

Energy Transfer Partners, L.P.

Form 10-Q

April 09, 2007

[Table of Contents](#)

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

For the Quarterly Period Ended February 28, 2007

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-11727

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**ENERGY TRANSFER PARTNERS, L.P.**

(Exact name of registrant as specified in its charter)

Delaware  
(state or other jurisdiction or

incorporation or organization)

2838 Woodside Street Dallas, Texas 75204

(Address of principal executive offices and zip code)

73-1493906  
(I.R.S. Employer

Identification No.)

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(214) 981-0700

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 ☒ Accelerated filer ☐ Non accelerated filer ☐

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

At April 9, 2007, the registrant had units outstanding as follows:

Energy Transfer Partners, L.P. 110,890,596 Common Units  
26,086,957 Class G Units

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**Table of Contents**

**FORM 10-Q**

**INDEX TO FINANCIAL STATEMENTS**

**Energy Transfer Partners, L.P. and Subsidiaries**

	<b>Page</b>
<b><u>PART I</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
ITEM 1. <u>FINANCIAL STATEMENTS (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets February 28, 2007 and August 31, 2006</u>	1
<u>Condensed Consolidated Statements of Operations Three and Six Months Ended February 28, 2007 and 2006</u>	3
<u>Consolidated Statements of Comprehensive Income Three and Six Months Ended February 28, 2007 and 2006</u>	4
<u>Consolidated Statement of Partners Capital Six Months Ended February 28, 2007</u>	5
<u>Condensed Consolidated Statements of Cash Flows Six Months Ended February 28, 2007 and 2006</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	49
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	65
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	67
<b><u>PART II</u></b>	
<b><u>OTHER INFORMATION</u></b>	
ITEM 1. <u>LEGAL PROCEEDINGS</u>	68
ITEM 1A. <u>RISK FACTORS</u>	68
ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	70
ITEM 3. <u>DEFAULTS UPON SENIOR SECURITIES</u>	70
ITEM 4. <u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	70
ITEM 5. <u>OTHER INFORMATION</u>	70
ITEM 6. <u>EXHIBITS</u>	70
<u>SIGNATURES</u>	

## **Table of Contents**

### **Forward-Looking Statements**

Certain matters discussed in this report, excluding historical information, as well as some statements by Energy Transfer Partners, L.P. ( "Energy Transfer Partners" or the Partnership ) in periodic press releases and some oral statements of Energy Transfer Partners officials during presentations about the Partnership, include certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements using words such as anticipate, believe, intend, project, plan, continue, estimate, forecast, may, will, or similar expressions help identify forward-looking statements. Although the Partnership believes such forward-looking statements are based on reasonable assumptions and current expectations and projections about future events, no assurance can be given that every objective will be reached.

Actual results may differ materially from any results projected, forecasted, estimated or expressed in forward-looking statements since many of the factors that determine these results are subject to uncertainties and risks, difficult to predict, and beyond management's control. For additional discussion of risks, uncertainties and assumptions, see the Partnership's Annual Report on Form 10-K for the fiscal year ended August 31, 2006 filed with the Securities and Exchange Commission on November 13, 2006.

### **Definitions**

The following is a list of certain acronyms and terms generally used in the energy industry and throughout this document:

/d	per day
Bbls	barrels
Btu	British thermal unit, an energy measurement
Dekatherm	million British thermal units. A therm factor is used by gas companies to convert the volume of gas used to its heat equivalent, and thus calculate the actual energy used.
Mcf	thousand cubic feet
MMBtu	million British thermal unit
MMcf	million cubic feet
Bcf	billion cubic feet
NGL	natural gas liquid, such as propane, butane and natural gasoline
LIBOR	London Interbank Offered Rate
NYMEX	New York Mercantile Exchange
Reservoir	A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

(unaudited)

	February 28, 2007	August 31, 2006
<b><u>ASSETS</u></b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 76,074	\$ 26,041
Marketable securities	4,026	2,817
Accounts receivable, net of allowance for doubtful accounts	717,957	675,545
Inventories	194,690	387,140
Deposits paid to vendors	32,970	87,806
Exchanges receivable	38,185	23,221
Price risk management assets	14,810	56,139
Prepaid expenses and other	38,244	43,095
Total current assets	1,116,956	1,301,804
PROPERTY, PLANT AND EQUIPMENT, net	5,097,496	3,313,649
GOODWILL	722,403	604,409
INTANGIBLES AND OTHER LONG-TERM ASSETS, net	359,460	235,151
Total assets	\$ 7,296,315	\$ 5,455,013

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

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

(unaudited)

	February 28, 2007	August 31, 2006
<b><u>LIABILITIES AND PARTNERS' CAPITAL</u></b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 533,493	\$ 603,140
Exchanges payable	38,526	24,722
Customer advances and deposits	47,101	108,836
Accrued and other current liabilities	229,773	202,296
Price risk management liabilities	19,505	36,918
Current maturities of long-term debt	40,558	40,578
<b>Total current liabilities</b>	<b>908,956</b>	<b>1,016,490</b>
<b>LONG-TERM DEBT, less current maturities</b>	<b>3,187,894</b>	<b>2,589,124</b>
<b>DEFERRED INCOME TAXES</b>	<b>104,489</b>	<b>106,842</b>
<b>OTHER NON-CURRENT LIABILITIES</b>	<b>23,235</b>	<b>5,695</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
	<b>4,224,574</b>	<b>3,718,151</b>
<b>PARTNERS' CAPITAL:</b>		
General Partner	123,048	82,450
<b>Limited Partners:</b>		
Common Unitholders (110,890,596 and 110,726,999 units authorized, issued and outstanding at February 28, 2007 and August 31, 2006, respectively)	1,704,289	1,647,345
Class E Unitholders (8,853,832 units authorized, issued and outstanding held by subsidiary and reported as treasury units)		
Class G Unitholders (26,086,957 and 0 units authorized, issued and outstanding at February 28, 2007 and August 31, 2006, respectively)	1,228,938	
	<b>3,056,275</b>	<b>1,729,795</b>
Accumulated other comprehensive income, per accompanying statements	15,466	7,067
<b>Total partners' capital</b>	<b>3,071,741</b>	<b>1,736,862</b>
<b>Total liabilities and partners' capital</b>	<b>\$ 7,296,315</b>	<b>\$ 5,455,013</b>

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

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Dollars in thousands, except per unit data)

(unaudited)

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2007	2006	2007	2006
<b>REVENUES:</b>				
Midstream and transportation and storage	\$ 1,492,838	\$ 2,083,303	\$ 2,555,282	\$ 4,291,837
Propane and other	569,642	366,513	895,643	574,599
Total revenues	2,062,480	2,449,816	3,450,925	4,866,436
<b>COSTS AND EXPENSES:</b>				
Cost of products sold, midstream and transportation and storage	1,138,709	1,785,053	2,022,692	3,744,422
Cost of products sold, propane and other	347,107	223,778	550,467	355,036
Operating expenses	133,809	99,696	266,190	202,367
Depreciation and amortization	45,360	29,014	79,169	55,927
Selling, general and administrative	39,133	31,455	66,203	56,254
Total costs and expenses	1,704,118	2,168,996	2,984,721	4,414,006
OPERATING INCOME	358,362	280,820	466,204	452,430
<b>OTHER INCOME (EXPENSE):</b>				
Interest expense, net of interest capitalized	(40,772)	(28,542)	(82,234)	(56,935)
Equity in earnings (losses) of affiliates	(514)	106	4,373	(168)
Gain (loss) on disposal of assets	(3,229)	662	(1,285)	534
Interest and other income, net	1,423	2,302	3,094	3,261
INCOME BEFORE INCOME TAX EXPENSE AND MINORITY INTERESTS	315,270	255,348	390,152	399,122
Income tax expense	3,300	4,014	6,896	26,425
INCOME BEFORE MINORITY INTERESTS	311,970	251,334	383,256	372,697
Minority interests	(856)	(549)	(1,110)	(2,104)
NET INCOME	311,114	250,785	382,146	370,593
GENERAL PARTNER'S INTEREST IN NET INCOME	60,567	27,695	113,868	48,179
LIMITED PARTNERS' INTEREST IN NET INCOME	\$ 250,547	\$ 223,090	\$ 268,278	\$ 322,414
BASIC NET INCOME PER LIMITED PARTNER UNIT	\$ 1.33	\$ 1.37	\$ 1.91	\$ 2.13
BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	136,977,139	107,815,792	128,184,154	107,352,608
DILUTED NET INCOME PER LIMITED PARTNER UNIT	\$ 1.33	\$ 1.36	\$ 1.90	\$ 2.12

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DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	137,297,706	108,017,060	128,492,920	107,551,712
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The accompanying notes are an integral part of these condensed consolidated financial statements.



**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Dollars in thousands)

(unaudited)

	<b>Three Months Ended February 28,</b>		<b>Six Months Ended February 28,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 311,114	\$ 250,785	\$ 382,146	\$ 370,593
Other comprehensive income, net of tax:				
Reclassification adjustment for gains and losses on derivative instruments accounted for as cash flow hedges included in net income	(121,511)	(142,002)	(121,961)	(42,150)
Change in value of derivative instruments accounted for as cash flow hedges	75,953	138,097	129,158	164,643
Change in value of available-for-sale securities	1,421	254	1,202	123
Comprehensive income	\$ 266,977	\$ 247,134	\$ 390,545	\$ 493,209
<b>Reconciliation of Accumulated Other Comprehensive Income (Loss)</b>				
Balance, beginning of period	\$ 59,603	\$ 40,950	\$ 7,067	\$ (85,317)
Current period reclassification to earnings	(121,511)	(142,002)	(121,961)	(42,150)
Current period change in value	77,374	138,351	130,360	164,766
Balance, end of period	\$ 15,466	\$ 37,299	\$ 15,466	\$ 37,299
<b>Components of Accumulated Other Comprehensive Income</b>				
Commodity related derivative hedges			\$ 15,460	\$ 31,476
Interest rate derivative hedges			(1,497)	4,765
Available-for-sale securities			1,503	1,058
Balance, end of period			\$ 15,466	\$ 37,299

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

**Table of Contents**

**ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF PARTNERS' CAPITAL**

For the Six Months Ended February 28, 2007

(Dollars in thousands)

(unaudited)

	<b>General Partner</b>	<b>Limited Partners Common Unitholders</b>	<b>Class G Unitholders</b>
<b>Balance, August 31, 2006</b>	\$ 82,450	\$ 1,647,345	\$
Distributions to partners	(97,759)	(168,413)	(20,054)
Issuance of Class G Units to Energy Transfer Equity, LP			1,200,000
General Partner capital contribution	24,489		
Unit-based compensation expense		6,071	
Net income	113,868	219,286	48,992
<b>Balance, February 28, 2007</b>	\$ 123,048	\$ 1,704,289	\$ 1,228,938

The accompanying notes are an integral part of this condensed consolidated financial statement.

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

(unaudited)

	Six Months Ended	
	February 28,	
	2007	2006
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	\$ 617,895	\$ 438,058
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, net of cash acquired	(83,085)	(29,946)
Working capital settlement on prior year acquisitions		19,653
Capital expenditures	(542,930)	(255,101)
Advances to and investment in affiliates	(954,397)	
Proceeds from the sale of assets	19,200	3,875
Net cash used in investing activities	(1,561,212)	(261,519)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	2,493,030	1,013,188
Principal payments on debt	(2,428,492)	(1,168,322)
Net proceeds from issuance of limited partner units	1,200,000	132,387
Capital contribution from General Partner	24,489	2,702
Distributions to partners	(286,226)	(146,369)
Debt issuance costs	(9,451)	(1,196)
Net cash provided by (used in) financing activities	993,350	(167,610)
INCREASE IN CASH AND CASH EQUIVALENTS	50,033	8,929
CASH AND CASH EQUIVALENTS, beginning of period	26,041	24,914
CASH AND CASH EQUIVALENTS, end of period	\$ 76,074	\$ 33,843

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

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**Table of Contents**

**ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Dollar amounts in thousands, except per unit data)

(unaudited)

**1. OPERATIONS AND ORGANIZATION:**

The accompanying condensed consolidated balance sheet as of August 31, 2006, which has been derived from audited financial statements, and the unaudited interim financial statements and notes thereto of Energy Transfer Partners, L.P., and subsidiaries (collectively, the Partnership) as of February 28, 2007 and for the three-month and six-month periods ended February 28, 2007 and 2006, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim consolidated financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all the information and footnotes required by GAAP for complete consolidated financial statements. However, management believes that the disclosures made are adequate to make the information not misleading. The results of operations for interim periods are not necessarily indicative of the results to be expected for a full year due to the seasonal nature of the Partnership's operations, maintenance activities and the impact of forward natural gas prices and differentials on certain derivative financial instruments that are accounted for using mark-to-market accounting.

In the opinion of management, all adjustments (all of which are normal and recurring) have been made that are necessary to fairly state the consolidated financial position of Energy Transfer Partners and subsidiaries as of February 28, 2007, and the Partnership's results of operations for the three-month and six-month periods ended February 28, 2007 and 2006, respectively, and cash flows for the six-month periods ended February 28, 2007 and 2006. The unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto of Energy Transfer Partners presented in the Partnership's Annual Report on Form 10-K for the fiscal year ended August 31, 2006, as filed with the Securities and Exchange Commission on November 13, 2006.

Certain prior period amounts have been reclassified to conform to the 2007 presentation. These reclassifications have no impact on net income or total partners' capital.

**Business Operations**

In order to simplify the obligations of Energy Transfer Partners, L.P. under the laws of several jurisdictions in which we conduct business, our activities are conducted through four subsidiary operating partnerships, La Grange Acquisition, L.P. which conducts business under the assumed name of Energy Transfer Company (ETC OLP), a Texas limited partnership engaged in midstream and intrastate transportation and storage natural gas operations, Energy Transfer Interstate Holdings, LLC (ET Interstate), the parent company of Transwestern Pipeline Company, LLC (Transwestern), a Delaware limited liability company engaged in interstate transportation of natural gas, Heritage Operating L.P. (HOLP), a Delaware limited partnership engaged in retail and wholesale propane operations, and Titan Energy Partners, LP (Titan), a Delaware limited partnership engaged in retail propane operations, (collectively the Operating Partnerships). The Partnership, the Operating Partnerships, and their other subsidiaries are collectively referred to in this report as we, us, ETP, Energy Transfer or the Partnership.

**2. ESTIMATES AND SIGNIFICANT ACCOUNTING POLICIES:**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The natural gas industry conducts its business by processing actual transactions at the end of the month following the month of delivery. Consequently, the most current month's financial results for the midstream and transportation and storage segments are estimated using volume estimates and market prices. Any difference between estimated results and actual results are recognized in the following month's financial statements. Management believes that the operating results estimated for the three and six months ended February 28, 2007 and 2006 represent the actual results in all material respects.



## **Table of Contents**

Some of the other more significant estimates made by management include, but are not limited to, the timing of certain forecasted transactions that are hedged, allowances for doubtful accounts, the fair value of derivative instruments, useful lives for depreciation and amortization, purchase accounting allocations and subsequent realizability of intangible assets, deferred taxes, assets and liabilities resulting from the regulated ratemaking process (as discussed below), environmental reserves, and general business and medical self-insurance reserves. Actual results could differ from those estimates.

### **Significant Accounting Policies**

As a result of the acquisition of Transwestern on December 1, 2006, we have the following significant accounting policies in addition to the significant accounting policies described in our Form 10-K for the year ended August 31, 2006:

*Revenue Recognition* Transwestern is subject to Federal Energy Regulatory Commission (FERC) regulations. As a result, FERC may require the refund of revenues collected during the pendency of a rate proceeding in a final order. Transwestern establishes reserves for these potential refunds, as appropriate. No such reserves were required at February 28, 2007.

*Property, Plant and Equipment* An accrual of allowance for funds used during construction (AFUDC) is a utility accounting practice calculated under guidelines prescribed by the FERC and capitalized as part of the cost of utility plant. It represents the cost of servicing the capital invested in construction work-in-progress. AFUDC has been segregated into two component parts – borrowed funds and equity funds. The allowance for borrowed and equity funds used during construction totaled \$722 for the three and six months ended February 28, 2007.

*System Gas* Transwestern accounts for system balancing gas using the fixed asset accounting model established under FERC Order No. 581. Under this approach, system gas volumes are classified as fixed assets and valued at historical cost. Encroachments upon system gas are valued at current market prices. Transwestern may sell system gas in excess of its system operational requirements.

*Depreciation and Amortization* The provision for depreciation and amortization is computed using the straight-line method based on estimated economic or FERC mandated lives. Transwestern's composite depreciation rates are applied to the FERC functional groups of gross property having similar economic characteristics. Transmission Plant is depreciated at rates ranging from 1.2 percent to 2.86 percent per year. General Plant is depreciated at 10.0 percent per year. Intangible assets are amortized at rates ranging from 8.0 percent to 20.0 percent per year.

*Employee Benefits* Transwestern has entered into a VEBA trust (the "VEBA Trust") agreement with Bank One Trust Company as a trustee. The VEBA Trust has established or adopted plans to provide certain post-retirement life, sick, accident and other benefits. The VEBA Trust is a voluntary employees' beneficiary association under Section 501(c)(9) of the Tax Code, which provides benefits to employees of Transwestern. Transwestern's plan is in an overfunded position as of February 28, 2007. As the plans are supported through rates charged to customers, under FASB Statement No. 71, *Accounting for Effects of Certain Types of Regulation* (SFAS 71), to the extent Transwestern has collected amounts in excess of what is required to fund the plan, Transwestern has an obligation to refund the excess amounts to customers through rates. As such, Transwestern has recorded the overfunded position of \$830 within deferred assets and a corresponding regulatory liability of \$830.

Transwestern accounts for its OPEB liability and expense on an actuarial basis, recording its health and life benefit costs over the active service period of employees to the date of full eligibility for the benefits.

*Regulatory Assets and Liabilities* Transwestern is subject to regulation by certain state and federal authorities, is part of our interstate transportation segment and has accounting policies that conform to SFAS 71, which is in accordance with the accounting requirements and ratemaking practices of the regulatory authorities. The application of these accounting policies allows us to defer expenses and revenues on the balance sheet as regulatory assets and liabilities when it is probable that those expenses and revenues will be allowed in the ratemaking process in a period different from the period

## **Table of Contents**

in which they would have been reflected in the consolidated statement of operations by an unregulated company. These deferred assets and liabilities will be reported in results of operations in the period in which the same amounts are included in rates and recovered from or refunded to customers. Management's assessment of the probability of recovery or pass through of regulatory assets and liabilities will require judgment and interpretation of laws and regulatory commission orders. If, for any reason, we cease to meet the criteria for application of regulatory accounting treatment for all or part of our operations, the regulatory assets and liabilities related to those portions ceasing to meet such criteria would be eliminated from the condensed consolidated balance sheet for the period in which the discontinuance of regulatory accounting treatment occurs.

### ***New Accounting Standards***

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 also 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. The new FASB standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is a recognition process whereby the enterprise determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. Earlier application is permitted as long as the enterprise has not yet issued financial statements, including interim financial statements, in the period of adoption. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 should be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year. In February 2007 the SEC clarified that if a registrant changes how it classifies interest and penalties upon adoption of FIN 48, it should not reclassify amounts in prior periods. However, the registrant should disclose its prior classification policy. We are currently evaluating FIN 48 and have not yet determined the impact of such on our financial statements. We plan to adopt this statement on September 1, 2007.

FASB Staff Position No. EITF 00-19-2, *Accounting for Registration Payment Arrangements* (FSP 00-19-2). FSP 00-19-2, issued in December 2006, provides guidance related to the accounting for registration payment arrangements. FSP 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate arrangement or included as a provision of a financial instrument or arrangement, should be separately recognized and measured in accordance with FASB No. 5, *Accounting for Contingencies* (SFAS No. 5). FSP 00-19-2 requires that if the transfer of consideration under a registration payment arrangement is probable and can be reasonably estimated at inception, the contingent liability under such arrangement shall be included in the allocation of proceeds from the related financing transaction using the measurement guidance in SFAS No. 5. FSP 00-19-2 applies immediately to any registration payment arrangement entered into subsequent to the issuance of the Staff Position. For such arrangements issued prior to the issuance of FSP-00-19-2, the guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years. We are currently evaluating FSP 00-19-2 and have not yet determined the impact of such on our financial statements. We plan to adopt this Staff Position beginning September 1, 2007.

SFAS No. 154, *Accounting Changes and Error Correction – A Replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS 154). In May 2005, the FASB issued SFAS 154 which requires that the direct effect of voluntary changes in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to determine either the period-

## **Table of Contents**

specific effects or the cumulative effect of the change. Indirect effects of a change should be recognized in the period of the change. SFAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Management adopted the provisions of SFAS 154 September 1, 2006, as required. The impact of SFAS 154 will depend on the nature and extent of any voluntary accounting changes and correction of errors that occur in the future.

SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – An Amendment of FASB Statements No. 133 and 140* ( SFAS 155 ). SFAS 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement (new basis) event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. Early application is permitted only if: (a) it occurs at the beginning of an entity's fiscal year and (b) the entity has not yet issued any interim or annual financial statements for that fiscal year. We intend to adopt this statement when required at the start of fiscal year beginning September 1, 2007. The adoption of this statement is not expected to have a significant impact on us.

SFAS No. 157, *Fair Value Measurement*, ( SFAS 157 ). This new standard provides guidance for using fair value to measure assets and liabilities. The FASB believes the standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. The standard clarifies that for items that are not actively traded, such as certain kinds of derivatives, fair value should reflect the price in a transaction with a market participant, including an adjustment for risk, not just the company's mark-to-model value. SFAS 157 also requires expanded disclosure of the effect on earnings for items measured using unobservable data. Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. We are currently evaluating this statement and have not yet determined the impact of such on our financial statements. We plan to adopt this statement when required at the start of our fiscal year beginning September 1, 2008.

SFAS Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of SFAS Statements No. 87, 88, 106 and 132(R)*, ( SFAS 158 ). Issued in September 2006, this statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. We adopted the recognition and disclosure provisions of SFAS 158 on December 1, 2006 in connection with our acquisition of Transwestern, the effect of which was not material. The measurement provisions of the statement are effective for fiscal years ending after December 15, 2008. Management does not believe the adoption of the measurement provisions of this statement will have a material impact on our financial statements.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*, ( SFAS 159 ). This new standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in SFAS 159 are elective; however, the amendment applies to all entities with available-for-sale and trading securities. The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is



## Table of Contents

irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes the choice in the first 120 days of that fiscal year and also elects to apply the provisions of FASB Statement No. 157, *Fair Value Measurements* (discussed above). We are currently evaluating this statement and have not yet determined the impact of such on our financial statements. We plan to adopt this statement when required at the start of our fiscal year beginning September 1, 2008.

EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is, Gross Versus Net Presentation)* (EITF 06-3). This accounting guidance requires companies to disclose their policy regarding the presentation of tax receipts on the face of their income statements. The scope of this guidance includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes (gross receipts taxes are excluded). This guidance is effective for interim and annual reporting periods beginning after December 15, 2006 with earlier application permitted. As a matter of policy, we report such taxes on a net basis. We will adopt this EITF during our 2007 fiscal quarter ending May 31, 2007.

SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). In September 2006, the Securities and Exchange Commission (SEC) provided guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 establishes a dual approach that requires quantification of financial statement errors based on the effects of the error on each of the company's financial statements and the related financial statement disclosures. SAB 108 is effective for fiscal years ending after November 15, 2006. We are presently reviewing the impact of the adoption of SAB 108. However, we do not expect such adoption to have a material impact on our consolidated financial statements. We expect to adopt SAB 108 by August 31, 2007.

### 3. SIGNIFICANT ACQUISITIONS:

#### *Fiscal year 2007 acquisitions*

In September 2006 we acquired two small gathering systems in east and north Texas for an aggregate purchase price of \$30,589 in cash. The purchase and sale agreement for the gathering system in north Texas also has a contingent payment not to exceed \$25,000 to be determined eighteen months from the closing date. We will record the required adjustment to the purchase price allocation when the amount of actual contingent consideration is determinable beyond a reasonable doubt. These systems provide us with additional capacity in the Barnett Shale and in the Travis Peak area of east Texas and are included in our midstream operating segment. The cash paid for acquisitions was financed primarily from advances under the ETP Revolving Credit Facility.

On November 1, 2006, pursuant to agreements entered into with GE Energy Financial Services (GE) and Southern Union Company (Southern Union), we acquired the member interests in CCE Holdings, LLC (CCEH) from GE and certain other investors for \$1,000,000. We financed a portion of the CCEH purchase price with the proceeds from our issuance of 26,086,957 Class G Units to Energy Transfer Equity, L.P. simultaneous with the closing on November 1, 2006. The member interests acquired represented a 50% ownership in CCEH. On December 1, 2006, in a second and related transaction, CCEH redeemed ETP's 50% interest ownership in CCEH in exchange for 100% ownership of Transwestern which owns the Transwestern Pipeline, a 2,400 mile interstate natural gas pipeline. Following the final step, Transwestern became a new operating subsidiary and separate segment of ETP.

The total acquisition cost for Transwestern, net of cash acquired, was as follows:

Basis of investment in CCEH at November 30, 2006	\$ 956,348
Distributions received on December 1, 2006	(6,217)
Fair value of short and long-term debt assumed	532,377
Other assumed long-term indebtedness	10,097
Current liabilities assumed	40,194
Cash acquired	(7,777)
Acquisition costs incurred	11,753
Total	\$ 1,536,775



## Table of Contents

During the six months ended February 28, 2007, HOLP and Titan collectively acquired substantially all of the assets of three propane businesses. The aggregate purchase price for these acquisitions totaled \$10,608 which included \$10,266 of cash paid, net of cash acquired, and liabilities assumed of \$342. The cash paid for acquisitions was financed primarily with ETP's and HOLP's Senior Revolving Credit Facilities.

In December 2006 we purchased a gathering system in north Texas for \$32,000. The purchase and sale agreement for the gathering system in north Texas also has a contingent payment not to exceed \$21,000 to be determined two years after the closing date. We will record the required adjustment to the purchase price allocation when the amount of the actual contingent consideration is determinable beyond a reasonable doubt. The gathering system consists of approximately 36 miles of pipeline and has an estimated capacity of 70 MMcf/d. We expect the gathering system will allow us to continue expanding in the Barnett Shale area of north Texas.

In January 2007 we purchased a gathering system in New Mexico for \$8,000. The gathering system, which is included in our midstream segment, is approximately 27 miles long and is our first gathering system in New Mexico.

Except for the acquisition of the 50% member interests in CCEH, these acquisitions were accounted for under the purchase method of accounting in accordance with SFAS No. 141 and the purchase prices were allocated based on the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition. The acquisition of the 50% member interest in CCEH was accounted for under the equity method of accounting in accordance with APB Opinion No. 18, through November 30, 2006. The acquisition of 100% of Transwestern has been accounted for under the purchase method of accounting since the acquisition on December 1, 2006. Pro forma effects of the Transwestern acquisition are discussed below. In the aggregate, the other acquisitions described above are not material for pro forma disclosure purposes.

The following table presents the allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values for the acquisitions described above occurring during the period ended February 28, 2007, net of cash acquired:

Midstream and			
Intrastate			
	Transportation and		Propane
	Storage Acquisitions (Aggregated)	Transwestern Acquisition	Acquisitions (Aggregated)
Accounts receivable	\$	\$ 20,101	\$ 108
Inventory			43
Prepaid and other current assets		12,602	25
Property, plant, and equipment	47,656	1,254,968	9,222
Intangibles and other assets	23,015	133,880	475
Goodwill		115,224	735
Total assets acquired	70,671	1,536,775	10,608
Accounts payable		(7,432)	
Customer advances and deposits			(26)
Accrued and other current liabilities		(32,762)	
Short-term debt (paid in December 2006)		(13,000)	
Long-term debt		(519,377)	(316)
Other long-term obligations		(10,097)	
Total liabilities assumed		(582,668)	(342)
Net assets acquired	\$ 70,671	\$ 954,107	\$ 10,266

## Table of Contents

The purchase price for the acquisitions has been initially allocated based on the estimated fair value of the assets acquired and liabilities assumed. The Transwestern allocation was based on the preliminary results of independent appraisals. The purchase price allocations have not been completed and are subject to change. We expect to complete the allocations during the first quarter of fiscal year 2008.

Included in the additions for interstate property, plant and equipment is an aggregate plant acquisition adjustment of \$446,154, which represents costs allocated to Transwestern's transmission plant. This amount has not been included in the determination of tariff rates Transwestern charges to its regulated customers. The unamortized balance of this adjustment was \$442,967 at February 28, 2007 and is being amortized over 35 years, the composite weighted average estimated remaining life of Transwestern's assets as of the acquisition date.

Regulatory assets, included in intangible and other long-term assets on the condensed consolidated balance sheet, established in the Transwestern purchase price allocation consist of the following:

Accumulated reserve adjustment	\$ 41,985
AFUDC gross-up	9,570
Environmental reserves	6,623
South Georgia deferred tax receivable	2,581
Other	891
<b>Total Regulatory Assets acquired</b>	<b>\$ 61,650</b>

At February 28, 2007, all of Transwestern's regulatory assets are considered probable of recovery in rates.

We recorded the following intangible assets and goodwill in conjunction with the acquisitions described above:

	<b>Midstream and</b>		
	<b>Intrastate</b>		
	<b>Transportation and</b>		<b>Propane</b>
	<b>Storage Acquisitions</b>		<b>Acquisitions</b>
	<b>(Aggregated)</b>	<b>Transwestern</b>	<b>(Aggregated)</b>
		<b>Acquisition</b>	
Contract rights (6 to 15 years)	\$ 23,015	\$ 47,582	\$
Financing costs (7 to 9 years)		13,410	
Other			475
<b>Total amortizable intangible assets</b>	<b>23,015</b>	<b>60,992</b>	<b>475</b>
<b>Goodwill</b>		<b>115,224</b>	<b>735</b>
<b>Total intangible assets and goodwill acquired</b>	<b>\$ 23,015</b>	<b>\$ 176,216</b>	<b>\$ 1,210</b>

## **Table of Contents**

Goodwill was warranted because these acquisitions enhance our current operations, and certain acquisitions are expected to reduce costs through synergies with existing operations. We expect all of the goodwill acquired to be tax deductible. We do not believe that the acquired intangible assets have any significant residual value at the end of their useful life.

On December 13, 2006, we entered into an agreement with Kinder Morgan Energy Partners, L.P. for a 50/50 joint development of the Midcontinent Express Pipeline ( MEP ). The approximately 500-mile pipeline, which will originate near Bennington, Oklahoma, be routed through Perryville, Louisiana, and terminate at an interconnect with Transco in Butler, Alabama, will have an initial capacity of 1.4 Bcf per day. Pending necessary regulatory approvals, the approximately \$1,250,000 pipeline project is expected to be in service by February 2009. MEP has prearranged binding commitments from multiple shippers for 800,000 dekatherms per day which includes a binding commitment from Chesapeake Energy Marketing, Inc., an affiliate of Chesapeake Energy Corporation, for 500,000 dekatherms per day. MEP has executed a firm capacity lease agreement for up to 500,000 dekatherms per day of capacity on the Oklahoma intrastate pipeline system of Enogex, a subsidiary of OGE Energy, to provide transportation capacity from various locations in Oklahoma into and through MEP. The new pipeline will also interconnect with Natural Gas Pipeline Company of America, a wholly-owned subsidiary of Kinder Morgan, Inc., and with our previously announced 36-inch pipeline extending from the Barnett Shale and interconnecting with our Texoma pipeline near Paris, Texas. The MEP joint venture will be accounted for using the equity method of accounting prescribed by APB Opinion No. 18.

### ***Fiscal year 2006 acquisitions***

On June 1, 2006, we acquired all the propane operations of Titan for cash of approximately \$548,000, after working capital adjustments and net of cash acquired, and liabilities assumed of approximately \$46,000. We accounted for the Titan acquisition as a business combination using the purchase method of accounting in accordance with the provisions of SFAS 141. The purchase price has been initially allocated based on the estimated fair value of the individual assets acquired and the liabilities assumed at the date of the acquisition based on the results of an independent appraisal. As of February 28, 2007, we are waiting on certain information required to reasonably estimate the fair value of one of the assets acquired in the Titan acquisition. We expect to complete the purchase allocation during our third quarter of fiscal year 2007. The Titan operations have been included since the date of acquisition, thus the condensed consolidated results of operations for the three and six months ended February 28, 2007 include the Titan results of operations for the entire period. However, the three and six months ended February 28, 2006 do not include any of the Titan results of operations.

### ***Pro Forma Results of Operations***

The following unaudited pro forma consolidated results of operations for the six months ended February 28, 2007 and the three and six months ended February 28, 2006 are presented as if the Transwestern acquisition had been made on September 1, 2005. The operations of Transwestern have been included in our statements of operations since acquisition on December 1, 2006. Thus, pro forma information for the three months ended February 28, 2007 is not required.

**Table of Contents**

	Six Months Ended February 28, 2007	Three Months Ended February 28, 2006	Six Months Ended February 28, 2006
Revenues	\$ 3,509,817	\$ 2,504,242	\$ 4,981,784
Net income	\$ 399,052	\$ 260,835	\$ 394,193
Limited Partners interest in net income	\$ 284,846	\$ 227,627	\$ 335,857
Basic earnings per Limited Partner Unit	\$ 1.85	\$ 1.26	\$ 2.01
Diluted earnings per Limited Partner Unit	\$ 1.84	\$ 1.26	\$ 2.01

The pro forma consolidated results of operations include adjustments to give effect to depreciation of the amounts allocated to depreciable and amortizable assets, interest expense on acquisition debt, and certain other adjustments. The pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at the beginning of the periods presented or the future results of the combined operations.

**4. CASH, CASH EQUIVALENTS AND SUPPLEMENTAL CASH FLOW INFORMATION:**

Cash and cash equivalents include all cash on hand, demand deposits, and investments with original maturities of three months or less. We consider cash equivalents to include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

We place our cash deposits and temporary cash investments with high credit quality financial institutions. At times, such balances may be in excess of the Federal Deposit Insurance Corporation ( FDIC ) insurance limit.

Net cash flows provided by operating activities is comprised as follows:

	Six Months Ended February 28, 2007	2006
Net income	\$ 382,146	\$ 370,593
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	79,169	55,927
Amortization of finance costs charged to interest	2,156	1,369
Provision for loss on accounts receivable	851	473
Non-cash compensation on unit grants and other	6,071	5,827
Deferred income taxes	(2,417)	(861)
(Gain) loss on disposal of assets	1,285	(534)
Undistributed (earnings) losses of equity affiliates, net	(4,373)	168
Minority interests	1,110	2,104
Changes in operating assets and liabilities:		
Accounts receivable	(23,461)	23,170
Accounts receivable from related companies	(370)	3,811
Inventories	193,388	64,218
Deposits paid to vendors	54,837	4,250
Exchanges receivable	(8,700)	16,731
Prepaid expenses and other	16,412	(5,912)
Intangibles and other long-term assets	(951)	112
Regulatory assets	(5,055)	
Accounts payable	(45,624)	(144,105)
Accounts payable to related companies	1,497	(707)
Customer advances and deposits	(62,462)	(113,592)
Exchanges payable	7,274	(6,241)
Accrued and other current liabilities	(13,759)	8,563
Other long-term liabilities	8,393	(4,933)
Income taxes payable	(88)	21,527
Price risk management liabilities, net	30,566	136,100

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Net cash provided by operating activities	\$ 617,895	\$ 438,058
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**Table of Contents**

Supplemental cash flow information is as follows:

	Six Months Ended February 28,	
	2007	2006
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for interest, net of \$10,543 and \$ 2,321 capitalized for February 28, 2007 and 2006, respectively	\$ 83,911	\$ 10,654
Cash paid during the period for income taxes	\$ 5,945	\$ 3,007
Transfer of investment in affiliate in purchase of Transwestern (Note 3)	\$ 956,348	\$

**5. ACCOUNTS RECEIVABLE:**

Our intrastate midstream and transportation and storage operations deal with counterparties that are typically either investment grade or are otherwise secured with a letter of credit or other forms of security (corporate guaranty, prepayment, or master set off agreement). Management reviews midstream and transportation and storage accounts receivable balances bi-weekly. Credit limits are assigned and monitored for all counterparties of the midstream and transportation and storage operations. Management believes that the occurrence of bad debts in our intrastate midstream and transportation and storage segments was not significant for the three or six months ended February 28, 2007; therefore, an allowance for doubtful accounts for the midstream and transportation and storage segments was not deemed necessary. Bad debt expense related to these receivables is recognized at the time an account is deemed uncollectible. There was no bad debt expense recognized for the three or six months ended February 28, 2007 and 2006 in the midstream and intrastate transportation and storage segments.

Transwestern has a concentration of customers in the electric and gas utility industries. This concentration of customers may impact Transwestern's overall exposure to credit risk, either positively or negatively, in that the customers may be similarly affected by changes in economic or other conditions. From time to time, specifically identified customers having perceived credit risk are required to provide prepayments or other forms of collateral to Transwestern. Transwestern sought additional assurances from customers due to credit concerns, and held aggregate prepayments of \$598 at February 28, 2007, which are recorded in customer advances and deposits in the condensed consolidated balance sheets. Transwestern's management believes that the portfolio of receivables, which includes regulated electric utilities, regulated local distribution companies and municipalities, is subject to minimal credit risk. Transwestern establishes an allowance for doubtful accounts on trade receivables based on the expected ultimate recovery of these receivables. Transwestern considers many factors including historical customer collection experience, general and specific economic trends and known specific issues related to individual customers, sectors and transactions that might impact collectibility. There was no bad debt expense recognized for the three months ended February 28, 2007 related to Transwestern.

HOLP and Titan grant credit to their customers for the purchase of propane and propane-related products. Included in accounts receivable are trade accounts receivable arising from HOLP's retail and wholesale propane and Titan's retail propane operations and receivables arising from liquids marketing activities. Accounts receivable for retail and wholesale propane operations are recorded as amounts billed to customers less an allowance for doubtful accounts. The allowance for doubtful accounts for the retail and wholesale propane segments is based on management's assessment of the realizability of customer accounts, based on the overall creditworthiness of our customers, and any specific disputes.

We enter into netting arrangements with counterparties of derivative contracts to mitigate credit risk. Transactions are confirmed with the counterparty and the net amount is settled when due. Amounts outstanding under these netting arrangements are presented on a net basis in the condensed consolidated balance sheets.

Accounts receivable consisted of the following:

	February 28, 2007	August 31, 2006
Accounts receivable midstream and transportation and storage	\$ 532,059	\$ 570,569



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Accounts receivable propane	190,027	108,976
Less allowance for doubtful accounts	(4,129)	(4,000)
Total, net	\$ 717,957	\$ 675,545

**Table of Contents**

The activity in the allowance for doubtful accounts for the retail and wholesale propane segments consisted of the following for the six months ended February 28, 2007:

	<b>February 28, 2007</b>
Balance, beginning of period	\$ 4,000
Provision for loss on accounts receivable	851
Accounts receivable written off, net of recoveries	(722)
Balance, end of period	\$ 4,129

**6. INVENTORIES:**

Inventories consist principally of natural gas held in storage which is valued at the lower of cost or market utilizing the weighted-average cost method. Propane inventories are also valued at the lower of cost or market utilizing the weighted-average cost of propane delivered to the customer service locations, including storage fees and inbound freight costs. The cost of appliances, parts and fittings is determined by the first-in, first-out method.

Inventories consisted of the following:

	<b>February 28, 2007</b>	<b>August 31, 2006</b>
Natural gas, propane and other NGLs	\$ 178,024	\$ 371,430
Appliances, parts and fittings and other	16,666	15,710
Total inventories	\$ 194,690	\$ 387,140

**7. PROPERTY, PLANT AND EQUIPMENT:**

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated economic or FERC mandated lives of the assets. Expenditures for maintenance and repairs that do not add capacity or extend the useful life are expensed as incurred. Expenditures to refurbish assets that either extend the useful lives of the asset or prevent environmental contamination are capitalized and depreciated over the remaining useful life of the asset. Additionally, we capitalize certain costs directly related to the installation of company-owned propane tanks and construction of assets including internal labor costs, interest and engineering costs. Upon disposition or retirement of pipeline components or natural gas plant components, any gain or loss is recorded to accumulated depreciation. When entire pipeline systems, gas plants or other property and equipment are retired or sold, any gain or loss is included in our results of operations.

We review long-lived assets for impairment at least annually and whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such a review should indicate that the carrying amount of long-lived assets is not recoverable, we reduce the carrying amount of such assets to fair value. No impairment of long-lived assets was required during the periods presented.

Components and useful lives of property, plant and equipment were as follows:

	<b>February 28, 2007</b>	<b>August 31, 2006</b>
Land and improvements	\$ 67,450	\$ 63,220

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Buildings and improvements (10 to 30 years)	104,927	66,739
Pipelines and equipment (10 to 65 years)	2,781,758	1,757,103
Natural gas storage (40 years)	91,282	91,177
Bulk storage, equipment and facilities (3 to 30 years)	455,272	108,834
Tanks and other equipment (5 to 30 years)	504,726	472,944
Vehicles (5 to 10 years)	136,991	120,710
Right-of-way (20 to 65 years)	180,471	104,650
Furniture and fixtures (3 to 10 years)	19,414	16,283
Linepack	38,994	24,821
Pad Gas	55,482	57,327
Other (5 to 10 years)	85,282	27,395
	4,522,049	2,911,203
Less Accumulated depreciation	(316,009)	(242,137)
	4,206,040	2,669,066
Plus Construction work-in-process	891,456	644,583
Property, plant and equipment, net	\$ 5,097,496	\$ 3,313,649

## Table of Contents

Capitalized interest is included for pipeline construction projects. Interest is capitalized based on the current borrowing rate of our revolving credit facility. A total of \$10,543 of interest was capitalized for pipeline construction projects during the six months ended February 28, 2007 (excluding AFUDC, see Note 2).

Depreciation expense for the periods is as follows:

Three Months Ended		Six Months Ended	
February 28,		February 28,	
2007	2006	2007	2006
\$ 41,278	\$ 26,641	\$ 72,144	\$ 51,205

## 8. GOODWILL:

Goodwill is associated with acquisitions made for our midstream, intrastate transportation and storage, interstate transportation, and retail propane segments. Goodwill is tested for impairment annually at August 31, in accordance with Statement of Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, ( SFAS 142 ). The changes in the carrying amount of goodwill for the six month period ended February 28, 2007 were as follows:

	Intrastate		Interstate	Retail	Total
	Midstream	Transportation and Storage		Propane	
Balance, beginning of period	\$ 13,409	\$ 10,327	\$	\$ 580,673	\$ 604,409
Purchase accounting adjustments				3,777	3,777
Goodwill acquired			115,224	735	115,959
Sale of operations				(1,742)	(1,742)
Balance, end of period	\$ 13,409	\$ 10,327	\$ 115,224	\$ 583,443	\$ 722,403

The purchase price allocations for the Transwestern and other fiscal 2007 acquisitions (see Note 3) and our Titan acquisition in fiscal 2006 are preliminary. The final assessment of value and allocations for the fiscal 2007 acquisitions are expected to be completed by the first quarter of fiscal year 2008. We expect to complete the Titan purchase price allocation in our third quarter of fiscal 2007. There is no guarantee that the amounts allocated to goodwill will not change.

**Table of Contents****9. INTANGIBLES AND OTHER ASSETS:**

Intangibles and other long-term assets are stated at cost net of amortization computed on the straight-line method. We eliminate from our balance sheet the gross carrying amount and the related accumulated amortization for any fully amortized intangibles in the year they are fully amortized. Components and useful lives of intangibles and other long-term assets were as follows:

	February 28, 2007		August 31, 2006	
	Gross		Gross	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Noncompete agreements (5 to 15 years)	\$ 31,609	\$ (15,255)	\$ 31,593	\$ (13,012)
Customer lists (3 to 15 years)	129,161	(16,206)	87,480	(11,640)
Contract rights (6 to 15 years)	23,015	(226)		
Financing costs (3 to 15 years)	40,302	(6,372)	20,128	(4,441)
Consulting agreements (2 to 7 years)			132	(122)
Other (10 years)	2,677	(745)	2,677	(422)
Total amortizable intangible assets	226,764	(38,804)	142,010	(29,637)
Non-amortizable Trademarks	64,642		64,842	
Total intangible assets	291,406	(38,804)	206,852	(29,637)
Other long-term assets:				
Regulatory assets	61,650			
Investment in affiliates	12,651		41,344	
Long-term price risk management assets	1,726		2,192	
Other	30,831		14,400	
Total intangibles and other assets	\$ 398,264	\$ (38,804)	\$ 264,788	\$ (29,637)

Prior to February 28, 2007, the Partnership owned a 50% ownership interest in Mid-Texas Pipeline Company ( Mid-Texas ), a Texas general partnership, which owns approximately 139 miles of transportation pipeline that connects various receipt points in south Texas to delivery points at the Katy hub. Effective February 28, 2007 Mid-Texas was dissolved and each partner was assigned its 50% undivided interest in the pipeline. As a result of the dissolution and now owning an undivided interest, we control the marketing and bear the risk of ownership. As a result, we ceased the use of equity accounting at February 28, 2007 and will apply proportionate consolidation prospectively for our interest in the Mid-Texas pipeline. This represents a non-cash transaction.

Aggregate amortization expense of intangible assets is as follows:

	Three Months Ended		Six Months Ended	
	February 28, 2007		February 28, 2006	
Reported in depreciation and amortization	\$ 4,082	\$ 2,373	\$ 7,025	\$ 4,722
Reported in interest expense	\$ 1,317	\$ 692	\$ 2,156	\$ 1,369

The estimated aggregate amortization expense for the next five fiscal years is \$16,011 for the remainder of fiscal 2007; \$24,237 for 2008; \$23,171 for 2009; \$21,176 for 2010, and \$18,447 for 2011.

We review amortizable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable in accordance with Statement of Accounting Standards No. 144, *Accounting for the Impairment or Disposal of*

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*Long-Lived Assets* ( SFAS 144 ). If such a review should indicate that the carrying amount of amortizable intangible assets is not recoverable, we reduce the carrying amount of such assets to fair value. We review non-amortizable intangible assets for impairment annually at August 31, or more frequently if circumstances dictate, in accordance with SFAS 144. No impairment of intangible assets was required for the three and six month periods ended February 28, 2007 and 2006.

**Table of Contents****10. ACCRUED AND OTHER CURRENT LIABILITIES:**

Accrued and other current liabilities consist of the following:

	February 28, 2007	August 31, 2006
Capital expenditures	\$ 53,068	\$ 38,002
Employee wages and benefits	43,549	40,236
Operating expenses	12,013	16,839
Interest payable	23,229	13,956
Other accrued expenses	97,914	93,263
Total accrued and other current liabilities	\$ 229,773	\$ 202,296

**11. INCOME TAXES:**

As a limited partnership, we are generally not subject to income tax. We are, however, subject to a statutory requirement that our non-qualifying income (including income such as derivative gains from trading activities, service income, tank rentals and others) cannot exceed 10% of our total gross income, determined on a calendar year basis under the applicable income tax provisions. If the amount of our non-qualifying income exceeds this statutory limit, we would be taxed as a corporation. Accordingly, certain activities that generate non-qualified income are conducted through taxable corporate subsidiaries ( C corporations ). These C corporations are subject to federal and state income tax and pay the income taxes related to the results of their operations. For the three and six month periods ended February 28, 2007 and 2006, our non-qualifying income did not, or was not expected to, exceed the statutory limit.

Those subsidiaries which are taxable corporations follow the asset and liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ). Under SFAS 109, deferred income taxes are recorded based upon differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the underlying assets are received and liabilities settled.

On May 18, 2006, the State of Texas enacted House Bill 3 which replaced the existing state franchise tax with a margin tax . In general, legal entities that conduct business in Texas are subject to the Texas margin tax, including previously non-taxable entities such as limited partnerships and limited liability partnerships. The tax is assessed on Texas sourced taxable margin which is defined as the lesser of (i) 70% of total revenue or (ii) total revenue less (a) cost of goods sold or (b) compensation and benefits. Although the bill states that the margin tax is not an income tax, it has the characteristics of an income tax since it is determined by applying a tax rate to a base that considers both revenues and expenses. Therefore, we have accounted for Texas margin tax as income tax expense in the period subsequent to the law's effective date of January 1, 2007. For the three and six months ended February 28, 2007, we recognized current state income tax expense related to the Texas margin tax of \$1,854. There was no comparable state tax expense for the periods ended February 28, 2006.

The components of our federal and state income tax provision (benefit) are summarized as follows:

	Three Months Ended		Six Months Ended	
	February 28, 2007	February 28, 2006	February 28, 2007	February 28, 2006
Current provision:				
Federal	\$ 3,336	\$ 12,853	\$ 6,487	\$ 28,117
State	2,487	950	2,826	1,288
	5,823	13,803	9,313	29,405
Deferred benefit:				
Federal	(2,247)	(9,288)	(2,178)	(2,625)

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State	(276)	(501)	(239)	(355)
	(2,523)	(9,789)	(2,417)	(2,980)
Total	\$ 3,300	\$ 4,014	\$ 6,896	\$ 26,425



**Table of Contents**

The difference between the statutory rate and the effective rate is summarized as follows:

	Three Months Ended February 28,		Six Months Ended February 28,	
	2007	2006	2007	2006
Federal statutory tax rate	35.0%	35.0%	35.0%	35.0%
State income tax rate net of federal benefit	0.7%	3.4%	0.7%	3.4%
Earnings not subject to tax at the Partnership level	(34.7)%	(36.8)%	(33.9)%	(31.8)%
Effective tax rate	1.0%	1.6%	1.8%	6.6%

**12. INCOME PER LIMITED PARTNER UNIT:**

Our net income for partners' capital and income statement presentation purposes is allocated to the General Partner and Limited Partners in accordance with their respective partnership percentages, after giving effect to priority income allocations for incentive distributions, if any, to our General Partner, the holder of the Incentive Distribution Rights pursuant to the Partnership Agreement, which are declared and paid following the close of each quarter. Basic net income per limited partner unit, however, is computed in accordance with EITF Issue No. 03-6, *Participating Securities and the Two-Class Method Under FASB Statement No. 128* ( EITF 03-6 ), by dividing limited partners' interest in net income by the weighted average number of Common and Class G Units outstanding. In periods when our aggregate net income exceeds the aggregate distributions, EITF 03-6 requires us to present earnings per unit as if all of the earnings for the periods were distributed (see table below) and requires a separate computation for each quarter and year-to-date. For such periods, an increased amount of net income is allocated to the General Partner for the additional pro forma priority income attributable to the application of EITF 03-6. The General Partner is entitled to receive incentive distributions if the amount we distribute to our limited partners with respect to any quarter exceeds levels specified in the Partnership Agreement. Diluted net income per limited partner unit is computed by dividing net income available to limited partners, after considering the General Partner's interest, by the weighted average number of Common and Class G Units outstanding and of the effect of non-vested restricted units ( Unit Grants ) granted under the 2004 Unit Plan and predecessor plan computed using the treasury stock method.

A reconciliation of net income and weighted average units used in computing basic and diluted earnings per unit is as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2007	2006	2007	2006
Net income	\$ 311,114	\$ 250,785	\$ 382,146	\$ 370,593
Adjustments:				
General Partner's equity ownership	(6,222)	(5,016)	(7,643)	(7,412)
General Partner's incentive distributions	(54,345)	(22,679)	(106,225)	(40,767)
Limited Partner's interest in net income for statement of operations reporting	250,547	223,090	268,278	322,414
Additional earnings allocation to General Partner	(68,354)	(75,907)	(23,934)	(94,206)
Net income available to limited partners for income per unit computations	\$ 182,193	\$ 147,183	\$ 244,344	\$ 228,208
Weighted average limited partner units - basic	136,977,139	107,815,792	128,184,154	107,352,608
Basic net income per limited partner unit	\$ 1.33	\$ 1.37	\$ 1.91	\$ 2.13

## Edgar Filing: Energy Transfer Partners, L.P. - Form 10-Q

Weighted average limited partner units	136,977,139	107,815,792	128,184,154	107,352,608
Dilutive effect of Unit Grants	320,567	201,268	308,766	199,104
Weighted average limited partner units, assuming dilutive effect of Unit Grants	137,297,706	108,017,060	128,492,920	107,551,712
Diluted net income per limited partner unit	\$ 1.33	\$ 1.36	\$ 1.90	\$ 2.12

**Table of Contents****13. DEBT OBLIGATIONS:**

Long-term debt we assumed in connection with the Transwestern acquisition on December 1, 2006 was as follows:

5.39% Notes due November 17, 2014	\$ 270,000
5.54% Notes due November 17, 2016	250,000
<b>Total long-term debt outstanding</b>	<b>520,000</b>
Unamortized debt discount	(628)
<b>Total long-term debt assumed</b>	<b>\$ 519,372</b>

No principal payments are required under any of the debt agreements prior to their respective maturity dates. However, in connection with our acquisition of Transwestern, due to a change in control provision in Transwestern's debt agreements, Transwestern was required to pre-pay approximately \$307,000 of long-term debt, of which \$292,000 was paid in February 2007 and \$15,000 was paid in March 2007. These payments were financed with borrowings under ETP's Revolving Credit Facility.

Transwestern's credit agreements contain certain restrictions that, among other things, limit the incurrence of additional debt, the sale of assets and the payment of dividends and require certain debt to capitalization ratios.

On October 23, 2006, ETP issued a total of \$800,000 aggregate principal amount of Senior Notes comprised of \$400,000 of 6.125% Senior Notes due 2017 (the 2017 Notes) and \$400,000 of 6.625% Senior Notes due 2036 (the 2036 Notes and together with the 2017 Notes, the Notes). The Partnership used the proceeds of approximately \$791,000 (net of bond discounts of \$2,612 and financing costs of \$6,050) from the issuance of the Notes to repay borrowings and accrued interest outstanding under the ETP Revolving Credit Facility, to pay expenses associated with the offering and for general partnership purposes. Interest on the notes is due semiannually. The Partnership may redeem some or all of the Notes at any time, or from time to time, pursuant to the terms of the Indenture. All of the Partnership's obligations under the Notes are fully and unconditionally guaranteed by ETC OLP and Titan and substantially all of their present and future wholly-owned subsidiaries. These notes have been registered under the Securities Act pursuant to our S-3 Registration Statement which provides for the sale of a combination of units and debt totaling \$1,500,000.

We have a \$1,500,000 Amended and Restated Revolving Credit Facility (the ETP Revolving Credit Facility) available through June 29, 2011. Amounts borrowed under the ETP Revolving Credit Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. There is also a Swingline loan option with a maximum borrowing of \$75,000 at a daily rate based on LIBOR. The commitment fee payable on the unused portion of the facility varies based on our credit rating with a maximum fee of 0.175%. As of February 28, 2007, there was a balance of \$783,755 in revolving credit loans (including \$63,455 in Swingline loans) and \$57,306 in letters of credit. The weighted average interest rate on the total amount outstanding at February 28, 2007, was 5.979%. The total amount available under the ETP Revolving Credit Facility as of February 28, 2007, which is reduced by any amounts outstanding under the Swingline loan and letters of credit, was \$658,939. The ETP Revolving Credit Facility is fully and unconditionally guaranteed by ETC OLP and Titan and all of their direct and indirect wholly-owned subsidiaries. The ETP Revolving Credit Facility is unsecured and has equal rights to holders of our other current and future unsecured debt.

A \$75,000 Senior Revolving Facility (the HOLP Facility) is available to HOLP through June 30, 2011. The HOLP Facility has a swingline loan option with a maximum borrowing of \$10,000 at a prime rate. Amounts borrowed under the HOLP Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. The commitment fee payable on the unused portion of the facility varies based on the Leverage Ratio, as defined in the HOLP Facility credit agreement, with a maximum fee of 0.50%. The agreement includes provisions that may require contingent prepayments in the event of dispositions, loss of assets, merger or change of control. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts of HOLP, and the capital stock of HOLP's subsidiaries secure the HOLP Facility. As of February 28, 2007, there was no balance outstanding on the revolving credit loans. A Letter of Credit issuance is available to HOLP for up to 30 days prior to the maturity date of the HOLP Facility. There were outstanding Letters of Credit of \$1,002 at February 28, 2007. The sum of the loans made under the HOLP Facility plus the Letter of Credit Exposure and the aggregate amount of all swingline loans cannot exceed the \$75,000 maximum amount of the HOLP Facility. The amount available at February 28, 2007 was \$73,998.

## Table of Contents

We were in compliance with all of the covenants of our consolidated debt agreements at February 28, 2007 and August 31, 2006.

### 14. PARTNERS CAPITAL AND UNIT-BASED COMPENSATION PLANS:

#### Limited Partner Units

Limited Partner interests are represented by Common, Class E and Class G Units that entitle the holders thereof to the rights and privileges specified in the Partnership Agreement, as amended. As of February 28, 2007, we had limited partner interests represented by 110,890,596 Common Units and 26,086,957 Class G Units issued and outstanding, an aggregate 98% Limited Partner interest. There are also 8,853,832 Class E Units outstanding that are reported as treasury units, which units are entitled to receive distributions in accordance with their terms.

#### Common Units

The change in Common Units during the six month period ended February 28, 2007 is as follows:

<b>Balance, beginning of period</b>	110,726,999
Issuance of restricted Common Units under our unit-based compensation plans	163,597
<b>Balance, end of period</b>	110,890,596

Of the total restricted Common Units issued during the period, 154,239 were employee awards under our 2004 Unit Plan (discussed below), 7,025 were Director Awards under our 2004 Unit Plan, and 2,333 were Director Awards under our Restricted Unit Plan which vested on September 1, 2006. As of February 28, 2007, there are 1,333 unvested awards remaining under the Restricted Unit Plan (which was terminated in June 2004). No additional grants have been, or will be, made under the Restricted Unit Plan.

#### Class G Units

The change in Class G Units during the six month period ended February 28, 2007 is as follows:

<b>Balance, beginning of period</b>	
Issuance of Class G Units to Energy Transfer Equity, LP	26,086,957
<b>Balance, end of period</b>	26,086,957

On November 1, 2006, we issued 26,086,957 Class G Units to Energy Transfer Equity, LP ( ETE ) for aggregate proceeds of \$1,200,000 in order to fund a portion of the Transwestern Acquisition and to repay indebtedness we incurred in connection with the Titan acquisition. The Class G Units, a newly created class of our limited partner interests, were issued to ETE at a price of \$46.00 per unit, based upon a market discount from the closing price of our Common Units on October 31, 2006 of \$48.94. The terms of the Class G Units provide that they may be converted to Common Units upon approval of a majority of the votes cast by the holders of our Common Units provided that the total votes cast by such holders represent a majority of the Common Units entitled to vote. Prior to conversion of the Class G Units, the Class G Units will share in Partnership distributions and are entitled to all items of Partnership income, gain, loss, deduction and credit as if the Class G Units were Subordinated Units. Upon receiving the requisite approval by our Common Unitholders under a proposal to convert the Class G Units to Common Units, all Class G Units will convert to Common Units on a one-for-one basis. The Class G Units were issued to ETE pursuant to a customary agreement, and registration rights have been granted to ETE.

The Partnership will hold a meeting of its unitholders on May 1, 2007 to seek unitholder approval of the conversion of Class G Units to Common Units (see Note 20).



## Table of Contents

### Quarterly Distributions of Available Cash

On October 16, 2006, we paid a quarterly distribution related to the fourth quarter of our fiscal year 2006 of \$0.75 per Common Unit, or \$3.00 per unit annually, to Unitholders of record at the close of business on October 5, 2006.

On January 15, 2007, we paid a quarterly distribution related to the first quarter of our fiscal year 2007 of \$0.7688 per Limited Partner Unit, or \$3.075 per Limited Partner Unit annually, to Unitholders of record at the close of business on January 4, 2007.

On March 26, 2007, we declared a per unit cash distribution of \$0.7875, or \$3.15 per Limited Partner Unit annually (a \$0.0188 increase per Limited Partner Unit) for the quarter ended February 28, 2007, which will be paid on April 13, 2007 to Unitholders of record at the close of business on April 6, 2007.

On October 16, 2006, we paid a quarterly distribution of \$42,609 in the aggregate in respect of our General Partner's 2% general partner interest and its incentive distribution rights. On January 15, 2007, we paid a quarterly distribution of \$55,151 in the aggregate in respect of our General Partner's 2% general partner interest and its incentive distribution rights. Our General Partner's incentive distributions rights entitle it to receive incentive distributions to the extent that quarterly distributions to our Unitholders exceed \$0.275 per unit (which amount represents \$1.10 per unit on an annualized basis). These incentive distributions entitle our General Partner to increasing percentages of our cash distributions based upon exceeding incentive distribution thresholds specified in our Partnership Agreement, which incentive distribution rights entitle our General Partner to receive 50% of our cash distributions in excess of \$0.4125 per unit. At current distribution levels, our General Partner is entitled to receive cash distributions at the highest incentive distribution level of 50% with respect to our distributions in excess of \$0.4125 per unit.

The total amount of distributions declared (all from Available Cash from Operating Surplus) related to the six months ended February 28, 2007 was as follows:

Limited Partners -	
Common Units	\$ 172,573
Class E Units	6,242
Class G Units	40,598
General Partners -	
2% Ownership	6,646
Incentive Distribution Rights	106,225
	\$ 332,284

### Unit Based Compensation Plans

We follow the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) *Accounting for Stock-based Compensation* (SFAS 123R) for our unit-based compensation plans. Adoption of SFAS 123R during fiscal 2006 did not have a material effect on our net income. As provided in SFAS 123R, the Partnership values the unit awards based on the per unit grant-date market value reduced by the present value of the distributions expected to be paid on the units during the requisite service period to which the award recipients are not entitled. The present value of expected service period distributions is computed based on the risk-free interest rate, the expected life of the unit grants and the expected unit distributions.

We recognized compensation expense of \$2,908 and \$5,380 for the three months ended February 28, 2007 and 2006, respectively, and \$6,071 and \$5,827 for the six months ended February 28, 2007 and 2006, respectively, related to unit-based compensation plans, as discussed below.

#### 2004 Unit Plan

##### Employee Grants.

The Compensation Committee, in its discretion, may from time to time grant awards to any employee, upon such terms and conditions as it may determine appropriate and in accordance with specific general guidelines as defined by the Plan. All outstanding awards shall fully vest into units upon any Change in Control as defined by the Plan, or upon such terms as the Compensation Committee may require at the time the award

is granted.

## Table of Contents

Employee grants awarded under the 2004 Unit Plan will vest over a three-year period based upon the achievement of certain performance criteria. The expected life of each grant is assumed to be the minimum vesting period under certain performance criteria of each grant. Vesting occurs based upon the total return to our Unitholders as compared to a group of publicly traded partnership peer companies. One third of the awards will vest and convert to Common Units annually based on achievement of the performance criteria. Management deems it probable that all units will vest; thus, compensation expense was recorded. The issuance of Common Units pursuant to the 2004 Unit Plan is intended to serve as a means of incentive compensation, therefore, no consideration will be payable by the plan participants upon vesting and issuance of the Common Units.

We assumed a weighted average risk-free interest rate of 4.42% for the three and six months ended February 28, 2007 in estimating the present value of the future cash flows of the distributions during the vesting period on the measurement date of each employee grant. For the employee awards outstanding as of the period ended February 28, 2007, the grant-date average per unit cash distributions were estimated to be \$5.15. Upon vesting, ETP Common Units are issued.

The following table shows the activity of the employee grants during the six months ended February 28, 2007:

	Number	Weighted Average Fair Value
	of Units	Per Unit
Unvested awards as of August 31, 2006	357,750	\$ 24.96
Awards granted	399,500	43.36
Awards vested	(154,239)	23.78
Awards forfeited	(61,472)	33.38
Unvested awards as of February 28, 2007	541,539	\$ 38.02

The total expected compensation expense to be recognized related to the unvested employee awards as of February 28, 2007 is \$5,960 for the remainder of fiscal year 2007, \$4,885 for fiscal year 2008, and \$1,671 for fiscal year 2009.

### Director Grants

Each director who is not also (i) a shareholder or a direct or indirect employee of any parent, or (ii) a direct or indirect employee of ETP LLC, the Partnership, or a subsidiary ( Director Participant ), who is elected or appointed to the Board for the first time shall automatically receive, on the date of his or her election or appointment, an award of up to 2,000 ETP Common Units (the Initial Director's Grant ). Each September 1 that this Plan is in effect, each Director Participant who is in office on such September 1, shall automatically receive an award of Units equal to \$25 (as of October 2006, see below) divided by the fair market value of a Common Unit on such date ( Annual Director's Grant ). Each grant of an award to a Director Participant will vest at the rate of one third per year, beginning on the first anniversary date of the Award; provided however, notwithstanding the foregoing, (i) all awards to a Director Participant shall become fully vested upon a Change in Control, as defined by the Plan, unless voluntarily waived by such Director Participant, and (ii) all awards which have not yet vested on the date a Director Participant ceases to be a director shall vest on such terms as may be determined by the Compensation Committee.

We assumed a weighted average risk-free interest rate of 3.80% for the three and six months ended February 28, 2007 in estimating the present value of the future cash flows of the distributions during the vesting period on the measurement date of each Director Grant. For the Director Awards granted during the three and six months ended February 28, 2007, the grant-date average per unit cash distributions were estimated to be \$4.95.

The following table shows the activity of the Director Grants during the six months ended February 28, 2007:



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		Weighted Average
	Number	Fair Value
	of Units	Per Unit
Unvested awards as of August 31, 2006	15,951	\$ 22.54
Awards vested	(7,025)	22.45
Awards granted	3,240	41.47
Unvested awards as of February 28, 2007	12,166	\$ 27.63

## **Table of Contents**

The total expected compensation expense to be recognized related to the unvested Director Awards as of February 28, 2007 is expected to be \$89 for the remainder of fiscal year 2007, \$60 for fiscal year 2008, and \$14 for fiscal year 2009.

On October 17, 2006, the Compensation Committee recommended, following its receipt and review of an independent third-party compensation study, and the Board of Directors approved, an amendment to the 2004 Unit Plan to provide that Annual Director's Grants shall be equal to \$25 divided by the fair market value of Common Units on that date. All other Annual Director's Grants shall be measured at September 1 of each year.

### *Long-Term Incentive Grants*

The Compensation Committee may, from time to time, grant awards under the Plan to any executive officer or any employee it designates as a participant in accordance with general guidelines under the Plan. As of February 28, 2007, there have been no Long-Term Incentive Grants made under the Plan.

### *Related Party Awards*

Through February 28, 2007, a partnership controlled by a Director of our General Partner awarded to a new officer of ETP certain rights related to units of ETE previously issued by ETE to such Director. These rights include the economic benefits of ownership of these units based on a 5-year vesting schedule whereby the employee will vest in the units at a rate of 20% per year. None of the costs related to such awards are paid by ETP or ETE. Based on GAAP covering related party transactions and unit-based compensation arrangements, we are recognizing non-cash compensation expense over the vesting period based on the grant date per unit market value of the ETE units awarded the employees assuming no forfeitures. Awards granted for the six months ended February 28, 2007 result in a total non-cash compensation expense of approximately \$8,800 to be recognized over the related vesting period. For the three and six month periods ended February 28, 2007, we recognized non-cash compensation expense of \$354 as a result of these awards. As these units were outstanding prior to these awards, the awards do not represent an increase in the number of outstanding units of either ETP or ETE and are not dilutive to cash distributions per unit with respect to either ETP or ETE. We expect to recognize non-cash compensation expense as follows in future periods related to these awards:

Remainder of fiscal 2007	\$ 2,124
Fiscal 2008	2,969
Fiscal 2009	1,717
Fiscal 2010	1,009
Fiscal 2011	508
Fiscal 2012	119

## **15. REGULATORY MATTERS, COMMITMENTS, CONTINGENCIES, AND ENVIRONMENTAL LIABILITIES:**

### **Regulatory Matters**

On September 29, 2006, Transwestern filed revised tariff sheets under section 4(e) of the Natural Gas Act (NGA) proposing a general rate increase to be effective on November 1, 2006. On October 31, 2006, in

## **Table of Contents**

Docket No. RP06-614 the FERC issued its Order Accepting and Suspending Tariff Sheets Subject to Refund and Establishing a Hearing and Technical Conference (Commission's October 31, 2006 Order). In this Order the Commission accepted and suspended the revised tariff sheets for the maximum five-month statutory period to be effective April 1, 2007, subject to refund, and subject to the outcome of a hearing established by this order. Transwestern and the active parties in this proceeding engaged in settlement negotiations to resolve all issues set for hearing by the Commission's October 31, 2006 Order. On March 9, 2007, Transwestern filed with the FERC its Stipulation and Agreement of Settlement (Stipulation and Agreement) which, if approved by the commission, will settle these matters. The Stipulation provides for (i) revised base tariff rates, (ii) the amortization of certain costs, including the Enron Cash Balance Plan, regulatory commission expense, post retirement benefits, the accumulated reserve adjustment regulatory asset, deferred income taxes, and certain non-PCB environmental costs, and (iii) a depreciation rate of 1.20 percent for all transmission plant facilities.

On August 1, 2002, the FERC issued an Order to Respond (August 1 Order) to Transwestern. The order required Transwestern, within 30 days of the date of the order, to provide written responses stating why the FERC should not find that: (i) Transwestern violated FERC's accounting regulations by failing to maintain written cash management agreements with Enron; and (ii) the secured loan transactions entered into by Transwestern in November 2001 were imprudently incurred and why the costs arising from such transactions should be passed on to ratepayers. On September 2, 2002, Transwestern filed a response to the August 1 Order and subsequently entered into a procedural settlement with the FERC staff that resolved, as to Transwestern, the issues raised by the August 1 Order. The FERC approved this settlement on October 31, 2002; however, a group of Transwestern's customers filed a request for clarification and/or rehearing of the FERC order approving the settlement. This customer group claimed that there is an inconsistency between the language of the settlement agreement and the language of the FERC order approving the settlement. This alleged inconsistency relates to Transwestern's ability to pass through to its ratepayers the costs of any replacement or refinancing of the secured loan transactions entered into by Transwestern in November 2001. Transwestern filed a response to the customer group's request for rehearing and/or clarification and this matter is currently awaiting FERC action. If approved, the March 9, 2007 Stipulation in Docket No. RP06-614 (discussed above) would provide for the termination of this proceeding.

The Phoenix Expansion project, as filed with FERC on September 15, 2006, includes the construction and operation of approximately 260 miles of 36-inch or larger diameter pipeline extending from Transwestern's existing mainline in Yavapai County, Arizona to delivery points in the Phoenix, Arizona area and certain looping on Transwestern's existing San Juan Lateral with approximately 25 miles of 36-inch diameter pipeline. Total project costs are estimated to be approximately \$710,000 with a projected in-service date in the third or fourth calendar quarter of 2008, subject to FERC approval. Transwestern has incurred expenditures of \$31,487 through February 28, 2007 for the Phoenix Expansion project.

## **Commitments**

As a result of the Transwestern acquisition we have additional non-cancelable operating leases for property and equipment which require annual rental payments of approximately \$3,400 through year 2009 and \$300 through year 2020. Transwestern is currently negotiating an extension of the operating lease expiring in 2009.

Total rental expense under our operating leases was approximately \$5,838 and \$12,189 for the three and six months ended February 28, 2007, respectively, and has been included in operating expenses in the condensed consolidated statements of operations.

In the normal course of our business, we purchase, process and sell natural gas pursuant to long-term contracts and enter into long-term transportation and storage agreements. Such contracts contain terms that are customary in the industry. We believe that such terms are commercially reasonable and will not have a material adverse effect on our financial position or results of operations.

On October 3, 2006, we entered into a long-term agreement with CenterPoint Energy Resources Corp (CenterPoint) to provide the natural gas utility with firm transportation and storage services on our HPL System located along the Texas gulf coast region. Under the terms of this agreement, CenterPoint has contracted for 129 Bcf per year of firm transportation capacity combined with 10 Bcf of working gas storage capacity in our Bammel Storage facility. Under the new agreement with CenterPoint, we will no longer need to utilize predominately all of the Bammel Storage facility's working gas capacity for supplying CenterPoint's winter needs. This may reduce our working capital requirements that were necessary to finance the working gas while in storage and may provide us an opportunity to offer storage to third parties. This agreement went into effect on April 1, 2007.

## **Table of Contents**

We assumed in our HPL acquisition a contract with a service provider which obligated us to obtain certain compression, measurement and other services through 2007 with monthly payments of approximately \$1,700. We terminated the measurement portion of this contract in October 2006 for a payment of approximately \$7,000. The remaining compression services total approximately \$800 per month through October 2007.

## **Litigation and Contingencies**

The Operating Partnerships may, from time to time, be involved in litigation and claims arising out of their respective operations in the normal course of business. Natural gas and propane are flammable, combustible gases. Serious personal injury and significant property damage can arise in connection with their transportation, storage or use. In the ordinary course of business, we are sometimes threatened with or named as a defendant in various lawsuits seeking actual and punitive damages for product liability, personal injury and property damage. We maintain liability insurance with insurers in amounts and with coverages and deductibles management believes are reasonable and prudent, and which are generally accepted in the industry. However, there can be no assurance that the levels of insurance protection currently in effect will continue to be available at reasonable prices or that such levels will remain adequate to protect us and our Operating Partnerships from material expenses related to product liability, personal injury or property damage in the future.

In re Natural Gas Royalties Qui Tam Litigation. MDL Docket No. 1293 (D. WY), Jack Grynberg, an individual, has filed actions against a number of companies, including Transwestern, now transferred to the U.S. District Court for the District of Wyoming, for damages for mis-measurement of gas volumes and Btu content, resulting in lower royalties to mineral interest owners. On October 20, 2006, the District Judge adopted in part the earlier recommendation of the Special Master in the case and ordered the dismissal of the case against Transwestern. Transwestern believes that its measurement practices conformed to the terms of its FERC Gas Tariffs, which were filed with and approved by the Commission. As a result, Transwestern believes that it has meritorious defenses to these lawsuits (including FERC-related affirmative defenses, such as the filed rate/tariff doctrine, the primary/exclusive jurisdiction of FERC, and the defense that Transwestern complied with the terms of its tariffs) and will continue to vigorously defend against them, including any appeal which may be taken from the dismissal of the Grynberg case. Transwestern does not believe the outcome of this case will have a material adverse effect on its financial position, results of operations or cash flows. A hearing is scheduled for April 24, 2007 regarding Transwestern's Supplemental Brief for Attorneys' fees which was filed on January 8, 2007.

Transwestern is managing one threatened trespass action related to right of way (ROW) on Tribal or allottee land. The threatened action concerns 5,100 feet of ROW on private allotments within the Laguna Pueblo that expired on December 28, 2002. Transwestern received a letter dated March 19, 2003 from the United States Department of the Interior, Bureau of Indian Affairs (BIA) on behalf of the two allottees asserting trespass. Transwestern's legal exposure related to this matter is not currently determinable. Negotiations are ongoing on this matter.

Another action involves an agreement with the BIA covering 44 miles of ROW on a total of 68 Navajo allotments. This ROW agreement expired on January 1, 2004. One allottee sent a letter dated January 16, 2004 to the BIA claiming Transwestern trespassed and that allottee's claim of trespass has been settled and his consent has been acquired. Transwestern resolved this matter by filing a renewal application with the BIA during October 2002. However, discussions are ongoing with the BIA to approve the renewal application.

Effective December 16, 2004, Citicorp North America, Inc. (Citicorp) claimed, in its capacity as the Paying Agent and Co-Administrative Agent, that any recovery in the litigation captioned Enron Corp. et al. v. Citigroup, Inc. et al. (the Litigation), together with legal fees and expenses incurred by Citicorp in defending the Litigation, would be indemnity obligations (the Obligations) of Transwestern under its Credit Agreement dated November 13, 2001. Under the terms of the Purchase Agreement, CCE Holdings, LLC and certain of its subsidiaries are indemnified against the Obligations by Enron and certain of its subsidiaries. In January of 2005, Enron gave notice that it would assume the defense of and indemnify CCE Holdings, LLC, against any action by Citigroup to collect from Transwestern. Discovery is ongoing in the adversary proceeding and Transwestern has not been joined in the litigation. Accordingly, Transwestern does not believe that it has any material liability from Citicorp's claims.

## **Table of Contents**

At the time of the HPL acquisition, AEP Energy Services Gas Holding Company II, L.L.C., HPL Consolidation LP and its subsidiaries (the "HPL Entities"), their parent companies and American Electric Power Corporation ("AEP"), were engaged in ongoing litigation with Bank of America ("B of A") that related to AEP's acquisition of HPL in the Enron bankruptcy and B of A's financing of cushion gas stored in the Bammel Storage facility ("Cushion Gas"). This litigation is referred to as the "Cushion Gas Litigation". Under the terms of the Purchase and Sale Agreement and the related Cushion Gas Litigation Agreement, AEP and its subsidiaries that were the sellers of the HPL Entities retained control of the Cushion Gas Litigation and have agreed to indemnify ETC OLP and the HPL Entities for any damages arising from the Cushion Gas Litigation and the loss of use of the Cushion Gas, up to a maximum of the amount paid by ETC OLP for the HPL Entities and the working gas inventory. The Cushion Gas Litigation Agreement terminates upon final resolution of the Cushion Gas Litigation. In addition, under the terms of the Purchase and Sale Agreement, AEP retained control of additional matters relating to ongoing litigation and environmental remediation and agreed to bear the costs of or indemnify ETC OLP and the HPL Entities for the costs related to such matters.

Following the natural gas market disruptions and related natural gas price volatility occurring in the Houston Ship Channel market around the times of the hurricanes in the fall of 2005, federal regulatory agencies commenced inquiries into certain activities during this period. Subsequently, the FERC and the Commodity Futures Trading Commission initiated investigations into whether ETP engaged in manipulative or improper trading activities in the Houston Ship Channel market around the times of the hurricanes in the Fall of 2005 as well as into certain of ETP's transportation activities. In connection with these investigations, we have responded to discovery subpoenas, and have otherwise provided information to, these agencies concerning our physical sales of natural gas and financial derivatives transactions, along with certain natural gas transportation activities, during the fall of 2005 and other periods. It is our position that our trading and transportation activities during these periods complied in all material respects with applicable rules and regulations. We anticipate that we will engage in discussions with these agencies related to their views of possible violations of applicable laws and regulations, and potential penalties related thereto, and that these discussions will involve settlement negotiations to resolve these matters. Management believes that these agencies will require a payment in order to conclude these investigations in a negotiated settlement basis. Our existing accruals for litigation and contingencies include an accrual related to these matters. At this time, we are unable to predict the final outcome of these matters.

In addition to those matters described above, we or our subsidiaries are a party to various legal proceedings and/or regulatory proceedings incidental to our businesses. For each of these matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, the likelihood of an unfavorable outcome and the availability of insurance coverage. If we determine that an unfavorable outcome of a particular matter is probable, can be estimated and is not covered by insurance, we make an accrual for the matter. For matters that are covered by insurance, we accrue the related deductible. As new information becomes available, our estimates may change. The impact of these changes may have a significant effect on our results of operations in a single period.

The outcome of these matters cannot be predicted with certainty, and it is possible that the outcome of a particular matter will result in the payment of an amount in excess of the amount accrued for the matter. As our accrual amounts are non-cash, any cash payment of an amount in resolution of a particular matter would likely be made from cash from operations or borrowings.

As of February 28, 2007 and August 31, 2006, an accrual of \$30,275 and \$32,148, respectively, was recorded as accrued and other current liabilities on our condensed consolidated balance sheets for our contingencies and current litigation matters, excluding accruals related to environmental matters.

## **Environmental**

Our operations are subject to extensive federal, state and local environmental laws and regulations that require expenditures for remediation at operating facilities and waste disposal sites. Although we believe our operations are in substantial compliance with applicable environmental laws and regulations, risks of additional costs and liabilities are inherent in the natural gas pipeline and processing business, and there can be no assurance that significant costs and liabilities will not be incurred. Moreover, it is possible that other developments, such as increasingly stringent environmental laws, regulations and enforcement policies thereunder, and claims for damages to property or persons resulting from the operations, could result in substantial costs and liabilities. Accordingly, we have adopted policies, practices, and procedures in the areas of pollution control, product safety, occupational health, and the handling, storage, use, and disposal of hazardous materials to prevent material environmental or other damage, and to limit the financial liability, which could result from such events. However, some risk of environmental or other damage is inherent in the natural gas pipeline and processing business, as it is with other entities engaged in similar businesses.

## **Table of Contents**

Transwestern conducts soil and groundwater remediation at a number of its facilities. Some of the clean up activities include remediation of several compressor sites on the Transwestern system for presence of polychlorinated biphenyls (PCBs) which are not eligible for recovery in rates. The total accrued future estimated cost of remediation activities expected to continue for several years is \$13,100. Transwestern has requested recovery of the portion of soil and groundwater remediation not related to PCBs in the current rate case anticipated to become effective April 2007.

Transwestern continues to incur certain costs related to PCBs that migrated into customers' facilities. Because of the continued detection of PCBs in the customers' facilities downstream of Transwestern's Topock and Needles stations, Transwestern, as part of ongoing arrangements with customers, continues to incur costs associated with containing and removing the PCBs. Costs of these remedial activities totaled approximately \$200 for the period since acquisition. Future costs cannot be reasonably estimated because remediation activities are undertaken as claims are made by customers and former customers, and accordingly, no accrual has been established for these costs at February 28, 2007. However, such future costs are not expected to have a material impact on our financial position, results of operations or cash flows.

Environmental regulations were recently modified for United States Environmental Protection Agency's Spill Prevention, Control and Countermeasures (SPCC) program. We are currently reviewing the impact to our operations and expect to expend resources on tank integrity testing and any associated corrective actions as well as potential upgrades to containment structures. Costs associated with tank integrity testing and resulting corrective actions cannot be reasonably estimated at this time, but we believe such costs will not have a material adverse effect on our financial position, results of operations or cash flows.

In July 2001, HOLP acquired a company that had previously received a request for information from the U.S. Environmental Protection Agency (the EPA) regarding potential contribution to a widespread groundwater contamination problem in San Bernardino, California, known as the Newmark Groundwater Contamination. Although the EPA has indicated that the groundwater contamination may be attributable to releases of solvents from a former military base located within the subject area that occurred long before the facility acquired by HOLP was constructed, it is possible that the EPA may seek to recover all or a portion of groundwater remediation costs from private parties under the Comprehensive Environmental Response, Compensation, and Liability Act (commonly called Superfund). We have not received any follow-up correspondence from the EPA on the matter since our acquisition of the predecessor company in 2001. Based upon information currently available to HOLP, it is believed that HOLP's liability if such action were to be taken by the EPA would not have a material adverse effect on our financial condition or results of operations.

In conjunction with the October 1, 2002 acquisition of the Texas and Oklahoma natural gas gathering and gas processing assets from Aquila Gas Pipeline, Aquila, Inc. agreed to indemnify ETC OLP for any environmental liabilities that arose from the operation of the assets for the period prior to October 1, 2002. Aquila also agreed to indemnify ETC OLP for 50% of any environmental liabilities that arose from the operations of Oasis Pipe Line Company prior to October 1, 2002.

We also assumed certain environmental remediation matters related to eleven sites in connection with our acquisition of HPL.

Petroleum-based contamination or environmental wastes are known to be located on or adjacent to six sites on which HOLP presently has, or formerly had, retail propane operations. These sites were evaluated at the time of their acquisition. In all cases, remediation operations have been or will be undertaken by others, and in all six cases, HOLP obtained indemnification rights for expenses associated with any remediation from the former owners or related entities. We have not been named as a potentially responsible party at any of these sites, nor have our operations contributed to the environmental issues at these sites. Accordingly, no amounts have been recorded in our February 28, 2007 or August 31, 2006 condensed consolidated balance sheets. Based on information currently available to us, such projects are not expected to have a material adverse effect on our financial condition or results of operations.

Environmental exposures and liabilities are difficult to assess and estimate due to unknown factors such as the magnitude of possible contamination, the timing and extent of remediation, the determination of our liability in proportion to other parties, improvements in cleanup technologies and the extent to which environmental laws

## **Table of Contents**

and regulations may change in the future. Although environmental costs may have a significant impact on the results of operations for any single period, we believe that such costs will not have a material adverse effect on our financial position.

As of February 28, 2007 and August 31, 2006, an accrual on an undiscounted basis of \$17,552 and \$4,387, respectively, was recorded in our condensed consolidated balance sheets as accrued and other current liabilities and other non-current liabilities to cover material environmental liabilities related to certain matters assumed in connection with the HPL acquisition, the Transwestern acquisition, and the potential environmental liabilities for three sites that were formerly owned by Titan or its predecessors. A receivable of \$388 was recorded in our condensed consolidated balance sheets as of February 28, 2007 and August 31, 2006 to account for a predecessor's share of certain environmental liabilities of ETC OLP.

Based on information available at this time, and reviews undertaken to identify potential exposure, we believe the amount reserved for all of the above environmental matters is adequate to cover the potential exposure for clean-up costs.

In December 2003, the U.S. Department of Transportation issued a final rule requiring pipeline operators to develop integrity management programs to comprehensively evaluate their pipelines, and take measures to protect pipeline segments located in what the rule refers to as high consequence areas. The final rule resulted from the enactment of the Pipeline Safety Improvement Act of 2002. The final rule was effective as of January 14, 2004. Based on the results of our current pipeline integrity testing programs, we estimate that compliance with this final rule for our existing transportation assets will result in capital costs of \$7,006 during the period between the remainder of calendar year 2007 to 2008, as well as operating and maintenance costs of \$8,574 during that period. Integrity testing and assessment of all of these assets will continue, and the potential exists that results of such testing and assessment could cause us to incur even greater capital and operating expenditures for repairs or upgrades deemed necessary to ensure the continued safe and reliable operation of our pipelines.

## **16. PRICE RISK MANAGEMENT ASSETS AND LIABILITIES:**

### **Accounting for Derivative Instruments and Hedging Activities**

We apply Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ) as amended to account for our derivative financial instruments. This statement requires that all derivatives be recognized in the balance sheet as either an asset or liability measured at fair value. Special accounting for qualifying cash flow hedges allows a derivative's gains and losses to offset related results on the hedged item in the statement of operations and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting treatment.

Cash flows from derivatives accounted for as cash flow hedges are reported as cash flow from operating activities, in the same category as the cash flows from the items being hedged.

We use a combination of financial instruments including, but not limited to, futures, price swaps, options and basis swaps to manage our exposure to market fluctuations in the prices of natural gas and NGLs. We enter into these financial instruments with brokers who are clearing members with NYMEX and directly with counterparties in the over-the-counter ( OTC ) market. We are subject to margin deposit requirements under the OTC agreements and NYMEX positions. NYMEX requires brokers to obtain an initial margin deposit based on an expected volume of the trade when the financial instrument is initiated. This amount is paid to the broker by both counterparties of the financial instrument to protect the broker from default by one of the counterparties when the financial instrument settles. We also have maintenance margin deposits with certain counterparties in the OTC market. The payments on margin deposits occur when the value of a derivative exceeds our pre-established credit limit with the counterparty. Margin deposits are returned to us on the settlement date. We had net deposits with derivative counterparties of \$32,970 and \$87,806 as of February 28, 2007 and August 31, 2006, respectively, reflected as deposits paid to vendors on our consolidated balance sheets.

## **Table of Contents**

### **Commodity Price Risk**

We are exposed to market risks related to the volatility of natural gas, NGL and propane prices. To reduce the impact of this price volatility, we primarily use derivative commodity instruments (futures and swaps) to manage our exposure to fluctuations in commodity prices. We have established a formal risk management policy in which derivative financial instruments are employed in connection with an underlying asset, liability and/or anticipated transaction. At inception of a hedge, we formally document the relationship between the hedging instrument and the hedged item, the risk management objectives, and the methods used for assessing and testing effectiveness and how any ineffectiveness will be measured and recorded. We also assess, both at the inception of the hedge and on a quarterly basis, whether the derivatives that are used in our hedging transactions are highly effective in offsetting changes in cash flows. If we determine that a derivative is no longer highly effective as a hedge, we discontinue hedge accounting prospectively by including changes in the fair value of the derivative in current earnings. Furthermore, on a bi-weekly basis, management reviews the creditworthiness of the derivative counterparties to manage against the risk of default.

The market prices used to value our financial derivatives and related transactions have been determined using independent third party prices, readily available market information, broker quotes and appropriate valuation techniques.

### *Non-trading Activities*

We utilize various exchange-traded and over-the-counter commodity financial instrument contracts to limit our exposure to margin fluctuations in natural gas, NGL and propane prices. These contracts consist primarily of futures and swaps and are recorded at fair value on the consolidated balance sheets. If we designate a derivative financial instrument as a cash flow hedge and it qualifies for hedge accounting, a change in the fair value is deferred in Accumulated Other Comprehensive Income ( OCI ) until the underlying hedged transaction occurs. Any ineffective portion of a cash flow hedge's change in fair value is recognized each period in earnings. Realized gains and losses on derivative financial instruments that are designated as cash flow hedges are included in cost of products sold in the period the hedged transactions occur. Gains and losses deferred in OCI related to cash flow hedges remain in OCI until the underlying physical transaction occurs, unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter. For those financial derivative instruments that do not qualify for hedge accounting, the change in market value is recorded in cost of products sold in the consolidated statements of operations. We reclassified into earnings gains of \$119,548 and \$122,716 for the three and six months ended February 28, 2007, respectively, and gains of \$142,989 and \$41,675 for the three and six months ended February 28, 2006, respectively, related to commodity financial instruments that were previously reported in OCI.

We expect gains of \$18,038 to be reclassified into earnings over the next twelve months related to income currently reported in OCI. The amount ultimately realized, however, will differ as commodity prices change. The majority of our commodity-related derivatives are expected to settle within the next two years.

In the course of normal operations, we routinely enter into contracts such as forward physical contracts for the purchase and sale of natural gas, propane, and other NGLs, that under SFAS 133, qualify for and are designated as a normal purchase and sales contracts. Such contracts are exempted from the fair value accounting requirements of SFAS 133 and are accounted for using accrual accounting. For contracts that are not designated as normal purchase and sales contracts, the change in market value is recorded in costs of products sold in the consolidated statements of operations. In connection with the HPL acquisition, we acquired certain physical forward contracts that contain embedded options. These contracts have not been designated as normal purchase and sale contracts, and therefore, are marked to market in addition to the financial options that offset them. The Black-Scholes valuation model was used to estimate the value of these embedded options.

### *Trading Activities*

Trading activities are monitored independently by our risk management function and must take place within predefined limits and authorizations. Certain strategies are considered trading for accounting purposes and are executed with the use of a combination of financial instruments including, but not limited to, basis contracts and gas daily contracts. The derivative contracts that are entered into for trading purposes, subject to limits, are recognized on the consolidated balance sheets at fair value. The changes in the fair value of these derivative instruments are recognized in midstream and intrastate transportation and storage revenue in the



**Table of Contents**

consolidated statements of operations on a net basis. Net losses associated with trading activities for the three months ended February 28, 2007 were \$1,719 and net gains for the six months ended February 28, 2007 were \$1,244. Included in the trading revenue was unrealized losses of \$6,329 and \$17,529 for the three and six months ended February 28, 2007, respectively. For the three and six months ended February 28, 2006, trading activities consisted of losses of \$2,743 and gains of \$49,837, respectively, including unrealized losses of \$25,530 and \$19,117, respectively.

The following table details the outstanding commodity-related derivatives as of February 28, 2007 and August 31, 2006, respectively:

		Notional		
		Volume		
February 28, 2007	Commodity	MMBTU	Maturity	Fair Value
Mark to Market Derivatives				
(Non-Trading)				
Basis Swaps IFERC/NYMEX	Gas	23,023,316	2007-2009	\$ 3,347
Swing Swaps IFERC	Gas	17,592,500	2007-2008	1,275
Fixed Swaps/Futures	Gas	(23,765,000)	2007	25,294
Forward Physical Contracts	Gas	(4,043,550)	2007-2008	(320)
Options	Gas	(602,000)	2007-2008	742
Forward/Swaps in Gallons	Propane	4,452,000	2007	(524)
(Trading)				
Basis Swaps IFERC/NYMEX	Gas	(3,880,000)	2007-2008	\$ 5,514
Swing Swaps IFERC	Gas	68,200	2007	(6)
Forward Physical Contracts	Gas		2007	(1,141)
Cash Flow Hedging Derivatives				
(Non-Trading)				
Basis Swaps IFERC/NYMEX	Gas	2,282,500	2007	\$ (174)
Fixed Swaps/Futures	Gas	2,330,000	2007	189
August 31, 2006:				
Mark to Market Derivatives				
(Non-Trading)				
Basis Swaps IFERC/NYMEX	Gas	33,711,140	2006-2009	\$ (6,247)
Swing Swaps IFERC	Gas	(37,220,448)	2006-2008	2,618
Fixed Swaps/Futures	Gas	3,607,500	2006-2007	(170)
Forward Physical Contracts	Gas	(7,986,000)	2006-2008	(21,653)
Options	Gas	(1,046,000)	2006-2008	21,653
Forward/Swaps in Gallons	Propane	24,066,000	2006-2007	199
(Trading)				
Basis Swaps IFERC/NYMEX	Gas	(2,572,500)	2006-2008	\$ 21,995
Swing Swaps IFERC	Gas		2006	(31)
Forward Physical Contracts	Gas	(455,000)	2006	(68)
Cash Flow Hedging Derivatives				
(Non-Trading)				
Basis Swaps IFERC/NYMEX	Gas	(34,585,000)	2006-2007	\$ (2,987)
Fixed Swaps/Futures	Gas	(37,872,500)	2006-2007	2,043

Estimates related to our gas marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. We also attempt to maintain balanced positions in our non-trading activities to protect ourselves from the volatility in the energy commodities markets; however, net unbalanced positions can exist. Long-term physical contracts are tied to index prices. System gas, which is also tied to index prices, is expected to provide the gas required by our long-term physical contracts. When third-party gas is required to supply long-term contracts, a hedge is put in place to protect the margin on the contract. Financial contracts, which are not tied to physical delivery, will be offset with financial contracts to balance our positions. To the extent open commodity positions exist in

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our trading and non-trading activities, fluctuating commodity prices can impact our financial results and financial position, either favorably or unfavorably.

**Table of Contents**

During the three months ended February 28, 2007 and 2006, the Partnership discontinued application of hedge accounting in connection with certain derivative financial instruments that were qualified for and designated as cash flow hedges related to forecasted sales of natural gas stored in the Partnership's Bammel storage facilities. The discontinuation resulted from management's determination that the originally forecasted sales of natural gas from the storage facilities were no longer probable of occurring by the end of the originally specified time period, or within an additional two-month period of time thereafter. The determination was made principally due to the unseasonably warm weather that occurred during February through March. One of the key criteria to achieve hedge accounting under SFAS 133 is that the forecasted transaction be probable of occurring as originally set forth in the hedge documentation. As a result, during the three months ended February 28, 2007 and 2006, the Partnership recognized previously deferred unrealized gains of \$17,848 and \$84,680 from the discontinued application of hedge accounting, which is included in the reclassification into earnings from OCI during the three and six months ended February 28, 2007 and 2006, respectively. The Partnership classified the \$17,848 and \$84,680 as costs of products sold in its consolidated statements of operations.

**Interest Rate Risk**

We are exposed to market risk for changes in interest rates related to our bank credit facilities. We manage a portion of our interest rate exposures by utilizing interest rate swaps and similar arrangements which allow us to effectively convert a portion of variable rate debt into fixed rate debt.

We entered into treasury locks and interest rate swaps with a notional amount of \$300,000 during the third fiscal quarter of 2006. We elected to not apply hedge accounting to these financial instruments. Accordingly, changes in the fair value of these instruments are recorded as interest expense on the consolidated statements of operations. These instruments settled during the six months ended February 28, 2007 for a gain of \$567.

We entered into forward starting interest swaps with a notional value of \$400,000 during the three months ended August 31, 2006. The fair value of the swaps was recorded as a liability of \$14,955 and \$8,699 on the consolidated balance sheets as of February 28, 2007 and August 31, 2006, respectively. The swaps were accounted for as cash flow hedges under SFAS 133 and recorded as a component of OCI, to be reclassified to interest expense in the future as the related interest payments are made. These interest swaps were terminated subsequent to February 28, 2007 at a cost of approximately \$13,400.

In connection with the Titan acquisition, we assumed a three year LIBOR interest rate swap with a notional amount of \$125,000. The fair value of this swap as of February 28, 2007, and August 31, 2006 was a net liability and asset of \$425 and \$519, respectively, and was recorded as a component of price risk management assets and liabilities in the consolidated balance sheet. We elected to not apply hedge accounting to these financial instruments. Accordingly, changes in the fair value of these instruments are recorded as interest expense on the condensed consolidated statements of operations.

We reclassified into earnings gains of \$2,662 and losses of \$51 for the three and six months ended February 28, 2007, respectively, related to interest rate swaps that were previously reported in OCI. Losses of \$8 and gains of \$756 were reclassified into earnings for the three and six months ended February 28, 2006 related to interest rate swaps previously reported in OCI. We expect gains of \$197 to be reclassified into earnings over the next twelve months related to income on interest rate financial instruments currently reported in OCI. The amount ultimately realized, however, will differ as interest rates change.

The following represents gains (losses) on derivative activity for the periods presented:

	Three Months Ended February 28, 2007		Six Months Ended February 28, 2007	
	2007	2006	2007	2006
<b>Commodity-related</b>				
Unrealized gains (losses) recognized in revenues and cost of products sold related to commodity-related derivative activity, excluding ineffectiveness	\$ 23,817	\$ (35,744)	\$ 15,885	\$ 37,809
Ineffective portion of derivatives qualifying for hedge accounting	(1,103)	35,645	1,482	17,323
Realized gains included in revenues and cost of products sold	102,889	109,748	113,866	100,455
<b>Interest rate swaps</b>				
Unrealized gains (losses) on interest rate swap included in interest expense, excluding ineffectiveness	\$ 339	\$	\$ (1,573)	\$ (151)

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Ineffective portion of derivatives qualifying for hedge accounting	2,390		(436)	771
Realized gains (losses) on interest rate swap included in interest expense	345	(8)	1,137	135

34

## **Table of Contents**

### **Credit Risk**

We maintain credit policies with regard to our counterparties that we believe significantly minimize our overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit ratings), collateral requirements under certain circumstances and the use of standardized agreements which allow for netting of positive and negative exposure associated with a single counterparty.

Our counterparties consist primarily of financial institutions, major energy companies and local distribution companies. This concentration of counterparties may impact its overall exposure to credit risk, either positively or negatively in that the counterparties may be similarly affected by changes in economic, regulatory or other conditions. Based on our policies, exposures, credit and other reserves, management does not anticipate a material adverse effect on financial position or results of operations as a result of counterparty performance.

### **17. RELATED PARTY TRANSACTIONS:**

As of February 28, 2007 and August 31, 2006, we had advances due from a propane joint venture of \$7,804 and \$3,775, respectively, which are included in intangibles and other long-term assets on our condensed consolidated balance sheets.

Our natural gas midstream and intrastate transportation and storage operations secure compression services from third parties including Energy Transfer Technologies, Ltd., of which Energy Transfer Group, LLC is the General Partner. These entities are collectively referred to as the ETG Entities. Our Co-Chief Executive Officers have an indirect ownership in the ETG Entities. In addition, two of the General Partner's directors serve on the Board of Directors of the ETG Entities. The terms of each arrangement to provide compression services are, in the opinion of independent directors of the General Partner, no less favorable than those available from other providers of compression services. During the six months ended February 28, 2007 and 2006, we made payments totaling \$848 and \$1,813, respectively, to the ETG Entities for compression services provided to and utilized in our natural gas midstream and intrastate transportation and storage operations. As of February 28, 2007 and August 31, 2006, accounts payable to ETG related to compressor leases were not significant.

### **18. SUMMARIZED CONDENSED CONSOLIDATING FINANCIAL STATEMENTS:**

Our Revolving Credit Facility and Senior Notes are fully and unconditionally guaranteed by ETC OLP and Titan and all of their direct and indirect wholly-owned subsidiaries other than Transwestern (the "Subsidiary Guarantors"). HOLP and its direct and indirect subsidiaries, Heritage Holdings, Inc. and Transwestern do not guarantee our Revolving Credit Facility and Senior Notes. The Subsidiary Guarantors jointly and severally guarantee, on an unsecured senior basis, our obligations under our Revolving Credit Facility and Senior Notes. Following are our unaudited condensed consolidating financial information including our midstream, interstate, and propane Subsidiary Guarantors, our Non-Guarantor Subsidiaries and the Partnership on a consolidated basis. The condensed consolidating financial information presented herein complies with

**Table of Contents**

Rule 3-10 of Regulation S-X, is prepared on the equity method, and does not contain related financial statement disclosures that would be required with a complete set of financial statements presented in conformity with GAAP.

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET**

As of February 28, 2007

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Propane Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidation Adjustments	Consolidated
<b><u>ASSETS</u></b>						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 1,710	\$	\$ 20,666	\$ 53,698	\$	\$ 76,074
Marketable securities				4,026		4,026
Accounts receivable, net		513,597	39,731	164,965	(336)	717,957
Inventories		105,530	14,249	74,911		194,690
Deposits paid to vendors		32,970				32,970
Exchanges receivable		29,838		8,347		38,185
Price risk management assets		14,706	104			14,810
Prepaid expenses and other	675,847	38,645	29,017	19,791	(725,056)	38,244
Total current assets	677,557	735,286	103,767	325,738	(725,392)	1,116,956
PROPERTY, PLANT AND EQUIPMENT, net		3,108,399	182,973	1,806,124		5,097,496
GOODWILL		23,736	257,987	440,680		722,403
LONG-TERM NOTES RECEIVABLE FROM RELATED PARTY	283,815				(283,815)	
DEFERRED TAX ASSET			1,353		(1,353)	
INTANGIBLES AND OTHER LONG-TERM ASSETS, net	5,027,735	29,376	67,152	365,235	(5,130,038)	359,460
Total assets	\$ 5,989,107	\$ 3,896,797	\$ 613,232	\$ 2,937,777	\$ (6,140,598)	\$ 7,296,315

**LIABILITIES AND PARTNERS' CAPITAL**

CURRENT LIABILITIES:						
Accounts payable	\$ 300	\$ 407,058	\$ 23,164	\$ 103,307	\$ (336)	\$ 533,493
Exchanges payable		31,653		6,873		38,526
Customer advances and deposits		5,366	11,805	29,930		47,101
Accrued and other current liabilities	52,373	803,408	24,888	74,160	(725,056)	229,773
Price risk management liabilities	14,955	4,026	524			19,505
Current maturities of long-term debt			700	39,858		40,558
Total current liabilities	67,628	1,251,511	61,081	254,128	(725,392)	908,956
LONG-TERM DEBT, net of discount, less current maturities	2,728,934		456	458,504		3,187,894
LONG-TERM NOTES PAYABLE FROM RELATED PARTY				283,815	(283,815)	
DEFERRED INCOME TAXES		50,784		55,058	(1,353)	104,489
OTHER NONCURRENT LIABILITIES		2,030	3,478	17,727		23,235
COMMITMENTS AND CONTINGENCIES						

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		2,796,562	1,304,325	65,015	1,069,232	(1,010,560)	4,224,574
PARTNERS	CAPITAL	3,192,545	2,592,472	548,217	1,868,545	(5,130,038)	3,071,741
Total liabilities and partners capital		\$ 5,989,107	\$ 3,896,797	\$ 613,232	\$ 2,937,777	\$ (6,140,598)	\$ 7,296,315



**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET**

As of August 31, 2006

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Propane Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidation Adjustments	Consolidated
<b><u>ASSETS</u></b>						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 728	\$	\$ 2,182	\$ 23,131	\$	\$ 26,041
Marketable securities				2,817		2,817
Accounts receivable, net		570,569	18,154	86,822		675,545
Inventories		289,003	13,507	84,630		387,140
Deposits paid to vendors		87,806				87,806
Exchanges receivable		23,221				23,221
Price risk management assets	629	55,143	367			56,139
Prepaid expenses and other	399,813	41,426	24,511	12,888	(435,543)	43,095
Total current assets	401,170	1,067,168	58,721	210,288	(435,543)	1,301,804
PROPERTY, PLANT AND EQUIPMENT, net		2,596,015	201,893	515,741		3,313,649
GOODWILL		23,736	278,835	301,838		604,409
INTANGIBLES AND OTHER LONG-TERM ASSETS, net	3,848,223	38,864	79,612	229,686	(3,961,234)	235,151
Total assets	\$ 4,249,393	\$ 3,725,783	\$ 619,061	\$ 1,257,553	\$ (4,396,777)	\$ 5,455,013

**LIABILITIES AND PARTNERS' CAPITAL**

<b>CURRENT LIABILITIES:</b>						
Accounts payable	\$ 1,244	\$ 522,191	\$ 4,955	\$ 74,750	\$	\$ 603,140
Exchanges payable		24,722				24,722
Customer advances and deposits		16,524	24,623	67,689		108,836
Accrued and other current liabilities	45,261	533,831	22,512	36,235	(435,543)	202,296
Price risk management liabilities	8,699	28,219				36,918
Current maturities of long-term debt			871	39,707		40,578
Total current liabilities	55,204	1,125,487	52,961	218,381	(435,543)	1,016,490
LONG-TERM DEBT, net of discount, less current maturities	2,330,281		679	258,164		2,589,124
DEFERRED INCOME TAXES		51,253		55,589		106,842
OTHER NONCURRENT LIABILITIES		3,838		1,857		5,695
<b>COMMITMENTS AND CONTINGENCIES</b>						
	2,385,485	1,180,578	53,640	533,991	(435,543)	3,718,151
PARTNERS' CAPITAL	1,863,908	2,545,205	565,421	723,562	(3,961,234)	1,736,862
Total liabilities and partners' capital	\$ 4,249,393	\$ 3,725,783	\$ 619,061	\$ 1,257,553	\$ (4,396,777)	\$ 5,455,013



**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****For the three months ended February 28, 2007**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Propane Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidation Adjustments	Consolidated
<b>REVENUES:</b>						
Midstream and transportation and storage	\$	\$ 1,434,680	\$	\$ 58,158	\$	\$ 1,492,838
Propane and other			150,422	419,220		569,642
Total revenue		1,434,680	150,422	477,378		2,062,480
<b>COSTS AND EXPENSES:</b>						
Cost of products sold midstream and transportation and storage		1,138,709				1,138,709
Cost of products sold propane and other			87,410	259,697		347,107
Operating expenses		46,247	23,697	63,865		133,809
Depreciation and amortization		17,578	3,093	24,689		45,360
Selling, general and administrative	(407)	24,282	1,210	14,048		39,133
Total costs and expenses	(407)	1,226,816	115,410	362,299		1,704,118
OPERATING INCOME	407	207,864	35,012	115,079		358,362
<b>OTHER INCOME (EXPENSE):</b>						
Interest expense, net of interest capitalized	(35,522)	(3,331)	95	(14,079)	12,065	(40,772)
Equity in earnings (losses) of affiliates	335,580	(539)		25	(335,580)	(514)
Loss on disposal of assets		(2,422)	(374)	(433)		(3,229)
Interest and other income, net	10,649	1,484	1,165	190	(12,065)	1,423
INCOME BEFORE INCOME TAX EXPENSE AND MINORITY INTEREST	311,114	203,056	35,898	100,782	(335,580)	315,270
Income tax expense (benefit)		1,418	(1,353)	3,235		3,300
INCOME BEFORE MINORITY INTERESTS	311,114	201,638	37,251	97,547	(335,580)	311,970
Minority interests				(856)		(856)
NET INCOME	\$ 311,114	\$ 201,638	\$ 37,251	\$ 96,691	\$ (335,580)	\$ 311,114

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****For the three months ended February 28, 2006**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
<b>REVENUES:</b>					
Midstream and transportation and storage	\$	\$ 2,083,303	\$	\$	\$ 2,083,303
Propane and other			366,513		366,513
Total revenues		2,083,303	366,513		2,449,816
<b>COSTS AND EXPENSES:</b>					
Cost of products sold midstream and transportation and storage		1,785,053			1,785,053
Cost of products sold propane and other			223,778		223,778
Operating expenses		48,913	50,783		99,696
Depreciation and amortization		14,942	14,072		29,014
Selling, general and administrative	6,200	19,382	5,873		31,455
Total costs and expenses	6,200	1,868,290	294,506		2,168,996
OPERATING INCOME (LOSS)	(6,200)	215,013	72,007		280,820
<b>OTHER INCOME (EXPENSE):</b>					
Interest expense, net of interest capitalized	(22,464)	(1,872)	(8,052)	3,846	(28,542)
Equity in earnings (losses) of affiliates	275,770	234	(128)	(275,770)	106
Gain on disposal of assets		584	78		662
Interest and other income (expense), net	3,679	2,536	(67)	(3,846)	2,302
<b>INCOME BEFORE INCOME TAX EXPENSE AND MINORITY INTEREST</b>					
	250,785	216,495	63,838	(275,770)	255,348
Income tax expense		1,101	2,913		4,014
<b>INCOME BEFORE MINORITY INTERESTS</b>					
	250,785	215,394	60,925	(275,770)	251,334
Minority interests			(549)		(549)
NET INCOME	\$ 250,785	\$ 215,394	\$ 60,376	\$ (275,770)	\$ 250,785

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****For the six months ended February 28, 2007**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Propane Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidation Adjustments	Consolidated
<b>REVENUES:</b>						
Midstream and transportation and storage	\$	\$ 2,497,124	\$	\$ 58,158	\$	\$ 2,555,282
Propane and other			235,107	660,536		895,643
Total revenue		2,497,124	235,107	718,694		3,450,925
<b>COSTS AND EXPENSES:</b>						
Cost of products sold midstream and transportation and storage		2,022,692				2,022,692
Cost of products sold propane and other			140,134	410,333		550,467
Operating expenses		97,932	45,832	122,426		266,190
Depreciation and amortization		34,494	5,957	38,718		79,169
Selling, general and administrative	3,229	40,774	2,402	19,798		66,203
Total costs and expenses	3,229	2,195,892	194,325	591,275		2,984,721
OPERATING INCOME (LOSS)	(3,229)	301,232	40,782	127,419		466,204
<b>OTHER INCOME (EXPENSE):</b>						
Interest expense, net of interest capitalized	(73,975)	(3,098)	(1,208)	(20,503)	16,550	(82,234)
Equity in earnings (losses) of affiliates	444,262	(763)		24	(439,150)	4,373
Gain (loss) on disposal of assets		(2,386)	(374)	1,475		(1,285)
Interest and other income, net	15,088	3,244	1,156	156	(16,550)	3,094
INCOME BEFORE INCOME TAX EXPENSE AND MINORITY INTEREST	382,146	298,229	40,356	108,571	(439,150)	390,152
Income tax expense (benefit)		3,412	(1,354)	4,838		6,896
INCOME BEFORE MINORITY INTERESTS	382,146	294,817	41,710	103,733	(439,150)	383,256
Minority interests				(1,110)		(1,110)
NET INCOME	\$ 382,146	\$ 294,817	\$ 41,710	\$ 102,623	\$ (439,150)	\$ 382,146

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****For the six months ended February 28, 2006**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
<b>REVENUES:</b>					
Midstream and transportation and storage	\$	\$ 4,291,837	\$	\$	\$ 4,291,837
Propane and other			574,599		574,599
Total revenues		4,291,837	574,599		4,866,436
<b>COSTS AND EXPENSES:</b>					
Cost of products sold midstream and transportation and storage		3,744,422			3,744,422
Cost of products sold propane and other			355,036		355,036
Operating expenses		102,590	99,777		202,367
Depreciation and amortization		28,361	27,566		55,927
Selling, general and administrative	9,020	38,169	9,065		56,254
Total costs and expenses	9,020	3,913,542	491,444		4,414,006
OPERATING INCOME (LOSS)	(9,020)	378,295	83,155		452,430
<b>OTHER INCOME (EXPENSE):</b>					
Interest expense, net of interest capitalized	(43,068)	(4,192)	(15,782)	6,107	(56,935)
Equity in earnings (losses) of affiliates	417,091	(17)	(151)	(417,091)	(168)
Gain (loss) on disposal of assets		594	(60)		534
Interest and other income (expense), net	5,590	3,938	(160)	(6,107)	3,261
<b>INCOME BEFORE INCOME TAX EXPENSE AND MINORITY INTEREST</b>					
	370,593	378,618	67,002	(417,091)	399,122
Income tax expense		20,106	6,319		26,425
<b>INCOME BEFORE MINORITY INTERESTS</b>	370,593	358,512	60,683	(417,091)	372,697
Minority interests		(1,349)	(755)		(2,104)
<b>NET INCOME</b>	\$ 370,593	\$ 357,163	\$ 59,928	\$ (417,091)	\$ 370,593

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS****For the six months ended February 28, 2007**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Propane Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
<b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>	\$ 275,764	\$ 570,542	\$ 78,899	\$ 44,669	\$ (351,979)	\$ 617,895
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>						
Cash paid for acquisitions, net of cash acquired	(5,535)	(70,670)	(713)	(9,553)	3,386	(83,085)
Capital expenditures		(491,654)	(6,609)	(44,667)		(542,930)
Advances to and investment in affiliates	(1,051,237)			(3,160)	100,000	(954,397)
Proceeds from the sale of assets		9,755	1,662	7,783		19,200
Net cash used in investing activities	(1,056,772)	(552,569)	(5,660)	(49,597)	103,386	(1,561,212)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>						
Proceeds from borrowings	2,392,796		1,489	98,745		2,493,030
Principal payments on debt	(1,991,665)	(10,643)	(473)	(425,711)		(2,428,492)
Proceeds from borrowings from affiliates	2,216,939	2,348,571	91,632	318,965	(4,976,107)	
Payments on borrowings from affiliates	(2,759,168)	(2,092,431)	(87,893)	(36,615)	4,976,107	
Net proceeds from issuance of Common Units	1,200,000					1,200,000
Capital contribution from General Partner	24,489			100,000	(100,000)	24,489
Distributions to parent		(263,470)	(59,510)	(22,757)	345,737	
Distributions to partners	(292,468)				6,242	(286,226)
Debt issuance costs	(8,933)			(518)		(9,451)
Net cash provided by (used in) financing activities	781,990	(17,973)	(54,755)	32,109	251,979	993,350
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	982		18,484	27,181	3,386	50,033
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	728		2,182	26,517	(3,386)	26,041
<b>CASH AND CASH EQUIVALENTS, end of period</b>	\$ 1,710	\$	\$ 20,666	\$ 53,698	\$	\$ 76,074

**Table of Contents****ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS****For the six months ended February 28, 2006**

(In thousands)

	Parent	Midstream Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
<b>NET CASH FLOWS PROVIDED BY (USED IN)</b>					
OPERATING ACTIVITIES	\$ (49,672)	\$ 446,704	\$ 41,026	\$	\$ 438,058
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Cash paid for acquisitions, net of cash acquired		(17,124)	(12,822)		(29,946)
Working capital settlement on prior year acquisitions		19,653			19,653
Capital invested in subsidiaries	(132,387)			132,387	
Capital expenditures		(229,751)	(25,350)		(255,101)
Proceeds from the sale of assets		2,412	1,463		3,875
Net cash used in investing activities	(132,387)	(224,810)	(36,709)	132,387	(261,519)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Proceeds from borrowings	824,192		188,996		1,013,188
Proceeds from short term borrowings from affiliates	883,307	729,390		(1,612,697)	
Principal payments on debt	(925,192)		(243,130)		(1,168,322)
Principal payments received from affiliates	(729,390)	(883,307)		1,612,697	
Distributions to parent	(4,193)	(125,402)	(18,812)	148,407	
Distributions from subsidiaries	144,214		4,193	(148,407)	
Debt issuance costs	(1,196)				(1,196)
Equity offering	132,387				132,387
Capital contribution from general partner	2,702	57,387	75,000	(132,387)	2,702
Unit distributions	(146,369)				(146,369)
Net cash provided by (used in) financing activities	180,462	(221,932)	6,247	(132,387)	(167,610)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(1,597)	(38)	10,564		8,929
CASH AND CASH EQUIVALENTS, beginning of period	3,810	38	21,066		24,914
CASH AND CASH EQUIVALENTS, end of period	\$ 2,213	\$	\$ 31,630	\$	\$ 33,843



## **Table of Contents**

### **19. REPORTABLE SEGMENTS:**

As of February 28, 2007, our financial statements reflect five reportable segments:

ETC OLP:

midstream operations

intrastate transportation and storage operations

ET Interstate:

interstate transportation operations

HOLP and Titan:

retail propane operations

HOLP:

wholesale propane operations, including the operations of MP Energy Partnership

As of December 1, 2006, with the completion of our acquisition of Transwestern, we have a new reporting segment for our interstate transportation operations. As a result, the comparability of the segment operations information is affected by this addition. The volumes and results of operations data for the three months ended February 28, 2007 include the interstate operations for the entire period. However, the three and six month volumes and results of operations do not include the interstate operations for periods prior to December 1, 2006.

Segments below the quantitative thresholds are classified as "other". None of the components of the "other" segment have ever met any of the quantitative thresholds for determining reportable segments. Management has combined the domestic wholesale propane and foreign wholesale propane segments into one segment for all periods presented in this report. The combined segment is referred to as the wholesale propane segment.

Midstream and transportation and storage segment revenues and expenses include intersegment and intrasegment transactions, which are generally based on transactions made at market-related rates. Consolidated revenues and expenses reflect the elimination of all material intercompany transactions.

The midstream operations focus on the gathering, compression, treating, blending, processing, and marketing of natural gas, primarily on or through the Southeast Texas System, and marketing operations related to our producer services business. Revenue is primarily generated by the volumes of natural gas gathered, compressed, treated, processed, transported, purchased and sold through our pipelines (excluding the transportation pipelines) and gathering systems as well as the level of natural gas and NGL prices.

The intrastate transportation and storage operations focus on transporting natural gas through our Oasis Pipeline, ET Fuel System, East Texas Pipeline System, HPL System and Fort Worth Basin Pipeline. Revenue is typically generated from fees charged to customers to reserve firm capacity on or move gas through the pipeline on an interruptible basis. A monetary fee and/or fuel retention are also components of the fee structure. Excess fuel retained after consumption is typically valued at the first of the month published market prices and strategically sold when market prices are high. The intrastate transportation and storage operations also consist of the HPL System which generates revenue primarily from the sale of natural gas to electric utilities, independent power plants, local distribution companies, industrial end-users, and other marketing companies. The use of the Bammel storage reservoir allows us to purchase physical natural gas and then sell financial contracts at a price sufficient to cover its carrying costs and provide a gross profit margin. The HPL System also transports natural gas for a variety of third party customers.

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The interstate transportation operations focus on natural gas transportation of Transwestern, which owns and operates approximately 2,400 miles of interstate natural gas pipeline system extending from Texas and Oklahoma, through the San Juan Basin to the California border. Transwestern is a major natural gas transporter to the California border and delivers natural gas from the east end of its system to Texas intrastate and Midwest markets. The revenues of this segment consist primarily of fees earned from natural gas transportation services and operational gas sales from excess gas retained.

**Table of Contents**

Our retail and wholesale propane segments sell products and services to retail and wholesale customers. Intersegment sales by the foreign wholesale segment to the domestic segment are priced in accordance with the partnership agreement of MP Energy Partnership. We manage our propane segments separately as each segment involves different distribution, sale, and marketing strategies.

We evaluate the performance of our operating segments based on operating income exclusive of general partnership selling, general, administrative expenses, gain (loss) on disposal of assets, minority interests, interest expense, earnings (losses) from equity investments and income tax expense (benefit). Certain overhead costs relating to a reportable segment have been allocated for purposes of calculating operating income. Effective with the Transwestern acquisition on December 1, 2006, we began allocating administration expenses to our operating partnerships. The amounts of such allocations for the three and six months ended February 28, 2007 were approximately \$1,700 to midstream, \$1,500 to interstate transportation and \$2,500 to propane, for a total of approximately \$5,700.

The following table presents the financial information by segment for the following periods:

	Three Months Ended		Six Months Ended	
	February 28, 2007	February 28, 2006	February 28, 2007	February 28, 2006
Volumes:				
Midstream				
Natural gas MMBtu/d sold	819,611	1,529,856	900,238	1,528,616
NGLs bbls/d sold	15,901	9,537	13,723	9,879
Transportation and storage				
Natural gas MMBtu/d transported	5,030,631	4,231,797	4,918,191	4,349,137
Natural gas MMBtu/d sold	1,655,278	1,868,486	1,481,724	1,709,049
Interstate transportation				
Natural gas MMBtu/d transported	1,728,056		1,728,056	
Propane gallons (in thousands)				
Retail	253,715	165,758	394,346	254,496
Wholesale	32,428	28,243	55,711	47,844
Total gallons	286,143	194,001	450,057	302,340

	Three Months Ended		Six Months Ended	
	February 28, 2007	February 28, 2006	February 28, 2007	February 28, 2006
Revenues:				
Midstream	\$ 624,245	\$ 1,205,027	\$ 1,232,428	\$ 2,754,855
Eliminations	(297,620)			