Penn Virginia GP Holdings, L.P.
Form 10-Q
November 06, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 1-33171

PENN VIRGINIA GP HOLDINGS, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**20-5116532**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

THREE RADNOR CORPORATE CENTER, SUITE 300

100 MATSONFORD ROAD

RADNOR, PA	**19087**
(Address of principal executive offices)	**(Zip Code)**

(610) 687-8900

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes ¨ No

Indicate by a 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.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 x No

As of November 5, 2008, 39,047,500 common limited partner units were outstanding.

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PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1 ***Financial Statements***

PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME - unaudited

(in thousands, except per unit data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues				
Natural gas midstream	$ 241,282	$ 100,370	$ 601,127	$ 310,095
Coal royalties	33,308	24,426	88,911	73,455
Coal services	1,815	1,955	5,518	5,648
Other	8,871	3,453	23,039	9,350
Total revenues	285,276	130,204	718,595	398,548
Expenses				
Cost of midstream gas purchased	211,262	76,192	513,778	251,000
Operating	9,041	5,224	24,553	16,235
Taxes other than income	969	666	3,017	2,116
General and administrative	7,618	5,980	22,057	18,686
Depreciation, depletion and amortization	16,903	10,645	41,322	30,600
Total expenses	245,793	98,707	604,727	318,637
Operating income	39,483	31,497	113,868	79,911
Other income (expense)				
Interest expense	(7,060)	(4,678)	(17,366)	(11,842)
Other	(4,118)	426	(3,072)	1,245
Derivatives	15,742	(10,730)	(6,424)	(20,927)
Income from operations before minority interest	44,047	16,515	87,006	48,387
Minority interest	(23,783)	(7,637)	(43,878)	(23,488)
Net income	$ 20,264	$ 8,878	$ 43,128	$ 24,899
Basic and diluted net income per limited partner unit	$ 0.52	$ 0.23	$ 1.10	$ 0.64
Weighted average number of units outstanding, basic and diluted	39,075	39,075	39,075	39,070

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

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PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS - unaudited

(in thousands)

	September 30, 2008	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 19,007	$ 30,503
Accounts receivable	92,976	78,888
Derivative assets	3,825	1,212
Other current assets	4,845	4,104
Total current assets	120,653	114,707
Property, plant and equipment	1,068,328	877,571
Accumulated depreciation, depletion and amortization	(183,591)	(146,289)
Net property, plant and equipment	884,737	731,282
Equity investments	78,634	25,640
Goodwill	31,768	7,718
Intangibles, net	94,623	28,938
Derivative assets	1,051	
Other long-term assets	35,970	33,966
Total assets	$ 1,247,436	$ 942,251
Liabilities and Partners Capital		
Current liabilities		
Accounts payable	$ 67,438	$ 65,763
Accrued liabilities	13,341	10,903
Current portion of long-term debt		12,561
Deferred income	3,231	2,958
Derivative liabilities	16,988	41,733
Total current liabilities	100,998	133,918
Deferred income	8,604	6,889
Other liabilities	22,963	19,517
Derivative liabilities	2,982	1,315
Long-term debt of PVR	558,100	399,153
Minority interests in PVR	280,119	161,075
Partners capital	273,670	220,384
Total liabilities and partners capital	$ 1,247,436	$ 942,251

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

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PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - unaudited

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Cash flows from operating activities				
Net income	$ 20,264	$ 8,878	$ 43,128	$ 24,899
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, depletion and amortization	16,903	10,645	41,322	30,600
Derivative contracts:				
Total derivative losses (gains)	(14,239)	12,034	10,552	24,359
Cash settlements of derivatives	(14,054)	(4,702)	(33,279)	(8,963)
Non-cash interest expense	1,175	165	1,543	494
Minority interests in PVR	23,783	7,637	43,878	23,488
Equity earnings, net of distributions received	(1,409)	(255)	(1,415)	(1,133)
Other	(896)		(1,337)	(198)
Changes in operating assets and liabilities	(10,853)	(5,366)	(11,277)	(8,338)
Net cash provided by operating activities	20,674	29,036	93,115	85,208
Cash flows from investing activities				
Acquisitions	(156,791)	(93,423)	(253,031)	(145,879)
Additions to property, plant and equipment	(16,062)	(10,781)	(54,902)	(29,655)
Other	982		1,657	197
Net cash used in investing activities	(171,871)	(104,204)	(306,276)	(175,337)
Cash flows from financing activities				
Distributions to partners	(28,884)	(22,079)	(78,276)	(56,453)
Proceeds from PVR borrowings	242,000	107,000	366,800	169,000
Repayments of PVR borrowings	(65,400)	(18,000)	(220,800)	(23,000)
Net proceeds from issuance of PVR partners capital			138,015	
Other	(3,454)		(4,074)	860
Net cash provided by financing activities	144,262	66,921	201,665	90,407
Net increase (decrease) in cash and cash equivalents	(6,935)	(8,247)	(11,496)	278
Cash and cash equivalents beginning of period	25,942	22,212	30,503	13,687
Cash and cash equivalents end of period	$ 19,007	$ 13,965	$ 19,007	$ 13,965
Supplemental disclosure:				
Cash paid for interest	$ 6,764	$ 6,642	$ 17,136	$ 13,545
Noncash investing activities (see Note 3):				
Issuance of PVR units for acquisition	$ 15,171	$	$ 15,171	$
PVG units given as consideration for acquisition	$ 68,021	$	$ 68,021	$
Other liabilities	$ 4,673	$	$ 4,673	$

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

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PENN VIRGINIA GP HOLDINGS, L.P. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

September 30, 2008

1. Organization

Penn Virginia GP Holdings, L.P. (the Partnership, we, us or our) is a publicly traded Delaware limited partnership formed in June 2006 that currently owns three types of equity interests in Penn Virginia Resource Partners, L.P. (PVR), a publicly traded Delaware limited partnership. The equity interests are (1) a 2% general partner interest in PVR, which we hold through our 100% ownership interest in Penn Virginia Resource GP, LLC, PVR s general partner, (2) all of the incentive distribution rights, or IDRs, in PVR, which we hold through our 100% ownership interest in PVR s general partner and (3) an approximately 37% limited partner interest in PVR. With the IDRs, we receive an increasing percentage of PVR s quarterly distributions of available cash from operating surplus after certain levels of cash distributions have been achieved. Our only cash generating assets consist of our equity interests in PVR. Due to our control of the general partner of PVR, the financial results of PVR are included in our condensed consolidated financial statements. However, PVR functions with a capital structure that is independent of ours, consisting of its own debt instruments and publicly traded common units.

Our general partner is an indirect wholly owned subsidiary of Penn Virginia Corporation (Penn Virginia). As of September 30, 2008, Penn Virginia and its subsidiaries owned an approximately 77% limited partner interest in us. PVR was formed by Penn Virginia in July 2001 and completed its initial public offering in October 2001. PVR currently conducts operations in two business segments: (i) coal and natural resource management and (ii) natural gas midstream. As of September 30, 2008, we owned approximately 39% of PVR, consisting of a 2% general partner interest and an approximately 37% limited partner interest.

PVR s coal and natural resource management segment primarily involves the management and leasing of coal properties and the subsequent collection of royalties. PVR also earns revenues from other land management activities, such as selling standing timber, leasing fee-based coal-related infrastructure facilities to certain lessees and end-user industrial plants, collecting oil and gas royalties and from coal transportation, or wheelage, fees.

PVR s natural gas midstream segment is engaged in providing natural gas processing, gathering and other related services. PVR owns and operates natural gas midstream assets located in Oklahoma and Texas. PVR s natural gas midstream business derives revenues primarily from gas processing contracts with natural gas producers and from fees charged for gathering natural gas volumes and providing other related services. PVR also owns a natural gas marketing business, which aggregates third-party volumes and sells those volumes into intrastate pipeline systems and at market hubs accessed by various interstate pipelines.

2. Summary of Significant Accounting Policies

Our accounting policies are consistent with those described in our Annual Report on Form 10-K for the year ended December 31, 2007. Please refer to such Form 10-K for a further discussion of those policies.

Basis of Presentation

Unless otherwise indicated, for the purposes of these financial statements, the Partnership, we, us or our refers to Penn Virginia GP Holdings, L.P. and our subsidiaries. References to the parent company are intended to mean Penn Virginia GP Holdings, L.P. individually as the parent company and not on a consolidated basis.

Our condensed consolidated financial statements include the accounts of the Partnership, all of our wholly owned subsidiaries and PVR, of which we indirectly owned the sole 2% general partner interest and an approximately 37% limited partner interest as of September 30, 2008. Penn Virginia Resource GP, LLC, our wholly owned subsidiary, serves as PVR s general partner and controls PVR. Intercompany balances and transactions have been eliminated in consolidation. Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and Securities and Exchange Commission (SEC) regulations. These statements involve the use of

estimates and judgments where appropriate. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of our condensed consolidated financial statements have been included. These financial statements should be read in conjunction with our condensed consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2007. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

Gain on Sale of Subsidiary Units

We account for PVR equity issuances as sales of minority interest. For each PVR equity issuance, we have calculated a gain under SEC Staff Accounting Bulletin No. 51 (or Topic 5-H), Accounting for Sales of Stock by a Subsidiary (SAB 51). SAB 51 provides guidance on accounting for the effect of issuances of a subsidiary s stock on the parent s investment in that subsidiary. In some situations, SAB 51 allows registrants to elect an accounting policy of recording gains or losses on issuances of stock by a subsidiary either in income or as a capital transaction. Accordingly, we adopted a policy of recording SAB 51 gains and losses directly to partners capital. As a result of PVR s unit offering in May 2008, we recognized gains in partners capital of $39.5 million. See Note 4 PVR Unit Offering. As a result of the issuance of PVR units in the acquisition of Lone Star Gathering, L.P. (the Lone Star Acquisition), we recognized gains in partners capital of $4.0 million. See Note 3 Acquisitions.

New Accounting Standard

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*, which mandates that a noncontrolling (minority) interest shall be reported in the consolidated statement of financial position within equity, separately from the parent company s equity. This statement amends ARB No. 51 and clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity. SFAS No. 160 also requires consolidated net income to include amounts attributable to both the parent and noncontrolling interest and requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS No. 160 is effective for fiscal years and interim periods beginning after December 15, 2008. We are currently assessing the impact on our consolidated financial statements of adopting SFAS No. 160 effective January 1, 2009.

In April 2008, the Financial Accounting Standards Board (FASB) issued Staff Position No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3), which amends SFAS No. 142, *Goodwill and Other Intangible Assets*. The pronouncement requires that companies estimating the useful life of a recognized intangible asset consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, consider assumptions that market participants would use about renewal or extension. FSP FAS 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. Effective January 1, 2009, we will prospectively apply FSP FAS 142-3 to all intangible assets purchased.

3. Acquisitions

Lone Star Gathering, L.P.

On July 17, 2008, PVR completed an acquisition of substantially all of the assets of Lone Star Gathering, L.P. (the Lone Star Acquisition). Lone Star s assets are located in the southern portion of the Fort Worth Basin of North Texas and include approximately 129 miles of gas gathering pipelines and approximately 240,000 acres dedicated by active producers. The Lone Star Acquisition expands the geographic scope of the PVR natural gas midstream segment into the Barnett Shale play in the Fort Worth Basin.

PVR acquired this business for approximately $164.3 million and a liability of $4.7 million, which represents the fair value of a $5.0 million guaranteed payment, plus contingent payments of $30.0 million and $25.0 million. Funding for the acquisition was provided by $80.7 million of borrowings under the revolving credit facility (the PVR Revolver), 2,009,995 of our common units (which PVR purchased from two subsidiaries of Penn Virginia for $61.8 million) and 542,610 newly issued PVR common units.

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The contingent payments will be triggered if revenues from certain assets located in a defined geographic area reach certain targets by or before June 30, 2013 and will be funded in cash or common units, at PVR s election.

The Lone Star Acquisition has been accounted for using the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations.* Under the purchase method of accounting, the total purchase price has been preliminarily allocated to the net tangible and intangible assets acquired from Lone Star based on their estimated fair values. The allocations of purchase consideration are subject to change pending further review of the fair value of the assets acquired and liabilities assumed and actual transaction costs. The purchase price allocation is preliminary due to our continual assessment of potentially assumed asset retirement obligations that we may incur and review of certain contracts. The purchase price allocation will be finalized for any potential assets or liabilities related to the assets acquired in the Lone Star Acquisition. The total purchase price was allocated to the assets purchased based upon preliminary fair values on the date of the Lone Star Acquisition as follows:

Cash consideration paid for Lone Star	$ 81,091
Fair value of PVG common units given as consideration for Lone Star	68,021
Fair value of PVR common units issued and given as consideration for Lone Star	15,171
Payment guaranteed December 31, 2009	4,673
Total purchase price	$ 168,956
Fair value of assets acquired:	
Property and equipment	$ 88,596
Intangible assets	69,200
Goodwill	11,160
Fair value of assets acquired	$ 168,956

The preliminary purchase price includes approximately $11.2 million of goodwill, all of which has been allocated to the natural gas midstream segment. A significant factor that contributed to the recognition of goodwill includes the ability to acquire an established business on the western border of the expanding Barnett Shale play in the Fort Worth Basin. Under SFAS No. 141 and SFAS 142, *Goodwill and Other Intangible Assets*, goodwill recorded in connection with a business combination is not amortized, but is tested for impairment at least annually. Accordingly, the accompanying pro forma combined income statement does not include amortization of the goodwill recorded in the acquisition. The preliminary purchase price includes approximately $69.2 million of intangible assets that are associated with assumed contracts and customer relationships. These intangible assets will be amortized over the period in which benefits are derived from the contracts and relationships assumed and will be reviewed for impairment under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* We estimate the useful lives of these intangible assets to be 20 years.

The following pro forma financial information reflects the consolidated results of operations of PVR as if the Lone Star Acquisition had occurred on January 1 of the reported period. The pro forma information includes adjustments primarily for depreciation of acquired property and equipment, the amortization of intangible assets, interest expense for acquisition debt and the change in weighted average common units resulting from the newly issued PVR common units given as consideration in the Lone Star Acquisition. The pro forma financial information is not necessarily indicative of the results of operations as it would have been had these transactions been effected on the assumed date:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2008	**2007**	**2008**	**2007**
	(in thousands)		**(in thousands)**	
Revenues	$ 285,580	$ 130,616	$ 722,161	$ 399,469
Net income	$ 17,615	$ 6,821	$ 30,479	$ 17,688
Net income per limited partner unit, basic & diluted	$ 0.45	$ 0.17	$ 0.78	$ 0.45

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Thunder Creek Gas Services, LLC

In April 2008, PVR acquired a 25% member interest in Thunder Creek Gas Services, LLC (Thunder Creek), a joint venture that gathers and transports coalbed methane in Wyoming s Powder River Basin for $51.6 million in cash, after customary closing adjustments. Funding for the acquisition was provided by borrowings under the PVR Revolver. The entire member interest is recorded in equity investments on the condensed consolidated balance sheet. This investment includes $37.3 million of fair value for the net assets acquired and $14.3 million of fair value paid in excess of PVR s portion of the underlying equity in the net assets acquired related to customer contracts and related customer relations. This excess is being amortized to equity earnings over the life of the underlying contracts. The earnings are recorded in other revenues on the condensed consolidated statements of income.

Based on our analysis of the fair value of this acquisition, we did not deem our acquisition of Thunder Creek to be a material business combination and therefore are not disclosing pro forma financial information in accordance with SFAS No. 141.

4. PVR Unit Offering

In May 2008, PVR issued to the public 5.15 million common PVR units representing limited partner interests in PVR and received $138.0 million in net proceeds. We made contributions to PVR of $2.9 million to maintain our 2% general partner interest. PVR used the net proceeds to repay a portion of its borrowings under the PVR Revolver.

5. Fair Value Measurement of Financial Instruments

We adopted SFAS No. 157, *Fair Value Measurements*, effective January 1, 2008, for financial assets and liabilities measured on a recurring basis. SFAS No. 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. FASB Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP SFAS 157-2), delays the application of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years and interim periods beginning after November 15, 2008. Examples of nonfinancial assets for which this FASB Staff Position delays application of SFAS No. 157 include business combinations, impairment and initial recognition of asset retirement obligations. We are currently assessing the impact on the financial statements of adopting FSP SFAS 157-2 effective January 1, 2009.

SFAS No. 157 requires fair value measurements to be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. Level 1 inputs generally provide the most reliable evidence of fair value.

Level 2: Quoted prices in markets that are not active or inputs, which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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The following table summarizes the valuation of PVR s financial instruments by the above SFAS No. 157 categories as of September 30, 2008 (in thousands):

		Fair Value Measurement at September 30, 2008, Using		
Description	Fair Value Measurements, September 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate swap liability - current	$ (1,399)	$	$ (1,399)	$
Interest rate swap liability - noncurrent	(1,960)		(1,960)	
Commodity derivative assets - current	3,825		3,825	
Commodity derivative assets - noncurrent	1,051		1,051	
Commodity derivative liability - current	(15,589)		(15,589)	
Commodity derivative liability - noncurrent	(1,022)		(1,022)	
Total	$ (15,094)	$	$ (15,094)	$

See Note 6 Derivative Instruments, for the effects of these instruments on our condensed consolidated statements of income.

We use the following methods and assumptions to estimate the fair values in the above table:

Commodity derivative instruments: The fair values of PVR s commodity derivative agreements are determined based on forward price quotes for the respective commodities. This is a level 2 input. We generally use the income approach, using valuation techniques that convert future cash flows to a single discounted value. The discount rates used in the discounted cash flow projections include a measure of nonperformance risk. See Note 6 Derivative Instruments.

Interest rate swaps: PVR has entered into interest rate swap agreements (the PVR Revolver Swaps) to establish fixed rates on a portion of the outstanding borrowings under the PVR Revolver. We estimate the fair value of the swaps based on published interest rate yield curves as of the date of the estimate. This is a level 2 input. The discount rates used in the discounted cash flow projections include a measure of nonperformance risk. See Note 6 Derivative Instruments.

6. Derivative Instruments

PVR Natural Gas Midstream Segment Commodity Derivatives

PVR utilizes costless collars, three-way collars and swap derivative contracts to hedge against the variability in cash flows associated with forecasted natural gas midstream revenues and cost of midstream gas purchased. PVR also utilizes swap derivative contracts to hedge against the variability in its frac spread. PVR s frac spread is the spread between the purchase price for the natural gas PVR purchases from producers and the sale price for the natural gas liquids, or NGLs, that PVR sells after processing. PVR hedges against the variability in its frac spread by entering into swap derivative contracts to sell NGLs forward at a predetermined swap price and to purchase an equivalent volume of natural gas forward on an MMBtu basis. While the use of derivative instruments limits the risk of adverse price movements, such use may also limit future revenues or cost savings from favorable price movements.

The counterparty to a costless collar contract is required to make a payment to PVR if the settlement price for any settlement period is below the floor price for such contract. PVR is required to make a payment to the counterparty if the settlement price for any settlement period is above the

ceiling price for such contract. Neither party is required to make a payment to the other party if the settlement price for any settlement period is equal to or greater than the floor price and equal to or less than the ceiling price for such contract. The counterparty to a swap contract is required to make a payment to PVR if the settlement price for any settlement period is less than the swap price for such contract, and PVR is required to make a payment to the counterparty if the settlement price for any settlement period is greater than the swap price for such contract.

A three-way option contract consists of a collar contract as described above plus a put option contract sold by PVR with a price below the floor price of the collar. This additional put requires PVR to make a payment to the counterparty if the settlement price for any settlement period is below the put option price. By combining the collar contract with the additional put option, PVR is entitled to a net payment equal to the difference between the floor price of the collar contract and the additional put option price if the settlement price is equal to or less than the additional put option price. If the settlement price is greater than the additional put option price, the

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result is the same as it would have been with a collar contract only. This strategy enables PVR to increase the floor and the ceiling prices of the collar beyond the range of a traditional collar contract while defraying the associated cost with the sale of the additional put option.

PVR determines the fair values of its derivative agreements based on forward price quotes for the respective commodities as of September 30, 2008, the credit risk of the counterparties and PVR s own credit risk. The following table sets forth PVR s positions as of September 30, 2008 for commodities related to natural gas midstream revenues and cost of midstream gas purchased:

			Weighted Average Price Collars			
	Average Volume Per Day	Weighted Average Price	Additional Put Option	Put	Call	Fair Value (in thousands)
Frac Spread	**(in MMBtu)**	**(per MMBtu)**				
Fourth Quarter 2008	7,824	$ 5.02				$ (2,805)
Ethane Sale Swap	**(in gallons)**	**(per gallon)**				
Fourth Quarter 2008	34,440	$ 0.4700				(706)
Propane Sale Swaps	**(in gallons)**	**(per gallon)**				
Fourth Quarter 2008	26,040	$ 0.7175				(1,751)
Crude Oil Sale Swaps	**(in barrels)**	**(per barrel)**				
Fourth Quarter 2008	560	$ 49.27				(2,611)
Natural Gasoline Collar	**(in gallons)**			**(per gallon)**		
Fourth Quarter 2008	6,300			$ 1.4800	$ 1.6465	(266)
Crude Oil Collar	**(in barrels)**			**(per barrel)**		
Fourth Quarter 2008	400			$ 65.00	$ 75.25	(936)
Natural Gas Sale Swaps	**(in MMBtu)**	**(per MMBtu)**				
Fourth Quarter 2008	4,000	$ 6.97				219
Crude Oil Three-Way Collar	**(in barrels)**			**(per barrel)**		
First Quarter 2009 through Fourth Quarter 2009	1,000		$ 70.00	$ 90.00	$ 119.25	(1,128)
Frac Spread Collar	**(in MMBtu)**			**(per MMBtu)**		
First Quarter 2009 through Fourth Quarter 2009	6,000			$ 9.09	$ 13.94	1,435
Settlements to be paid in subsequent period						(3,186)
Natural gas midstream segment commodity derivatives - net liability						$ (11,735)

At September 30, 2008, PVR reported a (i) net derivative liability related to the natural gas midstream segment of $11.7 million and (ii) loss in accumulated other comprehensive income (AOCI) of $1.4 million related to derivatives in the natural gas midstream segment for which we discontinued hedge accounting in 2006. The $1.4 million loss will be recorded in earnings through the end of 2008 as the hedged transactions settle. See the *Adoption of SFAS No. 161* section below for the impact of the natural gas midstream commodity derivatives on our condensed consolidated statements of income.

Interest Rate Swaps

PVR has entered into the PVR Revolver Swaps to establish fixed rates on a portion of the outstanding borrowings under the PVR Revolver. Until March 2010, the notional amounts of the PVR Revolver Swaps total $210.0 million, or approximately 38% of PVR s total long-term debt outstanding as of September 30, 2008, with PVR paying a weighted average fixed rate of 4.23% on the notional amount, and the counterparties paying a variable rate equal to the three-month London Interbank Offered Rate (LIBOR). From March 2010 to December 2011, the notional amounts of the Revolver Swaps total $150.0 million with PVR paying a weighted average fixed rate of 4.23% on the notional amount, and the counterparties paying a variable rate equal to the three-month LIBOR. Settlements on the PVR Revolver

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Swaps are recorded as interest expense. Certain of the PVR Revolver Swaps are designated as cash flow hedges. Accordingly, the effective portion of the change in the fair value of the transactions for the swaps that are designated as cash flow hedges are recorded each period in AOCI. PVR reported a (i) derivative liability of $3.4 million at September 30, 2008 and (ii) loss in AOCI of $2.0 million at September 30, 2008 related to the PVR Revolver Swaps. In connection with periodic settlements, we recognized $0.8 million and $1.2 million in net hedging losses in interest expense for the three and nine months ended September 30, 2008.

Adoption of SFAS No. 161

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, *an Amendment of FASB Statement No. 133*, which amends and expands SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We elected to adopt SFAS No. 161 early, effective June 30, 2008. SFAS No. 161 requires companies to disclose how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows.

The following table summarizes the effects of PVR s derivative activities, as well as the location of the gains and losses, on our condensed consolidated statements of income for the three and nine months ended September 30, 2008 (in thousands):

	Location of gain (loss) on derivatives recognized in income	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
Derivatives designated as hedging instruments under SFAS No. 133:			
Interest rate contracts	Interest expense	$ (854)	$ (1,213)
Decrease in net income resulting from derivatives designated as hedging instruments under SFAS No. 133		**$ (854)**	**$ (1,213)**
Derivatives not designated as hedging instruments under SFAS No. 133:			
Interest rate contracts	Derivatives	$ (1,333)	$ (1,333)
Commodity contracts (1)	Natural gas midstream revenues	(1,987)	(6,235)
Commodity contracts (1)	Cost of midstream gas purchased	484	2,107
Commodity contracts	Derivatives	17,075	(5,091)
Increase (decrease) in net income resulting from derivatives not designated as hedging instruments under SFAS No. 133		**$ 14,239**	**$ (10,552)**
Total increase (decrease) in net income resulting from derivatives		**$ 13,385**	**$ (11,765)**
Realized and unrealized derivative impact:			
Cash paid for commodity contract settlements	Derivatives	(14,054)	(33,279)
Cash paid for interest rate contract settlements	Interest expense	(854)	(1,213)
Unrealized derivative gain	(2)	28,293	22,727
Total increase (decrease) in net income resulting from derivatives		**$ 13,385**	**$ (11,765)**

(1) These amounts represent reclassifications from AOCI. Subsequent to the discontinuation of hedge accounting for commodity derivatives in 2006, amounts remaining in AOCI have been reclassified into earnings in the same period or periods during which the original hedge forecasted transaction affects earnings. The amount remaining in AOCI that will be reclassified to earnings in future periods is $1.4 million.

(2) This activity represents unrealized gains in the natural gas midstream, cost of midstream gas purchased and derivatives lines on our condensed consolidated statements of income.

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Cash paid for commodity derivatives is included on the Derivatives line on our condensed consolidated statement of income, and cash paid for interest rate swaps is included on the Interest expense line on our condensed consolidated statement of income.

The following table summarizes the fair value of PVR s derivative instruments, as well as the locations of these instruments on our condensed consolidated balance sheets as of September 30, 2008 (in thousands):

	Balance Sheet Location	Derivative Assets	Derivative Liabilities
		Fair values as of September 30, 2008	
Derivatives designated as hedging instruments under SFAS No. 133:			
Interest rate contracts	Derivative liabilities - current	$	$ 92
Interest rate contracts	Derivative liabilities - noncurrent		206
Total derivatives designated as hedging instruments under SFAS No. 133		$	$ 298
Derivatives not designated as hedging instruments under SFAS No. 133:			
Interest rate contracts	Derivative liabilities - current		