DCP Midstream Partners, LP
Form 10-Q
November 14, 2006

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

(Mark One)

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

**For the quarterly period ended September 30, 2006**

**OR**

o **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: 001-32678**

**DCP MIDSTREAM PARTNERS, LP**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **03-0567133** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **370 17th Street, Suite 2775 Denver, Colorado** | **80202** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code**: 303-633-2900**

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 þ No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

As of November 7, 2006, there were outstanding 10,357,143 common limited partner units, 7,142,857 subordinated units and 200,312 class C units.

**DCP MIDSTREAM PARTNERS, LP**
**FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2006**
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## CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Our reports, filings and other public announcements may from time to time contain statements that do not directly or exclusively relate to historical facts. Such statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can typically identify forward-looking statements by the use of forward-looking words, such as may, could, project, believe, anticipate, expect, estimate, potential, pl other similar words.

All statements that are not statements of historical facts, including statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements.

These forward-looking statements reflect our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors, many of which are outside our control. Important factors that could cause actual results to differ materially from the expectations expressed or implied in the forward-looking statements include known and unknown risks. Known risks and uncertainties include, but are not limited to, the risks set forth in Item 1A. Risk Factors in our annual report on Form 10-K for the year ended December 31, 2005 as well as the following risks and uncertainties:

- our ability to access the debt and equity markets, which will depend on general market conditions and the credit ratings for our debt obligations;
- our use of derivative financial instruments to hedge commodity and interest rate risks;
- the level of creditworthiness of counterparties to our transactions;
- the amount of collateral required to be posted from time to time in our transactions;
- changes in laws and regulations, particularly with regard to taxes, safety and protection of the environment or the increased regulation of the gathering and processing industry;
- the timing and extent of changes in commodity prices, interest rates and demand for our services;
- weather and other natural phenomena;
- industry changes, including the impact of consolidations, alternative energy sources, technological advances and changes in competition;
- our ability to obtain required approvals for construction or modernization of gathering and processing facilities and propane terminals, and the timing of production from such facilities, which are dependent on the issuance by federal, state and municipal governments, or agencies thereof, of building, environmental and other permits, the availability of specialized contractors and work force and prices of and demand for products;
- our ability to grow through acquisitions, contributions from our parent or internal growth projects;
- the extent of our success in connecting natural gas supplies to gathering and processing systems;
- the extent of our success in distributing wholesale propane supplies through our owned and leased facilities; and
- general economic, market and business conditions.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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## PART I. FINANCIAL INFORMATION

**Item 1**. ***Financial Statements***

### DCP MIDSTREAM PARTNERS, LP
### CONDENSED CONSOLIDATED BALANCE SHEETS
### (Unaudited)

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| | ($ in millions) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 15.1 | $ 42.2 |
| Short-term investments | 4.2 | |
| Accounts receivable: | | |
| Trade, net of allowance for doubtful accounts of $0.1 million at both periods | 15.5 | 24.4 |
| Affiliates | 21.3 | 56.5 |
| Other | 0.3 | 1.1 |
| Inventories | | 0.1 |
| Unrealized gains on non-trading derivative and hedging instruments | 3.5 | 0.1 |
| Other | 1.6 | 0.1 |
| Total current assets | 61.5 | 124.5 |
| Restricted investments | 100.0 | 100.4 |
| Property, plant and equipment, net | 173.6 | 168.9 |
| Intangible asset, net | 2.1 | 2.1 |
| Equity method investment | 5.4 | 5.3 |
| Unrealized gains on non-trading derivative and hedging instruments | 6.8 | 5.4 |
| Other non-current assets | 0.5 | 0.7 |
| Total assets | $ 349.9 | $ 407.3 |
| **LIABILITIES AND PARTNERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable: | | |
| Trade | $ 23.2 | $ 42.5 |
| Affiliates | 3.0 | 42.0 |
| Other | 0.9 | 2.5 |
| Unrealized losses on non-trading derivative and hedging instruments | 0.9 | 2.4 |
| Accrued interest payable | 0.4 | 0.8 |
| Other | 8.3 | 3.2 |
| Total current liabilities | 36.7 | 93.4 |
| Long-term debt | 190.0 | 210.1 |
| Unrealized losses on non-trading derivative and hedging instruments | 3.2 | 2.5 |
| Other long-term liabilities | 1.0 | 0.4 |

| | | |
|---|---|---|
| Total liabilities | 230.9 | 306.4 |
| Commitments and contingent liabilities | | |
| Partners equity: | | |
| Common unitholders (10,357,143 units issued and outstanding at both periods) | 221.0 | 215.8 |
| Subordinated unitholders (7,142,857 convertible units issued and outstanding at both periods) | (103.2) | (109.7) |
| General partner interest (2% interest with 357,143 equivalent units outstanding at both periods) | (5.1) | (5.6) |
| Accumulated other comprehensive income | 6.3 | 0.4 |
| Total partners equity | 119.0 | 100.9 |
| Total liabilities and partners equity | $ 349.9 | $ 407.3 |

See accompanying notes to condensed consolidated financial statements.

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**DCP MIDSTREAM PARTNERS, LP**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | (in millions, except per unit amounts) | | | |
| Operating revenues: | | | | |
| Sales of natural gas, NGLs and condensate | $ 50.3 | $ 208.0 | $ 136.6 | $ 441.1 |
| Sales of natural gas, NGLs and condensate to affiliates | 44.7 | 19.4 | 160.0 | 53.1 |
| Transportation and processing services | 3.8 | 2.9 | 11.2 | 8.4 |
| Transportation and processing services to affiliates | 3.2 | 3.0 | 9.2 | 8.3 |
| Total operating revenues | 102.0 | 233.3 | 317.0 | 510.9 |
| Operating costs and expenses: | | | | |
| Purchases of natural gas and NGLs | 68.5 | 173.6 | 224.7 | 410.6 |
| Purchases of natural gas and NGLs from affiliates | 11.6 | 43.7 | 33.2 | 53.8 |
| Operating and maintenance expense | 3.6 | 5.0 | 10.9 | 11.5 |
| Depreciation and amortization expense | 3.0 | 2.9 | 8.9 | 8.8 |
| General and administrative expense | 3.1 | | 8.0 | |
| General and administrative expense affiliates | 1.3 | 4.6 | 4.1 | 8.2 |
| Total operating costs and expenses | 91.1 | 229.8 | 289.8 | 492.9 |
| Operating income | 10.9 | 3.5 | 27.2 | 18.0 |
| Earnings from equity method investment | | 0.1 | 0.1 | 0.4 |
| Interest income | 1.7 | | 4.7 | |
| Interest expense | 2.9 | | 8.1 | |
| Net income | 9.7 | 3.6 | 23.9 | 18.4 |
| Less: | | | | |
| Net income attributable to DCP Midstream Partners Predecessor | | (3.6) | | (18.4) |
| General partner interest in net income | (0.2) | | (0.5) | |
| Net income allocable to limited partners | $ 9.5 | $ | $ 23.4 | $ |
| Net income per limited partner unit basic and diluted | $ 0.51 | $ | $ 1.32 | $ |
| Weighted average limited partners units outstanding basic and diluted | 17.5 | | 17.5 | |

See accompanying notes to condensed consolidated financial statements.

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**DCP MIDSTREAM PARTNERS, LP**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | ($ in millions) | | | |
| Net income | $ 9.7 | $ 3.6 | $ 23.9 | $ 18.4 |
| Other comprehensive income: | | | | |
| Net unrealized gains on cash flow hedges | 10.1 | 0.4 | 7.3 | 0.4 |
| Reclassification of cash flow hedges into earnings | (0.7) | | (1.4) | |
| Total other comprehensive income | 9.4 | 0.4 | 5.9 | 0.4 |
| Total comprehensive income | $ 19.1 | $ 4.0 | $ 29.8 | $ 18.8 |

See accompanying notes to condensed consolidated financial statements.

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**DCP MIDSTREAM PARTNERS, LP**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**

| | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|
| | ($ in millions) | |
| OPERATING ACTIVITIES: | | |
| Net income | $ 23.9 | $ 18.4 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 8.9 | 8.8 |
| Undistributed earnings from equity method investment | (0.1) | (0.4) |
| Other, net | (1.8) | (0.1) |
| Change in operating assets and liabilities which provided (used) cash: | | |
| Accounts receivable | 44.5 | (33.7) |
| Net unrealized losses (gains) on non-trading derivative and hedging instruments | 0.3 | (0.1) |
| Inventories | 0.1 | |
| Accounts payable | (59.7) | 14.1 |
| Accrued interest | (0.4) | |
| Other current assets and liabilities | 0.7 | 0.5 |
| Other non-current assets and liabilities | 0.4 | 0.2 |
| Net cash provided by operating activities | 16.8 | 7.7 |
| INVESTING ACTIVITIES: | | |
| Capital expenditures | (11.0) | (5.3) |
| Proceeds from sales of assets | 0.1 | 0.6 |
| Purchases of available-for-sale securities | (5,377.0) | |
| Proceeds from sales of available-for-sale securities | 5,375.5 | |
| Net cash used in investing activities | (12.4) | (4.7) |
| FINANCING ACTIVITIES: | | |
| Payment on long-term debt | (20.1) | |
| Distributions to partners | (14.7) | |
| Contributions from Duke Energy Field Services, LLC | 3.3 | |
| Net change in advances from Duke Energy Field Services, LLC | | (3.0) |
| Net cash used in financing activities | (31.5) | (3.0) |
| Net change in cash and cash equivalents | (27.1) | |
| Cash and cash equivalents, beginning of period | 42.2 | |
| Cash and cash equivalents, end of period | $ 15.1 | $ |
| Supplementary cash flow information: | | |
| Cash paid for interest (net of amounts capitalized) | $ 8.4 | $ |

See accompanying notes to condensed consolidated financial statements.

**DCP MIDSTREAM PARTNERS, LP**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(Unaudited)**

**1. Description of Business and Basis of Presentation**

DCP Midstream Partners, LP, with its consolidated subsidiaries, or us, we or our, is engaged in the business of gathering, compressing, treating, processing, transporting and selling natural gas and producing, transporting and selling natural gas liquids, or NGLs.

Our partnership includes our North Louisiana system assets, or Minden, Ada and PELICO; our NGL transportation pipeline, or Seabreeze; and our 45% equity method investment in the Black Lake Pipe Line Company, or Black Lake, that were contributed to us on December 7, 2005 by Duke Energy Field Services, LLC, or DEFS. DEFS is owned 50% by Duke Energy Corporation, or Duke Energy, and 50% by ConocoPhillips. The condensed consolidated financial statements include a 50% equity interest in Black Lake for the period beginning January 1, 2005 through September 30, 2005. Upon closing of our initial public offering on December 7, 2005, DEFS retained a 5% interest in Black Lake. An affiliate of BP PLC owns the remaining interest and is the operator of Black Lake.

We closed our initial public offering of 10,350,000 common units at a price of $21.50 per unit on December 7, 2005. Proceeds from the initial public offering were $206.4 million, net of offering costs. Concurrent with the initial public offering, DEFS contributed the assets described above to us and retained (i) a 2% general partner interest; (ii) 7,142,857 subordinated units; and (iii) 7,143 common units, representing in aggregate an approximate 42% interest in our partnership. Our general partner is DCP Midstream GP, LP, a wholly-owned subsidiary of DEFS. See Note 4 for information related to the distribution rights of the common and subordinated unitholders and the incentive distribution rights held by the general partner.

DEFS directs our business operations through its ownership and control of our general partner. DEFS and its affiliates employees provide administrative support to us and operate our assets.

The condensed consolidated financial statements include our accounts and, prior to December 7, 2005, the assets, liabilities and operations contributed to us by DEFS and its wholly-owned subsidiaries, which we refer to as DCP Midstream Partners Predecessor, upon the closing of our initial public offering, and have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The condensed consolidated financial statements of DCP Midstream Partners Predecessor have been prepared from the separate records maintained by DEFS and may not necessarily be indicative of the conditions that would have existed, or the results of operations, if DCP Midstream Partners Predecessor had been operated as an unaffiliated entity. All significant intercompany balances and transactions have been eliminated in consolidation. Transactions between us and other DEFS operations have been identified in the condensed consolidated financial statements as transactions between affiliates (see Note 6).

The accompanying unaudited condensed consolidated financial statements in this quarterly report on Form 10-Q have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. Accordingly these condensed consolidated financial statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operations for the respective interim periods. Certain information and notes normally included in our annual financial statements have been condensed or omitted from these interim financial statements pursuant to such rules and regulations. These condensed consolidated financial statements and other information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2005.

**2. Summary of Significant Accounting Policies**

***Use of Estimates*** Conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes. Although these estimates are based on management s best available knowledge of current and expected future events, actual results could differ from those estimates.

***Short-Term and Restricted Investments*** Short-term investments were $4.2 million at September 30, 2006. There were no short-term investments at December 31, 2005. Restricted investments were $100.0 million and $100.4 million at September 30, 2006 and December 31, 2005, respectively. These investments primarily consist of commercial paper and various other high-grade debt securities. The restricted investments are used as collateral to secure the term loan portion of our credit facility and are to be used only for future capital or acquisition expenditures. Both the restricted and short-term investments are classified as available-for-sale securities under Statement of Financial Accounting Standards, or SFAS, No. 115, *Accounting for Certain*

*Investments in Debt and Equity Securities,* as management does not intend to hold them to maturity nor are they bought or sold with the objective of generating profits on short-term differences in prices. These investments are recorded at fair value with changes in fair value recorded as unrealized holding gains or losses in accumulated other comprehensive income, or AOCI. At both September 30, 2006 and December 31, 2005, no amounts related to these investments were deferred in AOCI. Due to the short-term, highly liquid nature of the securities held by us and as interest rates are re-set on a daily, weekly or monthly basis, the cost, including accrued interest on investments, approximates fair value.

***Accounting for Risk Management and Hedging Activities and Financial Instruments*** Each derivative not qualifying for the normal purchases and normal sales exception under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* or SFAS 133, as amended, is recorded on a gross basis in the condensed consolidated balance sheets at its fair value as unrealized gains or unrealized losses on non-trading derivative and hedging instruments. Derivative assets and liabilities remain classified in our condensed consolidated balance sheets as unrealized gains or unrealized losses on non-trading derivative and hedging instruments at fair value until the contractual settlement period occurs.

All derivative activity reflected in the condensed consolidated financial statements for periods prior to December 7, 2005 was transacted by DEFS and its subsidiaries prior to our initial public offering and was transferred and/or allocated to us. All derivative activity reflected in the condensed consolidated financial statements from December 7, 2005 has been and will be transacted by us, although DEFS personnel execute various transactions on our behalf (see Note 6). Management designated each energy commodity derivative as non-trading. Certain non-trading derivatives are further designated as either a hedge of a forecasted transaction or future cash flow (cash flow hedge), a hedge of a recognized asset, liability or firm commitment (fair value hedge), or normal purchases or normal sales, while certain non-trading derivatives, which are related to asset-based activity, are designated as non-trading derivative activity. For the periods presented, we did not have any non-trading derivative activity. We did have cash flow and fair value hedge activity and normal purchases and normal sales activity included in these condensed consolidated financial statements. For each derivative, the accounting method and presentation of gains and losses or revenue and expense in the condensed consolidated statements of operations are as follows:

| **Classification of Contract** | **Accounting Method** | **Presentation of Gains & Losses or Revenue & Expense** |
|---|---|---|
| Non-trading derivative activity | Mark-to-market (a) | Net basis in gains and losses from non-trading derivative activity |
| Cash flow hedge | Hedge method (b) | Gross basis in the same statement of operations category as the related hedged item |
| Fair value hedge | Hedge method (b) | Gross basis in the same statement of operations category as the related hedged item |
| Normal purchases or normal sales | Accrual method (c) | Gross basis upon settlement in the corresponding statement of operations category based on purchase or sale |

(a) Mark-to-market An accounting method whereby the change in the fair value of the asset or liability is recognized in the results of operations in gains and losses from non-trading derivative activity during the current period.

(b) Hedge method An accounting method whereby the effective portion of the change in the fair value of the asset or liability is recorded as a balance sheet adjustment and there is no recognition in the results of operations for the effective portion until the service is provided or the associated delivery period occurs.

(c) Accrual method An accounting method whereby there is no recognition in the results of operations for changes in fair value of a contract until the service is provided or the associated delivery period occurs.

*Cash Flow and Fair Value Hedges* For derivatives designated as a cash flow hedge or a fair value hedge, management prepares formal documentation of the hedge in accordance with SFAS 133. In addition, management formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. All components of each derivative gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted.

The fair value of a derivative designated as a cash flow hedge is recorded in the condensed consolidated balance sheets as unrealized gains or unrealized losses on non-trading derivative and hedging instruments. The effective portion of the change in fair value of a derivative designated as a cash flow hedge is recorded in partners equity as AOCI and the ineffective portion is recorded in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate. During the period in which the hedged transaction occurs, amounts in AOCI associated with the hedged transaction are reclassified to the condensed consolidated statements of operations in the same accounts as the item being hedged. Hedge accounting is discontinued prospectively when it is determined that the derivative no longer qualifies as an effective hedge, or when it is no longer probable that the hedged transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge, the derivative is subject to the mark-to-market accounting method prospectively. The derivative continues to be carried on the condensed consolidated balance sheet at its fair value; however, subsequent changes in its fair value are recognized in current period earnings. Gains and losses related to discontinued hedges that were previously accumulated in AOCI will remain in AOCI until the hedged transaction occurs, unless it is probable that the hedged transaction will not occur, in which case, the gains and losses that were previously deferred in AOCI will be immediately recognized in current period earnings.

The fair value of a derivative designated as a fair value hedge is recorded in the condensed consolidated balance sheets as unrealized gains or unrealized losses on non-trading derivative and hedging instruments. We recognize the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item in earnings in the current period. All derivatives designated and accounted for as fair value hedges are classified in the same category as the item being hedged in the results of operations.

*Valuation* When available, quoted market prices or prices obtained through external sources are used to verify a contract s fair value. For contracts with a delivery location or duration for which quoted market prices are not available, fair value is determined based on pricing models developed primarily from historical and expected correlations with quoted market prices.

Changes in market prices and management estimates directly affect the estimated fair value of these contracts. Accordingly, it is reasonably possible that such estimates may change in the near term.

***Property, Plant and Equipment*** Property, plant and equipment are recorded at historical cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The costs of maintenance and repairs, which are not significant improvements, are expensed when incurred. Expenditures to extend the useful lives of the assets are capitalized.

We have adopted SFAS No. 143, *Accounting for Asset Retirement Obligations,* or SFAS 143, and Financial Accounting Standards Board, or FASB, Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations,* or FIN 47, which address financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard and interpretation apply to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the life of the asset. The liability increases due to the passage of time based on the time value of money until the obligation is settled. FIN 47 requires the recognition of a liability for a conditional asset retirement obligation as soon as the fair value of the liability can be reasonably estimated. A conditional asset retirement obligation is defined as an unconditional legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity.

***Impairment of Long-Lived Assets*** Management periodically evaluates whether the carrying value of long-lived assets has been impaired when circumstances indicate the carrying value of those assets may not be recoverable. This evaluation is based on undiscounted cash flow projections. The carrying amount is not recoverable if it exceeds the undiscounted sum of cash flows expected to result from the use and eventual disposition of the asset. Management considers various factors when determining if these assets should be evaluated for impairment, including but not limited to:

significant adverse change in legal factors or in the business climate;

a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset;

an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset;

significant adverse changes in the extent or manner in which an asset is used or in its physical condition;

a significant change in the market value of an asset; or

a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its estimated useful life.

If the carrying value is not recoverable, an impairment loss is measured as the excess of the asset s carrying value over its fair value. Management assesses the fair value of long-lived assets using commonly accepted techniques, and may use more than one method, including, but not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. Significant changes in market conditions resulting from events such as the condition of an asset or a change in management s intent to utilize the asset would generally require management to reassess the cash flows related to the long-lived assets.

***Impairment of Equity Method Investment*** We evaluate our equity method investment for impairment when events or changes in circumstances indicate, in management s judgment, that the carrying value of such investment may have experienced an other-than-temporary decline in value. When evidence of loss in value has occurred, management compares the estimated fair value of the investment to the carrying value of the investment to determine whether an impairment has occurred. Management assesses the fair value of its equity method investment using commonly accepted techniques, and may use more than one method, including, but not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. If the estimated fair value is less than the carrying value and management considers the decline in value to be other than temporary, the excess of the carrying value over the estimated fair value is recognized in the financial statements as an impairment.

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

sales of natural gas, NGLs and condensate;

natural gas gathering, processing and transportation, from which we generate revenues primarily through the compression, gathering, treating, processing and transportation of natural gas; and

NGL transportation from which we generate revenues from transportation fees.

Revenues associated with sales of natural gas, NGLs and condensate are recognized when title passes to the customer, which is when the risk of ownership passes to the purchaser and physical delivery occurs. Revenues associated with transportation and processing fees are recognized as the services are provided.

For gathering and processing services, we receive either fees or commodities from natural gas producers depending on the type of contract. Commodities received are in turn sold and recognized as revenue in accordance with the criteria outlined above. Under the percentage-of-proceeds contract type, we are paid for our services by keeping a percentage of the NGLs produced and a percentage of the residue gas resulting from processing the natural gas. Under the percentage-of-index contract type, we purchase wellhead natural gas and sell processed natural gas and NGLs to third parties.

We recognize revenues for non-trading derivative activity net in the condensed consolidated statements of operations as (losses) gains from non-trading derivative activity, in accordance with EITF Issue No. 02-03, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities.* These activities include mark-to-market gains and losses on energy derivative contracts and the financial or physical settlement of energy derivative contracts.

We generally report revenues gross in the condensed consolidated statements of operations, in accordance with Emerging Issues Task Force, or EITF, Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent.* Except for fee- based agreements, we act as the principal in these transactions, take title to the product, and incur the risks and rewards of ownership.

***Equity-Based Compensation*** Under our long term incentive plan, or the Plan, equity-based instruments may be granted to our key employees. DCP Midstream GP, LLC adopted the Plan for employees, consultants and directors of DCP Midstream GP, LLC and its affiliates who perform services for us. The Plan provides for the grant of unvested units, phantom units, unit options

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and substitute awards and the grant of distribution equivalent rights. Subject to adjustment for certain events, an aggregate of 850,000 common units may be delivered pursuant to awards under the Plan. Awards that are canceled, forfeited or are withheld to satisfy DCP Midstream GP, LLC s tax withholding obligations are available for delivery pursuant to other awards. The Plan is administered by the compensation committee of DCP Midstream GP, LLC s board of directors. We first granted awards under the Plan during 2006.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment,* or SFAS 123R, which establishes accounting for stock-based awards exchanged for employee and non-employee services. Accordingly, equity classified stock-based compensation cost is measured at grant date, based on the estimated fair value of the award, and is recognized as expense over the vesting period. Liability classified stock-based compensation cost is remeasured at each reporting date and is recognized over the requisite service period. Compensation expense for awards with graded vesting provisions is recognized on a straight-line basis over the requisite service period of each separately vesting portion of the award. Awards granted to non-employees are accounted for under the provisions of EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.*

Since no equity-based awards were outstanding or granted during the three and nine months ended September 30, 2005, pro forma disclosures are not necessary relating to what earnings available for limited partners, basic earnings per limited partner unit and diluted earnings per limited partner unit would have been if we had applied the fair value recognition provisions of SFAS 123R to all equity-based compensation awards.

***Net Income per Limited Partner Unit*** Basic and diluted net income per limited partner unit is calculated by dividing limited partners interest in net income, less any applicable pro forma general partner incentive distributions under EITF Issue No. 03-6, *Participating Securities and the Two-Class Method Under FASB Statement No. 128,* or EITF 03-6, by the weighted average number of outstanding limited partner units during the period (see Note 5).

***Reclassifications*** Certain prior period amounts have been reclassified in the condensed consolidated financial statements to conform to the current period presentation.

**3. Recent Accounting Pronouncements**

***SFAS No. 157, Fair Value Measurements,* or SFAS 157** In September 2006, the FASB issued SFAS 157, which provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. SFAS 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. SFAS 157 does not expand the use of fair value to any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not currently expect SFAS 157 to have a material impact on our consolidated results of operations, cash flows or financial position.

***SFAS No. 154, Accounting Changes and Error Corrections*, or SFAS 154** In June 2005, the FASB issued SFAS 154, a replacement of APB Opinion No. 20, *Accounting Changes,* or APB 20, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements.* Among other changes, SFAS 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. SFAS 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) carried forward without change the guidance within APB 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. The adoption of SFAS 154 on January 1, 2006 did not have an impact on our consolidated results of operations, cash flows or financial position.

***FIN No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement 109,* or FIN 48** In July 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for the first fiscal year beginning after December

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15, 2006. The adoption of FIN 48 is not expected to have a material impact on our consolidated results of operations, cash flows or financial position.

***EITF Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty*, or EITF 04-13** In September 2005, the FASB ratified the EITF s consensus on Issue 04-13, which requires an entity to treat sales and purchases of inventory between the entity and the same counterparty as one transaction for purposes of applying APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* when such transactions are entered into in contemplation of each other. When such transactions are legally contingent on each other, they are considered to have been entered into in contemplation of each other. The EITF also agreed on other factors that should be considered in determining whether transactions have been entered into in contemplation of each other. EITF 04-13 is to be applied to new arrangements that we enter into in reporting periods beginning after March 15, 2006. The adoption of EITF 04-13 did not have a material impact on our consolidated results of operations, cash flows or financial position.

***Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,* or SAB 108** In September 2006, the SEC issued SAB 108 to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires entities to quantify misstatements based on their impact on each of their financial statements and related disclosures. SAB 108 is effective as of the end of our 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. We do not expect the adoption of this standard to have a material impact on our consolidated results of operations, cash flows or financial position.

**4. Partnership Equity and Distributions**

***General*** Our partnership agreement requires that, within 45 days after the end of each quarter, we distribute all of our Available Cash (defined below) to unitholders of record on the applicable record date, as determined by the general partner.

***Definition of Available Cash*** Available Cash, for any quarter, consists of all cash and cash equivalents on hand at the end of that quarter:

less the amount of cash reserves established by the general partner to:

- provide for the proper conduct of our business;

- comply with applicable law, any of our debt instruments or other agreements; or

- provide funds for distributions to the unitholders and to the general partner for any one or more of the next four quarters;

plus, if the general partner so determines, all or a portion of cash and cash equivalents on hand on the date of determination of Available Cash for the quarter.

***General Partner Interest and Incentive Distribution Rights*** The general partner is entitled to 2% of all quarterly distributions that we make prior to its liquidation. This general partner interest is represented by 357,143 equivalent units. The general partner has the right, but not the obligation, to contribute a proportionate amount of capital to us to maintain its current general partner interest. The general partner s initial 2% interest in these distributions will be reduced if we issue additional units in the future and the general partner does not contribute a proportionate amount of capital to us to maintain its 2% general partner interest.

The incentive distribution rights held by the general partner entitles it to receive an increasing share of Available Cash when pre-defined distribution targets are achieved. The general partner s incentive distribution rights are not reduced if we issue additional units in the future and the general partner does not contribute a proportionate amount of capital to us to maintain its 2% general partner interest. Please read the *Distributions of Available Cash during the Subordination Period* and *Distributions of Available Cash after the Subordination Period* sections below for more details about the distribution targets and their impact on the general partner s incentive distribution rights.

***Subordinated Units*** All of the subordinated units are held by DEFS. The partnership agreement provides that, during the subordination period, the common units will have the right to receive distributions of Available Cash each quarter in an amount equal to $0.35 per common unit, or the Minimum Quarterly Distribution, plus any arrearages in the payment of the Minimum

Quarterly Distribution on the common units from prior quarters, before any distributions of Available Cash may be made on the subordinated units. These units are deemed subordinated because for a period of time, referred to as the subordination period, the subordinated units will not be entitled to receive any distributions until the common units have received the Minimum Quarterly Distribution plus any arrearages from prior quarters. Furthermore, no arrearages will be paid on the subordinated units. The practical effect of the subordinated units is to increase the likelihood that during the subordination period there will be Available Cash to be distributed on the common units. The subordination period will end, and the subordinated units will convert to common units, on a one for one basis, when certain distribution requirements, as defined in the partnership agreement, have been met. The earliest date at which the subordination period may end is December 31, 2008 and 50% of the subordinated units may convert to common units as early as December 31, 2007. The rights of the subordinated unitholders, other than the distribution rights described above, are substantially the same as the rights of the common unitholders.

***Distributions of Available Cash during the Subordination Period*** The partnership agreement requires that we make distributions of Available Cash for any quarter during the subordination period in the following manner:

*first,* 98% to the common unitholders, pro rata, and 2% to the general partner, until we distribute for each outstanding common unit an amount equal to the Minimum Quarterly Distribution for that quarter;

*second,* 98% to the common unitholders, pro rata, and 2% to the general partner, until we distribute for each outstanding common unit an amount equal to any arrearages in payment of the Minimum Quarterly Distribution on the common units for any prior quarters during the subordination period;

*third,* 98% to the subordinated unitholders, pro rata, and 2% to the general partner, until we distribute for each subordinated unit an amount equal to the Minimum Quarterly Distribution for that quarter; and

*fourth,* 98% to all unitholders, pro rata, and 2% to the general partner, until each unitholder receives a total of $0.4025 per unit for that quarter (the First Target Distribution);

*fifth,* 85% to all unitholders, pro rata, and 15% to the general partner, until each unitholder receives a total of $0.4375 per unit for that quarter (the Second Target Distribution);

*sixth,* 75% to all unitholders, pro rata, and 25% to the general partner, until each unitholder receives a total of $0.525 per unit for that quarter (the Third Target Distribution); and

*thereafter,* 50% to all unitholders, pro rata, and 50% to the general partner (the Fourth Target Distribution).

***Distributions of Available Cash after the Subordination Period*** The partnership agreement requires that we make distributions of Available Cash from operating surplus for any quarter after the subordination period in the following manner:

*first,* 98% to all unitholders, pro rata, and 2% to the general partner, until each unitholder receives a total of $0.4025 per unit for that quarter;

*second,* 85% to all unitholders, pro rata, and 15% to the general partner, until each unitholder receives a total of $0.4375 per unit for that quarter;

*third,* 75% to all unitholders, pro rata, and 25% to the general partner, until each unitholder receives a total of $0.525 per unit for that quarter; and

*thereafter,* 50% to all unitholders, pro rata, and 50% to the general partner.

In February 2006, we paid a cash distribution of $0.095 per unit to unitholders of record on February 3, 2006. That distribution represented the pro rata portion of our Minimum Quarterly Distribution of $0.35 per unit for the period December 7, 2005, the closing of our initial public offering, through December 31, 2005. In May 2006, we paid a cash distribution of $0.35 per unit to unitholders of record on May 5, 2006. In August 2006, we paid a cash distribution of $0.38 per unit to unitholders of record on August 4, 2006.

On October 25, 2006, the board of directors of DCP Midstream Partners general partner declared a quarterly distribution of $0.405 per unit, payable on November 14, 2006 to unitholders of record on November 6, 2006.

**5. Net Income per Limited Partner Unit**

Our net income is allocated to the general partner and the limited partners, including the holders of the subordinated units, in accordance with their respective ownership percentages, after giving effect to incentive distributions paid to the general partner.

EITF 03-6 addresses the computation of earnings per share by entities that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the entity when, and if, it declares dividends on its common stock.

EITF 03-6 requires that securities that meet the definition of a participating security be considered for inclusion in the computation of basic earnings per unit using the two-class method. Under the two-class method, earnings per unit is calculated as if all of the earnings for the period were distributed under the terms of the partnership agreement, regardless of whether the general partner has discretion over the amount of distributions to be made in any particular period, whether those earnings would actually be distributed during a particular period from an economic or practical perspective, or whether the general partner has other legal or contractual limitations on its ability to pay distributions that would prevent it from distributing all of the earnings for a particular period.

EITF 03-6 does not impact our overall net income or other financial results; however, in periods in which aggregate net income exceeds the First Target Distribution level, it will have the impact of reducing net income per limited partner unit. This result occurs as a larger portion of our aggregate earnings, as if distributed, is allocated to the incentive distribution rights of the general partner, even though we make distributions on the basis of Available Cash and not earnings. In periods in which our aggregate net income per unit does not exceed the First Target Distribution level, EITF 03-6 does not have any impact on our calculation of earnings per limited partner unit. During the three months ended September 30, 2006, our aggregate net income per unit exceeded the Third Target Distribution level, and as a result we allocated $0.6 million in additional earnings to the general partner in accordance with EITF 03-6. During the nine months ended September 30, 2006, our aggregate net income per limited partner unit exceeded the Second Target Distribution level, and as a result we allocated $0.3 million in additional earnings to the general partner.

Basic and diluted net income per limited partner unit is calculated by dividing limited partners interest in net income, less pro forma general partner incentive distributions under EITF 03-6, by the weighted average number of outstanding limited partner units during the period.

The following table illustrates our calculation of net income per limited partner unit for the three and nine months ended September 30, 2006 ($ in millions):

| | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2006 |
|---|---|---|
| Net income | $ 9.7 | $ 23.9 |
| Less: General partner interest in net income | (0.2) | (0.5) |
| Limited partners interest in net income (Note 4) | 9.5 | 23.4 |
| Additional earnings allocation to general partner | (0.6) | (0.3) |
| Net income available to limited partners under EITF 03-6 | $ 8.9 | $ 23.1 |
| Net income per limited partner unit basic and diluted | $ 0.51 | $ 1.32 |

**6. Agreements and Transactions with Affiliates**

***DEFS***

***Omnibus Agreement***

Upon the closing of our initial public offering, we entered into an Omnibus Agreement with DEFS. Under the Omnibus Agreement, we are required to pay DEFS for salaries of operating personnel and employee benefits for DEFS employees operating our assets as well as capital expenditures, maintenance and repair costs, taxes and other direct costs incurred by DEFS on our behalf, associated with our assets. We also pay an annual fee of $4.8 million to DEFS. The annual fee is for centralized corporate functions performed by DEFS on our behalf, including legal, accounting, cash management, insurance administration and claims processing, risk management, health, safety and environmental, information technology, human resources, credit, payroll, internal audit, taxes and engineering. In the second quarter of 2006, we amended the Omnibus Agreement. The amendment clarifies that the annual fee of

$4.8 million under the agreement is fixed at such amount, subject to annual increases in the consumer price index and increases in connection with the expansion of our operations through the acquisition or construction of new assets or businesses.

For the nine months ended September 30, 2005, our share of general and administrative expenses and employee retirement and medical plans and other service fees was allocated based on our proportionate net investment (consisting of property, plant and equipment, net, equity method investment, and intangible assets, net) compared to DEFS net investment. In management s estimation, the allocation methodologies used are reasonable and resulted in an allocation to us of our costs of doing business borne by DEFS. Further details regarding the Omnibus Agreement are included in Note 7 in our annual report on the 2005 Form 10-K.

***Other Agreements and Transactions with DEFS***

Prior to our initial public offering on December 7, 2005, we participated in DEFS cash management program. As a result, we had no cash balances prior to December 7, 2005, and all cash management activity was managed by DEFS on our behalf, including collection of receivables, payment of payables, and the settlement of sales and purchases transactions between us and DEFS, which were recorded as parent advances and included in accounts receivable affiliates or accounts payable affiliates. Subsequent to our initial public offering, we maintain separate cash accounts, which are managed by DEFS.

DEFS owns certain assets and is party to certain contractual relationships around our PELICO system that are periodically used for the benefit of PELICO. DEFS is able to source natural gas upstream of PELICO and deliver it to the inlet of the PELICO system, and is able to take natural gas from the outlet of the PELICO system and market it downstream of PELICO. Because of DEFS ability to move natural gas around PELICO, there are certain contractual relationships around PELICO that define how natural gas is bought and sold between DEFS and DCP Midstream Partners.

Effective December 2005, we entered into a contractual arrangement with a subsidiary of DEFS that provides that DEFS will purchase natural gas and transport it to the PELICO system, where we will buy the gas from DEFS at its weighted average cost delivered to the PELICO system, plus a contractually agreed-to marketing fee and other related adjustments. In addition, for a significant portion of the gas that we sell out of our PELICO system, DEFS will purchase that natural gas from us and transport it to a sales point at a price equal to its net weighted average sales price, less a contractually agreed-to marketing fee and other related adjustments. We generally report revenues and purchases associated with these activities gross in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate to affiliates and purchases of natural gas and NGLs from affiliates.

The above agreement was amended and restated effective February 2006 in response to DEFS securing additional access to natural gas for our PELICO system. The revised agreement is described below:

DEFS will supply PELICO s system requirements that exceed its on-system supply. Accordingly, DEFS purchases natural gas and transports it to our PELICO system, where we buy the gas from DEFS at the actual acquisition cost plus transportation service charges incurred. We generally report purchases associated with these activities gross in the condensed consolidated statements of operations as purchases of natural gas, NGLs and condensate from affiliates.

If our PELICO system has volumes in excess of the on-system demand, DEFS will purchase the excess natural gas from us and transport it to sales points at an index based price, less a contractually agreed-to marketing fee. We generally report revenues associated with these activities gross in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate to affiliates.

In addition, DEFS may purchase other excess natural gas volumes at certain PELICO outlets for a price that equals the original PELICO purchase price from DEFS, plus a portion of the index differential between upstream sources to certain downstream indices with a maximum differential and a minimum differential, plus a fixed fuel charge and other related adjustments. We generally report revenues and purchases associated with these activities net in the condensed consolidated statements of operations as transportation and processing services to affiliates.

Effective December 2005, we entered into a contractual arrangement with a subsidiary of DEFS that provides that for certain industrial end-user customers of the PELICO system we may sell aggregated natural gas to a subsidiary of DEFS which in turn would resell natural gas to these customers. The sales price to the subsidiary of DEFS is equal to that subsidiary of DEFS net weighted average sales price delivered from the PELICO system less a contractually agreed to marketing fee, which is recorded in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate to affiliates.

Effective December 2005, we entered into a contractual arrangement with a subsidiary of DEFS that provides that DEFS will purchase the NGLs that were historically purchased by the Seabreeze pipeline, and DEFS will pay us to transport the NGLs pursuant to a fee-based rate that will be applied to the volumes transported. We have entered into this fee-based contractual arrangement with the objective of generating approximately the same operating income per barrel transported that we realized when we were the purchaser and seller of NGLs. We do not take title to the products transported on the NGL pipeline; rather, the shipper retains title and the associated commodity price risk. DEFS is the sole shipper on the Seabreeze pipeline under a 17-year transportation agreement expiring in 2022. We generally report revenues associated with these activities in the condensed consolidated statements of operations as transportation and processing services to affiliates.

We sell NGLs and condensate from our Minden and Ada processing plants, and condensate from our PELICO system to a subsidiary of DEFS equal to that subsidiary of DEFS net weighted average sales price adjusted for transportation and other charges from the tailgate of the respective asset, which is recorded in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate to affiliates.

Management anticipates continuing to purchase these commodities from and sell these commodities to DEFS in the ordinary course of business.

In the second quarter of 2006, we entered into a letter agreement with DEFS whereby DEFS will make capital contributions to us as reimbursement for capital projects which were forecasted to be completed prior to our initial public offering, but were not completed by that date. Pursuant to the letter agreement, DEFS made capital contributions to us of $0.1 million and $3.3 million for the three and nine months ended September 30, 2006, respectively, to reimburse us for the capital costs we incurred, primarily for growth capital projects. DEFS will make additional capital contributions to us until all these projects have been completed, which is expected in the fourth quarter of 2006.

***Duke Energy***

We charge transportation fees to Duke Energy and its affiliates. Management anticipates continuing to provide transportation services to Duke Energy and its affiliates in the ordinary course of business.

***ConocoPhillips***

We have multiple agreements whereby we provide a variety of services to ConocoPhillips and its affiliates. The agreements include fee-based and percentage of proceeds gathering and processing arrangements, gas purchase and gas sales agreements. Management anticipates continuing to purchase from and sell these commodities to ConocoPhillips and its affiliates in the ordinary course of business. In addition, we may be reimbursed by ConocoPhillips for certain capital projects where the work is performed by us. We received $2.7 million and $0.1 million of capital reimbursements during the nine months ended September 30, 2006 and 2005, respectively.

The following table summarizes the transactions with DEFS, Duke Energy and ConocoPhillips as described above ($ in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Duke Energy Field Services: | | | | |
| Sales of natural gas, NGLs and condensate | $44.7 | $17.2 | $159.9 | $46.4 |
| Transportation and processing services | $ 1.0 | $ | $ 3.5 | $ |
| Purchases of natural gas and NGLs | $ 9.3 | $30.5 | $ 25.7 | $30.8 |
| General and administrative expense | $ 1.3 | $ 4.6 | $ 4.1 | $ 8.2 |
| Duke Energy: | | | | |
| Transportation and processing services | $ | $ 0.2 | $ | $ 0.4 |
| Purchases of natural gas and NGLs | $ | $ 8.5 | $ | $10.1 |
| ConocoPhillips: | | | | |
| Sales of natural gas, NGLs and condensate | $ | $ 2.2 | $ 0.1 | $ 6.7 |
| Transportation and processing services | $ 2.2 | $ 2.8 | $ 5.7 | $ 7.9 |
| Purchases of natural gas and NGLs | $ 2.3 | $ 4.7 | $ 7.5 | $12.9 |

We had accounts receivable and accounts payable with affiliates as follows ($ in millions):

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Duke Energy Field Services: | | |
| Accounts receivable | $ 16.7 | $ 53.5 |
| Accounts payable | $ 1.6 | $ 39.5 |
| Duke Energy: | | |
| Accounts receivable | $ 0.4 | $ 0.4 |
| Accounts payable | $ 0.5 | $ |
| ConocoPhillips: | | |
| Accounts receivable | $ 4.2 | $ 2.6 |
| Accounts payable | $ 0.9 | $ 2.5 |

**7. Risk Management and Hedging Activities, Credit Risk and Financial Instruments**

Management has established a comprehensive risk management policy, or the Risk Management Policy, and a risk management committee to monitor and manage market risks associated with commodity prices.

***Commodity price risk*** Our principal operations of gathering, processing and transporting natural gas, and the accompanying operations of producing, transporting and marketing of NGLs create commodity price risk due to market fluctuations in commodity prices, primarily with respect to the prices of NGLs, natural gas and crude oil. As an owner and operator of natural gas processing and other midstream assets, we have an inherent exposure to market variables and commodity price risk. The amount and type of price risk is dependent on the underlying natural gas contracts to purchase and process raw natural gas. Risk is also dependent on the types and mechanisms for sales of natural gas and NGLs, and related products produced, processed, transported or stored.

***Credit risk*** In the Natural Gas Services segment, we sell natural gas to marketing affiliates of natural gas pipelines, marketing affiliates of integrated oil companies, marketing affiliates of DEFS, national wholesale marketers, industrial end-users and gas-fired power plants. In the NGL Logistics segment, our principal customers include an affiliate of DEFS, producers and marketing companies. Concentration of credit risk may affect our overall credit risk in that these customers may be similarly affected by changes in economic, regulatory or other factors. Where exposed to credit risk, management analyzes the counterparties financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of these limits on an ongoing basis. We operate under DEFS corporate credit policy. DEFS corporate credit policy, guidelines, as well as the standard terms and conditions of our agreements prescribe the use of financial responsibility and reasonable grounds for adequate assurances. These provisions allow our credit department to request that a counterparty remedy credit limit violations by posting cash or letters of credit for exposure in excess of an established credit line. The credit line represents an open credit limit, determined in accordance with DEFS credit policy and guidelines. The agreements also provide that the inability of a counterparty to post collateral is sufficient cause to terminate a contract and liquidate all positions. The adequate assurance provisions also allow us to suspend deliveries, cancel agreements or continue deliveries to the buyer after the buyer provides security for payment in a form satisfactory to us.

***Commodity cash flow hedges*** In September 2005, we executed a series of derivative financial transactions which have been designated as cash flow hedges of the price risk associated with our forecasted sales of natural gas, NGLs and condensate. As a result of those transactions, effective January 1, 2006 we hedged approximately 80% of our expected natural gas and NGL commodity price risk relating to our percentage of proceeds gathering and processing contracts, and 80% of our expected condensate commodity price risk relating to condensate recovered from gathering operations through 2010.

In June 2006, we executed a derivative financial transaction which has been designated as a cash flow hedge of the price risk associated with our 2011 forecasted sales of condensate. As a result of this transaction, we hedged approximately 60% of our expected 2011 condensate commodity price risk relating to condensate recovered from gathering operations.

We use natural gas and crude oil swaps to hedge the impact of market fluctuations in the price of NGLs, natural gas and condensate. The effective portion of the change in fair value of a derivative designated as a cash flow hedge is accumulated in AOCI, and the ineffective portion is recorded in the condensed consolidated statements of operations as sales of natural gas, NGLs and condensate. For the three and nine months ended September 30, 2006, we recognized gains of approximately $0.1 million and losses of approximately $0.4 million, respectively, due to the ineffectiveness of these cash flow hedges. For the three

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and nine months ended September 30, 2006, gains of $0.7 million and $1.4 million, respectively, were reclassified into earnings as a result of settlements. For both the three and nine months ended September 30, 2006, no derivative gains or losses were reclassified from AOCI to current period earnings as a result of the discontinuance of cash flow hedges related to certain forecasted transactions that are not probable of occurring, or due to a derivative no longer qualifying as an effective hedge. All components of each derivative s gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted.

During the period in which the hedged transaction occurs, amounts in AOCI associated with the hedged transaction will be reclassified to the condensed consolidated statements of operations in the same accounts as the item being hedged. As of September 30, 2006 and December 31, 2005, there were net deferred gains of $6.6 million and $0.4 million, respectively, related to commodity cash flow hedge derivative contracts in AOCI. As of September 30, 2006, $2.6 million of deferred net gains on derivative instruments in AOCI are expected to be reclassified into earnings during the next 12 months as the hedged transactions are settled; however, due to the volatility of the commodities markets, the corresponding value in AOCI is subject to change prior to its reclassification into earnings.

***Commodity fair value hedges*** We use fair value hedges to hedge exposure to changes in the fair value of an asset or a liability (or an identified portion thereof) that is attributable to fixed price risk. We may hedge producer price locks (fixed price gas purchases) to reduce our exposure to fixed price risk by swapping the fixed price risk for a floating price position (New York Mercantile Exchange or index-based).

For the three and nine months ended September 30, 2006 and 2005, the gains or losses representing the ineffective portion of our fair value hedges were not significant. All components of each derivative s gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted. During the three and nine months ended September 30, 2006 and 2005, there were no firm commitments that no longer qualified as fair value hedge items and therefore, we did not recognize an associated gain or loss.

***Commodity non-trading derivative activity*** The marketing of energy related products and services exposes us to the fluctuations in the market values of exchanged instruments. Our marketing program is designed to realize margins related to fluctuations in commodity prices and differences in natural gas prices at various receipt and delivery points across the system for our Natural Gas Services segment. DEFS manages our marketing portfolios in accordance with our Risk Management Policy, which limits exposure to market risk.

***Interest rate cash flow hedge*** On March 14, 2006, we entered into interest rate swap agreements to hedge the variable interest rate on a portion of the balance outstanding under our credit agreement. The interest rate swap agreements have been designated as cash flow hedges, and effectiveness is determined by matching the principal balance and terms with that of the specified obligation. The effective portions of changes in fair value are recognized in AOCI in the accompanying condensed consolidated balance sheet. As of September 30, 2006, a loss of $0.3 million was deferred in AOCI related to these swaps. As of September 30, 2006, $0.1 million of deferred net gains on derivative instruments in AOCI are expected to be reclassified into earnings during the next 12 months as the hedged transactions are settled; however, due to the volatility of the interest rate markets, the corresponding value in AOCI is subject to change prior to its reclassification into earnings. Ineffective portions of changes in fair value are recognized in earnings. The agreements reprice prospectively approximately every 90 days, and expire on December 7, 2010. Under the terms of the interest rate swap agreements, we pay a fixed rate of 5.08% and receive interest payments based on three-month the London Interbank Offered Rate, or LIBOR, on a total notional amount of $75.0 million. The differences to be paid or received under the interest rate swap agreements are recognized as an adjustment to interest expense. The agreements are with major financial institutions, which are expected to fully perform under the terms of the agreements.

**8. Debt**

***Credit Facility with Financial Institutions*** On December 7, 2005, we entered into a 5-year credit agreement, or the Credit Agreement, providing a $250.0 million revolving credit facility and a $100.1 million term loan facility. The unused portion of the revolving credit facility may be used for letters of credit. The Credit Agreement matures on December 7, 2010. The Credit Agreement prohibits us from making distributions of Available Cash to unitholders if any default or event of default (as defined in the Credit Agreement) exists. The Credit Agreement requires us to maintain at all times (commencing with the quarter ended March 31, 2006) a leverage ratio (the ratio of our consolidated indebtedness to our consolidated EBITDA, in each case as is defined by the Credit Agreement) of less than or equal to 4.75 to 1.0 (and on a temporary basis for not more than three consecutive quarters following the acquisition of assets in the midstream energy business of not more than 5.25 to 1.0); and maintain at the end of each fiscal quarter an interest coverage ratio (defined to be the ratio of adjusted EBITDA, as defined by the

Credit Agreement to be earnings before interest, taxes and depreciation and amortization and other non-cash adjustments, for the four most recent quarters to interest expense for the same period) of greater than or equal to 3.0 to 1.0. The term loan bears interest at a rate equal to either LIBOR plus 0.15%, the federal funds rate plus 0.5%, or the Wachovia Bank prime rate. The term loan s interest rate as of September 30, 2006 was 5.48%. The revolving credit facility bears interest at a rate equal to LIBOR plus an applicable margin, which ranges from 0.27% to 1.025%, based on leverage level or credit rating, or the higher of the federal funds rate plus 0.50% or Wachovia Bank s prime rate plus an applicable margin of 0% to 0.025%, based on leverage level. The revolving credit facility s weighted average interest rate as of September 30, 2006 was 5.88%. The revolving credit facility incurs an annual facility fee of 0.08% to 0.35%, depending on the applicable leverage level or debt rating. This fee is paid on drawn and undrawn portions of the revolving credit facility. At September 30, 2006, we paid facility fees at a rate of 0.15% per annum.

At September 30, 2006, there was $90.0 million outstanding on the revolving credit facility and $100.0 million outstanding on the term loan facility, which is fully collateralized by high-grade securities. There were no letters of credit outstanding as of September 30, 2006. In December 2005, we incurred $0.7 million of debt issuance costs associated with the Credit Agreement. These expenses are deferred as other non-current assets in the accompanying condensed consolidated balance sheets and will be amortized over the term of the Credit Agreement.

**9. Commitments and Contingent Liabilities**

***Litigation*** We are not a party to any significant legal proceedings but are a party to various administrative and regulatory proceedings that have arisen in the ordinary course of our business. Management currently believes that the ultimate resolution of these matters, taken as a whole, and after consideration of amounts accrued, insurance coverage or other indemnification arrangements, will not have a material adverse effect upon our consolidated results of operations, financial position or cash flows.

In June 2006, a DEFS customer whose plant is served by our Seabreeze pipeline notified DEFS that off specification NGLs had been received into their facility. Our Seabreeze pipeline transports NGLs owned by DEFS that are delivered to the customer under the terms of a transportation agreement. The customer has sent a letter to DEFS claiming that the off specification NGLs delivered to their facility caused damage to their plant facility. This incident is currently under investigation by all parties. Management does not believe the ultimate resolution of this issue will have a material adverse effect on our consolidated results of operations, financial position or cash flows.

DEFS is engaged in an ongoing commercial dispute with a customer at our Minden processing plant that dates back to August 2000, which is prior to our acquisition of this asset from DEFS as part of our December 7, 2005 initial public offering. Although DEFS is leading the negotiations of this dispute, we may be responsible for a portion of potential payments, if any, for periods of time after December 7, 2005. It is not possible to predict with certainty whether we will incur any liability or to estimate the damages, if any, we might incur in connection with this matter. Management does not believe the ultimate resolution of this issue will have a material adverse effect on our consolidated results of operations, financial position or cash flows.

***Insurance*** In 2005, DEFS carried insurance coverage, which included our assets and operations, with an affiliate of Duke Energy. Beginning in 2006, DEFS elected to carry our property and excess liability insurance coverage with an affiliate of Duke Energy and an affiliate of ConocoPhillips. DEFS provides our remaining insurance coverage with a third party insurer. DEFS insurance coverage includes (1) commercial general public liability insurance for liabilities arising to third parties for bodily injury and property damage resulting from operations, (2) workers compensation liability coverage to required statutory limits, (3) automobile liability insurance for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage, (4) excess liability insurance above the established primary limits for commercial general liability and automobile liability insurance, (5) property insurance covering the replacement value of all real and personal property damage, including damages arising from boiler and machinery breakdowns, windstorms, earthquake, flood damage and business interruption/extra expense, and (6) directors and officers insurance covering our directors and officers for acts related to our activities. All coverages are subject to certain limits and deductibles, the terms and conditions of which are common for companies with similar types of operations. Effective August 2006, we contracted with a third party insurer for our property and primary liability insurance coverage.

A portion of the insurance costs described above are allocated by DEFS to us through the allocation methodology described in Note 7 of the 2005 Form 10-K.

***Environmental*** The operation of pipelines, plants and other facilities for gathering, transporting, processing, treating, or storing natural gas, NGLs and other products is subject to stringent and complex laws and regulations pertaining to health, safety and the environment. As an owner or operator of these facilities, we must comply with United States laws and regulations at the federal, state and local levels that relate to air and water quality, hazardous and solid waste management and disposal, and other environmental matters. The cost of planning, designing, constructing and operating pipelines, plants, and other facilities must incorporate compliance with environmental laws and regulations and safety standards. Failure to comply with these laws and regulations may trigger a variety of administrative, civil and potentially criminal enforcement measures, including citizen suits, which can include the assessment of monetary penalties, the imposition of remedial requirements, and the issuance of injunctions or restrictions on operation. Management believes that, based on currently known information, compliance with these laws and regulations will not have a material adverse effect on our consolidated results of operations, financial position or cash flows.

***Indemnification*** DEFS has indemnified us for three years after the closing of our initial public offering against certain potential environmental claims, losses and expenses associated with the operation of the assets and occurring before the closing of our initial public offering, on December 7, 2005. DEFS maximum liability for this indemnification obligation is $15.0 million and DEFS does not have any obligation under this indemnification until our aggregate losses exceed $250,000. DEFS has no indemnification obligations with respect to environmental claims made as a result of additions to or modifications of environmental laws promulgated after the closing date of our initial public offering. We have agreed to indemnify DEFS against environmental liabilities related to our assets to the extent DEFS is not required to indemnify us.

Additionally, DEFS will indemnify us for three years after the closing for losses attributable to title defects, certain retained assets and liabilities (including preclosing legal actions relating to contributed assets) and income taxes attributable to pre-closing operations. We will indemnify DEFS for all losses attributable to the postclosing operations of the assets contributed to us, to the extent not subject to DEFS indemnification obligations. In addition, DEFS has agreed to indemnify us for up to $5.3 million of our pro rata share of any capital contributions required to be made by us to Black Lake associated with any repairs to the Black Lake pipeline that are determined to be necessary as a result of the ongoing pipeline integrity testing occurring from 2005 through 2007. DEFS has also agreed to indemnify us for up to $4.0 million of the costs associated with any repairs to the Seabreeze pipeline that are determined to be necessary as a result of the scheduled pipeline integrity testing occurring in 2006 and 2007.

**10. Equity-Based Compensation**

***Performance Units*** During the nine months ended September 30, 2006, we granted 40,560 Performance Units to certain employees. Performance Units generally cliff vest at the end of a three year performance period. The number of Performance Units which will ultimately vest range from 0% to 150% of the Performance Units granted or 0 to 60,840 Performance Units, depending on the achievement of specified performance targets over a three year period ending on December 31, 2008. The final performance payout is determined by the Compensation Committee of our board of directors. Each Performance Unit includes a distribution equivalent right, which will be paid at the end of the performance period. The grant date fair value and measurement date fair value of these Performance Units was approximately $1.1 million. We recorded approximately $0.1 million and $0.2 million of expense related to the Performance Units during the three and nine months ended September 30, 2006, respectively. There was no compensation expense related to Performance Units prior to January 1, 2006. At September 30, 2006, there was approximately $1.0 million of unrecognized compensation expense related to the Performance Units that is expected to be recognized over a weighted-average period of 2.3 years.

The estimate of Performance Units that are expected to vest is based on highly subjective assumptions that could potentially change over time, including the expected forfeiture rate and achievement of performance targets. Therefore the amount of unrecognized compensation expense noted above does not necessarily represent the value that will ultimately be realized in our condensed consolidated statements of operations.

***Phantom Units*** During the nine months ended September 30, 2006, we granted 35,900 Phantom Units to certain employees. Of these Phantom Units, 23,900 will vest upon the three year anniversary of the grant date and the remaining 12,000 units vest ratably over three years. Each phantom unit includes a distribution equivalent right, which are paid quarterly in arrears. The grant date fair value of these Phantom Units was approximately $0.9 million and the measurement date fair value was approximately $1.0 million. We recorded approximately $0.2 million and $0.3 million of expense related to the Phantom Units during the three and nine months ended September 30, 2006, respectively. There was no compensation expense related to Phantom Units prior to January 1, 2006. At

September 30, 2006 there was approximately $0.7 million of unrecognized compensation expense related to the Phantom Units that is expected to be recognized over a weighted-average period of 1.9 years.

The estimate of Phantom Units that are expected to vest is based on highly subjective assumptions that could potentially change over time, including the expected forfeiture rate. Therefore the amount of unrecognized compensation expense noted

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above does not necessarily represent the value that will ultimately be realized in our condensed consolidated statements of operations.

We intend to settle the Performance Units and Phantom Units, or Awards, which are accounted for as liability awards, in cash upon vesting. Compensation expense is recognized ratably over each vesting period, and will be remeasured quarterly for all Awards outstanding until the units are vested. The fair value of all Awards is determined based on the closing price of DCP Midstream Partners common units at each measurement date. During both the three and nine months ended September 30, 2006, no awards were forfeited, vested or settled.

**11. Business Segments**

Our operations are located in the United States and are organized into two reporting segments (1) Natural Gas Services and (2) NGL Logistics.

***Natural Gas Services*** The Natural Gas Services segment consists of the North Louisiana system assets, an integrated gas gathering, compression, treating, processing, and transportation system located in northern Louisiana and southern Arkansas that includes the Minden and Ada natural gas processing plants and gathering systems and the PELICO intrastate natural gas gathering and transportation pipeline.

***NGL Logistics*** The NGL Logistics segment consists of the Seabreeze NGL transportation pipeline located along the Gulf Coast area of southeastern Texas and a non-operated equity interest in Black Lake, an interstate NGL pipeline located in northern Louisiana and southeastern Texas and regulated by the Federal Energy Regulatory Commission, or FERC.

These segments are monitored separately by management for performance against its internal forecast and are consistent with internal financial reporting. These segments have been identified based on the differing products and services, regulatory environment and the expertise required for these operations. Gross margin is a performance measure utilized by management to monitor the business of each segment. The accounting policies for the segments are the same as those described in Note 2.

The following tables set forth our segment information.

**Three months ended September 30, 2006 ($ in millions):**

| | Natural Gas Services | NGL Logistics | Other(b) | Total |
|---|---|---|---|---|
| Total operating revenues | $ 100.4 | $ 1.6 | $ | $ 102.0 |
| Gross margin (a) | $ 20.7 | $ 1.2 | $ | $ 21.9 |
| Operating and maintenance expense | (3.1) | (0.5) | | (3.6) |
| Depreciation and amortization expense | (2.7) | (0.3) | | (3.0) |
| General and administrative expense | | | (3.1) | (3.1) |
| General and administrative expense affiliates | | | (1.3) | (1.3) |
| Earnings from equity method investment | | | | |
| Interest income | | | 1.7 | 1.7 |
| Interest expense | | | (2.9) | (2.9) |
| Net income (loss) | $ 14.9 | $ 0.4 | $ (5.6) | $ 9.7 |
| Capital expenditures | $ 0.2 | $ 3.9 | $ | $ 4.1 |

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**Three months ended September 30, 2005 ($ in millions):**

| | Natural Gas Services | NGL Logistics | Other(b) | Total |
|---|---|---|---|---|
| Total operating revenues | $ 171.1 | $ 62.2 | $ | $ 233.3 |
| Gross margin (a) | $ 15.3 | $ 0.7 | $ | $ 16.0 |
| Operating and maintenance expense | (4.9) | (0.1) | | (5.0) |
| Depreciation and amortization expense | (2.8) | (0.1) | | (2.9) |
| General and administrative expense affiliates | | | (4.6) | (4.6) |
| Earnings from equity method investment | | 0.1 | | 0.1 |
| Net income (loss) | $ 7.6 | $ 0.6 | $ (4.6) | $ 3.6 |
| Capital expenditures | $ 2.4 | $ | $ | $ 2.4 |

**Nine months ended September 30, 2006 ($ in millions):**

| | Natural Gas Services | NGL Logistics | Other(b) | Total |
|---|---|---|---|---|
| Total operating revenues | $ 312.8 | $ 4.2 | $ | $ 317.0 |
| Gross margin (a) | $ 55.9 | $ 3.2 | $ | $ 59.1 |
| Operating and maintenance expense | (10.1) | (0.8) | | (10.9) |
| Depreciation and amortization expense | (8.2) | (0.7) | | (8.9) |
| General and administrative expense | | | (8.0) | (8.0) |
| General and administrative expense affiliates | | | (4.1) | (4.1) |
| Earnings from equity method investment | | 0.1 | | 0.1 |
| Interest income | | | 4.7 | 4.7 |
| Interest expense | | | (8.1) | (8.1) |
| Net income (loss) | $ 37.6 | $ 1.8 | $ (15.5) | $ 23.9 |
| Capital expenditures | $ 6.1 | $ 4.9 | $ | $ 11.0 |

**Nine months ended September 30, 2005 ($ in millions):**

| | Natural Gas Services | NGL Logistics | Other(b) | Total |
|---|---|---|---|---|
| Total operating revenues | $ 367.7 | $ 143.2 | $ | $ 510.9 |
| Gross margin (a) | $ 43.8 | $ 2.7 | $ | $ 46.5 |
| Operating and maintenance expense | (11.3) | (0.2) | | (11.5) |
| Depreciation and amortization expense | (8.3) | (0.5) | | (8.8) |
| General and administrative expense affiliates | | | (8.2) | (8.2) |
| Earnings from equity method investment | | 0.4 | | 0.4 |
| Net income (loss) | $ 24.2 | $ 2.4 | $ (8.2) | $ 18.4 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Capital expenditures | $ | 5.3 | $ | | $ | | $ | 5.3 |

The following table sets forth our segment assets ($ in millions):

| | | September 30, 2006 | | December 31, 2005 |
|---|---|---|---|---|
| Current assets | $ | 61.5 | $ | 124.5 |
| Non-current assets: | | | | |
| Natural Gas Services | $ | 149.4 | $ | 152.8 |
| NGL Logistics | | 31.7 | | 23.5 |
| Other (c) | | 107.3 | | 106.5 |
| Total non-current assets | $ | 288.4 | $ | 282.8 |
| Total assets | $ | 349.9 | $ | 407.3 |

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(a) Gross margin consists of total operating revenues less purchases of natural gas and NGLs. Gross margin is viewed as a non-GAAP measure under the rules of the SEC, but is included as a supplemental disclosure because it is a primary performance measure used by management as it represents the results of product sales versus product purchases. As an indicator of our operating performance, gross margin should not be considered an alternative to, or more meaningful than, net income or cash flow as determined in accordance with GAAP. Our gross margin may not be comparable to a similarly titled measure of another company because other entities may not calculate gross margin in the same manner.

(b) Other consists of general and administrative expense, interest income and interest expense.

(c) Other non-current assets not allocable to segments consist of restricted investments, unrealized gains on non-trading derivative and hedging instruments, and other non-current assets.

**12. Income Taxes**

We are structured as a master limited partnership which is a pass-through entity for U.S. income tax purposes. In May 2006, the State of Texas enacted a new margin-based franchise tax into law that replaces the existing franchise tax. This new tax is commonly referred to as the Texas margin tax. Corporations, limited partnerships, limited liability companies, limited liability partnerships and joint ventures are examples of the types of entities that are subject to the new tax. The tax is considered an income tax for purposes of adjustments to the deferred tax liability. The tax is determined by applying a tax rate to a base that considers both revenues and expenses. The Texas margin tax becomes effective for franchise tax reports due on or after January 1, 2008. The 2008 tax will be based on revenues earned during the 2007 fiscal year.

The Texas margin tax is assessed at 1% of taxable margin apportioned to Texas. We have computed taxable margin as the total revenue less cost of goods sold. The deferred tax liabilities associated with the Texas margin tax were insignificant.

**13. Subsequent Events**

In November 2006, DEFS contributed its wholesale propane logistics company, Gas Supply Resources LLC, or GSR, to us for approximately $77.0 million, including $67.4 million in cash, $5.7 million in limited partner units and $3.9 million to be paid to complete the construction of a new propane terminal, subject to standard closing conditions. We financed this transaction with our existing credit facility and the issuance of 200,312 class C units. DEFS will continue to operate GSR s assets. As a result of this transaction, our Omnibus Agreement with DEFS was amended to increase the annual fee payable to DEFS by $2.0 million for incremental general and administrative expenses.

On October 25, 2006, the board of directors of DCP Midstream Partners general partner declared a quarterly distribution of $0.405 per unit, payable on November 14, 2006 to unitholders of record on November 6, 2006.

In October 2006, we announced that DEFS has committed to contribute assets to us that will have a value anticipated to approximate $250.0 million. The transaction is targeted for the second quarter of 2007. The assets and the purchase price, along with the other terms of any specific transaction between DEFS and DCP Midstream Partners, are subject to the approval of the boards of directors of both DEFS and DCP Midstream Partners general partner, as well as the conflicts committee of DCP Midstream Partners.

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

*The following discussion analyzes our financial condition and results of operations. You should read the following discussion of our financial condition and results of operations in conjunction with our condensed consolidated financial statements and notes included elsewhere in this Form 10-Q and in our annual report on Form 10-K for the year ended December 31, 2005, or 2005 Form 10-K. We refer to the assets, liabilities and operations contributed to us by Duke Energy Field Services, LLC and its wholly-owned subsidiaries upon the closing of our initial public offering as DCP Midstream Partners Predecessor.*

**Overview**

We are a Delaware limited partnership formed by Duke Energy Field Services, LLC, or DEFS, to own, operate, acquire and develop a diversified portfolio of complementary midstream energy assets. We operate two business segments:

- our Natural Gas Services segment, which consists of Minden, Ada and PELICO, or our North Louisiana system, natural gas gathering, processing and transportation system; and

- our NGL Logistics segment, which consists of our interests in two natural gas liquid, or NGL, pipelines.

The historical financial statements of DCP Midstream Partners Predecessor included in this quarterly report and discussed elsewhere herein include DCP Midstream Partners Predecessor s 50% ownership interest in Black Lake Pipe Line Company, or Black Lake. However, effective December 7, 2005, DEFS retained a 5% interest and we own a 45% interest in Black Lake.

**Factors That Significantly Affect Our Results**

The results of operations for our Natural Gas Services segment are impacted by increases and decreases in the volume of natural gas that we gather and transport through our systems, which we refer to as throughput volume. Throughput volumes and capacity utilization rates generally are driven by wellhead production and our competitive position on a regional basis and more broadly by demand for natural gas, NGLs and condensate.

Our results of operations for our Natural Gas Services segment are also impacted by the fees we receive and the margins we generate. Our processing contractual arrangements can have a significant impact on our profitability. Because of the volatility of the prices for natural gas, NGLs and condensate, as of January 1, 2006 we have hedged approximately 80% of our commodity price risk associated with our gathering and processing arrangements through 2010 with natural gas and crude oil swaps, and as of June 30, 2006, we have hedged approximately 60% of our currently anticipated 2011 condensate price risk with crude oil swaps. With these swaps, we have substantially reduced our exposure to commodity price movements with respect to those volumes under these types of contractual arrangements for this period. For additional information regarding our hedging activities, please read Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk Hedging Strategies in our 2005 Form 10-K. Actual contract terms will be based upon a variety of factors, including natural gas quality, geographic location, the competitive commodity and pricing environment at the time the contract is executed and customer requirements. Our gathering and processing contract mix and, accordingly, our exposure to natural gas, NGL and condensate prices, may change as a result of producer preferences, our expansion in regions where some types of contracts are more common and other market factors.

Our results of operations for our NGL Logistics segment are impacted by the throughput volumes of the NGLs we transport on our two NGL pipelines. Both of these NGL pipelines transport NGLs exclusively on a fee basis.

Our results of operations for our Natural Gas Services segment and our NGL Logistics segment are impacted by inflation. Inflation in the United States has been relatively low in recent years, however, our industry has experienced rising inflation due to increased activity in the energy sector. Consequently, our costs for chemicals, utilities, materials and supplies, contract labor and major equipment purchases have increased. In the future, we may continue to be affected by inflation.

Upon the closing of our initial public offering, DEFS contributed to us the assets, liabilities and operations reflected in the historical financial statements other than the accounts receivable of DCP Midstream Partners Predecessor, certain liabilities and a 5% interest in Black Lake, which were not contributed to us. The historical financial statements of DCP Midstream Partners Predecessor do not give effect to various items that affected our results of operations and liquidity following the closing of our initial public offering, including the items described below:

the indebtedness we incurred at the closing of our initial public offering increased our interest expense;

we have entered into long-term hedging arrangements for approximately 80% of our expected natural gas, NGL and condensate commodity price risk relating to our gathering and processing arrangements through 2010, and approximately 60% of our expected condensate commodity price risk relating to our gathering and processing arrangements in 2011; and

we anticipate incurring approximately $10.5 million of general and administrative expense during the year ending December 31, 2006, excluding our acquisition of Gas Supply Resources LLC discussed below, relating to operating as a separate publicly held limited partnership, some of which will be allocated to us by DEFS. These incremental expenses include compensation and benefit expenses of the personnel who provide direct support to our operations, costs associated with annual and quarterly reports to unitholders, tax return and Schedule K-1 preparation and distribution, independent auditor fees, costs associated with the Sarbanes-Oxley Act of 2002, investor relations activities, registrar and transfer agent fees, incremental director and officer liability insurance costs and director compensation. These incremental expenses exclude $4.8 million per the Omnibus Agreement for other various general and administrative services.

As a result of pipeline integrity testing scheduled during 2006, it is reasonably possible that we may experience lower volumes and increased operating costs on Seabreeze, our NGL transportation pipeline. The Black Lake pipeline is currently experiencing increased operating costs due to pipeline integrity testing that commenced in 2005 and will continue into 2007. We expect that our results of operations related to our non-controlling interest in Black Lake will benefit in 2007 from the completion of this pipeline integrity testing, although it is possible that the integrity testing will result in the need for pipeline repairs, in which case the operations of this pipeline may be interrupted while the repairs are being made. DEFS has agreed to indemnify us for up to $5.3 million of our pro rata share of any capital contributions required to be made by us to Black Lake associated with repairing the Black Lake pipeline that are determined to be necessary as a result of the pipeline integrity testing and up to $4.0 million of the costs associated with any repairs to the Seabreeze pipeline that are determined to be necessary as a result of the pipeline integrity testing.

Finally, we intend to make cash distributions to our unitholders and our general partner. Due to our cash distribution policy, we expect that we will distribute to our unitholders most of the cash generated by our operations. As a result, we expect that we will rely upon external financing sources, including other debt and common unit issuances, to fund our acquisition and expansion capital expenditures.

**Recent Events**

In November 2006, DEFS contributed its wholesale propane logistics company, Gas Supply Resources LLC, or GSR, to us for approximately $77.0 million, including $67.4 million in cash, $5.7 million in limited partner units and $3.9 million to be paid to complete the construction of a new propane terminal, subject to standard closing conditions. We financed this transaction with our existing credit facility and the issuance of 200,312 class C units. DEFS will continue to operate GSR s assets. As a result of this transaction, our Omnibus Agreement with DEFS was amended to increase the annual fee payable to DEFS by $2.0 million for incremental general and administrative expenses.

On October 25, 2006, the board of directors of DCP Midstream Partners general partner declared a quarterly distribution of $0.405 per unit, payable on November 14, 2006 to unitholders of record on November 6, 2006.

In October 2006, we announced that DEFS has committed to contribute assets to us that will have a value anticipated to approximate $250.0 million. The transaction is targeted for the second quarter of 2007. The assets and the purchase price, along with the other terms of any specific transaction between DEFS and DCP Midstream Partners, are subject to the approval of the boards of directors of both DEFS and DCP Midstream Partners general partner, as well as the conflicts committee of DCP Midstream Partners.

In October 2006, Michael J. Bradley, the President and Chief Executive Officer of DCP Midstream GP, LLC, the general partner of our general partner, and member of its board of directors, resigned from those positions to join another company. On November 10, 2006, Mark A. Borer was appointed as President and Chief Executive Officer and elected to the board of directors of DCP Midstream GP, LLC, effective immediately. Also on November 10, 2006, we announced the transition of the Chairman of the Board position of DCP Midstream GP, LLC, from Jim W. Mogg to Fred J. Fowler, which will occur after the release of our first quarter, 2007 earnings.

In the second quarter of 2006, we entered into a letter agreement with DEFS whereby DEFS will make capital contributions to us to reimburse for capital projects which were forecasted to be completed prior to our initial public offering, but were not completed by that date. Pursuant to the letter agreement, DEFS made capital contributions to us of approximately $0.1 million and $3.3 million for the three and nine months ended September 30, 2006, respectively, to reimburse us for the costs we incurred, primarily for growth capital projects. DEFS will make additional capital contributions to us in the future until all these projects have been completed.

In the second quarter of 2006, we amended our Omnibus Agreement with DEFS, under which we receive certain general and administrative services from DEFS for an annual fee of $4.8 million through 2008. The amendment clarifies that the annual fee of $4.8 million under the agreement is fixed at such amount, subject to annual increases in the consumer price index and increases in connection with expansion of our operations through the acquisition or construction of new assets or businesses.

In March 2006, we announced that we had entered into agreements with ConocoPhillips to expand the current gathering and transportation services relationship between us. The new agreements add acreage and extend the terms of the existing dedication through 2011. As a result of these agreements, 17 new wells were added to our system through September 30, 2006, with additional volumes possible over the next three years.

In February 2006, we announced plans to construct a new 37-mile NGL pipeline to connect a DEFS gas processing plant to the Seabreeze pipeline for a cost of approximately $12.0 million. The project is expected to be completed during the fourth quarter of 2006 and is supported by a 10-year NGL product dedication by DEFS. Volumes from DEFS are expected to be approximately 5,300 barrels per day, or Bbls/d.

Effective December 2005, we entered into a contractual arrangement with DEFS that provides that DEFS will purchase natural gas and transport it to the PELICO system, where we will buy the gas from DEFS at its weighted average cost delivered to the PELICO system, plus a contractually agreed-to marketing fee and other related adjustments. In addition, for a significant portion of the gas that we sell out of our PELICO system, DEFS will purchase that natural gas from us and transport it to a sales point at a price equal to its net weighted average sales price, less a contractually agreed-to marketing fee and other related adjustments.

The above agreement was amended and restated effective February 2006. The revised agreement requires that DEFS supply PELICO s system requirements that exceed its on-system supply. Accordingly, DEFS purchases natural gas and transports it to our PELICO system, where we buy the gas from DEFS at the actual acquisition cost plus transportation service charges incurred. If our PELICO system has volumes in excess of the on-system demand, DEFS will purchase the excess natural gas from us and transport it to sales points at an index-based price, less a contractually agreed-to marketing fee. In addition, DEFS may purchase other excess natural gas volumes at certain PELICO outlets for a price that equals the original PELICO purchase price from DEFS, plus a portion of the index differential between upstream sources to certain downstream indices with a maximum differential and a minimum differential, plus a fixed fuel charge and other related adjustments.

## Our Operations

We manage our business and analyze and report our results of operations on a segment basis. Our operations are divided into our Natural Gas Services segment and our NGL Logistics segment.

### *Natural Gas Services Segment*

Results of operations from our Natural Gas Services segment are determined primarily by the volumes of natural gas gathered, compressed, treated, processed, transported and sold through our gathering, processing and pipeline systems; the volumes of NGLs and condensate sold; and the level of our realized natural gas, NGL and condensate prices. We generate our revenues and our gross margins for our Natural Gas Services segment principally under the following types of contractual arrangements:

> *Fee-based arrangements.* Under fee-based arrangements, we receive a fee or fees for one or more of the following services: gathering, compressing, treating, processing or transporting natural gas. Our fee-based arrangements include natural gas purchase arrangements pursuant to which we purchase natural gas at the wellhead or other receipt points at an index related price at the delivery point less a specified amount, which specified amount is generally the same as the transportation fees we would otherwise charge for transportation of natural gas from the wellhead location to the delivery point. Revenues associated with these arrangements may be included as sales of natural gas, NGLs and condensate or transportation and processing services. The revenue we earn is directly related to the volume of natural gas that flows

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through our systems and is not directly dependent on commodity prices. To the extent a sustained decline in commodity prices results in a decline in volumes, however, our revenues from these arrangements would be reduced.

*Percentage-of-proceeds arrangements.* Under percentage-of-proceeds arrangements, we generally purchase natural gas from producers at the wellhead, transport the wellhead natural gas through our gathering system, treat and process the natural gas, and then sell the resulting residue natural gas and NGLs at index prices based on published index market prices. We remit to the producers either an agreed-upon percentage of the actual proceeds that we receive from our sales of the residue natural gas and NGLs, or an agreed upon percentage of the proceeds based on index related prices for the natural gas and the NGLs, regardless of the actual amount of the sales proceeds we receive. Under these types of arrangements, our revenues correlate directly with the price of natural gas and NGLs.

As of January 1, 2006, we have hedged approximately 80% of our currently anticipated natural gas and NGL commodity price risk associated with our percentage-of-proceeds arrangements through 2010 with natural gas and crude oil swaps. With these swaps, we expect our exposure to commodity price movements to be substantially reduced. Additionally, as part of our gathering operations, we recover and sell condensate. The margins we earn from condensate sales are directly correlated with crude oil prices. As of January 1, 2006, we have hedged approximately 80% of our currently anticipated condensate price risk through 2010 with crude oil swaps. As of June 30, 2006, we have hedged approximately 60% of our currently anticipated condensate price risk during 2011 with crude oil swaps. For additional information regarding our hedging activities, please read Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk Hedging Strategies in our 2005 Form 10-K.

We also purchase a small portion of our natural gas under percentage-of-index arrangements. Under percentage-of-index arrangements, we purchase natural gas from the producers at the wellhead at a price that is either at a fixed percentage of the index price for the natural gas that they produce, or at an index based price less a fixed fee to gather, compress, treat and/or process their natural gas. We then gather, compress, treat and/or process the natural gas, and then sell the residue natural gas and NGLs at index related prices. Under these types of arrangements, our cost to purchase the natural gas from the producer is based on the price of natural gas. As a result, our gross margin under these arrangements increases as the price of NGLs increases relative to the price of natural gas, and our gross margin under these arrangements decreases as the price of natural gas increases relative to the price of NGLs.

The natural gas supply for the gathering pipelines and processing plants in our North Louisiana system is derived primarily from natural gas wells located in five parishes in northern Louisiana. The PELICO system also receives natural gas produced in Texas through its interconnect with other pipelines that transport natural gas from Texas into western Louisiana. This five parish area has experienced significant levels of drilling activity, providing us with opportunities to access newly developed natural gas supplies. Our primary suppliers of natural gas to the North Louisiana system are Anadarko Petroleum Corporation and ConocoPhillips (one of our affiliates), which collectively represented approximately 62% of the 289 MMcf/d of natural gas supplied to this system during the nine months ended September 30, 2006. We actively seek new supplies of natural gas, both to offset natural declines in the production from connected wells and to increase throughput volume. We obtain new natural gas supplies in our operating areas by contracting for production from new wells, connecting new wells drilled on dedicated acreage, or by obtaining natural gas that has been released from other gathering systems.

We sell natural gas to marketing affiliates of natural gas pipelines, marketing affiliates of integrated oil companies, marketing affiliates of DEFS, national wholesale marketers, industrial end-users and gas-fired power plants. We typically sell natural gas under market index related pricing terms. In addition, under our merchant arrangements, we use a subsidiary of DEFS as our agent to purchase natural gas from third parties at pipeline interconnect points, as well as residue gas from our Minden and Ada processing plants, and then resell the aggregated natural gas to third parties. We also have entered into a contractual arrangement with a subsidiary of DEFS that requires DEFS to supply PELICO s system requirements that exceed its on-system supply. Accordingly, DEFS purchases natural gas and transports it to our PELICO system, where we buy the gas from DEFS at the actual acquisition cost plus transportation service charges incurred. If our PELICO system has volumes in excess of the on-system demand, DEFS will purchase the excess natural gas from us and transport it to sales points at an index based price less a contractually agreed to marketing fee. In addition, DEFS may purchase other excess natural gas volumes at certain PELICO outlets for a price that equals the original PELICO purchase price from DEFS plus a portion of the index differential between upstream sources to certain downstream indices with a maximum differential and a minimum differential plus a fixed fuel charge and other related adjustments. To the extent possible, we match the pricing of our supply portfolio to our sales portfolio in order to lock in value and reduce our overall commodity price risk. We manage the commodity price risk of our supply portfolio and sales portfolio with both physical and financial transactions. As a service to our customers, we may enter into physical fixed price natural gas purchases and sales, utilizing financial derivatives to swap this fixed price risk back to market index. We account for such a physical fixed price transaction and the related financial derivative as a fair value hedge. We occasionally will enter into financial derivatives to lock in price differentials across the PELICO system to maximize the value of pipeline capacity. These financial derivatives are accounted for using mark-to-market accounting. We also gather, process and transport natural gas under fee-based transportation contracts.

The NGLs extracted from the natural gas at the Minden processing plant are sold at market index prices to an affiliate of DEFS and transported to the Mont Belvieu hub via the Black Lake pipeline. The NGLs extracted from the natural gas at the Ada processing plant are sold at market index prices to third parties and are delivered to the third parties trucks at the tailgate of the plant.

***NGL Logistics Segment***

Historically, we have gathered and transported NGLs either under fee-based transportation contracts or through purchasing the NGLs at the inlet of the pipeline and selling the NGLs at the outlet. In conjunction with our formation, we entered into a contractual arrangement with DEFS that requires DEFS to purchase the NGLs that were historically purchased by us, and to pay us to transport the NGLs pursuant to a fee-based rate that is applied to the volumes transported. We entered into this fee-based contractual arrangement with the objective of generating approximately the same operating income per barrel transported that we realized when we were the purchaser and seller of NGLs.

Our pipelines provide transportation services to customers on a fee basis. Therefore, the results of operations for this business are generally dependent upon the volume of product transported and the level of fees charged to customers. We will not take title to the products transported on our NGL pipelines; rather, the shipper retains title and the associated commodity price risk. For the Seabreeze pipeline, we are responsible for any line loss or gain in NGLs. For the Black Lake pipeline, any line loss or gain in NGLs is allocated to the shipper. The volumes of NGLs transported on our pipelines are dependent on the level of production of NGLs from processing plants connected to our NGL pipelines. When natural gas prices are high relative to NGL prices, it is less profitable to process natural gas because of the higher value of natural gas compared to the value of NGLs and because of the increased cost of separating the mixed NGLs from the natural gas. As a result, we have experienced periods in the past, and will likely experience periods in the future, in which higher natural gas prices reduce the volume of natural gas processed at plants connected to our NGL pipelines and, in turn, lower the NGL throughput on our assets. In the markets we serve, our pipelines are the sole pipeline facility transporting NGLs from the supply source.

**How We Evaluate Our Operations**

Our management uses a variety of financial and operational measurements to analyze our performance. These measurements include the following (1) volumes, (2) gross margin, including segment gross margin, (3) operating and maintenance expense and general and administrative expense, (4) EBITDA and (5) distributable cash flow. Gross margin, segment gross margin, EBITDA and distributable cash flow measurements are not accounting principles generally accepted in the United States of America, or GAAP, financial measures.

***Volumes*** We view throughput volumes on our North Louisiana system and the Seabreeze and Black Lake pipelines as an important factor affecting our profitability. We gather and transport some of the natural gas and NGLs under fee-based transportation contracts. Revenue from these contracts is derived by applying the rates stipulated to the volumes transported. Pipeline throughput volumes from existing wells connected to our pipelines will naturally decline over time as wells deplete. Accordingly, to maintain or to increase throughput levels on these pipelines and the utilization rate of the North Louisiana system s natural gas processing plants, we must continually obtain new supplies of natural gas and NGLs. Our ability to maintain existing supplies of natural gas and NGLs and obtain new supplies are impacted by (1) the level of workovers or recompletions of existing connected wells and successful drilling activity in areas currently dedicated to our pipelines and (2) our ability to compete for volumes from successful new wells in other areas. The throughput volumes of NGLs on our Seabreeze pipeline and the Black Lake pipeline are substantially dependent upon the quantities of NGLs produced at our processing plants as well as NGLs produced at other processing plants that have pipeline connections with the NGL pipelines. We regularly monitor producer activity in the areas served by the North Louisiana system and the Seabreeze and Black Lake pipelines and pursue opportunities to connect new supply to these pipelines.

***Gross Margin*** We view our gross margin as an important performance measure of the core profitability of our operations. We review our gross margin monthly for consistency and trend analysis.

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We define gross margin as total operating revenues less purchases of natural gas and NGLs, and we define segment gross margin for each segment as total operating revenues for that segment less purchases of natural gas and NGLs for that segment. Our gross margin equals the sum of our segment gross margins. Gross margin is included as a supplemental disclosure because it is a primary performance measure used by management as it represents the results of product sales and purchases, a key component of our operations. As an indicator of our operating performance, gross margin should not be considered an alternative to, or more meaningful than, net income, operating income, cash flows from operating activities or any other measure of financial performance presented in accordance with GAAP.

With respect to our Natural Gas Services segment, we calculate our gross margin as our total operating revenues for this segment less purchases of natural gas and NGLs. Operating revenues consist of sales of natural gas, NGLs and condensate resulting from our gathering, compression, treating, processing and transportation activities, fees associated with the gathering of natural gas, and any gains and losses realized from our non-trading derivative activity related to our natural gas asset-based marketing. Purchases include the cost of natural gas and NGLs purchased by us. Our gross margin is impacted by our contract portfolio. We purchase the wellhead natural gas from the producers under fee-based arrangements, percentage-of-proceeds arrangements or percentage-of-index arrangements. Our gross margin generated from percentage-of-proceeds gathering and processing contracts is directly correlated to the price of natural gas and NGLs. Under percentage-of-index arrangements, our gross margin is adversely affected when the price of NGLs falls in relation to the price of natural gas. Generally, our contract structure allows for us to allocate fuel costs and other measurement losses to the producer or shipper and, therefore, does not impact gross margin. Additionally, as part of our gathering operations, we recover and sell condensate. The margins we earn from condensate sales are directly correlated with crude oil prices.

Our gross margin and segment gross margin may not be comparable to a similarly titled measure of another company because other entities may not calculate gross margin and segment gross margin in the same manner.

**Reconciliation of Non-GAAP Measures**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | ($ in millions) | | | |
| **Reconciliation of net income to gross margin:** | | | | |
| Net income | $ 9.7 | $ 3.6 | $ 23.9 | $ 18.4 |
| Add: | | | | |
| Interest expense | 2.9 | | 8.1 | |
| Depreciation and amortization expense | 3.0 | 2.9 | 8.9 | 8.8 |
| Operating and maintenance expense | 3.6 | 5.0 | 10.9 | 11.5 |
| General and administrative expense | 4.4 | 4.6 | 12.1 | 8.2 |
| Less: | | | | |
| Interest income | 1.7 | | 4.7 | |
| Earnings from equity method investment | | 0.1 | 0.1 | 0.4 |
| Gross margin | $ 21.9 | $ 16.0 | $ 59.1 | $ 46.5 |
| **Reconciliation of segment net income to segment gross margin:** | | | | |
| ***Natural Gas Services segment:*** | | | | |
| Segment net income | $ 14.9 | $ 7.6 | $ 37.6 | $ 24.2 |
| Add: | | | | |
| Depreciation and amortization expense | 2.7 | 2.8 | 8.2 | 8.3 |
| Operating and maintenance expense | 3.1 | 4.9 | 10.1 | 11.3 |
| Segment gross margin | $ 20.7 | $ 15.3 | $ 55.9 | $ 43.8 |
| ***NGL Logistics segment:*** | | | | |
| Segment net income | $ 0.4 | $ 0.6 | $ 1.8 | $ 2.4 |
| Add: | | | | |
| Depreciation and amortization expense | 0.3 | 0.1 | 0.7 | 0.5 |
| Operating and maintenance expense | 0.5 | 0.1 | 0.8 | 0.2 |
| Less: | | | | |
| Earnings from equity method investment | | 0.1 | 0.1 | 0.4 |
| Segment gross margin | $ 1.2 | $ 0.7 | $ 3.2 | $ 2.7 |

***Operating and Maintenance Expense and General and Administrative Expense*** Operating and maintenance expenses are costs associated with the operation of a specific asset. Direct labor, ad valorem taxes, repairs and maintenance, utilities, and contract services comprise the most significant portion of our operating and maintenance expense. These expenses are relatively independent of the volumes through our systems but may fluctuate slightly depending on the activities performed during a specific period.

A substantial amount of our general and administrative expense is incurred through DEFS. For the three and nine months ended September 30, 2006, our general and administrative expenses were $4.4 million and $12.1 million, respectively. Under our Omnibus Agreement with DEFS, as amended, we will pay DEFS $4.8 million annually for 2006, for the provision by DEFS or its affiliates of various general and administrative services to us. For 2007 and 2008, the fee will be increased by the percentage increase in the consumer price index for the applicable year. In addition, our general partner will have the right to agree to further increases in connection with expansions of our operations through the acquisition or construction of new assets or businesses with the concurrence of the special committee of our board of directors. We also reimbursed DEFS through July 2006 for our allocable share of insurance expenses related to our businesses and properties as well as insurance expenses related to director and officer liability coverage. These insurance expenses were $0.1 million and $0.8 million for the three and nine months ended September 30, 2006, respectively.

We anticipate incurring approximately $10.5 million of general and administrative expense during the year ending December 31, 2006, excluding our acquisition of GSR, related to operating as a separate publicly held limited partnership, some of which will be allocated to us by DEFS. These incremental expenses are related to compensation and benefit expenses of the personnel who provide direct support to our operations. Also included in the public limited partnership expenses are expenses associated with annual and quarterly reports to unitholders, tax return and Schedule K-1 preparation and distribution, independent auditor fees, costs associated with the Sarbanes-Oxley Act of 2002, investor relations activities, registrar and transfer agent fees, incremental director and officer liability insurance costs and director compensation. These incremental expenses exclude $4.8 million per the Omnibus Agreement for other various general and administrative services.

***EBITDA and Distributable Cash Flow*** We define EBITDA as net income less interest income, plus interest expense and depreciation and amortization expense. EBITDA is used as a supplemental liquidity measure by our management and by external users of our financial statements, such as investors, commercial banks, research analysts and others, to assess the ability of our assets to generate cash sufficient to pay interest costs, support our indebtedness, make cash distributions to our unitholders and general partner and finance maintenance capital expenditures. EBITDA is also a financial measurement that is reported to our lenders and used as a gauge for compliance with our financial covenants under our credit facility, which requires us to maintain (1) a leverage ratio (the ratio of our consolidated indebtedness to our consolidated EBITDA, in each case as is defined by the 5-year credit agreement, or the Credit Agreement) of not more than 4.75 to 1.0 and on a temporary basis for not more than three consecutive quarters following the consummation of asset acquisitions in the midstream energy business, not more than 5.25 to 1.0; and (2) an interest coverage ratio (the ratio of our consolidated EBITDA to our consolidated interest expense, in each case as is defined by the Credit Agreement) of greater than or equal to 3.0 to 1.0 determined as of the last day of each quarter for the four-quarter period ending on the date of determination. Our EBITDA may not be comparable to a similarly titled measure of another company because other entities may not calculate EBITDA in the same manner.

EBITDA is also used as a supplemental performance measure by our management and by external users of our financial statements, such as investors, commercial banks, research analysts and others, to assess:

- financial performance of our assets without regard to financing methods, capital structure or historical cost basis;
- our operating performance and return on capital as compared to those of other companies in the midstream energy industry, without regard to financing methods or capital structure; and
- viability of acquisitions and capital expenditure projects and the overall rates of return on alternative investment opportunities.

EBITDA should not be considered an alternative to, or more meaningful than, net income, operating income, cash flows from operating activities or any other measure of financial performance presented in accordance with GAAP as measures of operating performance, liquidity or ability to service debt obligations.

We define distributable cash flow as EBITDA, plus interest income, less interest expense, maintenance capital expenditures, net of reimbursable projects, earnings from equity method investment and adjustments for non-cash hedge ineffectiveness. In the first nine months of 2006, we also adjusted for a post-closing reimbursement from DEFS for maintenance capital expenditures. Maintenance capital expenditures are capital expenditures made to replace partially or fully depreciated assets, to maintain the existing operating capacity of our assets and to extend their useful lives, or other capital expenditures that are incurred in maintaining existing system volumes and related cash flows. Non-cash hedge ineffectiveness refers to the ineffective portion of our cash flow hedges, which is recorded in earnings in the current period. This amount is considered to be non-cash for the purpose of computing distributable cash because settlement will not occur until future periods and will be impacted by future changes in commodity prices. Distributable cash flow is used as a supplemental financial measure by our management and by external users of our financial statements, such as investors, commercial banks, research analysts and other, to assess our ability to make cash distributions to our unitholders and our general partner.

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**Reconciliation of Non-GAAP Measures**

| | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2006 |
|---|---|---|
| | ($ in millions) | |
| **Reconciliation of net income to EBITDA:** | | |
| Net income | $ 9.7 | $ 23.9 |
| Interest income | (1.7) | (4.7) |
| Interest expense | 2.9 | 8.1 |
| Depreciation and amortization expense | 3.0 | 8.9 |
| EBITDA | $ 13.9 | $ 36.2 |
| **Reconciliation of net cash provided by operating activities to EBITDA:** | | |
| Net cash provided by operating activities | $ 6.0 | $ 16.8 |
| Interest income | (1.7) | (4.7) |
| Interest expense | 2.9 | 8.1 |
| Earnings from equity method investment | | 0.1 |
| Net changes in operating assets and liabilities | 6.2 | 14.1 |
| Other, net | 0.5 | 1.8 |
| EBITDA | $ 13.9 | $ 36.2 |

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|---|---|---|
| | ($ in millions) | |
| **Reconciliation of net income to EBITDA:** | | |
| Net income | $ 3.6 | $ 18.4 |
| Depreciation and amortization | 2.9 | 8.8 |
| EBITDA | $ 6.5 | $ 27.2 |
| **Reconciliation of net cash provided by operating activities to EBITDA:** | | |
| Net cash provided by operating activities | $ (10.2) | $ 7.7 |
| Earnings from equity method investment | 0.1 | 0.4 |
| Net changes in operating assets and liabilities | 16.5 | 19.0 |
| Other, net | 0.1 | 0.1 |

| | | | | |
|---|---|---|---|---|
| EBITDA | $ | 6.5 | $ | 27.2 |

**Critical Accounting Policies and Estimates**

Our critical accounting policies and estimates are described in Item 7 of our 2005 Form 10-K. The accounting policies and estimates used in preparing our interim condensed consolidated financial statements for the three and nine months ended September 30, 2006 are the same as those described in our 2005 Form 10-K.

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## Results of Operations

***Consolidated Overview***

The following table and discussion is a summary of our condensed consolidated results of operations for the three and nine months ended September 30, 2006 and 2005. The results of operations by segment are discussed in further detail following this consolidated overview discussion.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | ($ in millions) | | | |
| Operating revenues: | | | | |
| Sales of natural gas, NGLs and condensate | $ 95.0 | $ 227.4 | $ 296.6 | $ 494.2 |
| Transportation and processing services | 7.0 | 5.9 | 20.4 | 16.7 |
| Total operating revenues | 102.0 | 233.3 | 317.0 | 510.9 |
| Purchases of natural gas and NGLs | 80.1 | 217.3 | 257.9 | 464.4 |
| Gross margin (a) | 21.9 | 16.0 | 59.1 | 46.5 |
| Operating and maintenance expense | (3.6) | (5.0) | (10.9) | (11.5) |
| General and administrative expense | (4.4) | (4.6) | (12.1) | (8.2) |
| Earnings from equity method investment (b) | | 0.1 | 0.1 | 0.4 |
| EBITDA (c) | 13.9 | 6.5 | 36.2 | 27.2 |
| Depreciation and amortization expense | (3.0) | (2.9) | (8.9) | (8.8) |
| Interest income | 1.7 | | 4.7 | |
| Interest expense | (2.9) | | (8.1) | |
| Net income | $ 9.7 | $ 3.6 | $ 23.9 | $ 18.4 |
| Segment financial and operating data: | | | | |
| ***Natural Gas Services Segment:*** | | | | |
| Financial data: | | | | |
| Segment gross margin (a) | $ 20.7 | $ 15.3 | $ 55.9 | $ 43.8 |
| Operating data: | | | | |
| Natural gas throughput (MMcf/d) | 393 | 367 | 381 | 339 |
| NGL gross production (Bbls/d) | 5,384 | 4,507 | 5,222 | 4,795 |
| ***NGL Logistics Segment:*** | | | | |
| Financial data: | | | | |
| Segment gross margin (a) | $ 1.2 | $ 0.7 | $ 3.2 | $ 2.7 |
| Operating data: | | | | |
| Seabreeze throughput (Bbls/d) | 20,272 | 17,046 | 19,667 | 15,334 |
| Black Lake throughput (Bbls/d) (c) | 5,410 | 4,708 | 4,858 | 4,972 |

(a) Gross margin consists of total operating revenues less purchases of natural gas and

NGLs and segment gross margin for each segment consists of total operating revenues for that segment less purchases of natural gas and NGLs for that segment. Please read How We Evaluate Our Operations above.

(b) Represents 50% of the throughput volumes and earnings of Black Lake for the three and nine months ended September 30, 2005. Upon closing of our initial public offering on December 7, 2005, DEFS retained a 5% interest in Black Lake. We own a 45% interest in Black Lake.

(c) EBITDA consists of net income plus net interest expense and depreciation and amortization expense. Please read How We Evaluate Our Operations above.

***Three Months Ended September 30, 2006 vs. Three Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $131.3 million, or 56%, to $102.0 million in 2006 from $233.3 million in 2005, primarily due to the following:

- $71.4 million decrease primarily attributable to lower natural gas prices and sales volumes and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO revenues from a gross presentation to a net presentation, partially offset by an increase in NGL and condensate prices and sales volumes; and

- $61.7 million decrease primarily attributable to lower sales for our Seabreeze pipeline, primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; offset by

- $1.1 million increase in transportation revenue attributable to an increase in volumes and the Seabreeze pipeline change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; and

- $0.7 million increase related to commodity hedging, which increased operating revenues during the third quarter of 2006.

*Purchases of Natural Gas and NGLs* Purchases of natural gas and NGLs decreased $137.2 million, or 63%, to $80.1 million in 2006 from $217.3 million in 2005, primarily due to the following:

- $76.1 million decrease attributable to lower cost of raw natural gas supply primarily driven by lower natural gas prices and decreased purchased volumes, and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO purchases from a gross presentation to a net presentation, partially offset by higher NGL and condensate prices and purchased volumes; and

- $61.1 million decrease attributable to lower purchases for our Seabreeze pipeline, primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement.

*Gross Margin* Gross margin increased $5.9 million, or 37%, to $21.9 million in 2006 from $16.0 million in 2005, primarily due to higher NGL and condensate prices. Additionally, an increase in natural gas throughput volumes, higher contractual fees charged to customers related to pipeline imbalances, and an increase in marketing activity and throughput across our PELICO system due to atypical differences in natural gas prices at various receipt and delivery points across the system contributed to the system. The market conditions causing the differentials in natural gas prices may not continue in the future, nor can we assure our ability to capture upside margin if these market conditions do occur.

*Operating and Maintenance Expense* Operating and maintenance expense decreased $1.4 million, or 28%, to $3.6 million in 2006 from $5.0 million in 2005, primarily due to lower equipment lease expense and lower repairs and maintenance expense in our Natural Gas Services segment.

*General and Administrative Expense* General and administrative expense decreased $0.2 million, or 4%, to $4.4 million in 2006 from $4.6 million in 2005.

*Earnings from Equity Method Investment* There were insignificant earnings from equity method investment for the three months ended September 30, 2006. Earnings from equity method investment were $0.1 million for the three months ended September 30, 2005.

***Nine Months Ended September 30, 2006 vs. Nine Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $193.9 million, or 38%, to $317.0 million in 2006 from $510.9 million in 2005, primarily due to the following:

$142.2 million decrease primarily attributable to lower sales for our Seabreeze pipeline, primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; and

$56.1 million decrease attributable primarily to lower natural gas prices and sales volumes and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO revenues from a gross presentation to a net presentation, partially offset by higher NGL and condensate prices and sales volumes; offset by

$3.7 million increase in transportation revenue, primarily attributable to an increase in volumes and the Seabreeze pipeline change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; and

$0.7 million increase related to commodity hedging.

*Purchases of Natural Gas and NGLs* Purchases of natural gas and NGLs decreased $206.5 million, or 44%, to $257.9 million in 2006 from $464.4 million in 2005, primarily due to the following:

$139.5 million decrease attributable to lower purchases for our Seabreeze pipeline, primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; and

$67.0 million decrease attributable to lower cost of raw natural gas supply driven by lower natural gas prices and decreased purchased volumes, and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO purchases from a gross presentation to a net presentation, partially offset by higher NGL and condensate prices and purchased volumes.

*Gross Margin* Gross margin increased $12.6 million, or 27%, to $59.1 million in 2006 from $46.5 million in 2005, primarily due to higher NGL and condensate prices. Additionally, an increase in marketing activity and throughput across our PELICO system due to atypical differences in natural gas prices at various receipt and delivery points across the system, and an increase in natural gas throughput volumes contributed to this increase. The market conditions causing the differentials in natural gas prices may not continue in the future, nor can we assure our ability to capture upside margin if these market conditions do occur.

*Operating and Maintenance Expense* Operating and maintenance expense decreased $0.6 million, or 5%, to $10.9 million in 2006 from $11.5 million in 2005, primarily as a result of lower costs associated with repairs and maintenance and equipment lease expenses, partially offset by higher direct labor costs.

*General and Administrative Expense* General and administrative expense increased $3.9 million, or 48%, to $12.1 million in 2006 from $8.2 million in 2005, primarily due to the following:

higher public limited partnership expenses of approximately $1.9 million primarily attributable to tax return and Schedule K-1 preparation and distribution, independent auditor fees, costs associated with the Sarbanes-Oxley Act of 2002, and incremental director and officer liability insurance costs; and

higher labor, benefits, insurance and other administrative expense allocated primarily from DEFS of approximately $2.0 million.

*Earnings from Equity Method Investment* Earnings from equity method investment decreased $0.3 million to $0.1 million in 2006 from $0.4 million in 2005. This decrease was primarily due to an increase in Black Lake operating costs as a result of pipeline integrity testing during the first quarter of 2006.

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***Results of Operations Natural Gas Services Segment***

This segment consists of our North Louisiana system, which includes our PELICO system and our Minden and Ada processing plants and gathering systems.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| | **($ in millions)** | | | |
| Operating revenues: | | | | |
| Sales of natural gas, NGLs and condensate | $ 94.5 | $ 165.2 | $ 295.6 | $ 351.0 |
| Transportation and processing services | 5.9 | 5.9 | 17.2 | 16.7 |
| Total operating revenues | 100.4 | 171.1 | 312.8 | 367.7 |
| Purchases of natural gas and NGLs | 79.7 | 155.8 | 256.9 | 323.9 |
| Segment gross margin (a) | 20.7 | 15.3 | 55.9 | 43.8 |
| Operating and maintenance expense | (3.1) | (4.9) | (10.1) | (11.3) |
| Depreciation and amortization expense | (2.7) | (2.8) | (8.2) | (8.3) |
| Natural Gas Services segment net income | $ 14.9 | $ 7.6 | $ 37.6 | $ 24.2 |
| Operating data: | | | | |
| Natural gas throughput (MMcf/d) | 393 | 367 | 381 | 339 |
| NGL gross production (Bbls/d) | 5,384 | 4,507 | 5,222 | 4,795 |

(a) Segment gross margin for each segment consists of total operating revenues for that segment less purchases of natural gas and NGLs for that segment. Please read How We Evaluate Our Operations above.

***Three Months Ended September 30, 2006 vs. Three Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $70.7 million, or 41%, to $100.4 million in 2006 from $171.1 million in 2005, primarily due to the following:

- $52.6 million decrease primarily attributable to lower natural gas sales volumes and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO revenues from a gross presentation to a net presentation; and

- $25.4 million decrease attributable to a decrease in natural gas prices; offset by

- $3.5 million increase attributable to an increase in NGL and condensate sales volumes;

- $3.1 million increase attributable to an increase in NGL and condensate prices; and

- $0.7 million increase related to commodity hedging, which increased operating revenues during the third quarter of 2006.

*Purchases of Natural Gas and NGLs* Purchases of natural gas and NGLs decreased $76.1 million, or 49%, to $79.7 million in 2006 from $155.8 million in 2005. This decrease was due to lower cost of raw natural gas supply driven by lower natural gas prices and decreased purchase volumes, and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO purchases from a gross presentation to a net presentation, partially offset by higher NGL and condensate prices and purchased volumes.

*Segment Gross Margin* Segment gross margin increased $5.4 million, or 35%, to $20.7 million in 2006 from $15.3 million in 2005, primarily as a result of the following factors:

- $2.0 million increase attributable to higher NGL and condensate prices, and by lower natural gas prices resulting in favorable frac spreads, which are the differences between the value of the NGLs extracted from processing and the value of the Btu equivalent of the residue natural gas;

$1.3 million increase primarily attributable to an increase in natural gas throughput volumes as a result of a decrease in September 2005 volumes due to the impact of hurricane Katrina;

$1.3 million increase attributable to higher contractual fees charged to customers related to pipeline imbalances;

$1.3 million increase attributable to an increase in marketing activity and throughput across our PELICO system due to atypical differences in natural gas prices at various receipt and delivery points across the system. The market conditions causing the differentials in natural gas prices may not continue in the future, nor can we assure our ability to capture upside margin if these market conditions do occur; and

$0.7 million increase related to commodity hedging, which increased operating revenues during the third quarter of 2006; offset by

$1.2 million decrease primarily attributable to a change in contract mix.

*Operating and Maintenance Expense* Operating and maintenance expense decreased $1.8 million, or 37%, to $3.1 million in 2006 from $4.9 million in 2005, primarily due to lower costs associated with equipment leases and repairs and maintenance.

NGL production in 2006 increased 877 barrels per day, or 19%, to 5,384 barrels per day from 4,507 barrels per day in 2005, due primarily to higher throughput volume at our Minden processing plant. Natural gas transported and/or processed during 2006 increased 26 MMcf/d, or 7%, to 393 MMcf/d from 367 MMcf/d in 2005, primarily as a result of higher natural gas volumes processed at our Minden gathering system.

***Nine Months Ended September 30, 2006 vs. Nine Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $54.9 million, or 15%, to $312.8 million in 2006 from $367.7 million in 2005, primarily due to the following:

$65.9 million decrease attributable to a decrease in natural gas sales volumes and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO revenues from a gross presentation to a net presentation;

$7.5 million decrease attributable to an decrease in natural gas prices; offset by

$13.3 million increase attributable to an increase in NGL and condensate prices;

$4.0 million increase primarily attributable to higher NGL and condensate volumes;

$0.7 million increase related to commodity hedging; and

$0.5 million increase in transportation revenue primarily attributable to an increase in natural gas throughput.

*Purchases of Natural Gas and NGLs* Purchases of natural gas and NGLs decreased $67.0 million, or 21%, to $256.9 million in 2006 from $323.9 million in 2005, primarily due to lower costs of raw natural gas supply, driven by lower natural gas prices and decreased purchased volumes, and an amendment to a contract with an affiliate which resulted in a prospective change in the reporting of certain PELICO purchases from a gross presentation to a net presentation, partially offset by higher NGL and condensate prices and purchased volumes.

*Segment Gross Margin* Segment gross margin increased $12.1 million, or 28%, to $55.9 million in 2006 from $43.8 million in 2005, primarily as a result of the following factors:

$6.5 million increase attributable to higher NGL and condensate prices and favorable frac spreads;

$5.9 million increase attributable to an increase in marketing activity and throughput across our PELICO system due to atypical differences in natural gas prices at various receipt and delivery points across the system. The market conditions

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causing the differentials in natural gas prices may not continue in the future, nor can we assure our ability to capture upside margin if these market conditions do occur;

$2.5 million increase primarily attributable to an increase in natural gas throughput volumes;

$0.7 million increase related to commodity hedging; and

$0.6 million increase attributable to higher contractual fees charged to customers related to pipeline imbalances; offset by

$2.3 million decrease primarily attributable to a change in contract mix; and

$1.8 million decrease attributable to higher netback prices paid to the producers at Minden and Ada.

*Operating and Maintenance Expense* Operating and maintenance expense decreased $1.2 million, or 11%, to $10.1 million in 2006 from $11.3 million in 2005, primarily as a result of lower costs associated with equipment leases and repairs and maintenance.

NGL production during 2006 increased 427 barrels per day, or 9%, to 5,222 barrels per day from 4,795 barrels per day in 2005 due primarily to higher throughput volume at our Minden processing plant. Natural gas transported and/or processed during 2006 increased 42 MMcf/d, or 12%, to 381 MMcf/d from 339 MMcf/d in 2005 primarily as a result of higher natural gas volumes transported on our PELICO system and processed at our Minden gathering system.

***Results of Operations NGL Logistics Segment***

This segment includes our NGL transportation pipelines, which includes our Seabreeze pipeline and our interest in Black Lake.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | ($ in millions) | | | |
| Operating revenues: | | | | |
| Sales of NGLs | $ 0.5 | $ 62.2 | $ 1.0 | $ 143.2 |
| Transportation and processing services | 1.1 | | 3.2 | |
| Total operating revenues | 1.6 | 62.2 | 4.2 | 143.2 |
| Purchases of NGLs | 0.4 | 61.5 | 1.0 | 140.5 |
| Segment gross margin (a) | 1.2 | 0.7 | 3.2 | 2.7 |
| Operating and maintenance expense | (0.5) | (0.1) | (0.8) | (0.2) |
| Depreciation and amortization expense | (0.3) | (0.1) | (0.7) | (0.5) |
| Earnings from equity method investment | | 0.1 | 0.1 | 0.4 |
| NGL Logistics segment net income | $ 0.4 | $ 0.6 | $ 1.8 | $ 2.4 |
| Operating data: | | | | |
| Seabreeze throughput (Bbls/d) | 20,272 | 17,046 | 19,667 | 15,334 |
| Black Lake throughput (Bbls/d) (b) | 5,410 | 4,708 | 4,858 | 4,972 |

(a) Segment gross margin for each segment consists of total operating revenues for that segment less purchases of natural gas and NGLs for that segment. Please read How We Evaluate Our Operations above.

(b) Represents 50% of the throughput volume of the Black Lake pipeline during the three and nine months ended September 30, 2005. Upon closing of our initial public offering on December 7, 2005, DEFS retained a 5% interest in Black Lake. We own a 45% interest in Black Lake.

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***Three Months Ended September 30, 2006 vs. Three Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $60.6 million, or 97%, to $1.6 million in 2006 from $62.2 million in 2005, primarily due to the following factors:

- $61.7 million decrease primarily attributable to lower sales for our Seabreeze pipeline primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; offset by

- $1.1 million increase in transportation revenue attributable to an increase in volumes and the change in contract terms in December 2005, from a purchase and sale arrangement to a fee-based contractual transportation arrangement.

*Purchases of NGLs* Purchases of NGLs decreased $61.1 million, or 99%, to $0.4 million in 2006 from $61.5 million in 2005 attributable to lower purchases due to the change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement.

*Segment Gross Margin* Segment gross margin increased $0.5 million, or 71%, to $1.2 million in 2006 from $0.7 million in 2005, primarily due to increased transportation revenue.

*Operating and Maintenance Expense* Operating and maintenance expense increased $0.4 million, or 400%, to $0.5 million in 2006 from $0.1 million in 2005, primarily as a result of higher costs associated with asset integrity and equipment rentals.

*Earnings from Equity Method Investment* There were insignificant earnings from equity method investment for the three months ended September 30, 2006. Earnings from equity method investment were $0.1 million for the three months ended September 30, 2005.

Overall, our Seabreeze pipeline experienced an increase in throughput volume of 3,226 Bbls per day during the third quarter of 2006 as a result of a decrease in September 2005 volumes due to the impact of hurricane Katrina.

***Nine Months Ended September 30, 2006 vs. Nine Months Ended September 30, 2005***

*Total Operating Revenues* Total operating revenues decreased $139.0 million, or 97%, to $4.2 million in 2006 from $143.2 million in 2005, primarily due to the following factors:

- $142.2 million decrease primarily attributable to lower sales for our Seabreeze pipeline, primarily due to a change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement; offset by

- $3.2 million increase in transportation revenue attributable to and increase in volumes and the change in contract terms in December 2005, from a purchase and sale arrangement to a fee-based contractual transportation arrangement.

*Purchases of NGLs* Purchases of NGLs decreased $139.5 million, or 99%, to $1.0 million in 2006 from $140.5 million in 2005 attributable to lower purchases due to the change in contract terms in December 2005 from a purchase and sale arrangement to a fee-based contractual transportation arrangement.

*Segment Gross Margin* Segment gross margin increased $0.5 million, or 19%, to $3.2 million in 2006 from $2.7 million in 2005, primarily due to increased transportation revenue.

*Operating and Maintenance Expense* Operating and maintenance expense increased $0.6 million, or 300%, to $0.8 million in 2006 from $0.2 million in 2005, primarily as a result of higher costs associated with asset integrity and equipment rentals.

*Earnings from Equity Method Investment* Earnings from equity method investment decreased $0.3 million to $0.1 million in 2006 from $0.4 million in 2005, primarily due to an increase in Black Lake operating costs as a result of pipeline integrity testing during the first quarter of 2006.

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Overall, our Seabreeze pipeline experienced an increase in throughput volume of 4,333 Bbls per day during the nine months ended September 30, 2006 as a result of a temporary disruption in supply from a third-party pipeline in 2005, which was restored in June 2005, as well as a decrease in September 2005 volumes due to the impact of hurricane Katrina.

**Liquidity and Capital Resources**

Historically, our sources of liquidity included cash generated from operations and funding from DEFS. Our cash receipts were deposited in DEFS bank accounts and all cash disbursements were made from these accounts. Thus, historically our financial statements have reflected no cash balances. Cash transactions handled by DEFS for us were reflected in partners equity as intercompany advances between DEFS and us. Following our initial public offering, we maintain our own bank accounts, which are managed by DEFS.

We expect our sources of liquidity to include:

- cash generated from operations;
- cash distributions from Black Lake;
- borrowings under our revolving credit facility;
- cash realized from the liquidation of securities that are pledged under our term loan facility;
- issuance of additional partnership units; and
- debt offerings.

We anticipate our more significant uses of resources to include:

- capital expenditures; and
- quarterly distributions to our unitholders.

We used a portion of our retained $206.4 million from our initial public offering to (1) purchase $100.1 million of high-grade securities, which were used as collateral to secure the term loan portion of our credit facility, (2) pay approximately $4.0 million of expenses associated with our initial public offering and related formation transactions, (3) distribute approximately $8.6 million in cash to subsidiaries of DEFS as reimbursement for capital expenditures incurred by subsidiaries of DEFS prior to our initial public offering related to assets contributed to us upon the closing of our initial public offering, which distribution was made in partial consideration of the assets contributed to us upon the closing of our initial public offering, and (4) use the remaining amount of approximately $93.7 million to fund payables and future capital expenditures (including potential acquisitions), working capital and other general partnership purposes.

We believe that cash generated from these sources will be sufficient to meet our short-term working capital requirements, long-term capital expenditure requirements and quarterly cash distributions. Our hedging program may require us to post collateral depending on commodity price movements. DEFS has issued parental guarantees for our commodity hedging transactions that span through 2010, which may reduce our requirement to post collateral.

Changes in natural gas, NGL and condensate prices and the terms of our processing arrangements have a direct impact on our generation and use of cash from operations, due to their impact on net income, along with the resulting changes in working capital. As of January 1, 2006, we have hedged approximately 80% of our share of anticipated natural gas and NGL price risk associated with our percentage-of-proceeds arrangements through 2010 with natural gas and crude oil swaps. Additionally, as part of our gathering operations, we recover and sell condensate. We have hedged approximately 80% of our share of anticipated condensate price risk associated with our gathering operations through 2010 with crude oil swaps. As of June 30, 2006, we have hedged approximately 60% of our currently anticipated condensate price risk during 2011 with crude oil swaps. For additional information regarding our hedging activities, please read Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk Hedging Strategies in our 2005 Form 10-K.

***Working Capital*** Working capital is the amount by which current assets exceed current liabilities. Our working capital requirements are primarily driven by changes in accounts receivable and accounts payable. These changes are impacted by changes in the prices of commodities that we buy and sell. In general, our working capital requirements increase in periods of rising commodity prices and decline in periods of falling commodity prices. However, our working capital needs do not necessarily change at the same rate as commodity prices, because both accounts receivable and accounts payable are impacted by the same commodity prices. We had working capital of $24.8 million as of September 30, 2006, compared to working capital of $31.1 million as of December 31, 2005. During these periods, the decrease in working capital was primarily due to the timing of fluctuations in accounts receivable and accounts payable, as described above. We expect that our future working capital requirements will be impacted by these same factors.

***Cash flow*** Net cash provided by operating activities, net cash used in investing activities and net cash used in financing activities for the nine months ended September 30, 2006 and 2005 were as follows:

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2006 | 2005 |
| | ($ in millions) | |
| Net cash provided by operating activities | $ 16.8 | $ 7.7 |
| Net cash used in investing activities | $(12.4) | $(4.7) |
| Net cash used in financing activities | $(31.5) | $(3.0) |

***Net Cash Provided by Operating Activities*** The changes in net cash provided by operating activities are attributable to our net income, adjusted for non-cash charges, as presented in the condensed consolidated statements of cash flows and changes in working capital, as discussed above.

***Net Cash Used in Investing Activities*** Net cash used in investing activities during the nine months ended September 30, 2006 and 2005 primarily consisted of capital expenditures for construction and expansion of our infrastructure in addition to well connections and other upgrades to our existing facilities. Included in net cash used in investing activities are purchases of available-for-sale securities and proceeds from sales of available-for-sale securities, each in the amount of approximately $5.4 billion during the nine months ended September 30, 2006. These purchases and sales consist of short-term and restricted investments. Short-term investments are generally available for general corporate purposes and our restricted investments secure the term loan portion of the credit facility and are to be used only for future capital or acquisition expenditures.

***Net Cash Used in Financing Activities*** Net cash used in financing activities during the nine months ended September 30, 2006 represents the payment of $20.0 million on our revolving credit facility and $0.1 million on our term loan facility, and $14.7 million of distributions to our unitholders and general partner, offset by $3.3 million of contributions from DEFS. Net cash used in financing activities during the nine months ended September 30, 2005 represents the pass through of our net cash flows to DEFS under its cash management program as discussed above.

***Capital Requirements*** The midstream energy business can be capital intensive, requiring significant investment to maintain and upgrade existing operations. In our Natural Gas Services segment, a significant portion of the cost of constructing new gathering lines to connect to our gathering system is generally paid for by the natural gas producer. In this segment, our expansion capital expenditures may include the construction of new pipelines that would facilitate greater movement of natural gas from western Louisiana and eastern Texas to the market hub that the PELICO system is connected to near Perryville, Louisiana. This hub provides access to several intrastate and interstate pipelines, including pipelines that transport natural gas to the northeastern United States.

Our capital requirements have consisted primarily of, and we anticipate will continue to consist of the following:

- maintenance capital expenditures, which are cash expenditures where we add on to or improve capital assets owned or acquire or construct new capital assets if such expenditures are made to maintain, including over the long term, our operating capacity or revenues; and expansion capital expenditures, which are cash expenditures for acquisitions or capital improvements (where we add on to or improve the capital assets owned, or acquire or construct new gathering lines, treating facilities, processing plants, fractionation facilities, pipelines, terminals, docks, truck racks, tankage and other storage, distribution or transportation facilities and related or similar midstream assets) in each case if such addition, improvement, acquisition or construction is made to increase our operating capacity or revenues or that of our equity interests.

Given our objective of growth through acquisitions, expansion of existing assets and other internal growth projects, we anticipate that we will continue to invest significant amounts of capital to grow and acquire assets. We actively consider a variety of assets for potential acquisitions and expansion projects.

We have budgeted maintenance capital expenditures of $2.2 million and expansion capital expenditures of $23.6 million for the year ending December 31, 2006. During the nine months ended September 30, 2006, our capital expenditures totaled $11.0 million, including maintenance capital expenditures of $2.1 million and expansion capital expenditures of $8.9 million. For the nine months ended September 30, 2006, we had changes in receivables and collections for maintenance capital expenditures, from DEFS and producers, of approximately $0.7 million. As a result, our total maintenance capital expenditures net of reimbursements are approximately $1.4 million for the nine months ended September 30, 2006. We expect our maintenance capital spending net of reimbursements from DEFS and producers for the year ending December 31, 2006 to be in line with our budget.

Annual maintenance capital expenditures in 2006 are expected to be lower than 2005 as a result of the completion of a 2005 project to add and modify compression and flow lines to increase volumes at the Ada processing plant. Annual expansion capital expenditures in 2006 are expected to increase as compared to 2005 as a result of the new NGL project, for which expansion capital expenditures are expected to be approximately $12.0 million, $4.8 million of which was expended during the nine months ended September 30, 2006. We expect to fund future capital expenditures with restricted investments, funds generated from our operations, borrowings under our credit facility, the issuance of additional partnership units as appropriate given market conditions and the liquidation of high-grade securities that have been pledged under our credit facility.

***Cash Distributions to Unitholders*** Our partnership agreement requires that, within 45 days after the end of each quarter, we distribute all cash and cash equivalents on hand at the end of the quarter, less certain reserves as identified in the partnership agreement, to unitholders of record on the applicable record date. We made cash distributions to our unitholders of $6.7 million and $14.7 million during the three and nine months ended September 30, 2006, respectively. We intend to make quarterly distribution payments to our unitholders to the extent we have sufficient cash from operations after the establishment of reserves.

***Description of Credit Agreement*** On December 7, 2005, we entered into a 5-year credit agreement that consisted of:

a $250.0 million revolving credit facility; and

a $100.1 million term loan facility.

The revolving credit facility is available for general purposes, including working capital, letters of credit, capital expenditures, acquisitions and cash distributions. We had outstanding indebtedness of $90.0 million under our revolving credit facility as of September 30, 2006.

We had outstanding indebtedness of $100.0 million under the term loan facility as of September 30, 2006. Amounts repaid under the term loan facility, which consist of $0.1 million during the second quarter of 2006, may not be reborrowed. The full balance on the term loan was collateralized, as required by the Credit Agreement, by investments in high-grade securities as of September 30, 2006 for future use in funding capital expenditures (including potential acquisitions) and in order to reduce our cost of borrowings under the term loan facility.

We have the option of increasing the size of the revolving credit facility to $550.0 million with the consent of the issuing lenders.

Our obligations under the revolving credit facility are unsecured, and the term loan facility is secured at all times by high-grade securities in an amount equal to or greater than the outstanding principal amount of the term loan. We may sell any portion of the collateral for the term loan facility at any time as long as we use the proceeds from the sale to repay term loan borrowings. Upon any prepayment of term loan borrowings, the amount of our revolving credit facility will automatically increase to the extent that the repayment of our term loan facility is made in connection with an acquisition of assets in the midstream energy business.

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We may prepay all loans at any time without penalty, subject to the reimbursement of lender breakage costs in the case of prepayment of London Interbank Offered Rate, or LIBOR, borrowings. Indebtedness under the revolving credit facility bears interest, at our option, at either (1) the higher of the federal funds rate plus 0.50% or Wachovia Bank s prime rate plus an applicable margin of 0% to 0.025% based on leverage level or (2) LIBOR plus an applicable margin which ranges from 0.27% to 1.025% dependent upon the leverage level or credit rating. As of September 30, 2006, the $100.0 million term loan facility bears interest at LIBOR plus a rate per annum of 0.15%. The revolving credit facility incurs an annual facility fee of 0.08% to 0.35% depending on the applicable leverage level or debt rating. This fee is paid on drawn and undrawn portions of the revolving credit facility. At September 30, 2006 we paid facility fees at a rate of 0.15% per annum.

The Credit Agreement prohibits us from making distributions of Available Cash to unitholders if any default or event of default (as defined in the Credit Agreement) exists. The Credit Agreement requires us to maintain a leverage ratio (the ratio of our consolidated indebtedness to our consolidated EBITDA, in each case as is defined by the Credit Agreement) of not more than 4.75 to 1.0 and on a temporary basis for not more than three consecutive quarters following the consummation of asset acquisitions in the midstream energy business of not more than 5.25 to 1.0. The Credit Agreement also requires us to maintain an interest coverage ratio (the ratio of our consolidated EBITDA to our consolidated interest expense, in each case as is defined by the Credit Agreement) of equal or greater than 3.0 to 1.0 determined as of the last day of each quarter for the four-quarter period ending on the date of determination.

***Interest rate cash flow hedge*** On March 14, 2006, we entered into interest rate swap agreements to modify a portion of the variable rate line of credit to a fixed rate obligation, thereby reducing the exposure to market rate fluctuations. The interest rate swap agreements have been designated as cash flow hedges, and effectiveness is determined by matching the principal balance and terms with that of the specified obligation. The effective portions of changes in fair value are recognized in accumulated other comprehensive income in the accompanying condensed consolidated balance sheets. Ineffective portions of changes in fair value are recognized in earnings. The agreements expire on December 7, 2010 and reprice prospectively approximately every 90 days. Under the terms of the interest rate swap agreements, we pay a fixed rate of 5.08% and receive interest payments based on three-month LIBOR on a total notional amount of $75.0 million. The differences to be paid or received under the interest rate swap agreements are recognized as an adjustment to interest expense. The agreements are with major financial institutions, which are expected to fully perform under the terms of the agreements.

***Total Contractual Cash Obligations*** A summary of our total contractual cash obligations as of September 30, 2006, is as follows:

| | Payments Due By Period | | | | |
|---|---|---|---|---|---|
| | Total | Remainder of 2006 | 2007-2008 | 2009-2010 | 2011 and Thereafter |
| | ($ in millions) | | | | |
| Long-term debt (a) | $ 190.0 | $ | $ | $ 190.0 | $ |
| Operating lease obligations | 0.2 | | 0.1 | 0.1 | |
| Purchase obligations (b) | 1.5 | 1.5 | | | |
| Other long-term liabilities (c) | 0.4 | | 0.1 | | 0.3 |
| Total | $ 192.1 | $ 1.5 | $ 0.2 | $ 190.1 | $ 0.3 |

(a) Interest payments on long-term debt are not included as they are based on floating interest rates and we cannot determine with accuracy the repayment date or the amount of the interest payment.

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(b) Purchase obligations total $1.5 million of various non-cancelable commitments for capital projects expected to be completed in the remainder of 2006. Purchase obligations exclude $27.1 million of accounts payable, $0.4 million of accrued interest payable and $8.3 million of other current liabilities recognized on the September 30, 2006 condensed consolidated balance sheet. Purchase obligations also exclude $0.9 million of current and $3.2 million of long-term unrealized losses on non-trading derivative and hedging instruments included on the September 30, 2006 condensed consolidated balance sheet. These amounts represent the current fair value of various derivative contracts and do not represent future cash purchase obligations. These contracts may be settled financially at the difference between the future market price and the contractual price and may result in cash payments or cash receipts in the future, but generally do not require delivery of physical quantities. In addition, many of our gas purchase contracts include short- and long-term commitments to purchase produced gas at market prices. These contracts, which have no minimum quantities, are excluded from the table.

(c) Other long-term liabilities include $0.3 million of asset retirement obligations and $0.1 million of environmental reserves

recognized on
the
September 30,
2006 condensed
consolidated
balance sheet.

**Recent Accounting Pronouncements**

***Statement of Financial Accounting Standards, or SFAS, No. 157, Fair Value Measurements,* or SFAS 157** In September 2006, the Financial Accounting Standards Board, or FASB, issued SFAS 157, which provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. SFAS 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. SFAS 157 does not expand the use of fair value to any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not currently expect SFAS 157 to have a material impact on our consolidated results of operations, cash flows or financial position.

***SFAS No. 154, Accounting Changes and Error Corrections,* or SFAS 154** In June 2005, the FASB issued SFAS 154, a replacement of APB Opinion No. 20, *Accounting Changes,* or APB 20, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements.* Among other changes, SFAS 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. SFAS 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) carried forward without change the guidance within APB 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. SFAS 154 did not have a material impact on our consolidated results of operations, cash flows or financial position.

***FIN No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement 109,* or FIN 48** In July 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for the first fiscal year beginning after December 15, 2006. The adoption of FIN 48 is not expected to have a material impact on our consolidated results of operations, cash flows or financial position.

***Emerging Issues Task Force, or EITF, Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty,* or EITF 04-13** In September 2005, the FASB ratified the EITF s consensus on Issue 04-13, which requires an entity to treat sales and purchases of inventory between the entity and the same counterparty as one transaction for purposes of applying APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* when such transactions are entered into in contemplation of each other. When such transactions are legally contingent on each other, they are considered to have been entered into in contemplation of each other. The EITF also agreed on other factors that should be considered in determining whether transactions have been entered into in contemplation of each other. EITF 04-13 is to be applied to new arrangements that we enter into in reporting periods beginning after March 15, 2006. The adoption of EITF 04-13 did not have a material impact on our consolidated results of operations, cash flows or financial position.

***Staff Accounting Bulletin No. 108,* *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,* or SAB 108** In September 2006, the SEC issued SAB 108 to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires entities to quantify misstatements based on their impact on each of their financial statements and related disclosures. SAB 108 is effective as of the end of our 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. We do not expect the adoption of this standard to have a material impact on our consolidated results of operations, cash flows or financial position.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

For an in-depth discussion of our market risks, see Quantitative and Qualitative Disclosures about Market Risk in our 2005 Form 10-K.

***Risk Management Policy***

Management has established a comprehensive risk management policy, or the Risk Management Policy, and a risk management committee to monitor and manage market risks associated with commodity prices. Our risk management committee is composed of senior executives who receive regular briefings on positions and exposures, credit exposures and overall risk management in the context of market activities. The risk management committee is responsible for the overall management of credit risk and commodity price risk, including monitoring exposure limits. The Risk Management Policy was adopted and the risk management committee was formed effective with our board of directors approval effective February 8, 2006. Prior to the formation of the risk management committee, we were utilizing DEFS risk management policies, procedures and risk management committee.

***Interest Rate Risk***

Interest rates on future credit facility draws and debt offerings could be higher than current levels, causing our financing costs to increase accordingly. Although this could limit our ability to raise funds in the debt capital markets, we expect to remain competitive with respect to acquisitions and capital projects, as our competitors would face similar circumstances. Based on the unhedged borrowings under our revolving credit facility as of September 30, 2006 of $15.0 million, a 0.5% movement in the base rate or LIBOR rate would result in an approximately $0.1 million annualized increase or decrease in interest expense.

On March 14, 2006, we entered into interest rate swap agreements to modify a portion of the variable rate line of credit to a fixed rate obligation, thereby reducing the exposure to market rate fluctuations. The agreements expire on December 7, 2010 and reprice prospectively approximately every 90 days. Under the terms of the interest rate swap agreements, we pay a fixed rate and receive interest payments based on three-month LIBOR on a total notional amount of $75 million. The agreements are with major financial institutions, which are expected to fully perform under the terms of the agreements.

***Commodity Price Risk***

We are exposed to the impact of market fluctuations in the prices of natural gas, NGLs and condensate as a result of our gathering, processing and sales activities. We employ established policies and procedures to manage our risks associated with these market fluctuations using various commodity derivatives, including forward contracts, swaps and futures. For the year ending December 31, 2006, we expect that a $1.00 per MMBtu decrease in the price of natural gas, a $0.10 per gallon decrease in NGL prices and a $5.00 per barrel decrease in condensate prices would decrease our gross margin by approximately $0.2 million, $0.3 million and $0.3 million, respectively. These sensitivities include the effect of our hedging strategies executed in September 2005. Please read Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk Hedging Strategies in our 2005 Form 10-K for more information about these hedging strategies and our commodity price risk.

As of September 30, 2006, we have hedged approximately 80% of our expected natural gas, NGL and condensate commodity price risk through 2010 and approximately 60% of our expected condensate commodity price risk in 2011.

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## Item 4. *Controls and Procedures*

### Evaluation of Disclosure Controls and Procedures

Our management, including the Chief Financial Officer and the Chief Executive Officer of DCP Midstream GP, LLC, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and concluded that, as of the end of the period covered by this report, the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. The required information was effectively recorded, processed, summarized and reported within the time period necessary to prepare this quarterly report. Our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our reports under the Exchange Act are accumulated and communicated to management, including the Chief Financial Officer and the Chief Executive Officer of DCP Midstream GP, LLC, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the nine months ended September 30, 2006 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

# PART II. OTHER INFORMATION

## Item 1. *Legal Proceedings*

The information required for this item is provided in Note 9, Commitments and Contingent Liabilities, included in the notes to the condensed consolidated financial statements included under Part I. Item 1, which information is incorporated by reference into this item.

## Item 6. *Exhibits*

**Exhibits**

| Exhibit Number | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**Table of Contents**

## 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, in the City of Denver, State of Colorado, on November 14, 2006.

DCP Midstream Partners, LP

By: DCP Midstream GP, LP
*its General Partner*

By: DCP Midstream GP, LLC
*its General Partner*

By: /s/ Thomas E. Long

Name: Thomas E. Long
Title: Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

## EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
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| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |



align:right; ">$2,990,000(1) Bonus $29,934,192(2) $29,834,411(2)

Value of Medical Benefits
$468,759(3) $467,196(3) Total $33,402,951 $33,291,608

(1)
Assumes a base salary of $1,000,000 per year.

(2)
Assumes that the annual cash bonus of Mr. Goldfarb for the remainder of the term of his employment will be equal to the bonus granted to Mr. Goldfarb for fiscal 2015.

(3)
Includes the premiums to be paid by G-III for life insurance and supplemental long term disability coverage.

Sammy Aaron, Vice Chairman

| | Termination without Cause or Resignation for Good Reason | Termination without Cause or Resignation for Good Reason in Connection with a Change in Control |
|---|---|---|
| Base Salary | $ 750,000(1) | $ 1,500,000(1) |
| Bonus | $ 6,513,458(2) | $ 13,026,916(2) |
| Value of Medical Benefits | $ 7,382(3) | $ 14,764(3) |
| Total | $ 7,270,840 | $ 14,541,680 |

(1)
Assumes a base salary of $750,000 per year.

(2)
Assumes that the annual cash bonus of Mr. Aaron for the remainder of the term of his employment will be equal to the bonus granted to Mr. Aaron for fiscal 2015.

(3)
Includes the premiums to be paid by G-III for life insurance.

Neal S. Nackman, Chief Financial Officer

| | Termination without Cause or Resignation for Good Reason in Connection with a Change in Control |
|---|---|
| Base Salary | $ 637,500(1) |
| Bonus | $ 909,000(2) |
| Value of Medical Benefits | $ 15,660(3) |
| Total | $ 1,562,160 |

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(1)
Assumes a base salary of $450,000 per year.

(2)
Assumes that the annual cash bonus earned by Mr. Nackman during the two fiscal years preceding the fiscal year in which Mr. Nackman's employment terminates is $606,000, which is equal to the bonus granted to Mr. Nackman for fiscal 2015.

(3)
Includes the premiums to be paid by G-III for life insurance.

Wayne S. Miller, Chief Operating Officer

| | Termination without Cause or Resignation for Good Reason | Termination without Cause or Resignation for Good Reason in Connection with a Change in Control |
|---|---|---|
| Base Salary | $ 1,125,000(1) | $ 1,125,000(1) |
| Bonus | $ 750,000(2) | $ 3,843,000(3) |
| Value of Medical Benefits | $ 69,750(4) | $ 69,750(4) |
| Total | $ 1,944,750 | $ 5,037,750 |

(1)
Assumes a base salary of $750,000 per year.

(2)
Pursuant to his employment agreement, Mr. Miller is deemed to have been granted a bonus of $500,000 per year.

(3)
Assumes that the annual cash bonus earned by Mr. Miller during the two fiscal years preceding the fiscal year in which Mr. Miller's employment terminates is $2,562,000, which is equal to the bonus granted to Mr. Miller for fiscal 2015.

(4)
Includes the premiums to be paid by G-III for life insurance.

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DIRECTOR COMPENSATION

Our Non-Employee directors receive an annual cash retainer of $35,000 per year for service as a director of G-III. In addition, Non-Employee Directors receive a fee of $1,000 per Board or Committee meeting attended, subject to the proviso in the next sentence, plus reimbursement of reasonable out-of-pocket expenses incurred in connection with attendance at Board meetings. Members of the Audit and Compensation Committees receive an annual retainer of $10,000, provided that no per meeting fees are paid unless the number of Audit or Compensation Committee meetings exceeds five per year.

Additional annual fees paid to Non-Employee Directors are as follows:

| Role | Annual Fee |
|---|---|
| Lead Independent Director | $ 30,000 |
| Chair of the Audit Committee | $ 20,000 |
| Chair of the Compensation Committee | $ 10,000 |
| Chair of the Nominating and Corporate Governance Committee | $ 6,000 |

In June 2014, the Compensation Committee decided to adopt a policy that it would make an annual grant to non-employee directors of RSUs valued at $100,000 with a vesting period of three years. It was also decided that the Lead Independent Director would receive an additional grant of RSUs valued at $50,000 that would also vest over a period of three years.

Fiscal 2015 Director Compensation Table

Set forth below is a table presenting compensation information with respect to all of our Directors for the fiscal year ended January 31, 2015, other than Morris Goldfarb and Sammy Aaron. Neither Mr. Goldfarb nor Mr. Aaron receives any compensation for his services as a director, because each of them serves as and is compensated as an executive officer. Compensation information for Messrs. Goldfarb and Aaron is reported in the Fiscal 2015 Summary Compensation Table appearing elsewhere in this Proxy Statement.

| Name | Fees Earned or Paid in Cash ($)(1) | Stock Awards ($)(2) | All Other Compensation ($) | Total ($) |
|---|---|---|---|---|
| Thomas J. Brosig | 44,833 | 99,976 | — | 144,809 |
| Alan Feller | 54,167 | 99,976 | — | 154,143 |
| Jeffrey Goldfarb(3) | — | — | — | — |
| Jeanette Nostra(4) | — | — | — | — |
| Laura Pomerantz | 41,500 | 99,976 | — | 141,476 |
| Allen Sirkin | 42,500 | 99,976 | — | 142,476 |
| Willem van Bokhorst | 47,167 | 99,976 | — | 147,143 |
| Cheryl Vitali | 37,833 | 99,976 | — | 137,809 |
| Richard White | 82,833 | 149,922 | — | 232,755 |

(1)
The amount indicated includes the annual cash retainer, annual payments to the chairs of committees and fees for each Board or committee meeting attended.

(2)
In June 2014, our Compensation Committee granted each of Thomas Brosig, Alan Feller, Laura Pomerantz, Willem van Bokhorst, Cheryl Vitali and Richard White RSUs that enable each of them to receive up to 2,414 shares of our

Common Stock, subject to satisfaction of specified conditions. In addition, our Compensation Committee granted an additional 1,206 RSUs to Mr. White in recognition of his service as Lead Independent Director. All of these awards became effective after each director's election to the Board at the 2014 Annual Meeting and vest over a three-year period. The dollar value of these stock awards is based on the closing price per share of our Common Stock on the grant date, which constitutes the grant date fair value computed in accordance with FASB ASC Topic 718. For a discussion of valuation assumptions, see Note H to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended January 31, 2015. At January 31, 2015, the directors named in the table above held unvested RSUs as follows: Mr. Thomas Brosig, 9,614 RSUs; Mr. Alan Feller, 9,614 RSUs; Mr. Jeffrey Goldfarb, 129,598 RSUs; Ms. Jeanette Nostra, 25,200 RSUs; Ms. Laura Pomerantz, 9,614 RSUs; Mr. Allen Sirkin, 8,814 RSUs; Mr. Willem van Bokhorst, 9,614 RSUs; Ms. Cheryl Vitali, 10,414 RSUs; and Mr. Richard White, 10,820 RSUs. In addition, at that date, the following directors held stock options to purchase our common stock as follows: Mr. Thomas Brosig, 3,600; Mr. Alan Feller, 1,200; Ms. Laura Pomerantz, 25,200; Mr. Willem van Bokhorst, 30,000; and Mr. Richard White, 15,600.

(3)
Jeffrey Goldfarb does not receive any compensation for his services as a director because he is compensated as our employee. Certain compensation information with respect to Mr. Goldfarb, who is a director and an employee of ours, is set forth under “Certain Relationships and Related Transactions.”

(4)
Ms. Nostra does not receive any compensation for her services as a director because she is compensated as our employee.

PROPOSAL NO. 1
ELECTION OF DIRECTORS

Eleven directors are to be elected at the Annual Meeting. Unless otherwise specified, the enclosed proxy will be voted in favor of the eleven persons named below (all of whom are currently our directors) to serve until the next Annual Meeting of Stockholders and until their respective successors shall have been duly elected and qualified. If any of these nominees becomes unavailable for any reason, or if a vacancy should occur before the election, the shares represented by your proxy will be voted for the person, if any, who is designated by the Board of Directors to replace the nominee or to fill the vacancy on the Board. All of the nominees listed below have consented to be named as such and have indicated their intent to serve if elected. The Board of Directors has no reason to believe that any of the nominees will be unable to serve or that any vacancy on the Board of Directors will occur.

Set forth below is information provided by each director with respect to that person's age, all positions held, principal occupation and business experience for the past five years and the names of other publicly-held companies of which the director currently serves as a director or has served as a director during the past five years. We also provide information regarding each nominee's specific experience, qualifications, attributes or skills that led our Board to the conclusion that the nominee should serve as a director.

| Director | Age | Year First Became Director | Business Experience |
|---|---|---|---|
| Morris Goldfarb | 64 | 1974 | Chairman of the Board, Chief Executive Officer and President of G-III. Mr. Goldfarb has served as an executive officer of G-III and our predecessors since our formation in 1974. Mr. Goldfarb serves as a director of Oppenheimer Holdings Inc.(but is not standing for reelection at its annual meeting held in May 2015) and RLJ Entertainment, Inc. Mr. Goldfarb served as a director of Black Ridge Oil & Gas, Inc. from November 2010 until October 2012 and of Christopher & Banks Corporation from January 2011 to June 2013. Mr. Goldfarb has significant knowledge of all facets of our company. His long history with the company, combined with his leadership skills and operating experience, makes him particularly well-suited to be our Chairman and serve on our Board. |
| Sammy Aaron | 55 | 2005 | Vice Chairman of G-III since our acquisition of J. Percy for Marvin Richards Ltd. in July 2005. Mr. Aaron is the Chief Executive Officer of our Calvin Klein divisions. From 1998 to July 2005, he served as President of J. Percy for Marvin Richards, Ltd. Mr. Aaron has over 25 years of experience and expertise in the apparel industry, as well as a broad working knowledge of our company, enabling him to make significant contributions to our Board. |
| Thomas J. Brosig(3) | 65 | 1992 | Mr. Brosig is currently a strategic business consultant. Mr. Brosig was Chief Executive Officer of MVB Holdings LLC from December 2011 until November 2012. Mr. Brosig was a consultant in the gaming and hospitality industries from 2003 to 2011. From January 1999 through February 2003, he served as Senior Vice-President for Park Place Entertainment. For more than five years prior to 1999, he served its predecessor, Grand Casinos, Inc., in various executive capacities including as its President and Chief Executive Officer from September 1996 to January 1999. |

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| Director | Age | Year First Became Director | Business Experience |
|---|---|---|---|
| | | | Mr. Brosig is an experienced business executive whose leadership roles in the past at other public companies provide him with insight and perspective as a member of our Board. |
| Alan Feller(1) | 74 | 1996 | Mr. Feller is currently retired. Mr. Feller was our Chief Financial Officer from December 1989 to April 1998, and served as our Executive Vice President, Treasurer and Secretary from January 1990 through July 1995. Mr. Feller served as a consultant to us from May 1998 through October 1999. Mr. Feller is a Certified Public Accountant. Mr. Feller has broad knowledge about us from his service as an officer and director of G-III. His financial and accounting background are of great service to our Board. |
| Jeffrey Goldfarb | 38 | 2009 | Since 2004, Mr. Goldfarb has served as our Director of Business Development. He has been employed full-time by G-III in several other capacities since 2002. Mr. Goldfarb serves as a director of Fashion Delivers Charitable Foundation, Inc., a charitable organization that facilitates the donation of excess apparel inventory to disaster victims and other people in need. Mr. Goldfarb is also licensed as an attorney. Mr. Goldfarb has worked in a variety of positions at G-III that provide him with a broad knowledge of our business and the ability to provide significant input to our Board with respect to operational matters. |
| Jeanette Nostra | 61 | 2013 | Ms. Nostra is currently a senior advisor at G-III. She served as G-III's President from April 1997 to September 2013. From March 2008 to July 2011, Ms. Nostra also acted as President of the G-III's Andrew Marc division. G-III has employed Ms. Nostra since 1981, and her responsibilities have included sales, marketing, product development and licensing for selected divisions, as well as business development for international sales. As a result, she brings broad knowledge about our business to the Board. |
| Laura Pomerantz(2) | 67 | 2005 | Since October 2014, Ms. Pomerantz has been Vice Chairman and Head of Strategic Accounts at Cushman & Wakefield. Since April 2013, she has also served as Principal and Chief Executive Officer of Laura Pomerantz Real Estate LLC, a real estate firm offering commercial real estate advisory and execution services. From 2001 until April 2013, Ms. Pomerantz was a principal of PBS Real Estate, LLC, a real estate firm offering commercial real estate advisory and execution services. Since 1994, she has also been President of LHP Consulting and Management, a real estate consulting firm. She serves as a director of Retail Opportunity Investments Corp., a publicly traded REIT. Ms. Pomerantz is an experienced business executive with a significant background in the real estate, apparel and retail fields that is of great benefit to decision-making by our Board. |

| Director | Age | Year First Became Director | Business Experience |
|---|---|---|---|
| Allen Sirkin(2) | 73 | 2013 | Mr. Sirkin was employed by PVH Corp., one of the world's largest apparel companies, from 1985 until June 2012. He served as Chairman of PVH's Apparel Group from 1990 until 1995, was named Vice Chairman, Dress Shirts in 1995 and became President and Chief Operating Officer of PVH in March 2006. Mr. Sirkin relinquished his role as Chief Operating Officer of PVH in February 2012 and retired from PVH in June 2012. Prior to his service with PVH, he was employed by a number of apparel companies in senior executive positions. Mr. Sirkin's long and distinguished career and his extensive experience in and knowledge of the apparel industry are of great benefit to our Board. |
| Willem van Bokhorst(1)(2) | 69 | 1989 | Managing Partner of STvB Advocaten, a Curaçao law firm with offices in Curaçao, Amsterdam and New York, for more than twenty five years. Mr. van Bokhorst has significant international business and legal experience that are valuable assets to our Board. |
| Cheryl Vitali(3) | 54 | 2011 | Ms. Vitali is the General Manager for the Kiehl's Worldwide division of L'Oreal, a leading cosmetics and beauty products company, where she oversees the worldwide strategy, product innovation and retail marketing plans for the Kiehl's brand. She has been with L'Oreal since 2003 and has also served as Senior Vice President — Marketing for the Lancôme brand from 2009 to 2010 and the Maybelline New York/Garnier brand from 2003 to 2009. Prior to L'Oreal, she held various executive positions with Revlon Consumer Products Company, a cosmetics and beauty care company. She was Executive Vice President, General Manager, Revlon Global Brands, from 2000 to 2002 and Executive Vice President, Marketing Portfolio Group from 1998 to 2000. Ms. Vitali served as Vice President, Marketing, Playtex Intimate Apparel, a division of the Sara Lee Corporation, from 1995 through 1998. Ms. Vitali is an experienced business executive with significant retail, marketing and consumer product experience and expertise that is of great benefit to our Board. |
| Richard White(1)(2)(3)(4) | 61 | 2003 | Mr. White has been a Managing Director and head of the Private Equity Investment Department of Oppenheimer & Co. Inc. since June 2004. From 2002 to June 2004, he served as President of Aeolus Capital Group LLC, an investment management firm. From 1985 until 2002, he was a Managing Director at CIBC Capital Partners, an affiliate of CIBC World Markets, and its predecessor firm, Oppenheimer & Co., Inc. During that time, Mr. White worked in both the Investment Banking and Private Equity Investing departments. Mr. White is a director of Escalade Inc., a manufacturer of sporting goods. Mr. White served as a director of Real Goods Solar, Inc., a residential and commercial solar energy company, from December 2013 until December 2014 and of Lakes Entertainment Inc., a company that develops and manages casino properties, from |

| Director | Age | Year First Became Director | Business Experience |
|---|---|---|---|
| | | | December 2006 until June 2013. Mr. White previously served as a director of G-III from November 1991 to July 1993. Mr. White is a Certified Public Accountant and has been a high level participant in the investment banking, private equity and finance area for his entire business career. His understanding of strategic planning, acquisitions and the capital markets, as well as the apparel industry, enable him to make significant contributions to our Board. |

(1)
Member of the Audit Committee

(2)
Member of the Compensation Committee

(3)
Member of the Nominating and Corporate Governance Committee

(4)
Lead Independent Director

Morris Goldfarb and Jeffrey Goldfarb are father and son, respectively.
THE BOARD OF DIRECTORS DEEMS THE ELECTION AS DIRECTORS OF THE ELEVEN NOMINEES LISTED ABOVE TO BE IN THE BEST INTERESTS OF G-III AND OUR STOCKHOLDERS AND RECOMMENDS A VOTE “FOR” THEIR ELECTION.
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PROPOSAL NO. 2
APPROVAL OF THE 2015 LONG-TERM INCENTIVE PLAN
General Information
Our stockholders are being asked to approve the 2015 Plan as set forth in this Proposal No. 2. Our Board of Directors adopted the 2015 Plan on April 1, 2015, subject to approval by our stockholders at our Annual Meeting. The 2015 Plan would replace the 2005 Plan, which will expire on June 9, 2015; for the avoidance of doubt, any shares available under our 2005 Plan will not be carried over into our 2015 Plan. The 2015 Plan would allow us to continue making various forms of equity- and cash-based incentive compensation awards to our officers, employees and other eligible personnel similar to those authorized by the expiring 2005 Plan. Also, if approved by our stockholders, the 2015 Plan would allow us to grant performance-based incentive awards that are intended to be exempt from the tax deduction limitations of Section 162(m) of the Code.
Long-term equity and other forms of incentive compensation have been and are expected to continue to be necessary and key components of our overall compensation program. The Board believes that our ability to grant equity-based incentive compensation under the 2015 Plan will enable us to meet several objectives that are important to the success and growth of our business, including, for example, fostering an ownership mentality that aligns the interests of our management and other personnel with those of our stockholders, and enabling us to attract, motivate, reward and retain talented individuals whose skills, experience and efforts are essential to the continuing success and development of our business and the enhancement of stockholder value. In determining the number of shares to be requested, we considered our historical three-year burn rate, as well as the publicly disclosed views of shareholders and shareholder advisory firms.
If the 2015 Plan is not approved, we will lose what has become an indispensable part of our compensation program (due to the expiration of the 2005 Plan). The Board believes we would therefore face serious challenges to our ability to attract and retain management and other key personnel which, if not otherwise addressed, would adversely affect our business. Our ability to continue making incentive compensation awards that are deductible for income tax purposes would also be significantly diminished. In short, the Board believes strongly that approval of the 2015 Plan is in the best interests of our company and our stockholders and that, if the 2015 Plan is not approved, our business and the interests of our stockholders will be harmed.
Equity Compensation Plan Information
The following table provides information as of January 31, 2015, the last day of fiscal 2015, regarding securities issued under our existing equity compensation plans that were in effect during fiscal 2015. All share amounts in this table have been adjusted to reflect the two-for-one stock split that was effective on May 1, 2015.

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 2,560,588(1) | $ 11.16(2) | 3,521,954(3) |
| Equity compensation plans not approved by security holders | N/A | N/A | N/A |
| Total | 2,560,588(1) | $ 11.16(2) | 3,521,954(3) |

(1)
Includes outstanding awards of 469,176 stock options, which have a weighted average exercise price of $11.16 and weighted average remaining term of 5.2 years, and 2,091,412 shares of Common Stock issuable upon vesting of RSUs.

(2)
RSUs are excluded when determining the weighted average exercise price of outstanding options.

(3)
Includes 961,366 shares of Common Stock reserved under the 2005 Plan., options to purchase 430,776 shares and RSU's representing 2,091,412 shares that have not fully vested under the 2005 Plan, and options to purchase 38,400 shares under the expired 1999 Non-Employee Directors Plan.

The following table provides more up-to-date information, and includes all outstanding awards, as of May 1, 2015:

| | |
|---|---|
| Shares subject to outstanding awards(1) | 2,537,588 |
| Shares available for future equity awards under the 2005 Plan(2) | 961,366 |
| Shares to be available for future equity awards under the 2015 Plan(3) | 2,500,000 |
| Total shares | 5,998,954 |
| Percentage of outstanding shares (diluted)(4) | 11.8% |

(1)
Includes 446,176 outstanding stock options with a weighted average exercise price of $11.16 and a weighted average remaining term of 5.2 years. Includes 2,091,412 outstanding RSUs, with a combined weighted average remaining term of 3.0 years.

(2)
This is the number of shares that remain available at May 1, 2015 for new awards under the 2005 Plan. These shares will cease to be available upon expiration of the 2005 Plan on June 9, 2015.

(3)
This is the number of shares that will be reserved for awards under the 2015 Plan. Although 961,366 shares remain available at May 1, 2015 for new awards under the 2005 Plan, these shares will cease to be available upon expiration of the 2005 Plan on June 9, 2015. If approved by stockholders, the 2015 Plan will be our only plan authorizing the grant of equity awards.

(4)
The number of outstanding shares (the denominator in this calculation) includes all Common Stock outstanding at May 1, 2015 and includes potential dilution from issuance of unissued shares reserved for outstanding awards under the 2005 Plan and future awards under the 2015 Plan.

Reasons for Stockholder Approval

The Board seeks stockholder approval of the 2015 Plan in order to meet requirements of the NASDAQ Global Select Market, on which our shares are listed and, as noted above, to permit us to grant awards under the 2015 Plan that qualify for tax deductibility without limitation under Section 162(m) of the Code. Stockholder approval of the 2015 Plan will also permit us to grant "incentive stock options" (within the meaning of Section 422 of the Code), which may provide more favorable tax treatment to employees. In addition, we regard stockholder approval of the 2015 Plan as desirable and consistent with our past practice and with corporate governance best practices generally.

Certain Features Included in the Proposed 2015 Plan

The 2015 Plan includes a number of features that are designed to reflect best corporate governance and compensation practices and otherwise take into account our stockholders' interests, including —

•

The 2015 Plan would allow us to grant various forms of equity- and cash-based incentive compensation opportunities, including stock options, stock appreciation rights, restricted stock, restricted stock units and performance-based stock or cash awards and, in turn, provide our Compensation Committee with sufficient flexibility to structure appropriate incentives and respond to market-competitive changes in compensation practices;

- There is no “evergreen” provision for automatically replenishing the authorized pool of shares available for awards under the 2015 Plan;

- There are limitations on the number of shares and the value of cash incentive awards that may be made to any individual in any fiscal year;

- Repricing of stock options or stock appreciation rights or cash buyouts of underwater stock options or stock appreciation rights is prohibited without stockholder approval;

- The granting of discounted stock options and stock appreciation rights and the granting of "reload" or replacement options are prohibited;

- Shares repurchased by us on the open market with proceeds from the exercise of stock options may not be returned to the pool of shares available for awards under the 2015 Plan;

- Awards that are continued or assumed in connection with a change in control are subject to "double trigger" vesting;

- Awards are subject to minimum vesting of at least one year, and the Compensation Committee has only limited authority to accelerate vesting upon termination of a participant's employment;

- Awards made under the 2015 Plan are subject to our executive incentive compensation clawback policies; and

- Our Compensation Committee may grant performance-based awards under the 2015 Plan that are intended to qualify for exemption from the compensation deduction limitations of Section 162(m) of the Code.

Summary of the 2015 Plan

A general description of the principal terms of the 2015 Plan adopted by the Board is set forth below. This description is qualified in its entirety by reference to the full text of the 2015 Plan, set forth in Appendix A. All share amounts take into account our two-for-one stock split that was effective May 1, 2015.

Types of Award; Eligibility. The 2015 Plan would enable us to grant non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, other forms of equity-based awards and performance-based cash incentive awards to our and any of our subsidiaries' employees, non-employee directors, consultants, independent contractors and other service providers and to grant "incentive stock options" (within the meaning of Section 422 of the Code) to our and any of our subsidiaries' employees. We estimate that the total number of eligible persons currently is approximately 6,600; a total of 139 employees and directors hold outstanding equity awards under our 2005 Plan.

Authorized Shares; Share-Counting Rules. We would be able to issue up to 2,500,000 shares of our Common Stock pursuant to awards made under the 2015 Plan, subject to the following share-counting rules:

- The total number of shares covered by an award of stock appreciation rights that is settled in shares (and not just the number of shares issued in settlement of the award) will be deemed to have been issued;

- Shares that are used or withheld to satisfy the exercise price or tax withholding obligations under an award will be deemed to have been issued under the 2015 Plan and will not be available for issuance under future grants;

- Shares purchased by us with cash received from the exercise of an option will not be available for awards made under the 2015 Plan; and

- The following shares will be deemed not to have been issued and will remain available for issuance under new awards: (a) shares covered by an option or stock appreciation right that is forfeited or otherwise terminated or canceled for any reason other than exercise; (b) shares covered by restricted stock, restricted stock unit or other awards that are forfeited; (c) shares covered by an award that is settled in cash or that otherwise terminates without shares being issued; and (d) shares issued pursuant to awards that are assumed, converted or substituted as a result of the acquisition of another company or a combination with another company.

On May 20, 2015, the closing price per share of our Common Stock in transactions reported on the NASDAQ Global Select Market was $58.02 per share.

Individual Award Limitations. No more than 400,000 shares may be issued pursuant to awards granted to any individual in any fiscal year. The maximum performance-based cash incentive award that may be made to any individual under the 2015 Plan for any fiscal year is $10,000,000.

Adjustments for Capital Changes. In the event of a stock split, reverse stock split, stock dividend, extraordinary cash dividend or other capital change involving the outstanding shares of our Common Stock, the aggregate number of shares that may be issued under the 2015 Plan, the fiscal year share limitations on individual awards, the number, class and exercise price of shares covered by outstanding awards and performance goals expressed in or with respect to shares will be subject to equitable adjustment in order to avoid undue dilution or enlargement of the benefits available under the 2015 Plan and any outstanding awards.

Administration. In general, the Compensation Committee of the Board, acting in its discretion, will have full authority and responsibility for administering the 2015 Plan. Subject to the terms of the 2015 Plan, the Compensation Committee may select the persons who will receive awards, determine the types of awards to be granted and prescribe the terms and conditions of such awards. The Compensation Committee will also be responsible for construing, interpreting and applying the provisions of the 2015 Plan and of any award made under the 2015 Plan, and its decisions and determinations will be final and binding on all persons. We will indemnify the members of the Compensation Committee and others to whom authority is delegated for claims they may incur in connection with the administration of the 2015 Plan, unless attributable to fraud or willful misconduct.

Vesting Limitations. The Compensation Committee will not have the authority to accelerate the vesting of an outstanding award by reason of a participant's termination of employment unless either (a) the termination is in connection with a change in control of our company (as defined in the 2015 Plan) or on account of the participant's death, disability or retirement, or (b) the termination occurs for any other reason and the net number of shares that would be issued because of the acceleration is not more than 10% of the aggregate number of shares that may be issued under the 2015 Plan. In addition, all share-based awards granted by the Compensation Committee must provide a vesting condition of at least one year.

Stock Options. The Compensation Committee may grant stock options under the 2015 Plan, subject to such terms and conditions as the Compensation Committee may prescribe. Stock options granted under the Plan may be classified as "incentive stock options" (within the meaning of Section 422 of the Code) or as non-qualified options (i.e., options which do not qualify as "incentive stock options"). The exercise price of any stock option granted under the 2015 Plan must be at least equal to the fair market value of our Common Stock on the date the option is granted (110% of fair market value in the case of "incentive stock options" granted to ten percent stockholders). The maximum term of an option granted under the 2015 Plan is ten years (five years in the case of "incentive stock options" granted to ten percent stockholders).

Stock Appreciation Rights. The Compensation Committee may grant stock appreciation rights under the 2015 Plan, subject to such terms and conditions as the Compensation Committee may prescribe. A stock appreciation right allows the participant to receive payment, in cash and/or shares of our Common Stock, equal to the difference between the fair market value of our Common Stock on the date the stock appreciation right is exercised and the base price specified in the award. The base price must be at least equal to the fair market value of our Common Stock on the date the stock appreciation right is granted. The maximum term of a stock appreciation right granted under the 2015 Plan is ten years.

Restricted Stock. The Compensation Committee may grant restricted stock awards under the 2015 Plan, pursuant to which shares of our Common Stock are issued to the participant subject to specified vesting and other terms and conditions. In general, the holder of restricted shares will have all of the rights of a stockholder with respect to such shares. Dividends on restricted shares will be subject to the same vesting, forfeiture and payment terms and conditions that apply to the restricted shares. In general, if the recipient of a restricted stock award terminates employment or service, any unvested shares will be forfeited.

Restricted Stock Units. The Compensation Committee may grant restricted stock units under the 2015 Plan. Restricted stock units represent the right to receive shares of our Common Stock in the future, subject to specified vesting and other terms and conditions. Vested restricted stock units may be settled in cash and/or shares of our Common Stock. The holder of restricted stock units may not vote the underlying

shares before the units become vested and the shares are issued. The Compensation Committee may provide for the crediting of dividend equivalents with respect to restricted stock units (based upon dividends paid to our stockholders), subject to applicable vesting and payment conditions. In general, if the recipient of restricted stock units terminates employment or service, any unvested restricted stock units (and related dividend equivalents) will be forfeited.

Other Forms of Stock Award; Performance-Based Cash Incentive Awards. The Compensation Committee may grant other forms of awards under the 2015 Plan that are denominated or payable in, valued in whole or in part by reference to, or otherwise based upon or related to, shares of our Common Stock, including, for example, performance share awards, performance unit awards, stock bonus awards and dividend equivalent awards. Any such other awards will be settled in the form of cash and/or shares of our Common Stock and will be subject to the provisions of the 2015 Plan and any vesting and other terms and conditions prescribed by the Compensation Committee. In addition, the 2015 Plan authorizes the Compensation Committee to make annual and/or long-term cash incentive awards that are contingent on the achievement of pre-established performance goals and such other terms and conditions as the Compensation Committee may prescribe.

Section 162(m) Performance Awards and Goals. Section 162(m) of the Code imposes a $1 million deduction limit on annual compensation paid to each of our Named Executive Officers (other than our Chief Financial Officer). Section 162(m) provides an exemption from the deduction limit for "performance-based compensation" that meets certain conditions, including a stockholder approval condition. The 2015 Plan authorizes our Compensation Committee to grant restricted stock, restricted stock units, cash and other incentive awards that are intended to qualify for this exemption. In general, a performance-based award made under the 2015 Plan may qualify for the performance-based compensation exemption if, among other things, the amount earned under the award and/or vesting of the award is conditioned upon the attainment of objective performance goals that are pre-established by the Compensation Committee and that are based upon any one or more of the following performance factors, in each case taking into account such adjustments and other objective factors the Compensation Committee may specify at the time a performance goal is established: (a) revenues on a corporate or product by product basis, gross profit or gross profit growth; (b) earnings from operations, earnings before or after taxes, earnings before or after interest, depreciation, amortization, incentives, service fees and/or extraordinary or special items; (c) net income or net income per share (basic or diluted); (d) return measures, including return on assets, return on investment, return on capital, total capital or tangible capital, return on sales and return on equity; (e) cash flow, free cash flow, cash flow return on investment, or net cash provided by operations; (f) economic value created or added; (g) operating margin or profit margin; (h) expense or cost targets; (i) objective measures of customer satisfaction; (j) working capital targets; (k) inventory control; (l) debt targets; (m) implementation, completion or attainment of measurable objectives with respect to store openings or closings, acquisitions and divestitures, and recruiting and maintaining personnel; and/or (n) share price (including, without limitation, growth measures, market capitalization and/or total stockholder return).

In establishing performance goals with respect to an award intended to qualify for the Section 162(m) performance-based compensation exemption, the performance factors listed above may be expressed by reference to our performance and/or the performance of any one or more subsidiaries and/or the performance of any of our or any subsidiary's divisions, business segments or business units, and may be based upon comparisons of any of the indicators of performance relative to other companies (or subsidiaries, divisions, business segments or business units of other companies) or relevant indices. Subject to compliance with the Treasury regulations under Section 162(m) of the Code, the Compensation Committee may adjust performance goals as necessary or appropriate in order to account for changes in law or accounting rules, principles or standards or to reflect the impact of extraordinary or unusual items, events or circumstances which, if not taken into account, would result in windfalls or hardships that are not consistent with the intent and purposes of an award, including without limitation (a) restructurings, discontinued operations, extraordinary items, and other unusual or non-recurring charges, (b) an event either not directly related to our operations or not within the reasonable control of our management, (c) acquisitions and divestitures, or (d) changes in generally accepted accounting principles. If dividends or dividend equivalents are paid or credited on performance-based awards, they will be subject to the same performance conditions as apply to the underlying awards.

Transferability of Awards. In general, awards made under the 2015 Plan may not be transferred or assigned, except under certain circumstances as may be permitted by the Compensation Committee.

Recoupment of Awards. The 2015 Plan provides that shares and/or cash distributed pursuant to awards made under the 2015 Plan are subject to our incentive compensation clawback policies as in effect from time to time and, as applicable, the clawback requirements of Section 954 of the Dodd-Frank Act.

No Repricing of Awards. Without the approval of our stockholders, we may not (a) reduce the exercise price of options or stock appreciation rights, (b) cancel outstanding options or stock appreciation rights in exchange for options or stock appreciation rights with a lower exercise price or (c) cancel options or stock appreciation rights in exchange for cash or securities at a time when the per share exercise price is higher than the per share fair market value of our Common Stock.

Payment of Exercise Price and Tax Withholding. In general, the exercise price under a stock option and tax withholding obligation resulting from the exercise or settlement of an award may be satisfied in cash and/or in such other ways as the Compensation Committee may permit, including, for example, by the participant’s delivery of previously-owned shares, broker-assisted cashless exercise or by our issuing a net amount of shares pursuant to which we hold back shares that would otherwise be issued in connection with such exercise or settlement that have a value equal to the exercise price and/or the minimum required amount of the participant’s tax withholding obligation.

Change in Control. If, in connection with a “change in control” (as defined in the 2015 Plan), existing awards are continued or converted into substantially equivalent awards of the successor company, then the existing or substitute awards will generally remain governed by their respective vesting and other terms and conditions, except that (a) any performance-based earnout condition will be deemed to have been satisfied at the greater of the target level or the level that would have been attained if the pre-Change in Control performance had continued at the same rate through the end of the performance period, and (b) vesting of the awards will accelerate if, within two years after the change in control, the participant’s employment terminates by reason of death, or is terminated by the successor company without “cause” or by the participant for “good reason” (as those terms are defined in the 2015 Plan). If an existing award is not continued, assumed or converted into a substantially similar award upon a change in control, then any performance-based earnout condition will be deemed to have been satisfied at the maximum level, the award will be deemed to be fully vested immediately prior to the change in control and, to the extent not previously exercised or settled, the award will be canceled at the time of the change in control in exchange for the right to receive the change in control transaction value of the award.

Amendment and Termination. The Board may amend or terminate the 2015 Plan, provided such action does not have an adverse effect on any then outstanding awards. Amendments to the 2015 Plan will be subject to stockholder approval if such approval is necessary in order to satisfy applicable legal or stock exchange listing requirements. Stock exchange rules generally require stockholder approval of increases in the shares reserved under a plan or other material modifications, but such rules do not require that all amendments be submitted to stockholders. Therefore, it is possible that the 2015 Plan could be amended in ways that increase the cost to us without further stockholder approval.

Term of the 2015 Plan. The Board adopted the 2015 Plan on April 1, 2015, subject to approval by our stockholders at the Annual Meeting. The 2015 Plan (if it is approved by our stockholders) will terminate on the tenth anniversary of the date of its approval by our stockholders. Any shares remaining available under our 2005 Plan, which will expire on June 9, 2015, will not be carried over to the 2015 Plan.

Certain U.S. Income Tax Consequences. Set forth below is a brief summary of material U.S. income tax consequences applicable to awards made under our 2015 Plan. This discussion is intended for general informational purposes and not as tax guidance to any participant who may receive an award under the 2015 Plan.

Non-qualified Stock Options

A non-qualified stock option is an option that does not qualify as an “incentive stock option” under Section 422 of the Code. The grant of a nonqualified stock option is not a taxable event. In general, a participant who exercises a nonqualified stock option will realize ordinary income on the date the option is

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exercised equal to the excess of the value of the shares acquired on that date over the option exercise price paid for the shares, and we will be entitled to a corresponding tax deduction. In general, the participant's tax basis in the shares will be equal to the value of the shares on the date the option is exercised, and the participant's holding period for the shares will begin on that date. Gain or loss on a subsequent sale of the shares will be long- or short-term capital gain or loss, depending on whether the sale occurs more than one year after the participant's holding period begins.

Incentive Stock Options

In general, no taxable event will occur upon either the grant or exercise of an option that qualifies as an "incentive stock option" under Section 422 of the Code (although the exercise may have alternative minimum tax consequences to the participant). A participant will realize taxable income (or loss) when shares acquired upon the exercise of an "incentive stock option" are subsequently sold. If the participant sells the shares more than two years after the date the option is granted and more than one year after the date the option is exercised, any gain or loss realized on the sale will be long-term capital gain or loss, and we will not be entitled to a tax deduction. If the participant sells the shares before the end of either of those two holding periods, any gain realized on the sale will be taxable as ordinary income to the extent that the value of the shares on the date the option is exercised exceeds the option exercise price paid for the shares, and any remaining gain will be capital gain. In general, we will be entitled to a tax deduction equal to any ordinary income realized by the participant upon the sale of the shares.

Stock Appreciation Rights

The grant of a stock appreciation right is not a taxable event. In general, a participant will realize ordinary income when a stock appreciation right is exercised, equal to the value of the shares of our Common Stock and/or the amount of cash received by the participant in connection with such exercise, and we will be entitled to a corresponding tax deduction. The participant's tax basis in the shares will be equal to the exercise-date value of the shares received, and the participant's holding period for the shares will begin on that date. Gain or loss on a subsequent sale of the shares will be long- or short-term capital gain or loss, depending on whether the sale occurs more than one year after the participant's holding period begins.

Restricted Stock

In general, a participant who receives shares of restricted stock will not realize taxable income unless and until the shares become vested, at which time the participant will realize ordinary income equal to the then fair market value of the vested shares and we will be entitled to a corresponding tax deduction. The participant's tax basis for the shares will be equal to their fair market value on the vesting date and, upon a subsequent sale of the vested shares, the participant will realize long- or short-term capital gain, depending on whether the sale occurs more than one year after the vesting date (when ordinary income was realized). A participant may make an early income election within 30 days after he or she receives shares of restricted stock, in which case the participant will realize ordinary income on the date the shares are received equal to the fair market value of the shares on that date, and we would be entitled to a corresponding tax deduction. If an early income election is made, no income would be realized if and when the shares become vested and, upon a subsequent sale of the shares, any gain or loss will be treated as long- or short-term capital gain or loss, depending on whether the sale occurs more than one year after the date the shares were issued to the participant (in the form of restricted shares).

Restricted Stock Units and Other Awards

In general, a participant who receives shares of our Common Stock and/or cash in settlement of a restricted stock unit award will realize ordinary income equal to the then value of the shares and/or cash he or she received, and we will have a corresponding tax deduction. Similarly, if a participant receives cash and/or shares pursuant to a performance unit, performance share or other form of award under Plan, then, in general, the participant will realize ordinary income upon such receipt equal to the then fair market value of the shares and/or the amount of cash received, and we will be entitled to a corresponding tax deduction. The participant's tax basis in any such shares will generally be equal to the value of the shares on the date that ordinary income is realized, and the participant's tax holding period for the shares will generally begin on that date. Gain or loss on a subsequent sale of the shares will be long- or short-term capital gain or loss, depending on whether the sale occurs more than one year after the participant's holding period begins.

Section 162(m) of the Code

In general, Section 162(m) of the Code imposes a $1 million deduction limit on compensation paid by a publicly held company to its chief executive officer and each of the company's three other most highly compensated named executive officers (other than the chief financial officer). The deduction limit does not apply, however, to qualifying "performance-based" compensation. If approved by our stockholders, the 2015 Plan will allow us to grant performance-based equity and cash incentive awards that are intended to qualify for the "performance-based" compensation exemption.

Withholding

We have the right to deduct or withhold, or require a participant to remit to us, any amounts sufficient to satisfy applicable tax withholding requirements arising in connection with the exercise, vesting, lapse of restrictions or other taxable event pertaining to any awards made under the 2015 Plan. The Compensation Committee may, at the time the award is granted or thereafter, require or permit any such withholding requirement to be satisfied, in whole or in part, by delivery of, or withholding from the award, shares having a fair market value on the date of withholding equal to the minimum amount required to be withheld for tax purposes.

New Plan Benefits

Future grants under the 2015 Plan will be made at the discretion of the Compensation Committee and, accordingly, are not yet determinable. In addition, benefits under the 2015 Plan will depend on a number of factors, including the fair market value of our Common Stock on future dates. Consequently, it is not possible to determine the benefits that might be received by participants receiving discretionary grants under the 2015 Plan.

THE BOARD OF DIRECTORS DEEMS PROPOSAL NO. 2 TO BE IN THE BEST INTERESTS OF G-III AND OUR STOCKHOLDERS AND RECOMMENDS A VOTE "FOR" APPROVAL OF THE 2015 LONG-TERM INCENTIVE PLAN.

PROPOSAL NO. 3
AMENDMENT TO THE CERTIFICATE OF INCORPORATION
TO INCREASE THE NUMBER OF AUTHORIZED COMMON SHARES

The Board of Directors has unanimously approved, subject to stockholder approval, an amendment to Paragraph (A) of Article Fourth of our certificate of incorporation to increase the total number of authorized shares of Common Stock from 80,000,000 shares to 120,000,000 shares. The number of authorized shares of Common Stock was not affected by our two-for-one stock split effective May 1, 2015. The number of authorized shares of our preferred stock will remain the same, at 1,000,000 shares.

We are asking you to vote on the following resolution:

RESOLVED, that the Certificate of Incorporation, as previously amended on June 7, 2011, be further amended pursuant to a Certificate of Amendment of Certificate of Incorporation (the “Certificate of Amendment”, such that Paragraph (A) of Article FOURTH of the Certificate of Incorporation be amended to read in its entirety as follows:

FOURTH: A. Authorized Capital Stock. The total number of shares of all classes of stock which this Corporation shall have authority to issue is ONE HUNDRED TWENTY-ONE MILLION (121,000,000) shares, consisting of ONE MILLION (1,000,000) shares of Preferred Stock, par value $.01 per share (hereinafter, the “Preferred Stock”), and ONE HUNDRED TWENTY MILLION (120,000,000) shares of Common Stock, par value $.01 per share (hereinafter, the “Common Stock”).

Use of Authorized Shares. All share numbers below have been adjusted for our two-for-one stock split effective May 1, 2015.

In fiscal 2013, we granted 771,970 shares of restricted stock and options to purchase 170,000 shares of G-III common stock as equity compensation to our employees and directors.

In fiscal 2014, we granted 631,500 shares of restricted stock as equity compensation to our employees and directors.

In fiscal 2015, we sold 3,450,000 shares of our Common Stock in an underwritten public offering that closed in June 2014. We received net proceeds of $128.7 million from this offering after payment of the underwriting discount and expenses of the offering. In addition, we granted 522,170 shares of restricted stock as equity compensation to our employees and directors.

Shares Issued or Reserved. On April 1, 2015, our Board of Directors declared a two-for-one stock split of our Common Stock that was effected in the form of a stock dividend of one share of Common Stock for share of Common Stock owned. At May 1, 2015, after giving effect to the stock split, there were 44,980,194 shares of Common Stock outstanding. An aggregate of 5,998,954 shares of Common Stock were reserved for issuance pursuant to our stock plans, including the 2,500,000 shares of our Common Stock subject to the 2015 Plan that is being submitted to our stockholders for approval at the Annual Meeting and outstanding equity awards granted under the 2005 Plan. At May 1, 2015, outstanding equity awards granted under the 2005 Plan include options to purchase 446,176 shares and restricted stock units (“RSUs”) representing 2,091,412 shares that have not fully vested. In addition, there are 961,366 shares that remain available for grant under the 2005 Plan that expires on June 9, 2015. As a result, as of May 1, 2015, we had outstanding or reserved for issuance 50,979,148 of the 80,000,000 authorized shares of Common Stock.

Purposes of the Proposed Increase. If the proposed amendment is approved by our stockholders, the additional shares authorized will be available for general corporate purposes. The additional shares authorized could be issued at the direction of the Board of Directors from time to time for any proper corporate purpose, including, without limitation, the acquisition of other businesses, the raising of additional capital for use in our business, a split or dividend on then outstanding shares or in connection with any employee share plan or program.

Our company has grown significantly over the past few years. We review and evaluate potential capital raising activities, strategic transactions and other corporate actions on an ongoing basis to determine if such actions would be in the best interests of G-III and its stockholders. Our Board believes that the currently available number of unissued and unreserved shares of Common Stock does not provide sufficient flexibility for corporate action in the future, and that additional authorized shares would provide us with needed ability to issue Common Stock or Common Stock-based instruments in the future to take advantage of opportunities that are presented to us or favorable market conditions without the potential expense or delay incident to obtaining stockholder approval for a particular issuance. Our Board of Directors will determine whether, when and on what terms the issuance of shares of Common Stock or Common Stock-based instruments may be warranted. The additional shares of Common Stock will be available for issuance without further action by our stockholders unless such action is required by applicable law or by the NASDAQ Listing Rules. Subject to stockholder approval of our 2015 Plan, G-III may issue up to 2,500,000 shares of our Common Stock pursuant to awards made under the 2015 Plan from time to time. Depending on market conditions and other factors, we may raise additional capital through the issuance of equity securities. We have no current plans to issue additional shares for any other purpose. Under our certificate of incorporation, stockholders do not have preemptive rights with respect to the authorization of additional shares of Common Stock.

Dilutive Impact. Adoption of the amendment to our certificate of incorporation would not have an immediate dilutive effect on the proportionate voting power or other rights of existing stockholders. However, as is true for shares presently authorized but unissued, the future issuance of Common Stock authorized by the amendment may, among other things, dilute the earnings per share of the Common Stock, decrease existing stockholders' percentage equity ownership, dilute the voting rights of existing stockholders and, depending on the price at which they are issued, could have a negative effect on the market price of the Common Stock. Current stockholders have no preemptive or similar rights. Accordingly, current stockholders do not have a prior right to purchase any new issue of Common Stock in order to maintain their proportionate ownership thereof.

Although not a factor in the Board of Directors' decision to propose the amendment, one of the effects of the amendment to our certificate of incorporation may be to enable the Board of Directors to render more difficult or to discourage an attempt to obtain control of G-III, since the issuance of these additional shares of Common Stock could be used to dilute the stock ownership of persons seeking to obtain control or otherwise increase the cost of obtaining control of us. As of March 1, 2015, our directors and executive officers, in the aggregate, beneficially owned 11.5% of our outstanding Common Stock.

Interests of Certain Persons

While none of our directors or executive officers has a present commitment to purchase any of the additional authorized shares, it is possible that one of more of such persons will participate in any future transaction in which we issue additional shares of Common Stock or securities convertible into Common Stock, in which case the participating officers and directors may be deemed to have an interest in the approval of this Proposal No. 3.

THE BOARD OF DIRECTORS DEEMS PROPOSAL NO. 3 TO BE IN THE BEST INTERESTS OF G-III AND OUR STOCKHOLDERS AND RECOMMENDS A VOTE "FOR" APPROVAL THEREOF.

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PROPOSAL NO. 4
ADVISORY VOTE ON COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

The Dodd-Frank Act enables stockholders to vote to approve, on an advisory (non-binding) basis, the compensation of our Named Executive Officers as disclosed in this Proxy Statement in accordance with the SEC's rules. In light of the results of the stockholders' nonbinding advisory vote at the 2011 Annual Meeting with respect to the frequency with which stockholders will vote for the approval of the compensation of G-III's Named Executive Officers, G-III currently intends to hold an annual nonbinding advisory vote on such Named Executive Officer compensation.

We are asking our stockholders to indicate their support for the compensation of our Named Executive Officers as disclosed in this Proxy Statement. This proposal, commonly known as a "say-on-pay" proposal, gives stockholders the opportunity to express their views on the compensation paid to our Named Executive Officers. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our Named Executive Officers and the philosophy, policies and practices described in this Proxy Statement. Accordingly, we are asking the stockholders to vote "FOR" the following resolution at the Annual Meeting:

RESOLVED, that G-III's stockholders approve, on an advisory basis, the compensation of G-III's Named Executive Officers, as disclosed in G-III's Proxy Statement for the 2015 Annual Meeting of Stockholders, pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the compensation tables, and other related tables and disclosure.

The "say-on-pay" vote is advisory, and therefore is not binding on us, the Compensation Committee or the Board of Directors. However, the Board and the Compensation Committee value the opinions of our stockholders and, to the extent there is any significant vote against the Named Executive Officer compensation as disclosed in this Proxy Statement, will consider the stockholders' concerns and the Board and Compensation Committee will evaluate whether any actions are necessary to address those concerns.

THE BOARD OF DIRECTORS DEEMS PROPOSAL NO. 4 TO BE IN THE BEST INTERESTS OF G-III AND OUR STOCKHOLDERS AND RECOMMENDS A VOTE "FOR" APPROVAL THEREOF.

AUDIT COMMITTEE REPORT

In accordance with its written charter adopted by the Board of Directors, the Audit Committee of the Board of Directors is responsible for, among other things, overseeing G-III's accounting and financial reporting processes and reviewing and discussing G-III's audited financial statements with management.

Management is responsible for G-III's financial reporting process including its system of internal control and for the preparation of consolidated financial statements in accordance with generally accepted accounting principles. G-III's independent auditors are responsible for auditing those financial statements. The responsibility of the Audit Committee is to monitor and review these processes. Members of the Audit Committee are not employees of G-III and are not required to be accountants or auditors by profession. Therefore, the Audit Committee has relied, without independent verification, on management's representation that the financial statements have been prepared with integrity and objectivity and in conformity with generally accepted accounting principles and on the representations of the independent auditors included in their report of G-III's financial statements.

The oversight by the Audit Committee does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or policies, or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee cannot give assurance that G-III's financial statements are presented in accordance with generally accepted accounting principles, that the audit of G-III's financial statements has been carried out in accordance with generally accepted auditing standards or that G-III's independent accountants are in fact "independent."

Review of Audited Financial Statements. The Audit Committee has reviewed G-III's audited financial statements for the fiscal year ended January 31, 2015 as prepared by management and audited by Ernst & Young LLP, G-III's independent auditors, and has discussed these financial statements with management. In addition, the Audit Committee has discussed with Ernst & Young LLP the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communication With Those Charged With Governance), as amended, regarding the codification of statements on auditing standards. Furthermore, the Audit Committee has received the written disclosures and the letter from Ernst & Young LLP required by PCAOB Rule No. 3526, Communication with Audit Committees Concerning Independence, and has discussed with Ernst & Young LLP its independence.

Recommendation. In reliance on the reviews and discussions referenced above, the Audit Committee recommended to the Board of Directors that the audited financial statements for the fiscal year ended January 31, 2015 be included in G-III's Annual Report on Form 10-K for that fiscal year.

Audit Committee
Alan Feller, Chairman
Willem van Bokhorst
Richard White

PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table sets forth fees we paid for audit, audit-related, tax and other services provided by Ernst & Young LLP during each of the last two fiscal years.

| | Fiscal Year Ended January 31, | |
|---|---|---|
| | 2015 | 2014 |
| Audit fees | $ 1,965,000 | $ 1,350,000 |
| Audit-related fees | 849,000 | 356,000 |
| Tax fees | 537,044 | 350,514 |
| All other fees | — | — |
| Total | $ 3,351,044 | $ 2,056,514 |

Audit Fees. Audit fees include services associated with the audit of our annual financial statements included in our Annual Report on Form 10-K, the audit of management's assessment and overall effectiveness of internal controls over financial reporting, review of financial statements included in our quarterly reports on Form 10-Q, statutory audits required internationally during each fiscal year and work performed in connection with the issuance of consents related to registration statements filed by G-III.

Audit-Related Fees. In fiscal 2015, audit-related fees include fees related to our follow on public offering in June 2014 and financial and tax due diligence procedures performed in connection with potential acquisition transactions. In fiscal 2014, audit-related fees include financial and tax due diligence procedures performed in connection with the acquisition of G.H. Bass, as well as with respect to other potential acquisition transactions.

Tax Fees. Tax fees include services related to income tax compliance, assistance with tax audits, tax advice and tax planning. In fiscal 2015, these services primarily included services provided related to sales and use tax administration, transfer pricing studies, and assistance on various international tax issues. In fiscal 2014, these services primarily included services provided related to sales and use tax administration, transfer pricing studies, assistance on various state and local tax issues, and tax audits.

The Audit Committee has considered whether the provision of the above services is compatible with maintaining Ernst & Young LLP's independence and all of the above services were pre-approved by the Audit Committee.

It is the Audit Committee's policy to pre-approve all audit and permissible non-audit services to be performed by our independent accountants, the fees to be paid for those services and the time period over which those services are to be provided. On an annual basis, the independent accountants present a listing of all services they expect to perform for us in the ensuing one-year period, including fee estimates, in sufficient detail to enable the Audit Committee to perform an independence review of each proposed service. The Audit Committee reviews this list and approves appropriate services which, in the Audit Committee's judgment, will not impair the accountants' independence. With respect to any additional services proposed to be performed by the independent accountants during the year, management will evaluate the impact on the independent accountant's independence and obtain Audit Committee approval for such service. The Audit Committee has delegated interim pre-approval authority to the Chairman of the Audit Committee.

PROPOSAL NO. 5
RATIFICATION OF APPOINTMENT
OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The stockholders will be asked to ratify the appointment by the Audit Committee of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending January 31, 2016. If this appointment is not ratified by the stockholders, the Audit Committee will reconsider its decision. Ernst & Young LLP audited our financial statements for the fiscal year ended January 31, 2015. A representative of Ernst & Young LLP is expected to be present at the Annual Meeting, and will have an opportunity to make a statement if such person desires to do so, and is expected to be available to respond to appropriate questions from stockholders.

THE BOARD OF DIRECTORS DEEMS PROPOSAL NO. 5 TO BE IN THE BEST INTERESTS OF US AND OUR STOCKHOLDERS AND RECOMMENDS A VOTE “FOR” APPROVAL THEREOF.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

We have had in effect for many years a Code of Ethics that contains our conflicts of interest policy. Our Audit Committee has been responsible for reviewing transactions that might involve our Code of Ethics and for reviewing related party transactions. In addition, our Board of Directors has also adopted a written related party transactions policy. The policy covers all transactions between us and any related party (including any transactions requiring disclosure under Item 404 of Regulation S-K), other than transactions generally available to all employees and transactions involving less than ten thousand dollars ($10,000) when aggregated with all similar transactions. The Audit Committee is generally responsible for administering this policy. However, our policy permits the disinterested directors of the Board of Directors to exercise the authority otherwise assigned to the Audit Committee. A related party transaction may be consummated only if it is ratified or approved by the Audit Committee or disinterested members of the Board of Directors and if it is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party. Our Compensation Committee reviewed and approved the compensation of Jeffrey Goldfarb set forth in the next paragraph and our Audit Committee ratified the approval by our Compensation Committee.

Jeffrey Goldfarb, the son of Morris Goldfarb, our Chairman, Chief Executive Officer and President and a director, is our Director of Business Development. Jeffrey Goldfarb has been employed by us since 2002 in several different capacities. Jeffrey Goldfarb is also a member of our Board of Directors. For fiscal 2015, Jeffrey Goldfarb received a salary of $644,231 and a bonus of $809,000 for his services and our Compensation Committee granted him restricted stock units that enable him to receive up to 34,598 shares of our Common Stock that will become vested at an annual rate of 25% on each of October 5, 2016, 2017, 2018 and 2019 as the performance conditions for fiscal 2015 grants have been satisfied as described above. The grant date fair value under FASB ASC Topic 718 of the restricted stock units granted to Jeffrey Goldfarb was $1,157,995. We have entered into an executive transition agreement with Jeffrey Goldfarb under which he is entitled to receive specified severance payments and benefits in the event of his involuntary termination in conjunction with a change of control of G-III.

STOCKHOLDER PROPOSALS

All stockholder proposals which are intended to be presented at our Annual Meeting of Stockholders to be held in 2016 must be received by us no later than January 29, 2016 for inclusion in the Board of Directors' proxy statement and form of proxy relating to that meeting. Any stockholder proposal must also be proper in form and substance, as determined in accordance with the Exchange Act and the rules and regulations promulgated thereunder. All such proposals should be addressed to G-III Apparel Group, Ltd., 512 Seventh Avenue, New York, NY 10018, Attention: Secretary.

Any stockholder who intends to nominate a person for election to the Board of Directors or propose any other matter to be acted upon at the Annual Meeting of Stockholders to be held in 2016 (but not include such proposal in the Board of Directors' proxy statement and form of proxy) must inform us no later than April 1, 2016. If notice is not provided by that date, the persons named in the proxy for the 2016 Annual Meeting will be allowed to exercise their discretionary authority to vote upon any such proposal without the matter having been discussed in the proxy statement for the 2016 Annual Meeting. All notice should be addressed to G-III Apparel Group, Ltd., 512 Seventh Avenue, New York, NY 10018, Attention: Secretary.

For the nomination of any person to the Board of Directors, a the notice must set forth (a) the name, age, business address and residence address of the nominee, (b) the principal occupation or employment of the nominee, (c) the number of shares of capital stock of G-III which are owned of record and beneficially by the nominee (if any), (d) such other information concerning the nominee as would be required to be disclosed in a proxy statement soliciting proxies for the election of the nominee as a director in an election contest (even if an election contest is not involved) or that is otherwise required to be disclosed, under Section 14(a) of the Exchange Act and the rules and regulations promulgated thereunder, (e) the consent of the nominee to being named in the proxy statement as a nominee and to serving as a director if elected, and (f) as to the proposing stockholder: (i) the name and address of the proposing stockholder as they appear on G-III's books and of the beneficial owner, if any, on whose behalf the nomination is being made, (ii) the class and number of shares of G-III which are owned by the proposing stockholder (beneficially and of

record) and owned by the beneficial owner, if any, on whose behalf the nomination is being made, as of the date of the proposing stockholder's notice, (iii) a description of any agreement, arrangement or understanding with respect to such nomination between or among the proposing stockholder and any of its affiliates or associates, and any others (including their names) acting in concert with any of the foregoing, (iv) a description of any agreement, arrangement or understanding (including any derivative or short positions, profit interests, options, hedging transactions, and borrowed or loaned shares) that has been entered into as of the date of the proposing stockholder's notice by, or on behalf of, the proposing stockholder or any of its affiliates or associates, the effect or intent of which is to mitigate loss to, manage risk or benefit of share price changes for, or increase or decrease the voting power of the proposing stockholder or any of its affiliates or associates with respect to shares of stock of G-III, (v) a representation that the proposing stockholder is a holder of record of shares of G-III entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice, and (vi) a representation whether the proposing stockholder intends to deliver a proxy statement and/or form of proxy to holders of G-III's outstanding capital stock and/or otherwise to solicit proxies from stockholders in support of the nomination. G-III may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as an independent director of G-III or that could be material to a reasonable stockholder's understanding of the independence, or lack thereof, of such nominee.

For all business other than director nominations, the notice must set forth as to each matter the proposing stockholder proposes to bring before the annual meeting: (a) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (b) any other information relating to such stockholder and beneficial owner, if any, on whose behalf the proposal is being made, required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for the proposal and pursuant to and in accordance with Section 14(a) of the Exchange Act and the rules and regulations promulgated thereunder and (c) the information as to the proposing stockholder required by section (f) in the preceding paragraph.

OTHER BUSINESS

The Board of Directors knows of no other business to be acted upon at the Annual Meeting. However, if any other business properly comes before the Annual Meeting, it is the intention of the persons named in the enclosed proxy to vote on such matters in accordance with their best judgment.

The prompt return of your proxy will be appreciated and helpful in obtaining the necessary vote. Therefore, whether or not you expect to attend the Annual Meeting, please sign the proxy and return it in the enclosed envelope.

By Order of the Board of Directors

WAYNE S. MILLER
Secretary
New York, New York
May 29, 2015

A COPY OF OUR ANNUAL REPORT ON FORM 10-K WILL BE SENT WITHOUT CHARGE TO ANY STOCKHOLDER REQUESTING IT IN WRITING FROM: G-III APPAREL GROUP, LTD., ATTENTION: CORPORATE SECRETARY, 512 SEVENTH AVENUE, NEW YORK, NEW YORK 10018.

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Appendix A

G-III APPAREL GROUP, LTD.

2015 LONG-TERM INCENTIVE PLAN

ARTICLE 1

GENERAL

1.1 Purpose. The purpose of the Plan is to establish a vehicle through which the Company can provide equity-based and other incentive compensation opportunities in order to facilitate its ability to recruit, motivate, reward and retain qualified individuals who contribute or are expected to contribute to the success and growth of the Company.

1.2 Eligibility. Awards may be granted under the Plan to any employee or non-employee director of, and any consultant, independent contractor or other person who provides personal services to, the Company or any of its Subsidiaries, provided that Incentive Stock Options may be granted only to employees.

1.3 Types of Awards. Awards under the Plan may include, without limitation, Options, Stock Appreciation Rights, shares of Restricted Stock, Restricted Stock Units, other Share-based Awards and performance-based Cash Incentive Awards, all as described in Articles 5 through 7 hereof.

ARTICLE 2

DEFINITIONS

2.1 "Award" means an award made to an eligible director, employee or consultant under the Plan.

2.2 "Award Agreement" means an agreement, in written or electronic form, between the Company and a Participant setting forth the terms and conditions of an Award.

2.3 "Board" means the Board of Directors of the Company.

2.4 "Cause" has the meaning set forth in Section 9.3(a).

2.5 "Change in Control" has the meaning set forth in Section 9.3(b).

2.6 "Code" means the Internal Revenue Code of 1986, as amended.

2.7 "Committee" means the Compensation Committee of the Board.

2.8 "Company" means G-III APPAREL GROUP, LTD., a Delaware corporation, and any successor thereto.

2.9 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.10 "Exercise Price" means, with respect to an Option, the price at which a holder may purchase the Shares covered by the Option and, with respect to an SAR, the baseline price of the Shares covered by the SAR.

2.11 "Fair Market Value" means, as of any relevant date, the closing price per Share on such date on the principal securities exchange on which the Shares are traded or, if no Shares are traded on that date, the closing price per Share on the next preceding date on which Shares are traded, or (2) the value determined under such other method or convention as the Board or the Committee, acting in a consistent manner in accordance with the Plan and applicable tax law, may prescribe.

2.12 "Good Reason" has the meaning set forth in Section 9.3(c).

2.13 "Incentive Cash Award" means a performance-based cash Award described in Section 7.2.

2.14 "Incentive Stock Option" or "ISO" means an Option that qualifies as an "incentive stock option" within the meaning of Section 422 of the Code.

2.15 "Option" means an option to purchase Shares granted pursuant to Section 5.1.

2.16 "Participant" means any person who has been selected to receive an Award under the Plan or who holds an outstanding Award under the Plan.
2.17 "Performance-Based Exemption" means the performance-based compensation exemption from the compensation deduction limitations imposed by Section 162(m) of the Code, as set forth in Section 162(m)(4)(C) of the Code.
2.18 "Performance Factors" means any of the factors listed in Section 7.3(b) that may be used for Awards intended to qualify for the Performance-Based Exemption.
2.19 "Plan" means the incentive plan set forth herein, as it now exists or is hereafter amended.
2.20 "Restricted Stock" means stock issued in the name of a Participant pursuant to Section 6.1, subject to applicable transfer restrictions and vesting and other conditions.
2.21 "Restricted Stock Unit" or "RSU" means a contingent right to receive Shares in the future that is granted pursuant to Section 6.1.
2.22 "Section 409A" means Section 409A of the Code.
2.23 "Shares" means shares of the Company's common stock.
2.24 "Stock Appreciation Right" or "SAR" means a right to receive appreciation in the value of Shares that is granted pursuant to Section 5.2.
2.25 "Subsidiary" means (a) a corporation or other entity in an unbroken chain of corporations or other entities at least 50% of the total value or voting power of the equity securities of which is owned by the Company or by any other corporation or other entity in the chain, and (b) any other corporation or entity in which the Company has a 20% controlling interest, directly or indirectly, as may be designated by the Committee pursuant to the criteria set forth in Section 1.409A-1(b)(5)(iii)(E) of the Treasury regulations.
2.26 "Ten Percent Stockholder" means a person who owns or is deemed to own (under Section 424(d) of the Code) more than ten percent of the total combined voting power of all classes of stock of the Company or any Subsidiary.

ARTICLE 3
ADMINISTRATION

3.1 General. Except as specified herein or as otherwise determined by the Board, the Plan shall be administered by the Committee, the composition of which is governed by the Committee's charter.
3.2 Authority of the Committee. Subject to the provisions of the Plan, the Committee, acting in its discretion, shall have the power and authority to select the persons to whom Awards will be made, prescribe the terms and conditions of each Award and make amendments thereto, construe, interpret and apply the provisions of the Plan and of any Award Agreement, and make any and all determinations and take any and all other actions as it deems necessary or desirable in order to carry out the terms of the Plan or of any Award; provided that the Committee may not accelerate the vesting of an outstanding award by reason of the termination of a Participant's employment unless (a) such termination is in connection with a Change in Control or on account of the Participant's death, disability or retirement, or (b) such termination occurs for any other reason and the net number of shares the Company would issue by reason of such acceleration of vesting would not exceed 10% of the total number of Shares that may be issued under the Plan.
3.3 Delegation of Authority. To the fullest extent authorized or permitted by applicable law, including, without limitation, Section 157(c) of the Delaware General Corporation Law, the Committee may (i) delegate to officers of the Company or any affiliate, or committees thereof, the authority, subject to such terms as the Committee shall determine, to perform such functions, including the authority to grant Awards, as the Committee may determine, and (ii) delegate to any person or subcommittee (who may, but need not be members of the Committee) such Plan-related administrative authority and responsibilities as it deems appropriate. The Committee may not delegate its authority with respect to non-ministerial actions relating to individuals who are subject to the reporting requirements of Section 16(a) of the Exchange Act or Awards that are intended to qualify for the Performance-Based Exemption.

3.4 Indemnification. The Company shall indemnify and hold harmless each member of the Committee and the Board and any employee or director of the Company or any Subsidiary to whom any duty or power relating to the administration of the Plan or any Award is delegated from and against any loss, cost, liability (including any sum paid in settlement of a claim with the approval of the Board), damage and expense (including reasonable legal and other expenses incident thereto) arising out of or incurred in connection with the Plan, unless and except to the extent attributable to such person's fraud or willful misconduct.

ARTICLE 4

SHARES SUBJECT TO THE PLAN; INDIVIDUAL AWARD LIMITS

4.1 Shares Issuable under the Plan. Subject to Section 4.3, up to 2,500,000 Shares shall be available for grant and issuance pursuant to Awards made under the Plan, any or all of which may (but need not) be issued pursuant to ISOs. For purposes of these limitations, (a) the total number of Shares covered by stock-settled SARs (and not just the number of Shares issued in settlement of such SARs) shall be deemed to have been issued under the Plan, and (b) Shares covered and/or issued pursuant to an Award will again be available for grant and issuance pursuant to subsequent Awards to the extent such Shares are covered by or relate to (1) the unexercised portion of an Option or SAR that is forfeited or otherwise terminated or canceled for any reason other than exercise, (2) Restricted Stock Awards, RSU Awards or any other forms of Award that are forfeited, (3) subject to an Award that is settled in cash or that otherwise terminates without such Shares being issued, or (4) Shares issued pursuant to awards that are assumed, converted or substituted as a result of the acquisition of another company by the Company or a combination of the Company with another Company. Shares that are used or withheld to pay the exercise price of an Award or to satisfy the tax withholding obligations associated with the vesting or settlement of an Award will not be available for future grant and issuance under the Plan. Shares issued under the Plan may be either authorized and

4.2 unissued Shares, or authorized and issued Shares held in the Company's treasury, or any combination of the foregoing. For the avoidance of doubt, Shares purchased by the Company in the open market with proceeds from a cash exercise of an Option may not be added to the pool of Shares otherwise available under the Plan.

4.3 Individual Award Limitations. No more than 400,000 Shares may be issued pursuant to Awards granted to any Participant in any fiscal year of the Company. No more than $10,000,000 may be earned by any Participant for any fiscal year pursuant to Cash Incentive Awards made under Section 7.2. If the performance period for a Cash Incentive Award covers more than one fiscal year, then, for the purpose of applying the annual limit under the preceding sentence, the amount that may be earned by the Participant for each fiscal year covered by the performance period will be deemed to be equal to the quotient of (a) the maximum amount that may be earned pursuant to the Award, divided by (b) the number of such fiscal years.

4.4 Adjustments for Capital Changes. In the event of a split-up, spin-off, stock dividend, extraordinary cash dividend, recapitalization, consolidation of Shares, reverse stock split or other similar capital change, the number and class of Shares that may be issued under the Plan pursuant to Section 4.1, the number and class of Shares that may be issued pursuant to annual Awards granted to any Participant pursuant to Section 4.2, the number, class and/or Exercise Price (if any) of Shares subject to outstanding Awards and performance goals expressed in or with respect to Shares shall be equitably adjusted by and at the discretion of the Board or the Committee in order to prevent undue dilution or enlargement of the benefits available under the Plan or an outstanding Award, as the case may be, provided that the number of Shares subject to any outstanding Award shall always be a whole number. In furtherance of the foregoing, in the event of an "equity restructuring," each outstanding Award that constitutes a "share-based payment arrangement" (as such terms are defined in FASB Accounting Standards Codification Topic 718) shall be adjusted pursuant to this Section.

ARTICLE 5

STOCK OPTIONS; STOCK APPRECIATION RIGHTS

5.1 Grant of Company Stock Options. The Committee may grant Options to Participants upon such vesting, forfeiture and other terms and conditions as the Committee, acting in its discretion in accordance with the Plan, may determine, either at the time an Option is granted or, if the holder's rights are not adversely affected, at any subsequent time, provided that each Option shall have a vesting period of at least one year from the date of grant. Each Option will be deemed not to be an ISO (a non-ISO) unless, at the time the Option is granted, the Committee specifically designates such Option as an ISO. If an Option is designated as an ISO and if part or all of the Option does not qualify as an ISO for any reason, then the Option or the portion of the Option that does not so qualify will nevertheless remain outstanding and will be characterized as a non-ISO.

5.2 Grant of Stock Appreciation Rights. The Committee may grant Stock Appreciation Rights, or SARs, to Participants, either alone or in connection with the grant of an Option, upon such vesting, forfeiture and other terms and conditions as the Committee, acting in its discretion in accordance with the Plan, may determine, either at the time the SARs are granted or, if the holder's rights are not adversely affected, at any subsequent time, provided that SARs shall have a minimum vesting period of one year from the date of grant. Upon exercise, the holder of an SAR shall be entitled to receive cash and/or a number of whole Shares (as determined by the Committee) having a value equal to the product of X and Y, where —

X = the number of whole Shares as to which the SAR is being exercised, and

Y = the excess of (i) the Fair Market Value per Share on the date of exercise over (ii) the Exercise Price per Share covered by the SAR.

5.3 Exercise Price. The Committee shall determine the Exercise Price per Share under each Option and each SAR, provided that (a) the Exercise Price per Share shall be at least equal to the Fair Market Value per Share on the date the Option or SAR is granted; and (b) in the case of an ISO granted to a Ten Percent Stockholder, the Exercise Price per Share shall be at least equal to 110% of the Fair Market Value per Share on the date the ISO is granted.

5.4 Repricing and Reloading Prohibited. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, distribution (whether in the form of cash, Shares, other securities or other property), stock split, extraordinary cash dividend, recapitalization, change in control, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Common Shares or other securities, or similar transaction(s)), the Company may not, without obtaining stockholder approval: (a) reduce the Exercise Price under outstanding Options or SARs; (b) cancel outstanding Options or SARs in exchange for Options or SARs with a lower Exercise Price; or (c) cancel outstanding Options or SARs in exchange for cash or other securities at a time when the per Share Exercise Price under such Options or SARs is higher than the Fair Market Value. The Committee may not grant an Option that includes a "reload" feature or make any other Plan Awards that have the effect of providing a "reload" feature with respect to Shares used to satisfy the Option exercise price or applicable withholding tax.

5.5 Exercise Period of Options and SARs. The Committee may establish such vesting, forfeiture, expiration and other conditions as it deems appropriate (on

5.6 a grant-by-grant basis) with respect to the exercisability of an Option or SAR; provided, however, that, unless sooner terminated in accordance with its terms, each Option and each SAR shall automatically expire on the tenth anniversary of the date the Option or SAR is granted (or, in the case of an ISO granted to a Ten Percent Stockholder, on the fifth anniversary of the date the ISO is granted).

5.7 Exercise of Options. A Participant may exercise an outstanding Option that is vested and exercisable by transmitting to the Secretary of the Company (or another person designated by the Company for this purpose) a written notice identifying the Option that is being exercised and specifying the number of whole Shares to be purchased pursuant to such exercise, together with payment in full of the aggregate Exercise Price payable for such Shares and any applicable withholding taxes. The Exercise Price shall be payable in cash or by check or by any other means that the Committee may expressly permit, including, without limitation, (a) the Participant's surrender of previously-owned Shares, (b) the Company's withholding Shares that would otherwise be issued if the Exercise Price had been paid in cash, (c) payment pursuant to a broker-assisted cashless exercise program established and made available in accordance with applicable law, (d) any other method of payment that is permitted by applicable law, or (e) any combination of the foregoing. Applicable withholding taxes shall be payable in cash or by any other method that may be permitted or required by the Committee in accordance with Section 11.1. Shares tendered or withheld for the payment of the exercise price of an Option will be credited on the basis of the Fair Market Value of such Shares on the date they are tendered or withheld pursuant to such exercise.

5.8 Exercise of SARs. A Participant may exercise an outstanding SAR that is vested and exercisable by transmitting to the Secretary of the Company (or another person designated by the Company for this purpose) a written notice identifying the SAR that is being exercised and specifying the number of whole Shares for which the SAR is being exercised, together with payment in full of any applicable withholding taxes attributable to such exercise. Applicable withholding taxes shall be payable in cash or by any other method that may be permitted or required by the Committee in accordance with Section 11.1.

5.9 Termination of Employment or Service. Unless the Committee determines otherwise at the time of grant, or thereafter if no rights of a Participant are thereby reduced, in the event of the termination of a Participant's employment or service with the Company and its Subsidiaries, (a) the Participant will forfeit any then outstanding unvested Options or SARs, and (b) any then outstanding vested Option or SAR will remain outstanding for a period of at least 90 days (one year if such termination is due to the Participant's death) following the date of such termination (but in no event longer than the expiration of its stated term.) Notwithstanding the foregoing, if a Participant's employment or other service is terminated by the Company or a Subsidiary for Cause (as such term is defined in Section 9.3(a) below) or at a time when grounds for such a termination exist, the Participant's then outstanding Options and/or SARs (whether or not previously vested) shall immediately terminate and shall have no further force or effect.

5.10 Rights as a Stockholder. A Participant shall have no rights to vote or receive dividends or any other rights of a stockholder with respect to any Shares covered by an Option or SAR unless and until such Option or SAR is validly exercised and any such Shares are issued to the Participant (subject to Section 4.3). The Company will issue such Shares promptly after the exercise of such Option or SAR (to the extent the SAR is settled in Shares) is completed.

ARTICLE 6

RESTRICTED STOCK AND RESTRICTED STOCK UNIT AWARDS

6.1 Grant of Restricted Stock and RSU Awards. The Committee may grant Restricted Stock Awards and/or Restricted Stock Unit Awards (RSUs) to any Participant. Under a Restricted Stock Award, the Company issues Shares to the Participant when the Award is made subject to specified conditions and restrictions; and under an RSU Award, the Participant receives the right to receive Shares in the future upon satisfaction of specified terms and conditions. The vesting, forfeiture and other terms and conditions applicable to the Shares covered by a Restricted Stock Award or the RSUs and Shares covered by a Restricted Stock Unit Award (including, but not limited to, conditions and restrictions tied to the achievement of specified performance objectives and/or the completion of one or more specified periods of future service) will be determined by the Committee and will be set forth in the applicable Award Agreement, provided that each such Award will have a vesting period of at least one year from date of grant.

6.2 Restricted Shares. Shares issued pursuant to a Restricted Stock Award may be evidenced by book entries on the Company's stock transfer records pending satisfaction of the applicable vesting conditions. If a stock certificate for restricted Shares is issued, the certificate will bear an appropriate legend to reflect the nature of the conditions and restrictions applicable to the Shares. The Company may retain physical possession of any such stock certificate and may require a Participant to deliver a stock power to the Company, endorsed in blank, in order to facilitate the transfer back to the Company of restricted Shares that are forfeited. Notwithstanding the foregoing, if a Participant forfeits Shares covered by a Restricted Stock Award, the Shares that are forfeited shall automatically be cancelled on the books and records of the Company whether or not the Participant returns a certificate for such Shares or otherwise fails or refuses to execute documents or take other action requested by the Company in connection with the cancellation of the forfeited Shares. Except to the extent otherwise provided under the Plan or the Award Agreement, a Participant who holds unvested Shares pursuant to an outstanding Restricted Stock Award shall have all of the rights of a stockholder with respect to said Shares, including the right to vote the Shares and the right to receive dividends thereon (subject to the payment and vesting conditions described in Section 6.4 below).

6.3 Shares Covered by RSU Awards. No Shares will be issued pursuant to an RSU Award unless and until the applicable vesting and other conditions have been satisfied. The holder of an RSU Award shall have no rights as a stockholder with respect to Shares covered by the RSUs unless and until the RSUs becomes vested and the Shares covered by the vested RSUs are issued to the Participant. Subject to Section 6.4, the Committee may provide that a Participant who holds RSUs will be entitled to receive dividend equivalent credits based upon the dividends that would have been payable with respect to the Shares covered by the RSUs if such Shares were outstanding.

6.4 Dividends on Restricted Stock and RSU Shares. If a dividend is declared with respect to outstanding Shares, then, unless the Committee determines otherwise, a corresponding dividend will be credited to a Participant with respect to Shares covered by an outstanding Restricted Stock or RSU Award as if such Shares were outstanding and free of vesting and other conditions and restrictions. Dividend credits (if any) will be made in the form of cash or in the form of additional Shares of Restricted Stock or RSUs (based upon the then Fair Market Value per Share) or any combination thereof, all as determined by the Committee. Dividends credited with respect to Restricted Stock and RSU Awards shall be subject to the same vesting and forfeiture conditions and the same payment terms that are applicable to the Shares of Restricted Stock or RSU Shares to which such dividend credits apply and/or, if applicable, such different terms and conditions that may be required in order to comply with Section 409A.

6.5 Non-Transferability. No Restricted Stock Award and no Shares covered by a Restricted Stock Award, may be sold, assigned, transferred, disposed of, pledged or otherwise hypothecated other than to the Company or its designee in accordance with the terms of the Award or the Plan, and any attempt to do so shall be null and void.

6.6 Termination of Service Before Vesting; Forfeiture. Unless otherwise specified in the Award Agreement or otherwise subsequently determined by the Committee, unvested Shares held pursuant to a Restricted Stock Award and unvested RSUs held under an RSU Award shall be forfeited and canceled upon the termination of a Participant’s employment or other service with the Company and its Subsidiaries.

6.7 Timing Requirement for Settlement of RSUs. Unless otherwise specified in the applicable Award Agreement, RSUs shall be settled in the form of Shares or cash (as determined by the Committee) as soon as practicable after the RSUs become vested but in no event later than the 15th day of the third month following the calendar year in which the vesting of such RSUs occurs. Notwithstanding the foregoing, the terms of an RSU Award may expressly provide that settlement of vested RSUs covered by the Award will be deferred until a later date or the occurrence of a subsequent event, provided that any such deferral provision complies with the election, distribution timing and other requirements of Section 409A.

6.8 Receipt of Shares. A Participant who holds Shares that become vested under a Restricted Stock Award or who holds RSUs that become vested (to the extent the vested RSUs are settled in Shares) will be entitled to receive such Shares, subject to the payment or satisfaction of applicable withholding taxes. Applicable withholding taxes shall be payable in cash or by any other method that may be permitted or required by the Committee in accordance with Section 11.1.

ARTICLE 7

OTHER FORMS OF AWARD

7.1 Other Share-Based Awards. Subject to applicable law, the Committee, acting in its discretion, may grant such other forms of Award denominated or payable in, valued in whole or in part by reference to, or otherwise based upon or related to, Shares, including, without limitation, performance share awards, performance unit awards, stock bonus Awards, dividend equivalent Awards (either alone or in conjunction with other Awards), purchase rights for Shares, and Share-based Awards designed to comply with or take advantage of applicable laws outside of the United States. Each such Share-based Award will be made upon such vesting, forfeiture, performance and other terms and conditions as the Committee, acting in its discretion, may determine; provided that the vesting or earn out period under any such Award may not be less than one year, and provided further that dividend equivalent awards made in conjunction with other Share-based Awards shall be subject to the same vesting and forfeiture conditions and the same payment terms of the corresponding Share-Based Awards and/or, if applicable, such different terms and conditions that may be required in order to comply with Section 409A. If and when a Share-based Award granted

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under this Section becomes payable, payment may be made in the form of cash, whole Shares or a combination of cash and whole Shares (as determined by the Committee), with a payment in Shares being based upon their Fair Market Value on the applicable vesting or payment date(s).

7.2 Cash Incentive Awards. The Committee may make annual and/or long-term Cash Incentive Awards pursuant to which a Participant may earn the right to receive a cash payment that is conditioned upon the achievement of a specified performance goal or goals established by the Committee and communicated to the Participant as soon as practicable after the beginning of the applicable performance period and the satisfaction of such other terms and conditions as the Committee may prescribe. A Cash Incentive Award will be payable in the form of a single sum cash payment on or as soon as practicable after the date the Award becomes earned and vested, but in no event later than the 15th day of the third month of the following calendar year. Notwithstanding the foregoing, the Committee may require or permit the deferred payment and/or installment payout of all or part of any such Cash Incentive Award if (and only if) the Award is exempt from Section 409A or, if not so exempt, the deferred payout complies with the applicable terms and conditions of Section 409A.

7.3 Termination of Service Before Vesting; Forfeiture. Unless otherwise specified in the Award Agreement or otherwise subsequently determined by the Committee, unearned and/or unvested Share-based Awards and Cash Incentive Awards granted under this Article shall be forfeited and canceled upon the termination of a Participant's employment or other service with the Company and its Subsidiaries.

7.4 Dividend Equivalents under Performance-Based Awards. Dividends or dividend equivalents, if any, paid or credited with respect to performance-based Awards will be subject to the same performance conditions as apply to the underlying Awards.

ARTICLE 8

PERFORMANCE-BASED EXEMPTION AWARDS

8.1 Performance-Based Exemption — General. If the Committee intends that an Award should qualify for the Performance-Based Exemption (other than Options and SARs which otherwise qualify as "performance-based compensation" for purposes of Section 162(m) of the Code), then, except as otherwise permitted by Section 162(m) of the Code, the grant, exercise, vesting, amount and/or settlement of such Award shall be contingent upon achievement of one or more pre-established, objective performance goals, which shall be prescribed in writing by the Committee not later than 90 days after the commencement of the applicable performance period and in any event before completion of 25% of such performance period in accordance with the requirements of Section 162(m). Such performance goals shall be based on any one or more of the Performance Factors listed in Section 8.2 and may be expressed in absolute terms, relative to performance in prior periods and/or relative to performance of other companies or an index of other companies or on such other basis as the Committee, acting in a manner consistent with Section 162(m) of the Code, may determine. All determinations as to the establishment of performance goals, the amount of cash and/or the number of Shares that may be earned, the target level (and, if applicable, minimum and maximum levels) of actual achievement required as a condition of earning the Award, and the earned value of any Award intended to qualify for the Performance-Based Exemption shall be made by the Committee and shall be recorded in writing.

8.2 Performance Factors. Any one or more of the following Performance Factors may be used by the Committee in establishing performance goals for Awards intended to qualify for the Performance-Based Exemption, in each case taking into account such adjustments and other objective factors as the Committee may specify at the time the goal is established: (a) revenues on a corporate or product by product basis, gross profit or gross profit growth; (b) earnings from operations, earnings before or after taxes, earnings before or after interest, depreciation, amortization, incentives, service fees and/or extraordinary or special items; (c) net income or net income per share (basic or diluted); (d) return measures, including return on assets, return on investment, return on capital, total capital or tangible capital, return on sales or return on equity; (e) cash flow, free cash flow, cash flow return on investment, or net cash provided by operations; (f) economic value created or added; (g) operating margin or profit margin; (h) expense or cost targets; (i) objective measures of customer satisfaction; (j) working capital targets; (k) inventory control; (l) debt targets; (m) implementation, completion or attainment of measurable objectives with respect to store openings or closings, acquisitions and divestitures, and recruiting and maintaining personnel; and/or (n) share price (including, without limitation, growth measures, market capitalization and/or total stockholder return).

8.3 Performance Goals. In establishing performance goals with respect to an Award intended to qualify for the Performance Exemption, the applicable Performance Factors may be determined by reference to the Company's performance and/or the performance of any one or more Subsidiaries, divisions, business segments or business units of the Company and its Subsidiaries, and may be based upon comparisons of any of the indicators of performance relative to other companies (or subsidiaries, divisions, business segments or business units of other companies) or relevant indices. Subject to compliance with the Treasury regulations under Section 162(m) of the Code, the Committee may prescribe that performance goals under any such Award will be adjusted as necessary or appropriate in order to account for changes in law or accounting rules, principles or standards or to reflect the impact of extraordinary or unusual items, events or circumstances which, if not taken into account, would result in windfalls or hardships that are not consistent with the intent and purposes of the Award, including without limitation (a) restructurings, discontinued operations, extraordinary items, and other unusual

8.4 or non-recurring charges, (b) an event either not directly related to the operations of the Company or not within the reasonable control of the Company's management, (c) acquisitions and divestitures, or (d) changes in generally accepted accounting principles.

8.5 Discretion. The Committee shall have the authority, in its discretion, to reduce the formula amount or number of Shares otherwise payable pursuant to an Award that is intended to qualify for the Performance-Based Exemption, but may not increase the amount or number of Shares that would otherwise be payable under any such Award; provided that, in the case of an Award intended to constitute a "share-based payment arrangement" under FASB ASC Topic 718, the Committee may exercise its discretion under this Section only if such discretion is expressly reserved as part of the original terms of the Award.

8.6 Certification. No amount shall be paid and no Shares shall be distributed or released pursuant to an Award intended to qualify for the Performance-Based Exemption unless and until the Committee certifies in writing the extent of achievement of the applicable performance goal(s) and the corresponding amount that is earned by the Participant under such Award.

ARTICLE 9

CHANGE IN CONTROL

9.1 Assumption or Substitution of Outstanding Awards. If a "Change in Control" (as defined below) occurs, the parties to the Change in Control may agree that outstanding Awards shall be assumed by, or converted into a substitute award for or with respect to shares of common stock of, the successor or acquiring company (or a parent company thereof) on an economically equivalent basis. If the Change in Control does not involve an agreement with a third party, and if the Shares covered by an outstanding Award are still traded on a national securities exchange, then the Committee may unilaterally require that the Award be continued, assumed, converted or substituted in accordance with this Section. The vesting and other terms of any such assumed or substitute award shall be substantially the same as the vesting and other terms and conditions of the original Award, provided that (a) if the assumed or substituted Award is an Option or SAR, the number of shares and Exercise Price shall be adjusted in accordance with the principles set forth in Sections 1.424-1(a)(5) and 1.409A-1(b)(5)(v)(D) of the Treasury regulations, and (b) if the assumed or substituted Award is not an Option or SAR, the number of shares covered by the assumed or substitute Award will be based upon the Change in Control transaction value of the Company's outstanding Shares. If the original Award is subject to the satisfaction of performance conditions, then such performance conditions shall be deemed to have been satisfied immediately prior to the Change in Control at the greater of (x) the target performance level, or (y) the performance level that would have been attained if the rate or level of performance from the beginning of the performance period through the date of the Change in Control had continued at the same rate through the end of the performance period. If reasonably feasible, the assumed or substituted Award will also provide the participant with an opportunity to earn any remaining portion of the Award (over and above the portion deemed to have been earned under

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the preceding sentence) based upon the achievement of a performance goal for the entire performance period that is similar in nature to the corresponding performance goal under the original terms of the Award. If, within two years following a Change in Control, a Participant's employment or other service terminates due to the Participant's death or is terminated by the Company or a successor or acquiring company (or any of its or their affiliates) without "Cause" or by the Participant for "Good Reason" (as such terms are defined below), any then outstanding assumed or substitute Awards held by such terminated Participant shall immediately be fully vested, and any outstanding assumed or substitute Options and SARs will remain outstanding for 180 days after such termination of employment (or, if earlier, until the expiration of their original stated terms).

9.2 Awards Not Assumed or Substituted. If a Change in Control occurs and an outstanding Award is not assumed, converted, substituted or continued pursuant to Section 9.1, then such Award will be deemed fully vested and any performance conditions applicable to such Award will be deemed to have been satisfied immediately prior to the Change in Control at the maximum performance level specified in the Award for purposes of determining the extent to which the Award is earned. Each such Award shall be cancelled immediately prior to the effective time of the Change in Control in exchange for an amount equal to the per Share consideration received by the holders of outstanding Shares in the Change in Control transaction, reduced in the case of an Option or SAR by the Exercise Price for such Shares. No consideration will be payable in respect of the cancellation of an Option or SAR with an Exercise Price per Share that is equal to or greater than the value of the Change in Control transaction consideration per Share. The amount payable with respect to the cancellation of an outstanding Award pursuant to this section will be paid in cash, unless the parties to the Change in Control agree that some or all of such amount will be payable in the form of freely tradable shares of common stock of the successor or acquiring company (or a parent company thereof). Subject to Section 11.2, the payments contemplated by this Section 9.2 shall be made upon at or as soon as practicable following the effective time of the Change in Control. Notwithstanding the foregoing, the Committee, acting in its discretion, may prescribe different treatment of an Award in the circumstances governed by this Section, provided that the terms of such different treatment, together with a specific reference to this Section, are set forth in the applicable Award Agreement.

9.3 Certain Defined Terms.

(a) "Cause" means, with respect to any Participant and unless otherwise specified in the Participant's Award Agreement, (i) if there is an employment or other services agreement in effect between the Participant and the Company or a Subsidiary that defines the term "cause" (or a term of like import), the Participant's engaging in conduct that constitutes "cause" (or a term of like import) within the meaning of that agreement, or (ii) if there is no such employment or other services agreement in effect, "Cause" shall mean (1) a Participant's repeated failure or refusal to perform the duties of the Participant's employment, consistent with past practice and his or her position and title where such conduct shall not have ceased or been remedied within ten days following written warning from the Company specifying such conduct; (2) the Participant's conviction of, or entering a plea of guilty or no contest to, a felony; (3) the Participant's performance of any act or the Participant's failure to act, for which, if the Participant were prosecuted and convicted, a crime or offense involving money or property of the Company would have occurred; (4) the Participant's performance of any act or the Participant's failure to act which constitutes fraud or a breach of a fiduciary trust, including, without limitation, misappropriation of funds or a material misrepresentation of the Company's operating results or financial condition; (5) any attempt by the Participant to secure any personal profit (other than pursuant to the terms of the Participant's employment or through the Participant's ownership of equity in the Company) in connection with the business of the Company (for example, without limitation, using Company assets to pursue other interests, diverting to the Participant or to a third party any business opportunity belonging to the Company, insider trading or taking bribes or kickbacks); (6) the Participant's engagement in conduct or activities materially damaging to the property, business or reputation of the Company other than as a result of good faith performance of his duties; (7) the Participant's illegal use of controlled substances; (8) any act or omission by the Participant involving malfeasance or gross negligence in the performance of the duties of the Participant's employment to the material detriment of the Company; or (9) the entry of any order of a court that remains in effect and is not discharged for a period of at least sixty days, which enjoins or otherwise limits or restricts the performance by the Participant of the duties of the Participant's employment, relating to any contract, agreement or commitment made by or applicable to the Participant in favor of any former employer or any other person.

(b) A "Change in Control" shall be deemed to have occurred upon the happening of any of the following events:

(i) any "person" as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, a subsidiary of the Company, any trustee or other fiduciary holding securities under any employee benefit plan of the Company or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company), is or becomes, including pursuant to a tender or exchange offer for shares of Common Stock pursuant to which purchases are made, the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities, provided, however, that the provisions of this paragraph (a) shall not be applicable to any acquisition directly from the Company; or

(ii) individuals who, as of the date hereof, constitute the Board (the "Incumbent Board"), shall cease for any reason to constitute at least a majority thereof; provided, however, that any individual becoming a director subsequent to the date hereof whose appointment or election by the Board or nomination for election by the Company's stockholders was approved or recommended by a vote of at least two-thirds (2/3) of the directors then still in office who were either directors on the date hereof, or whose appointment, election or nomination for election was previously so approved or recommended, shall be considered a member of the Incumbent Board, but excluding for this purpose any new director whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of directors of the Company; or

(iii) there is consummated a merger or consolidation of the Company or any direct or indirect subsidiary of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior to such merger or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or any parent thereof) more than 50% of the combined voting power of the securities of the Company or such surviving entity or any parent thereof outstanding immediately after such merger or consolidation; or

(iv) there is consummated a plan of complete liquidation or dissolution of the Company or there is consummated the sale or disposition by the Company of all or substantially all of the Company's assets, in one transaction or a series of related transactions, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity, more than 50% of the combined voting power of the voting securities of which is owned by stockholders of the Company in substantially the same proportion as their ownership of the Company immediately prior to such sale.

(c) "Good Reason" shall have the meaning ascribed to that term (or a term of like import) in a Participant's employment agreement or, if such term (or a term of like import) is not defined in the Participant's employment agreement or there is no such agreement, then "Good Reason" shall mean any of the following events: (i) a material diminution of the Participant's duties and responsibilities that result in a material adverse effect on the Participant's status and authority, (ii) a change in the principal location of the Participant's employment to a location more than fifty (50) miles outside of New York City or the Participant's then current other business location, except for travel reasonably required as part of such employment, (iii) failure to timely pay the Participant any salary or bonus when due, or (iv) any reduction in (1) the Participant's annual rate of salary from the highest annual rate of salary in effect during the one-year period prior to the date of the Change of Control, or (2) the amount of annual bonus paid to the Participant after the date of the Change in Control in light of the results of operations of the Company for that year compared to the bonus paid for the most recent fiscal year prior to the date of the Change of Control in light of the results of operations of the Company for that year. Notwithstanding the foregoing, in order to terminate for "Good Reason," a Participant must specify in writing to the Company (or the successor or acquiring company or a parent thereof) the nature of the act or omission that the Participant deems to constitute Good Reason and provide the Company (or the successor or acquiring company or a parent thereof) 30 days after receipt of such notice to review and, if required, correct the situation (and thus prevent the Participant's termination for Good Reason). Notice of termination for Good Reason must be provided, if at all, within 90 days after the occurrence of the event or condition giving rise to such termination.

9.4 No Fractional Shares. In the event of an adjustment in the number of shares covered by any Award pursuant to the provisions hereof, any fractional shares resulting from such adjustment shall be disregarded, and each converted Award shall cover only the number of full shares resulting from the adjustment.

ARTICLE 10

AMENDMENT AND TERMINATION

10.1 Amendment and Termination of the Plan. The Board, acting in its sole discretion, may amend the Plan at any time and from time to time and may terminate the Plan at any time. Plan amendments will be subject to approval by the Company's stockholders if and to the extent such approval is required in order to satisfy applicable law and/or stock exchange listing rules. Unless sooner terminated, the Plan will terminate on the tenth anniversary of the date it is approved by the Company's stockholders (and the Plan will not become effective unless and until such approval is obtained).

10.2 Outstanding Awards. Except as specifically required or permitted by the Plan or an Award Agreement, no amendment of an Award Agreement, and no termination, amendment or modification of the Plan shall cause any then outstanding Award to be forfeited or altered in a way that adversely affects a Participant's rights, unless the Participant consents thereto. The rights of any person with respect to an Award that is outstanding at the time of the termination of the Plan shall not be affected solely by reason of such termination and shall continue in accordance with the terms of the Award and of the Plan, as each is then in effect or is thereafter amended.

ARTICLE 11

TAX WITHHOLDING; SECTION 409A

11.1 Tax Withholding. Each Award and the exercise, vesting and settlement of each Award shall be subject to a Participant's payment or other satisfaction of any applicable withholding taxes. The Committee, in its sole discretion and pursuant to applicable law and such procedures as it may specify from time to time, may require or permit the Participant to satisfy the tax withholding obligation(s) relating to an Award (in whole or in part) by or through (a) the payment of cash by the Participant, (b) the Company's withholding cash or Shares that would otherwise be paid, issued or released pursuant to the Award, (c) the transfer to the Company of other Shares owned by the Participant, (d) a broker-assisted cashless exercise arrangement that complies with applicable law, and/or (e) by such other means as the Committee may determine. The amount of a Participant's withholding tax obligation that is satisfied in Shares (whether previously-owned or withheld from the Shares that would otherwise be issued or released) shall be based upon the Fair Market Value of the Shares on the date such Shares are delivered or withheld. In no event may Shares be used to satisfy more than the minimum amount of a Participant's tax withholding obligation.

11.2 Section 409A Compliance. It is intended that Awards made under the Plan, including any deferred payment or settlement terms and conditions, shall be exempt from or comply with Section 409A. Without limiting the generality of the preceding sentence and notwithstanding anything to the contrary contained herein, the following provisions

11.3 shall apply with respect to an Award if and to the extent that such Award provides for the payment of "nonqualified deferred compensation" (within the meaning of Section 409A).

(a) If a Participant becomes entitled to payments (cash or Shares) under the Award on account of the "termination of the Participant's employment or other service" or words of like import, then such termination of employment or service will not be deemed to have occurred unless and until the Participant incurs a "separation from service" within the meaning of Section 409A.

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(b) If the Participant is a “specified employee” within the meaning of Section 409A at the time of his or her separation from service, then any such payment covered by Section 409A shall be delayed until the first business day following the earlier of (i) the date which is six months after the date of such separation from service, or (ii) the date of the Participant’s death. On the delayed payment date, the Participant (or the Participant’s beneficiary) will be entitled to receive a lump sum payment or distribution of the payments that otherwise would have been made during the period that such payments are delayed.
(c) If a payment covered by Section 409A would be accelerated on account of the occurrence of a “Change in Control,” then such payment shall not be made unless such Change in Control also constitutes a “change in ownership,” “change in effective control” or “change in ownership of a substantial portion of the Company’s assets” within the meaning of Section 409A. Any payment that would have been made except for the application of the preceding sentence shall be made in accordance with the payment or settlement schedule that would have applied under the Award in the absence of a Change in Control or, if earlier, on the date of the termination of the Participant’s employment or service (without regard to any further service or performance conditions that otherwise would have applied).
(d) Notwithstanding the foregoing, each Participant shall be solely responsible, and the Company shall have no liability to the Participant or otherwise, for or with respect to any taxes, acceleration of taxes, interest or penalties arising under Section 409A.

ARTICLE 12
MISCELLANEOUS

12.1 Non-Transferability. Except as otherwise specifically permitted by the Plan or the applicable Award Agreement, no Award shall be assignable or
12.2 transferable except upon the Participant’s death to his or her “beneficiary” (as defined below), and, during a Participant’s lifetime, an Option or SAR may be exercised only by the Participant or the Participant’s guardian or legal
12.3 sent of the Committee (which it may grant, condition or deny in its sole discretion for any or no reason), a Participant may make an inter vivos transfer of an Option (other than an ISO), SAR or RSU to any “family member” (within the meaning of Item A(1)(a)(5) of the General Instructions to SEC Form S-8 or a successor), including, without limitation, to one or more trusts, partnerships, limited liability companies and other entities which qualify as family members, provided that such transfer is not a transfer for value or is a transfer for value that the Committee determines is for estate planning purposes, and provided further that such transfer is permitted by applicable law and does not give rise to tax under Section 409A. For the purposes hereof, a Participant’s “beneficiary” is any person or entity (including, without limitation, a trust or estate) designated in writing by a Participant to succeed to the Participant’s Award(s) upon the Participant’s death, subject to the provisions hereof and of the applicable Award Agreement(s). A Participant may designate a beneficiary by delivering a written beneficiary designation to the Committee (or its designee) in such form and in such manner as the Committee (or its designee) may prescribe. Each beneficiary designation duly filed with the Committee (or its designee) will have the effect of superseding and revoking any prior beneficiary designation. If a Participant does not designate a beneficiary, or if no designated beneficiary survives the Participant, then the Participant’s estate will be deemed to be his or her beneficiary. The term “Participant,” as used herein, shall be deemed to include the Participant’s beneficiary if and to the extent the context requires.
12.4 Successors. All obligations of the Company with respect to Awards granted under the Plan shall be binding on any successor to the Company of all or substantially all of the business and/or assets of the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation or otherwise, and the term “Company” as used herein shall be construed accordingly.
12.5 Legal Construction. If any provision of the Plan shall be held illegal or invalid for any reason, such illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

12.6 Compliance with Law. The granting of Awards and the issuance of Shares under the Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.
12.7 Transfer Orders; Placement of Legends. All certificates for shares of Common Stock delivered under the Plan shall be subject to such stock-transfer orders and other restrictions as the Company may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange or market upon which the Common Stock may then be listed, and any applicable federal or state securities law. The Company may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.
12.8 Nonexclusivity of the Plan. No provision of the Plan, and neither its adoption Plan by the Board or submission to the stockholders for approval, shall be construed as creating any limitations on the power of the Board or a committee thereof to adopt such other incentive arrangements, apart from the Plan, as it may deem desirable.
12.9 Sub-Plans. The Committee may from time to time establish sub-plans under the Plan for purposes of satisfying securities, tax or other laws of any foreign jurisdictions that may apply to Participants who receive Awards. Any such sub-plan shall contain such limitations and other terms and conditions as the Committee determines are necessary or desirable for such purposes and shall be in such form (including, without limitation, as an appendix to the Plan) as the Committee deems appropriate. Each sub-plan shall be deemed a part of the Plan, but shall apply only to the Participants who are subject to the laws of the jurisdiction to which the sub-plan relates.
12.10 Uniformity Not Required. The provisions of the Award Agreements need not be uniform among all Awards, among all Awards of the same type, among all Awards granted to the same Participant, or among all Awards granted at the same time.
12.11 Claw Back Conditions. Notwithstanding anything to the contrary contained herein or in an Award Agreement, Awards and benefits otherwise provided by Awards made under the Plan shall be subject to the Company’s incentive compensation claw back policies as in effect from time to time, and, as applicable, the claw back requirements of the Dodd-Frank Act Section 954.
12.12 Limitation of Rights. The Plan shall not interfere with or limit in any way the right of the Company or of any Subsidiary to terminate any person’s employment or other service at any time, and the Plan shall not confer upon any person the right to continue in the employ or other service of the Company or any Subsidiary. No employee, director or other person shall have any right to be selected to receive an Award or, having been so selected, to be selected to receive a future Award.
12.13 Decisions and Determinations Final. All decisions and determinations made by the Board pursuant to the provisions hereof and, except to the extent rights or powers under the Plan are reserved specifically to the discretion of the Board, all decisions and determinations made by the Committee in connection with the exercise of its authority and responsibilities under the Plan (including, without limitation, decisions and determinations relating to the construction, interpretation and administration of the Plan or any Award), shall be final, binding and conclusive on all persons.
12.14 Governing Law. The Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of Delaware (without regard to the legislative or judicial conflict of laws rules of any state).

G-III APPAREL GROUP, LTD.Shareowner ServicesP.O. Box 64945St. Paul, MN 55164-0945Address Change Mark box, sign, and indicate changes below: ?The Board of Directors Recommends a Vote FOR all listed nominees for directors in Proposal 1 and FOR Proposals 2,3,4 and 5.1.Election of 01 Morris Goldfarb05 Jeffrey Goldfarb09 Willem

Van BokhorstVote FORVote WITHHELDdirectors:02 Sammy Aaron06 Jeanette Nostra10 Cheryl L. Vitaleall nomineesfrom all nominees03 Thomas J. Brosig07 Laura Pomerantz11 Richard White(except as marked) 04 Alan Feller08 Allen Sirkin Please fold here Do not separate (Instructions: To withhold authority to vote for any indicated nominee,write the number(s) of the nominee(s) in the box provided to the right.)2.Proposal to approve our 2015 Long-Term Incentive Plan: For Against Abstain3.Proposal to approve an amendment to our certificate of incorporation that For Against Abstain will increase the number of authorized shares of our common stock from 80,000,000 shares to 120,000,000 shares: 4.Advisory Vote to approve the compensation of named executive officers: For Against Abstain 5. Proposal to ratify the appointment of Ernst & Young LLP: For Against Abstain6. In their discretion upon such other business as may properly come before the meeting and any and all adjournments and Postponements thereof. Shares represented

by this Proxy will be voted in accordance with the instructions indicated in items 1,2,3,4 and 5. If no instruction is indicated, this Proxy will be voted FOR all listed nominees for directors in Proposal No. 1, FOR Proposal No. 2, FOR Proposal No. 3, FOR Proposal No. 4 and FOR Proposal No. 5. Any and all proxies heretofore given by the undersigned are hereby revoked.Date Signature(s) in Box Please sign exactly as your name(s) appear hereon. If shares are held by two or more persons each should sign. Trustees, executors and other fiduciaries should indicate their capacity. Shares held by corporations, partnerships, associations, etc.should be signed by an authorized person, giving full title orauthority.

G-III APPAREL GROUP, LTD.ANNUAL MEETING OF STOCKHOLDERSTuesday, June 9, 2015G-III Apparel Group, Ltd.proxyThis Proxy Is Solicited By The Board of Directors For The Annual Meeting of Stockholders To Be Held On June 9, 2015The undersigned, a stockholder of G-III Apparel Group, Ltd. (the “Corporation”), hereby constitutes and appoints Morris Goldfarb, Wayne S. Miller and Neal S. Nackman and each of them, the true and lawful proxies and attorneys-in-fact of the undersigned, with full power of substitution in each of them, to vote all shares of Common Stock of the Corporation which the undersigned is entitled to vote at the Annual Meeting of Stockholders of the Corporation to be held on Tuesday, June 9, 2015, and at any and all adjournments or postponements thereof, asfollows:See reverse for voting instructions.