.00 on all outstanding debt during an acquisition period) and an interest-to-EBITDA coverage ratio of no less than 3.00 to 1.00 (in each case, as such terms are defined in the credit agreement). As of September 30, 2010, we were in compliance with the covenants, including the financial ratios, contained in our credit agreement. Based on the most restrictive covenant, at September 30, 2010 our total available debt would be limited to approximately \$266.4 million of the \$400.0 million. Notably, the restriction on debt incurrence does not limit our ability to incur hedged inventory debt. Also, the formula for determining EBITDA in the context of the financial ratios allows for inclusion of *proforma* EBITDA for certain capital investments we may make in the future, including for acquisitions and certain capital expenditures related to our Pine Prairie expansion. We believe our credit facility and available debt capacity is adequate to fund our current capital program.

Our primary cash requirements include, but are not limited to (i) ordinary course of business uses, such as the payment of amounts related to storage costs incurred and other operating and general and administrative expenses, interest payments on our outstanding debt and distributions to our owners, (ii) maintenance and expansion capital expenditures, including purchases of base gas, (iii) acquisitions of assets or businesses and (iv) repayment of principal on our long-term debt. We generally expect to fund our short-term cash requirements through our primary sources of liquidity, which consist of our cash flow generated from operations as well as borrowings under our credit facility. In addition, we generally expect to fund our long-term needs, such as those resulting from expansion activities or acquisitions, through a variety of sources (either separately or in combination), which may include operating cash flows, borrowings under our credit facilities, and/or proceeds from the issuance of additional equity or debt securities.

PAA may elect, but is not obligated, to provide financial support to us under certain circumstances, such as in connection with an acquisition or expansion capital project. Our partnership agreement contains provisions designed to facilitate PAA's ability to provide us with financial support while reducing concerns regarding conflicts of interest by defining certain potential financing transactions between PAA and us as fair to our unitholders. As further defined in our partnership agreement, potential PAA financial support can include, but is not limited to, our issuance of common units to PAA, our borrowing of funds from PAA or guaranties or trade credit support to support the ongoing operations of us or our subsidiaries. We have no obligation to seek financing or support from PAA or to accept such financing or support if offered to us.

Congress recently enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, which includes provisions regarding the use of derivative financial instruments. The scope and applicability of these provisions is not entirely clear and regulations implementing certain aspects of the Act have not yet been issued. We are currently reviewing the provisions of this legislation and its potential impact on our business, and will continue to monitor the final rules and regulations as they develop.

Historical Cash Flow

As of September 30, 2010, we had a working capital surplus of approximately \$3.6 million. The following discussion summarizes our cash flow activity for the nine months ended September 30, 2010 and 2009.

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The following table presents a summary of our cash flows for the nine months ended September 30, 2010 and the periods September 3, 2009 through September 30, 2009 and January 1, 2009 through September 2, 2009 (in thousands):

	Nine Months Ended September 30, 2010	Successor September 3, 2009 through September 30, 2009 (See Note 1) (unaudited)	Predecessor January 1, 2009 through September 2, 2009 (See Note 1) (unaudited)
Net cash provided by (used in):			
Operating activities	\$ 32,226	\$ 4,415	\$ 22,603
Investing activities	\$ (67,958)	\$ 1,270	\$ (58,561)
Financing activities	\$ 33,037	\$ (25,214)	\$ 23,636
Net increase/(decrease) in cash	\$ (2,695)	\$ (19,529)	\$ (12,322)
Adjusted EBITDA	\$ 37,982	\$ 3,849	\$ 28,701

Operating Activities. Net cash provided by operating activities increased from approximately \$27.0 million in the 2009 period to approximately \$32.2 million in the 2010 period. Approximately \$5.1 million is due to interest expense on our intercompany note with PAA during the 2010 period that was payable in kind, whereas interest expense on debt outstanding during the 2009 period was paid in cash. Additionally, net income increased in the 2010 period as compared to the 2009 period. These increases were partially offset by a \$4.8 million change in working capital items period over period.

Investing Activities. Net cash used in investing activities consisted primarily of expansion capital expenditures associated with the expansion of our Pine Prairie facility during the 2010 and 2009 periods. Cash paid for expansion capital expenditures increased from approximately \$55.5 million in the 2009 period to approximately \$58.3 million in the 2010 period. This increase was offset by a \$6.1 million decrease in cash paid for base gas purchases related to the 10 Bcf and 8 Bcf of working gas capacity placed into service at our Pine Prairie facility during the second quarter of 2010 and 2009, respectively. Additionally, other investing activities decreased primarily due to the closure of the restricted cash, in accordance with the Pine Prairie revolving credit facility which was terminated in conjunction with the PAA Ownership Transaction.

Financing Activities. Net cash provided by financing consisted primarily of borrowings under debt facilities outstanding during each applicable period. During the 2009 period, net borrowings under our Predecessor's debt facilities, which were terminated in conjunction with the PAA Ownership Transaction, were approximately \$28.3 million, offset by a \$25.2 million repayment in the Successor period. Additionally, approximately \$4.6 million of financing costs were paid during this period. During the 2010 period, intercompany borrowings from PAA were approximately \$24.0 million. Net proceeds of \$268.2 million from the IPO, along with initial borrowings of \$200.0 million under the new credit facility, were used to repay intercompany borrowings of approximately \$468.4 million to PAA. Also during the 2010 period, we had net borrowings of \$21.5 million, we paid approximately \$9.6 million in cash distributions to our unit holders and \$0.2 million to our general partner and \$2.4 million of financing costs. Interest expense on our intercompany borrowings from PAA for the 2010 period was approximately \$5.1 million, which is net of approximately \$5.1 million of capitalized interest.

Capital Requirements

We use cash primarily for our acquisition activities, internal growth projects and distributions paid to our unitholders and general partner. We have made and will continue to make capital expenditures for acquisitions, expansion capital and maintenance capital. Historically, we have financed these expenditures primarily with cash generated by operations and the financing activities discussed above.

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Estimated Capital Expenditures. We estimate we will spend approximately \$90 million in expansion capital, including capitalized interest, during 2010, of which approximately \$66.1 million was incurred through September 30, 2010. Maintenance capital expenditures for 2010 are estimated to be approximately \$0.6 million, of which approximately \$0.3 million was incurred through September 30, 2010.

Distributions to Unitholders and General Partner. We intend to distribute 100.0% of our available cash within 45 days after the end of each quarter to unitholders of record and to our general partner. Available cash is generally defined as all of our cash and cash equivalents on hand at the end of each quarter less reserves established at the discretion of our general partner for future requirements. We expect to pay a minimum quarterly distribution of \$0.3375 per common unit and Series A subordinated unit for each complete calendar quarter, which equates to approximately \$15.0 million per full quarter or approximately \$60.0 million per full year, based on the number of common units, Series A subordinated units and general partner interest outstanding as of September 30, 2010. Our Series B subordinated units will not be entitled to receive distributions until they convert to Series A subordinated units or common units, as applicable. Such conversion is subject to the achievement of (i) certain operational targets at our Pine Prairie facility and (ii) certain distribution requirements in the future. For further information regarding distributions, please read "Our cash distribution policy and restrictions on distributions" in the Final Prospectus.

We believe that we have sufficient liquid assets, cash flow from operations and borrowing capacity under our credit agreement to meet our financial commitments, debt service obligations, contingencies and anticipated capital expenditures. We are, however, subject to business and operational risks that could adversely affect our cash flow. A material decrease in our cash flows would likely produce an adverse effect on our borrowing capacity.

Contingencies

See Note 5 to the condensed consolidated financial statements.

Commitments

Contractual Obligations. In the ordinary course of doing business, we lease storage and transportation capacity from third parties, incur debt and interest payments and enter into purchase commitments in conjunction with our operations and our capital expansion program.

The following table includes our best estimate of the amount and timing of the payments due under our contractual obligations as of September 30, 2010 (in millions):

	Total	2010	2011	2012	2013	2014	Thereafter
Long-term debt, interest and fees ⁽¹⁾	\$ 239.1	\$ 1.7	\$ 6.8	\$ 6.8	\$ 223.8	\$	\$
Leases storage, transportation, other	44.1	5.7	14.0	11.6	6.5	4.3	2.0
Purchase obligations	34.1	17.0	1.6	1.8	1.9	1.9	9.9
Other long-term liabilities	1.5	0.7	0.5	0.2		0.1	
Total	\$ 318.8	\$ 25.1	\$ 22.9	\$ 20.4	\$ 232.2	\$ 6.3	\$ 11.9

⁽¹⁾ Includes interest payments and commitment fees on our senior unsecured revolving credit facility.

Letters of Credit. In connection with our use of certain leased storage and transportation assets, we have periodically provided certain suppliers with irrevocable standby letters of credit to secure our obligations for the purchase of these services. Our liabilities with respect to these purchase obligations are recorded in accounts payable on our balance sheet in the month the services are provided. In certain instances, parental guarantees were provided by PAA in lieu of letters of credit. At September 30, 2010, we no longer have outstanding parental guarantees or outstanding letters of credit. Our \$400.0 million senior unsecured revolving credit facility provides us with the ability to issue letters of credit.

Off-Balance Sheet Arrangements

We have no significant off-balance sheet arrangements as defined by Item 307 of Regulation S-K.

Recent Accounting Pronouncements

See Note 2 to the condensed consolidated financial statements.

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Critical Accounting Policies and Estimates

For a discussion regarding our critical accounting policies and estimates, see **Critical Accounting Policies and Estimates** in the Final Prospectus.

Forward-Looking Statements

All statements included in this report, other than statements of historical fact, are forward-looking statements, including but not limited to statements incorporating the words anticipate, believe, estimate, expect, plan, inter-forecast, as well as similar expressions and statements regarding our business strategy, plans and objectives for future operations. The absence of these words, however, does not mean that the statements are not forward-looking. These statements reflect our current views with respect to future events, based on what we believe to be reasonable assumptions. Certain factors could cause actual results to differ materially from the results anticipated in the forward-looking statements. These factors include, but are not limited to:

- the impact of operational and commercial factors that could result in an inability on our part to satisfy our contractual commitments and obligations, including the impact of equipment performance, cavern operating pressures and cavern temperature variances;
- risks related to the development and operation of natural gas storage facilities;
- failure to implement or execute planned internal growth projects on a timely basis and within targeted cost projections;
- interruptions in service and fluctuations in tariffs or volumes on third party pipelines;
- general economic, market or business conditions and the amplification of other risks caused by volatile financial markets, capital constraints and pervasive liquidity concerns;
- the successful integration and future performance of acquired assets or businesses;
- our ability to obtain debt or equity financing on satisfactory terms to fund additional acquisitions, expansion projects, working capital requirements and the repayment or refinancing of indebtedness;
- the impact of current and future laws, rulings, governmental regulations, accounting standards and statements and related interpretations;
- significantly reduced volatility in natural gas markets for an extended period of time;
- factors affecting demand for natural gas and natural gas storage services and the rates we are able to charge for such services;
- our ability to maintain or replace expiring storage contracts at attractive rates and on other favorable terms;
- the effects of competition;
- shortages or cost increases of power supplies, materials or labor;
- weather interference with business operations or project construction;
- our ability to receive open credit from our suppliers and trade counterparties;
- continued creditworthiness of, and performance by, our counterparties, including financial institutions and trading companies with which we do business;
- the effectiveness of our risk management activities;
- the availability of, and our ability to consummate, acquisition or combination opportunities;
- environmental liabilities or events that are not covered by an indemnity, insurance or existing reserves;

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increased costs or unavailability of insurance;
fluctuations in the debt and equity markets, including the price of our units at the time of vesting under our long-term incentive plan;
future developments and circumstances at the time distributions are declared; and
other factors and uncertainties inherent in the development and operation of natural gas storage facilities.

Other factors, described herein, or factors that are unknown or unpredictable, could also have a material adverse effect on future results. Please read "Risks Factors" in the Final Prospectus. Except as required by applicable securities laws, we do not intend to update these forward-looking statements and information.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The following should be read in conjunction with Quantitative and Qualitative Disclosures About Market Risk included in the Final Prospectus. There have been no material changes to that information other than as discussed below. Also, see Note 3 to the condensed consolidated financial statements for additional discussion related to derivative instruments and hedging activities.

Commodity Price Risk

The fair value of our outstanding natural gas derivatives as of September 30, 2010 was a net liability of \$0.4 million. A 10.0% increase in natural gas prices would result in a net liability of \$0.3 million.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain written disclosure controls and procedures ("DCP"). The purpose of our DCP is to provide reasonable assurance that (i) information is recorded, processed, summarized and reported in a manner that allows for timely disclosure of such information in accordance with the securities laws and SEC regulations and (ii) information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow for timely decisions regarding required disclosure.

Applicable SEC rules require an evaluation of the effectiveness of the design and operation of our DCP. Management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our DCP as of the end of the period covered by this report, and our Chief Executive Officer and Chief Financial Officer found our DCP to be effective in providing reasonable assurance of the timely recording, processing, summarization and reporting of information, and in accumulation and communication of information to management to allow for timely decisions with regard to required disclosure.

Changes in Internal Control over Financial Reporting

In addition to the information concerning our DCP, we are required to disclose certain changes in our internal control over financial reporting. Although we have made various enhancements to our controls, there have been no changes in our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Certifications

The certifications of our Chief Executive Officer and Chief Financial Officer pursuant to Exchange Act rules 13a-14(a) and 15d-14(a) are filed with this report as Exhibits 31.1 and 31.2. The certifications of our Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350 are furnished with this report as Exhibits 32.1 and 32.2.

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**PART II.
OTHER INFORMATION**

Item 1. Legal Proceedings

We are not a party to any legal proceeding other than legal proceedings arising in the ordinary course of our business. Also, see Note 5 to the condensed consolidated financial statements for additional discussion regarding legal proceedings.

Item 1A. Risk Factors

In addition to the other information set forth in this report, careful consideration should be given to the risk factors discussed in the Risk Factors section of the Final Prospectus. There have been no material changes to the risk factors previously disclosed in the Final Prospectus.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]

Item 5. Other Information

None.

Item 6. Exhibits

- 1.1 Underwriting Agreement dated April 29, 2010, by and among PAA Natural Gas Storage, L.P., PNG GP LLC, Plains All American Pipeline, L.P. and the Underwriters named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed on May 4, 2010).
- 3.1 Certificate of Limited Partnership of PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 (333-164492) filed on January 25, 2010).
- 3.2 Second Amended and Restated Agreement of Limited Partnership of PAA Natural Gas Storage, L.P. dated August 16, 2010 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on August 20, 2010).
- 3.3 Certificate of Formation of PNG GP LLC (incorporated by reference to Exhibit 3.3 to the Registration Statement on Form S-1 (333-164492) filed on January 25, 2010).
- 3.4 Amended and Restated Limited Liability Company Agreement of PNG GP LLC dated May 5, 2010 (incorporated by reference to Exhibit 3.4 to the Quarterly Report on Form 10-Q filed on August 6, 2010).
- 10.1 Contribution Agreement dated as of April 29, 2010 by and among PAA Natural Gas Storage, L.P., PNG GP LLC, Plains All American Pipeline, L.P., PAA Natural Gas Storage, LLC, PAA/Vulcan Gas Storage, LLC, Plains Marketing, L.P. and Plains Marketing GP Inc. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 4, 2010).
- 10.2 Omnibus Agreement dated May 5, 2010 by and among Plains All American GP LLC, Plains All American Pipeline, L.P., PNG GP LLC and PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 11, 2010).
- 10.3 Tax Sharing Agreement dated May 5, 2010 by and among Plains All American Pipeline, L.P. and PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed on May 11, 2010).

- 10.4 Credit Agreement dated April 7, 2010 among PAA Natural Gas Storage, L.P., Bank of America, N.A., DnB Nor Bank ASA, Wells Fargo Bank, National Association, UBS Loan Finance LLC and Citibank, N.A. and the other lenders party thereto (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K filed May 11, 2010).

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- 10.5 Employment Agreement, effective November 1, 2008, between Dean Liollo and Plains All American GP LLC (incorporated by reference to Exhibit 10.10 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).
- 10.6 Employment Agreement, effective September 15, 2009, between Richard McGee and Plains All American GP LLC (incorporated by reference to Exhibit 10.9 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).
- 10.7 PAA Natural Gas Storage, L.P. 2010 Long Term Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on May 11, 2010).
- 10.8 Form of Phantom Unit and Distribution Equivalent Right Grant Letter (incorporated by reference to Exhibit 10.4 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).
- 10.9 * Form of Phantom Unit Grant Letter.
- 10.10 Form of PNG GP LLC Class B Restricted Unit Agreement (incorporated by reference to Exhibit 10.10 of the Quarterly Report on Form 10-Q filed on August 6, 2010).
- 31.1* Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 31.2* Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 32.1* Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350.
- 32.2* Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350.

Management
compensatory
plan or
arrangement.

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PAA NATURAL GAS STORAGE, L.P.

By: PNGS GP LLC, its general partner

Date: November 5, 2010

By: /s/ Greg L. Armstrong
Name: Greg L. Armstrong
Title: Chairman and Chief Executive
Officer (Principal Executive Officer)

Date: November 5, 2010

By: /s/ Dean Liollo
Name: Dean Liollo
Title: President

Date: November 5, 2010

By: /s/ Al Swanson
Name: Al Swanson
Title: Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

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EXHIBIT INDEX

- 1.1 Underwriting Agreement dated April 29, 2010, by and among PAA Natural Gas Storage, L.P., PNG GP LLC, Plains All American Pipeline, L.P. and the Underwriters named therein (incorporated by reference to Exhibit 1.1 to the Current Report on Form 8-K filed on May 4, 2010).
- 3.1 Certificate of Limited Partnership of PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 (333-164492) filed on January 25, 2010).
- 3.2 Second Amended and Restated Agreement of Limited Partnership of PAA Natural Gas Storage, L.P. dated August 16, 2010 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on August 20, 2010).
- 3.3 Certificate of Formation of PNG GP LLC (incorporated by reference to Exhibit 3.3 to the Registration Statement on Form S-1 (333-164492) filed on January 25, 2010).
- 3.4 Amended and Restated Limited Liability Company Agreement of PNG GP LLC dated May 5, 2010 (incorporated by reference to Exhibit 3.4 to the Quarterly Report on Form 10-Q filed on August 6, 2010).
- 10.1 Contribution Agreement dated as of April 29, 2010 by and among PAA Natural Gas Storage, L.P., PNG GP LLC, Plains All American Pipeline, L.P., PAA Natural Gas Storage, LLC, PAA/Vulcan Gas Storage, LLC, Plains Marketing, L.P. and Plains Marketing GP Inc. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 4, 2010).
- 10.2 Omnibus Agreement dated May 5, 2010 by and among Plains All American GP LLC, Plains All American Pipeline, L.P., PNG GP LLC and PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on May 11, 2010).
- 10.3 Tax Sharing Agreement dated May 5, 2010 by and among Plains All American Pipeline, L.P. and PAA Natural Gas Storage, L.P. (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed on May 11, 2010).
- 10.4 Credit Agreement dated April 7, 2010 among PAA Natural Gas Storage, L.P., Bank of America, N.A., DnB Nor Bank ASA, Wells Fargo Bank, National Association, UBS Loan Finance LLC and Citibank, N.A. and the other lenders party thereto (incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K filed May 11, 2010).
- 10.5 Employment Agreement, effective November 1, 2008, between Dean Liollo and Plains All American GP LLC (incorporated by reference to Exhibit 10.10 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).
- 10.6 Employment Agreement, effective September 15, 2009, between Richard McGee and Plains All American GP LLC (incorporated by reference to Exhibit 10.9 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).
- 10.7 PAA Natural Gas Storage, L.P. 2010 Long Term Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on May 11, 2010).
- 10.8

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Form of Phantom Unit and Distribution Equivalent Right Grant Letter (incorporated by reference to Exhibit 10.4 to Amendment No. 3 to the Registration Statement on Form S-1 (333-164492) filed on April 13, 2010).

- 10.9 * Form of Phantom Unit Grant Letter.
- 10.10 Form of PNG GP LLC Class B Restricted Unit Agreement (incorporated by reference to Exhibit 10.10 of the Quarterly Report on Form 10-Q filed on August 6, 2010).
- 31.1* Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 31.2* Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
- 32.1* Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350.
- 32.2* Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350.

Management
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arrangement.

* Filed herewith.