

ENERGY TRANSFER PARTNERS LP

Form 10-K

November 15, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended August 31, 2004

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

ENERGY TRANSFER PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

73-1493906

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

2838 Woodside Street, Dallas, Texas 75204

(Address of principal executive offices and zip code)

(918) 492-7272

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of class	Name of each exchange on which registered
Common Units	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act: None

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

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

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The aggregate market value as of February 29, 2004, of the registrant's Common Units held by non-affiliates of the registrant, based on the reported closing price of such units on the New York Stock Exchange on such date, was approximately \$880,100,000. Common Units held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Units have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

At November 12, 2004, the registrant had units outstanding as follows:

Energy Transfer Partners, L.P. 44,639,306 Common Units

Documents Incorporated by Reference: None

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ENERGY TRANSFER PARTNERS, L.P.

2004 FORM 10-K ANNUAL REPORT

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Energy Transfer Partners, L.P. is one of the ten largest publicly traded master limited partnerships in the United States. We are engaged in the natural gas midstream and transportation business through our operating subsidiary, La Grange Acquisition, L.P. (ETC OLP), and are a retail marketer of propane in the United States through our operating subsidiary, Heritage Operating, L.P. (HOLP). We are a publicly traded Delaware limited partnership formed in conjunction with an initial public offering as Heritage Propane Partners, L.P. in June of 1996. Following the completion of a series of transactions in January 2004, we combined the retail propane operations of Heritage Propane Partners, L.P. with the natural gas midstream and transportation operations of ETC OLP. In March 2004, we changed our name to Energy Transfer Partners, L.P. References to we, us, our, or the Partnership are intended to mean Energy Transfer Partners, L.P., our operating limited partnerships and subsidiaries. The business of Heritage Propane Partners, L.P. and Heritage Operating, L.P. prior to the transaction in January 2004, is referred to as Predecessor Heritage or Heritage.

ETC OLP's operations are divided into two business segments, consisting of the midstream segment and the transportation segment. We own and operate approximately 7,750 miles of natural gas gathering and transportation pipelines, four natural gas processing plants connected to our gathering systems, thirteen natural gas treating facilities and two natural gas storage facilities. Our midstream segment focuses on the gathering, compression, treating, blending, processing and marketing of natural gas and is currently concentrated in the Austin Chalk trend of southeast Texas, the Anadarko Basin of western Oklahoma and the Permian Basin of west Texas. Our transportation segment focuses on the transportation of natural gas mainly through the Oasis Pipeline, the Bossier Pipeline, and the ET Fuel System, which are described below.

Through HOLP, we are the fourth largest retail propane marketer in the United States, serving more than 650,000 customers from 310 customer service locations in 32 states. Our propane operations extend from coast to coast, with concentrations in the western, upper midwestern, northeastern and southeastern regions of the United States. Volumes of propane sold to retail customers have increased steadily from 63.2 million gallons for the fiscal year ended August 31, 1992, to 397.9 million gallons for the fiscal year ended August 31, 2004.

See Note 13 Reportable Segments to the Consolidated Financial Statements beginning on page F-1 of this report for financial information about these operating segments.

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
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

Energy Transfer Transactions

On January 20, 2004, Heritage and La Grange Energy, L.P. (La Grange Energy) completed a series of transactions whereby La Grange Energy contributed its subsidiary ETC OLP to Heritage in exchange for cash of \$300.0 million less the amount of ETC OLP debt in excess of \$151.5 million, less ETC OLP's accounts payable and other specified liabilities, plus agreed-upon capital expenditures paid by La Grange Energy relating to the ETC OLP business prior to closing, \$433.9 million of Heritage Common and Class D Units, and the repayment of the ETC OLP debt of \$151.5 million. These transactions and the other transactions described in the following paragraphs are referred to herein as the Energy Transfer Transactions. In conjunction with the Energy Transfer Transactions and

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prior to the contribution of ETC OLP to Heritage, ETC OLP distributed its cash and accounts receivables to La Grange Energy and an affiliate of La Grange Energy contributed an office building to ETC OLP. La Grange Energy also received 3,742,515 Special Units as consideration for the project it had in progress to construct the Bossier Pipeline. The Special Units converted to Common Units upon the Bossier Pipeline becoming commercially operational and such conversion being approved by Energy Transfer Partners, L.P.'s Unitholders. The Bossier Pipeline became commercially operational on June 21, 2004, and the Unitholders approved the conversion of the Special Units at a special meeting held on June 23, 2004.

Simultaneously with the transactions described in the preceding paragraph, La Grange Energy obtained control of Heritage by acquiring all of the interests in U.S. Propane, L.P., (U.S. Propane) the General Partner of Heritage, and U.S. Propane's general partner, U.S. Propane, L.L.C., from subsidiaries of AGL Resources, Atmos Energy Corporation, TECO Energy, Inc. and Piedmont Natural Gas Company, Inc. for \$30.0 million (the General Partner Transaction). In conjunction with the General Partner Transaction, U.S. Propane L.P. contributed its 1.0101% General Partner interest in HOLP to Heritage in exchange for an additional 1% General Partner interest in Heritage. Simultaneously with these transactions, Heritage purchased the outstanding stock of Heritage Holdings, Inc. (Heritage Holdings) for \$100.0 million.

Concurrent with the Energy Transfer Transactions, ETC OLP borrowed \$325.0 million from financial institutions and Heritage raised \$355.9 million of gross proceeds net of underwriter's discount through the sale of 9,200,000 Common Units at an offering price of \$38.69 per unit. The net proceeds were used to finance the Energy Transfer Transactions and for general partnership purposes.

Recent Acquisitions and Expansion

TUFCO Acquisition. On June 2, 2004, we announced the closing of the acquisition of the midstream natural gas assets of TXU Fuel Company, a gas transportation subsidiary of TXU Corp., which we refer to as the TUFCO acquisition, for approximately \$500.0 million in cash, subject to post-closing adjustments. The former TUFCO System, which we refer to as the ET Fuel System, serves some of the most active drilling areas in the United States. The ET Fuel System is comprised of approximately 2,000 miles of intrastate natural gas pipeline and related natural gas storage facilities located in Texas. With approximately 460 receipt and/or delivery points, including interconnects with pipelines providing direct access to power plants and interconnects with other intrastate and interstate pipelines, the ET Fuel System is strategically located near high-growth production areas and major markets such as the Waha Hub, the Katy Hub and the Carthage Hub, three major natural gas trading centers located in Texas. The ET Fuel System has total system throughput capacity of approximately 1.3 Bcf/d of natural gas and total working storage capacity of 14.0 Bcf of natural gas. The ET Fuel System had been operated by TUFCO primarily as a natural gas transmission pipeline system to supply natural gas from various natural gas producing areas to electric generating power plants of TXU Corp. and its affiliates, which we refer to as TXU. As part of this acquisition, we entered into an eight-year transportation agreement with TXU Portfolio Management Company, LP, a subsidiary of TXU, which we refer to as TXU Shipper, to transport a minimum of 115.6 MMbtu per year, subject to adjustments, of gas to TXU's electric generating power plants and two eight-year natural gas storage agreements with TXU Shipper to store gas at two natural gas storage facilities that are part of the ET Fuel System. We also acquired existing transportation contracts for the ET Fuel System with other natural gas producers, natural gas marketing companies, industrial end-users and other customers, which accounted for approximately 30% of the total revenue of the ET Fuel System for the year ended December 31, 2003.

Bossier Pipeline Expansion. In June 2004, we completed our Bossier Pipeline expansion, which consisted of 78 miles of pipeline that connected certain third party and ETC OLP-owned treating facilities to our Southeast Texas assets. The Bossier Pipeline expansion provides initial capacity of 500 MMcf/d that can be increased to 1.0 Bcf/d. The pipeline provides producers in North Central and East Texas access to the Katy Hub. We currently have contracted

under long-term agreements over 400 MMcf/d of pipeline capacity on the Bossier Pipeline.

Devon Acquisition. On November 1, 2004 we announced the closing of the acquisition of certain midstream natural gas assets of Devon Energy Corporation (Devon) for approximately \$64.6 million in cash after adjustments. The assets, known as the Texas Chalk and Madison Systems, include approximately 1,800 miles of gathering and mainline pipeline systems, four natural gas treating plants, condensate stabilization facilities, fractionation facilities and the 80 MMcf/d Madison gas processing plant.

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Fort Worth Basin Expansion. We are currently constructing a 54-mile pipeline in the Fort Worth Basin that will connect certain pipelines in North Texas. We expect that this expansion will provide us with 400 MMcf/d of pipeline capacity and is anticipated to be completed by March 2005. The expansion is estimated to cost approximately \$53.0 million, which we expect to finance from internally generated funds.

Recent Propane Acquisitions. In April 2004, we announced the acquisition of the assets of Edwards Propane of Marshville, North Carolina. Edwards Propane serves approximately 9,000 customers in and around the Marshville area. In July 2004, we announced the acquisition of the assets of Custer Gas Service, Inc., in Custer, South Dakota. Custer Gas serves approximately 1,800 customers in the Custer area. We recently announced two additional propane acquisitions made during the first quarter of fiscal year 2005. The acquisition of the assets of Boland Energy in September 2004 and of Trenton Propane in October 2004, added customer bases purchasing approximately 4.8 million gallons annually in the rural area west of St. Louis, Missouri and approximately 2.0 million gallons annually in the area north of Dallas, Texas, respectively.

Other Developments

Distribution Increases. On April 14, 2004, we paid a quarterly cash distribution of \$0.70 per Common Unit (an annualized rate of \$2.80 per Common Unit) on our outstanding Common Units for the second quarter of fiscal year 2004. The \$0.70 per Common Unit quarterly distribution represented an increase of \$0.05 per Common Unit (an annualized increase of \$0.20 per unit) over the distribution paid for the first quarter of fiscal 2004. In connection with the completion of our acquisition of the ET Fuel System, our Board of Directors approved an increase in the quarterly cash distribution from \$0.70 to \$0.75 per Common Unit, which resulted in an annualized rate of \$3.00 per Common Unit with respect to the quarter ended May 31, 2004. On September 20, 2004, we announced our twelfth increase in our quarterly cash distribution, a 10% increase to \$0.825 per Common Unit (an annualized rate of \$3.30 per unit) on our outstanding Common Units with respect to the quarter ended August 31, 2004.

Amendment to Midstream Credit Facilities. On June 1, 2004, we amended our credit facilities secured by the assets of ETC OLP, which we refer to as our Midstream Facilities, to increase the available borrowing capacity. The borrowing capacity under our Term Loan Facility was increased to \$725.0 million from \$325.0 million and the borrowing capacity under our Revolving Credit Facility was increased to \$225.0 million from \$175.0 million. Our Midstream Facilities were also amended to increase our leverage ratio to 4.75 to 1.0 during the 365-day period following the funding of the purchase price of the ET Fuel System and to 4.00 to 1.00 during any period other than the 365-day period following the funding of the purchase price of the ET Fuel System. Leverage ratio means, as of any date of determination, the ratio of (a) consolidated funded indebtedness to (b) consolidated EBITDA (terms as defined in the bank credit facilities) for the four fiscal quarter period most recently ended prior to the date of determination for which financial statements are available. Effective August 31, 2004 we amended the Credit Agreement relating to our Midstream Facilities to ease the administration of our reporting obligations thereunder and to correct other inconsistencies.

Special Unitholder Meeting. On June 23, 2004, we held a special meeting for our Common Unitholders of record on May 17, 2004 for the purpose of approving a proposal to change the terms of the Class D Units and the Special Units issued in connection with the Energy Transfer Transactions and to approve our 2004 Unit Plan. At the meeting, our Common Unitholders approved (1) the change in terms and conversion of all 7,721,542 outstanding Class D Units into 7,721,542 Common Units, (2) the change in terms and conversion of all 3,742,515 outstanding Special Units into 3,742,515 Common Units upon the Bossier Pipeline becoming commercially operational, which occurred on June 21, 2004, and (3) our 2004 Unit Plan, which provides for awards of Common Units and other rights to our employees, officers and directors.

Secondary Equity Offering. On June 30, 2004, we the completed of the sale of 4.5 million Common Units at a public offering price of \$39.20 per unit. Net proceeds from the Common Unit offering of approximately \$169.0 million were used to repay a portion of the outstanding indebtedness incurred to fund the ET Fuel System acquisition and for general partnership purposes. On July 2, 2004 we issued 675,000 Common Units to the Underwriters upon their exercise of their over-allotment option at the offering price of \$39.20 per unit.

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The following table set forth below contains certain information regarding our midstream and transportation assets.

Asset	Type	Length (Miles)	Approximate Wells Connected	Approximate Throughput Capacity MMcf/d)	Approximate Current	
					Average Throughput (MMcf/d)	Utilization of Capacity (%)
Midstream						
Southeast Texas System	Gathering pipelines	2,379	1,050	720	250	35%
	Processing facility			240	120	50%
	6 Treating facilities			490	163	33%
Southeast Texas System - Devon Assets (c)	Gathering pipelines	1,800	1,000	525	120	23%
	Processing facility			80	25	31%
	4 Treating facilities			250	70	28%
	Stabilizer plant Fractionator plant					
Elk City System	Gathering pipelines	318	300	410	250	61%
	Processing facility			130	120	92%
	2 Treating facilities			275	245	89%
Small Systems (a) (d)	Gathering pipelines	525	138	556	140	25%
	Processing facility			20	20	100%
	1 Treating facility			30	8	27%
Transportation						
Oasis Pipeline	Transportation pipeline	583		1,200	1,180	98%
ET Fuel System (b) Bossier Pipeline (c)	Transportation pipeline	2,000		1,300	730	56%
(East Texas Pipeline)	Transportation pipeline	132		500	300	60%
				Working Storage Capacity		

ET Fuel System (b)	Bethel Storage Facility	7.5 Bcf
	Bryson Storage Facility	6.5 Bcf

(a) We own interests in various midstream assets located in Texas and Louisiana. Amounts represent 100% and not just our interests.

(b) ET Fuel System was acquired in June 2004.

(c) Bossier Pipeline became operational in June 2004. Average throughput is based on date the pipeline became operational through August 31, 2004. Includes 78 miles of pipeline for Bossier Pipeline and 54 mile of pipeline for Katy Pipeline.

(d) Small Systems include: Chalkley, Rusk County, Whiskey Bay, Vantex, Ranger, Dorado, and Traders Creek.

(e) The Devon assets were acquired November 1, 2004 and will be added to the southeast Texas System. All information for these assets is based on Devon's prior historical information available.

Midstream and Transportation Operations. Our midstream and transportation operations are primarily located in major natural gas producing regions of Texas and Oklahoma. Our midstream and transportation assets, including the newly acquired ET Fuel System and the midstream assets acquired from Devon Energy Corporation on November 1, 2004, consist of our interests in approximately 7,750 miles of natural gas pipelines, four natural gas processing plants connected to our gathering systems with a total processing capacity of approximately 470 MMcf/d and thirteen natural gas treating facilities with a total treating capacity of approximately 1,050 MMcf/d. Our midstream and transportation operations relating to these assets consist of the following:

the gathering of natural gas from approximately 2,488 producing wells;

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the compression of natural gas to facilitate its flow from the wells through ETC OLP's gathering systems;

the treating and blending of natural gas to remove impurities such as carbon dioxide and hydrogen sulfide to ensure that the natural gas meets pipeline quality specifications;

the processing of natural gas to extract natural gas liquids, or NGLs; the sale of the pipeline quality natural gas, or residue gas, remaining after it is processed; and the sale of the NGLs to third parties at fractionation facilities where the NGLs are separated into their individual components, including ethane, propane, mixed butanes and natural gasoline;

the transportation of natural gas on the Oasis Pipeline, Bossier Pipeline, and ET Fuel Systems to industrial end-users, independent power plants, utilities and other pipelines; and

the purchase for resale of natural gas from producers connected to its systems and from other third parties. Our midstream segment consists of the following:

the Southeast Texas System, a 4,179-mile integrated system located in southeast Texas that gathers, compresses, treats, processes and transports natural gas from the Austin Chalk trend. The Southeast Texas System is a large natural gas gathering system covering thirteen counties between Austin and Houston. The system includes the La Grange processing plant, the Madison processing plant, and ten treating facilities. This system is connected to the Katy Hub through the 55-mile Katy Pipeline and is also connected to the Oasis Pipeline, as well as two power plants.

The La Grange and Madison processing plants are cryogenic natural gas processing plants that process the rich natural gas that flows through our system to produce residue gas and NGLs. The plants have a processing capacity of approximately 320 MMcf/d. Our ten treating facilities have an aggregate capacity of 740 MMcf/d. These treating facilities remove carbon dioxide and hydrogen sulfide from natural gas that is gathered into our system before the natural gas is introduced to transportation pipelines to ensure that the gas meets pipeline quality specifications.

the Elk City System, a 318-mile gathering system located in western Oklahoma that gathers, compresses, treats and processes natural gas from the Anadarko Basin. The Elk City System also includes the Elk City processing plant and one treating facility. The Elk City System is connected, either directly or indirectly, to six major interstate and intrastate natural gas pipelines providing access to natural gas markets throughout the United States. The Elk City System has a processing capacity of approximately 130 MMcf/d.

The Elk City System is located in an area where certain producers are actively drilling in the Springer, Atoka and Arbuckle formations in western Oklahoma at depths in excess of 15,000 feet. We recently moved one of our treating plants from Texas to Beckham County, Oklahoma to treat natural gas produced in the western portion of the system. We believe that many of the producers in the area will choose to treat their gas through our new treating plant due to the lack of other competitive alternatives.

an interest in various midstream assets located in Texas and Louisiana, including the Vantex System, the Rusk County Gathering System, the Whiskey Bay System, the Dorado System and the Chalkley Transmission System. On a combined basis, these assets have a capacity of approximately 600 MMcf/d.

marketing operations through our producer services business, in which we market the natural gas that flows through its assets, referred to as on-system gas, and attracts other customers by marketing volumes of natural gas that do not move through its assets, referred to as off-system gas. For both on-system and off-system gas, we

purchase natural gas from natural gas producers and other supply points

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and sell the natural gas to utilities, industrial consumers, other marketers and pipeline companies, thereby generating gross margins based upon the difference between the purchase and resale prices.

Substantially all of our on-system marketing efforts involve natural gas that flows through either the Southeast Texas System or the Oasis Pipeline. We market only a small amount of natural gas that flows through our Elk City System.

For the off-system gas, we purchase gas or act as an agent for small independent producers that do not have marketing operations. We develop relationships with natural gas producers to facilitate the purchase of their production on a long-term basis. We believe that this business provides us with strategic insights and valuable market intelligence, which may impact our expansion and acquisition strategy.

Our transportation segment consists of the following:

the Oasis Pipeline, a 583-mile natural gas pipeline that directly connects the Waha Hub to the Katy Hub. The Oasis pipeline is primarily a 36-inch diameter natural gas pipeline. It has bi-directional capability with approximately 1.2 Bcf/d of throughput capacity moving west-to-east and greater than 750 MMcf/d of throughput capacity moving east-to-west. The Oasis Pipeline has many interconnections with other pipelines, power plants, processing facilities, municipalities and producers.

The Oasis Pipeline is integrated with our Southeast Texas System and is an important component to maximizing our Southeast Texas System's profitability. The Oasis pipeline enhances the Southeast Texas System by:

providing us with the ability to bypass the La Grange processing plant when processing margins are unfavorable;

providing natural gas on the Southeast Texas system access to other third party supply and market points and interconnecting pipelines; and

allowing us to bypass our treating facilities on the Southeast Texas System and blend untreated natural gas from the Southeast Texas System with gas on the Oasis Pipeline while continuing to meet pipeline quality specifications.

the ET Fuel System, which serves some of the most active drilling areas in the United States, is comprised of approximately 2,000 miles of intrastate natural gas pipeline and related natural gas storage facilities. With approximately 460 receipt and/or delivery points, including interconnects with pipelines providing direct access to power plants and interconnects with other intrastate and interstate pipelines, the ET Fuel System is strategically located near high-growth production areas and provides access to the Waha Hub, the Katy Hub and the Carthage Hub, the three major natural gas trading centers in Texas. The ET Fuel System has total system throughput capacity of approximately 1.3 Bcf/d of natural gas and total working storage capacity of 14.0 Bcf of natural gas. Prior to our acquisition in June 2004, the ET Fuel System had been operated primarily as a natural gas transmission pipeline system to supply natural gas from various natural gas producing areas to electric generating power plants of TXU Corp. and its affiliates (TXU). In connection with our acquisition of the ET Fuel System, we entered into an eight-year transportation agreement with TXU Portfolio Management Company, LP (TXU Shipper), a subsidiary of TXU, to transport a minimum of 115.6 MMBtu per year, subject to certain adjustments as defined in the agreement. We also entered into two eight-year natural gas storage agreements with TXU Shipper to store gas at two natural gas storage facilities that were part of the ET Fuel system.

the Bossier Pipeline is a 78-mile natural gas pipeline that connects three treating facilities with our Southeast Texas System of which one treating facility is owned by us. This pipeline is the first phase of a multi-phased

project that will service producers in East and North Central Texas providing access to the Katy Hub. The Bossier Pipeline expansion has initial capacity of 500 MMcf/d and currently has over 400 MMcf/d of pipeline capacity contracted under long-term agreements with XTO Energy Inc. and other producers.

Table of Contents**Heritage Operating, L.P.**

We believe we are the fourth largest retail propane marketer in the United States, serving more than 650,000 customers from 310 customer service locations in 32 states. Our operations extend from coast to coast, with concentrations in the western, upper midwestern, northeastern and southeastern regions of the United States. We are also a wholesale propane supplier in the southwestern and southeastern United States and in Canada, the latter through participation in M-P Energy Partnership. M-P Energy Partnership is a Canadian partnership in which we own a 60% interest that is engaged in wholesale distribution and in supplying our northern U.S. locations. Our propane business has grown primarily through acquisitions of retail propane operations and, to a lesser extent, through internal growth. Since Heritage's inception through August 2004, we have completed 106 propane-related acquisitions for an aggregate purchase price of approximately \$738 million. Volumes of propane sold to retail customers have increased from 63.2 million gallons for the fiscal year ended August 31, 1992 to 397.9 million gallons for the fiscal year ended August 31, 2004.

Following is a summary of the retail sales volumes per fiscal year for the last three fiscal years.

	For the Years Ended August 31,		
	2002	2003	2004
Retail Gallons Sold (in millions):	329.6	375.9	397.9

Business Strategy

Our goal is to increase Unitholder distributions and the value of our Common Units. We believe we have engaged, and will continue to engage, in a well-balanced plan for growth through acquisitions, internally generated expansion, and measures aimed at increasing the profitability of our existing assets.

We intend to continue to operate as a diversified, growth-oriented master limited partnership with a focus on increasing the amount of cash available for distribution on each Common Unit. We believe that by pursuing independent operating and growth strategies for our midstream and transportation and propane businesses, we will be best positioned to achieve our objectives.

We expect that midstream and transportation acquisitions, such as our recent acquisition of the ET Fuel System, will be the primary focus of our acquisition strategy going forward, although we will also continue to pursue complementary propane acquisitions. We also anticipate that our midstream and transportation business will provide internal growth projects of greater scale compared to those available in our propane business.

Midstream and Transportation Business Strategies

Growth through acquisitions. As demonstrated by our recent acquisition of the ET Fuel System and our recent announcement of the Devon acquisition, we intend to make strategic acquisitions of midstream and transportation assets in our current areas of operation that offer the opportunity for operational efficiencies and the potential for increased utilization and expansion of our existing and acquired assets. We will also pursue midstream and transportation asset acquisition opportunities in other regions of the U.S. with significant natural gas reserves and high levels of drilling activity or with growing demand for natural gas. We believe we will be well positioned to benefit from the additional acquisition opportunities likely to arise as a result of the ongoing divestiture of midstream assets

by large industry participants.

Enhance profitability of existing assets. We intend to increase the profitability of our existing asset base by adding new volumes of natural gas, undertaking additional initiatives to enhance utilization and reducing costs by improving operations.

Engage in construction and expansion opportunities. We intend to leverage our existing infrastructure and customer relationships by constructing and expanding systems to meet new or increased demand for midstream services. These projects include expansion of existing systems, such as the Bossier Pipeline in east Texas and the

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Fort Worth Basin project in North Texas, and construction of new facilities. Once completed, we expect that these expansions will lead to additional growth opportunities in this area.

Increase cash flow from fee-based businesses. Fee-based margin represents approximately 76% of our midstream and transportation segments' total gross margin for the year ended August 31, 2004. We generated approximately 29% of our gross margin during the year ended August 31, 2004 from fees charged for providing midstream services, including a transportation fee we charge our producer services business for natural gas that it transports on the Oasis Pipeline equal to the fee charged to third parties. This transportation fee accounted for 9% of total gross margin for this period. These fee-based services are dependent on throughput volume and are typically less affected by short-term changes in commodity prices. We intend to seek to increase the percentage of our midstream business conducted with third parties under fee-based arrangements in order to reduce exposure to changes in the prices of natural gas and NGLs. For example, we expect the fee-based contracts associated with the Bossier Pipeline to significantly increase the fee-based component of our gross margin.

Propane Business Strategies

Growth through complementary acquisitions. We believe that our position as the fourth largest propane marketers provides us a solid foundation to continue our acquisition growth strategy through consolidation. We believe that the fragmented nature of the propane industry will continue to provide opportunities for growth through the acquisition of propane businesses that complement our existing asset base. In addition to focusing on propane acquisition candidates in our existing areas of operations, we will also consider core acquisitions in other higher-than-average population growth areas in which we have no presence in order to further reduce the impact adverse weather patterns and economic downturns in any one region may have on our overall operations.

Maintain low-cost, decentralized operations. We focus on controlling costs, and we attribute our low overhead costs primarily to our decentralized structure. By delegating all customer billing and collection activities to the customer service location level, as well as delegating other responsibilities to the operating level, we have been able to operate without a large corporate staff. In addition, our customer service location level incentive compensation program encourages employees at all levels to control costs while increasing revenues.

Pursue internal growth opportunities. In addition to pursuing expansion through acquisitions, we have aggressively focused on high return internal growth opportunities at our existing customer service locations. We believe that by concentrating our operations in areas experiencing higher-than-average population growth, we are well positioned to achieve internal growth by adding new customers.

Competitive Strengths

We believe that we are well positioned to compete in both the natural gas midstream and transportation and propane industries based on the following strengths:

Midstream and Transportation Business Strengths

We are diversified into major natural gas supply areas. We have a significant market presence in each of our operating areas, which are located in major natural gas producing regions of the United States.

Our Southeast Texas System has additional capacity, which provides opportunities for higher levels of utilization. We expect to connect new supplies of natural gas volumes by utilizing the available capacity on the Southeast Texas System. The available capacity also provides us with opportunities to extend the Southeast Texas System to additional natural gas producing areas, such as east Texas through the recently completed Bossier Pipeline.

Our assets provide marketing flexibility through our access to numerous markets and customers. Our Oasis Pipeline combined with its Southeast Texas System provides our customers direct access to the Waha and Katy Hubs and to virtually all other market areas in the United States via interconnections with major intrastate and interstate natural gas pipelines. Furthermore, our Oasis Pipeline is tied directly or indirectly to a number of major power generation facilities in Texas as well as several industrial and utility end-users. Additionally, our Elk City System has direct access to six major intrastate and interstate pipelines. With the acquisition of the ET Fuel System in June

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2004, we have also enhanced our opportunities with additional power plants, industrial users, municipals, and co-operatives, and the added storage facilities add flexibility for fuel management services.

Our ability to bypass our La Grange and Elk City processing plants reduces our commodity price risk. A significant benefit of our ownership of the Oasis Pipeline is that we can elect not to process natural gas at our La Grange processing plant when processing margins (or the difference between NGL sales prices and the cost of natural gas) are unfavorable. Instead of processing the natural gas, we are able to deliver natural gas meeting pipeline quality specifications by blending rich gas, or gas with a high NGL content, from the Southeast Texas System with lean gas, or gas with a low NGL content, transported on the Oasis Pipeline. This enables us to sell the blended natural gas for a higher price than we would have been able to realize upon the sale of NGLs if we had to process the natural gas to extract NGLs. In addition, we also have the option to not process natural gas at our Elk City processing plant because the gas produced in this area meets pipeline quality specifications without processing.

Propane Business Strengths

Experience in identifying, evaluating and completing acquisitions. Since inception through August 31, 2004, we completed 106 propane acquisitions. We follow a disciplined acquisition strategy that concentrates on propane companies that (1) are located in geographic areas experiencing higher-than-average population growth, (2) provide a high percentage of sales to residential customers, (3) have a strong reputation for quality service, and (4) own a high percentage of the propane tanks used by their customers. In addition, we attempt to capitalize on the reputations of the companies we acquire by maintaining local brand names, billing practices and employees, thereby creating a sense of continuity and minimizing customer loss. We believe that this strategy has also helped to make us an attractive buyer for many propane acquisition candidates from the seller's viewpoint.

Geographically diverse retail propane network. We believe our geographically diverse network of retail propane assets reduces our exposure to unfavorable weather patterns and economic downturns in any one geographic region, thereby reducing the volatility of our cash flows.

Operations that are focused in areas experiencing higher-than-average population growth. We believe that our concentration in higher-than-average population growth areas provides a strong economic foundation for expansion through acquisitions and internal growth. We do not believe that we are more vulnerable than our competitors to displacement by natural gas distribution systems because the majority of our areas of operations are located in rural areas where natural gas is not readily available.

Low-cost administrative infrastructure. We are dedicated to maintaining a low-cost operating profile and have a successful track record of aggressively pursuing opportunities to reduce costs. Of the 2,600 full-time employees as of October 31, 2004, only 98, or approximately 4%, were general and administrative.

Decentralized operating structure and entrepreneurial workforce. We believe that our decentralized operations foster an entrepreneurial corporate culture by: (1) having operational decisions made at the customer service location and operating level, (2) retaining billing, collection and pricing responsibilities at the local and operating level, and (3) rewarding employees for achieving financial targets at the local level.

Midstream Natural Gas Industry Overview

The midstream natural gas industry is the link between the exploration and production of natural gas and the delivery of its components to end-use markets and consists of natural gas gathering, compression, treating, processing and transportation and NGL fractionation and transportation. The midstream industry is generally characterized by regional competition based on the proximity of gathering systems and processing plants to natural gas producing

wells.

Natural gas has a widely varying composition, depending on the field, the formation, or the reservoir from which it is produced. The principal constituents of natural gas are methane and ethane, though most natural gas also contains varying amounts of heavier components, such as propane, butane and natural gasoline that may be removed by a number of processing methods. Most raw material produced at the wellhead is not suitable for long-haul pipeline transportation or commercial use and must be compressed, transported via pipeline to a central processing

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facility, and then processed to remove the heavier hydrocarbon components and other contaminants that would interfere with pipeline transportation or the end use of gas.

Demand for natural gas. Natural gas continues to be a critical component of energy consumption in the United States. According to the Energy Information Administration, or the EIA, total domestic consumption of natural gas is expected to increase by over 2.2% per annum, on average, to 27.1 Tcf by 2010, from an estimated 22.2 Tcf consumed in 2001, representing approximately 25% of all total end-user energy requirements by 2010. During the last five years, the United States has on average consumed approximately 22.6 Tcf per year, with average domestic production of approximately 19.1 Tcf per year during the same period. The industrial and electricity generation sectors currently account for the largest usage of natural gas in the United States.

Natural gas gathering. The natural gas gathering process begins with the drilling of wells into gas bearing rock formations. Once a well has been completed, the well is connected to a gathering system. Gathering systems generally consist of a network of small diameter pipelines and, if necessary, compression systems that collect natural gas from points near producing wells and transport it to larger pipelines for further transportation.

Natural gas compression. Gathering systems are operated at design pressures that will maximize the total throughput from all connected wells. Specifically, lower pressure gathering systems allow wells, which produce at progressively lower field pressures as they age, to remain connected to gathering systems and continue to produce for longer periods of time. As the pressure of a well declines, it becomes increasingly more difficult to deliver the remaining production in the ground against a higher pressure that exists in the connecting gathering system. Field compression is typically used to lower the pressure of a gathering system. If field compression is not installed, then the remaining production in the ground will not be produced because it cannot overcome the higher gathering system pressure. In contrast, if field compression is installed, then a well can continue delivering production that otherwise would not be produced.

Natural gas treating. Natural gas has a varied composition depending on the field, the formation and the reservoir from which it is produced. Natural gas from certain formations is high in carbon dioxide, hydrogen sulfide or certain other contaminants. Treating plants remove carbon dioxide and hydrogen sulfide from natural gas to ensure that it meets pipeline quality specifications.

Natural gas processing. Some natural gas produced by a well does not meet pipeline quality specifications or is not suitable for commercial use and must be processed to remove the mixed NGL stream. In addition, some natural gas produced by a well, while not required to be processed, can be processed to take advantage of favorable processing margins. Natural gas processing involves the separation of natural gas into pipeline quality natural gas, or residue gas, and a mixed NGL stream.

Natural gas fractionation. NGL fractionation facilities separate mixed NGL streams into discrete NGL products: ethane, propane, isobutane, normal butane and natural gasoline. Ethane is primarily used in the petrochemical industry as feedstock for ethylene, one of the basic building blocks for a wide range of plastics and other chemical products. Isobutane is fractionated from mixed butane (a stream of normal butane and isobutane in solution) or refined from normal butane through the process of isomerization, principally for use to enhance the octane content of motor gasoline. Normal butane is used as a petrochemical feedstock in the production of ethylene and butadiene (a key ingredient in synthetic rubber), as a blendstock for motor gasoline and to derive isobutane through isomerization. Natural gasoline, a mixture of pentanes and heavier hydrocarbons, is used primarily as motor gasoline blend stock or petrochemical feedstock. We acquired a fractionation facility as part of the asset acquisition from Devon on November 1, 2004.

Natural gas transportation. Natural gas transportation pipelines receive natural gas from other mainline transportation pipelines and gathering systems and deliver the natural gas to industrial end-users, utilities and other pipelines.

Propane Industry Overview

Propane, a by-product of natural gas processing and petroleum refining, is a clean-burning energy source recognized for its transportability and ease of use relative to alternative forms of stand-alone energy sources. Retail propane use falls into three broad categories: (i) residential applications, (ii) industrial, commercial and agricultural

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applications and (iii) other retail applications, including motor fuel sales. Residential customers use propane primarily for space and water heating. Industrial customers use propane primarily as fuel for forklifts, stationary engines, furnaces, as a cutting gas, in mining operations and in other process applications. Commercial customers, such as restaurants, motels, laundries and commercial buildings, use propane in a variety of applications, including cooking, heating and drying. In the agricultural market, propane is primarily used for tobacco curing, crop drying, poultry brooding and weed control. Other retail uses include motor fuel for cars and trucks, outdoor cooking and other recreational uses, propane resales and sales to state and local governments. In our wholesale operations, we sell propane principally to large industrial end-users and other propane distributors.

Propane is extracted from natural gas at processing plants or separated from crude oil during the refining process. Propane is normally transported and stored in a liquid state under moderate pressure or refrigeration for ease of handling in shipping and distribution. When the pressure is released or the temperature is increased, it is usable as a flammable gas. Propane is naturally colorless and odorless. An odorant is added to allow its detection. Like natural gas, propane is a clean burning fuel and is considered an environmentally preferred energy source.

Propane competes with other sources of energy, some of which are less costly for equivalent energy value. We compete for customers against suppliers of electricity, natural gas and fuel oil. Competition from alternative energy sources has been increasing as a result of reduced utility regulation. Except for certain industrial and commercial applications, propane is generally not competitive with natural gas in areas where natural gas pipelines already exist because natural gas is a significantly less expensive source of energy than propane. The gradual expansion of the nation's natural gas distribution systems has resulted in the availability of natural gas in many areas that previously depended upon propane. Although the extension of natural gas pipelines tends to displace propane distribution in areas affected, we believe that new opportunities for propane sales arise as more geographically remote neighborhoods are developed. Even though propane is similar to fuel oil in certain applications and market demand, propane and fuel oil compete to a lesser extent primarily because of the cost of converting from one to another. Based upon industry publications, propane accounts for three to four percent of household energy consumption in the United States.

In addition to competing with alternative energy sources, we compete with other companies engaged in the retail propane distribution business. Competition in the propane industry is highly fragmented and generally occurs on a local basis with other large multi-state propane marketers, thousands of smaller local independent marketers and farm cooperatives. Most of our customer service locations compete with five or more marketers or distributors. Each retail distribution outlet operates in its own competitive environment because retail marketers tend to locate in close proximity to customers. The typical retail distribution outlet generally has an effective marketing radius of approximately 50 miles although in certain rural areas the marketing radius may be extended by satellite locations.

The ability to compete effectively further depends on the reliability of service, responsiveness to customers and the ability to maintain competitive prices. We believe that our safety programs, policies and procedures are more comprehensive than many of our smaller, independent competitors and give us a competitive advantage over such retailers. We also believe that our service capabilities and customer responsiveness differentiate us from many of these smaller competitors. Our employees are on call 24-hours-a-day, 7-days-a-week for emergency repairs and deliveries.

The wholesale propane business is highly competitive. For fiscal year 2004, our domestic wholesale operations (excluding M-P Energy Partnership) accounted for only 3.0% of our total gallons sold in the United States and approximately 1.2% of our gross profit. We do not emphasize wholesale operations, but we believe that limited wholesale activities enhance our ability to supply our retail operations.

The Midstream and Transportation Segments

Competition

The business of providing natural gas gathering, transmission, treating, transporting and marketing services is highly competitive. Our principal areas of competition include obtaining natural gas supplies for the Southeast Texas System and Elk City System and natural gas transportation customers for the Oasis Pipeline, Bossier Pipeline, and the ET Fuel System. Our competitors include major integrated oil companies, interstate and intrastate pipelines

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and companies that gather, compress, treat, process, transport and market natural gas. The Southeast Texas System primarily competes with natural gas gathering and processing systems owned by Duke Energy Field Services. The Elk City System competes with natural gas gathering and processing systems owned by Enogex, Inc., Oneok Gas Gathering, L.L.C., CenterPoint Energy Field Services, Inc. and Enbridge, Inc., as well as producer-owned systems. The Oasis Pipeline competes directly with two other major intrastate pipelines that link the Waha Hub and the Houston area, one of which is owned by Duke Energy Field Services and the other, which is owned by El Paso and American Electric Power Service Corporation. The ET Fuel System and the Bossier Pipeline compete with various pipelines including those owned by Atmos Energy Corporation, Gulfterra Energy Partners, L.P., and Enbridge, Inc.

Many of our competitors, such as major oil and gas and pipeline companies, have capital resources and control supplies of natural gas substantially greater than ours. In marketing natural gas, we have numerous competitors, including marketing affiliates of interstate pipelines, major integrated oil companies, and local and national natural gas gatherers, brokers and marketers of widely various sizes, financial resources and experience. Local utilities and distributors of natural gas are, in some cases, engaged directly, and through affiliates, in marketing activities that compete with our marketing operations.

Credit Risk and Customers

We have a concentration of customers in natural gas transmission, distribution and marketing as well as industrial end-users and customers in the refining and petrochemical industries. We are diligent in attempting to ensure that we issue credit to credit-worthy customers. However, our purchase and resale of gas exposes us to significant credit risk, as the margin on any sale is generally a very small percentage of the total sale price. Therefore, a credit loss can be very large relative to our overall profitability.

During the year ended August 31, 2004, we had three customers that individually accounted for more than 10% of Midstream and Transportation segment revenues. While these customers represent a significant percentage of Midstream and Transportation segment revenues, the loss of any one of these customers would not have a material impact on our results of operations.

Regulation

Regulation by FERC of Interstate Natural Gas Pipelines. Under the Natural Gas Act (NGA), the Federal Energy Regulatory Commission (FERC) generally regulates the transportation of natural gas in interstate commerce. We do not own any interstate natural gas pipelines, so FERC does not directly regulate any of our pipeline operations pursuant to its jurisdiction under the NGA. However, FERC 's regulation influences certain aspects of our business and the market for our products. In general, FERC has authority over natural gas companies that provide natural gas pipeline transportation services in interstate commerce and its authority to regulate those services includes:

- the certification and construction of new facilities;
- the extension or abandonment of services and facilities;
- the maintenance of accounts and records;
- the acquisition and disposition of facilities;
- the initiation and discontinuation of services; and
- various other matters.

Failure to comply with the NGA can result in the imposition of administrative, civil and criminal remedies.

In recent years, FERC has pursued pro-competitive policies in its regulation of interstate natural gas pipelines. However, we cannot assure you that FERC will continue this approach as it considers matters such as pipelines rates and rules and policies that may affect rights of access to natural gas transportation capacity.

Intrastate Pipeline Regulation. Our intrastate natural gas pipeline operations generally are not subject to rate regulation by FERC, but they are subject to regulation by various agencies in Texas, principally the Texas Railroad Commission (TRRC), where they are located. However, to the extent that our intrastate pipeline systems transport natural gas in interstate commerce, the rates, terms and conditions of such transportation service are subject

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to FERC jurisdiction under Section 311 of the Natural Gas Policy Act (NGPA), which regulates, among other things, the provision of transportation services by an intrastate natural gas pipeline on behalf of a local distribution company or an interstate natural gas pipeline. Under Section 311, rates charged for transportation must be fair and equitable, and amounts collected in excess of fair and equitable rates are subject to refund with interest. Failure to comply with the NGPA can result in the imposition of administrative, civil and criminal remedies.

Our intrastate pipeline operations in Texas are subject to the Texas Utilities Code, as implemented by the TRRC. Generally, the TRRC is vested with authority to ensure that rates, operations and services of gas utilities, including intrastate pipelines, are just and reasonable and not discriminatory. The TRRC has authority to ensure that rates charged by intrastate pipelines for natural gas sales or transportation services are just and reasonable. The rates we charge for transportation services are deemed just and reasonable under Texas law unless challenged in a complaint. We cannot predict whether such a complaint will be filed against us or whether the TRRC will change its regulation of these rates. Failure to comply with the Texas Utilities Code can result in the imposition of administrative, civil and criminal remedies.

Gathering Pipeline Regulation. Section 1(b) of the NGA exempts natural gas gathering facilities from the jurisdiction of FERC under the NGA. We own a number of natural gas pipelines in Texas, Oklahoma and Louisiana that we believe meet the traditional tests FERC has used to establish a pipeline's status as a gatherer not subject to FERC jurisdiction. However, the distinction between FERC-regulated transmission services and federally unregulated gathering services is the subject of substantial, on-going litigation, so the classification and regulation of our gathering facilities are subject to change based on future determinations by FERC and the courts. State regulation of gathering facilities generally includes various safety, environmental and, in some circumstances, nondiscriminatory take requirements and in some instances complaint-based rate regulation.

In Texas, our gathering facilities are subject to regulation by the TRRC under the Texas Utilities Code in the same manner as described above for our intrastate pipeline facilities. Our operations in Oklahoma are regulated by the Oklahoma Corporation Commission through a complaint-based procedure. Under the Oklahoma Corporation Commission's regulations, we are prohibited from charging any unduly discriminatory fees for our gathering services and in certain circumstances are required to provide open access natural gas gathering for a fee. Louisiana's Pipeline Operations Section of the Department of Natural Resources' Office of Conservation is generally responsible for regulating intrastate pipelines and gathering facilities in Louisiana and has authority to review and authorize natural gas transportation transactions and the construction, acquisition, abandonment and interconnection of physical facilities. Historically, apart from pipeline safety, it has not acted to exercise this jurisdiction respecting gathering facilities. Our Chalkley System is regulated as an intrastate transporter, and the Office of Conservation has determined that our Whiskey Bay System is a gathering system.

We are subject to state ratable take and common purchaser statutes in all of the states in which we operate. The ratable take statutes generally require gatherers to take, without undue discrimination, natural gas production that may be tendered to the gatherer for handling. Similarly, common purchaser statutes generally require gatherers to purchase without undue discrimination as to source of supply or producer. These statutes are designed to prohibit discrimination in favor of one producer over another producer or one source of supply over another source of supply. These statutes have the effect of restricting our right as an owner of gathering facilities to decide with whom it contracts to purchase or transport natural gas.

Natural gas gathering may receive greater regulatory scrutiny at both the state and federal levels now that FERC has taken a more light-handed approach to regulation of the gathering activities of interstate pipeline transmission companies and a number of such companies have transferred gathering facilities to unregulated affiliates. For example, the TRRC has approved changes to its regulations governing transportation and gathering services performed by intrastate pipelines and gatherers, which prohibit such entities from unduly discriminating in favor of

their affiliates. Many of the producing states have adopted some form of complaint-based regulation that generally allows natural gas producers and shippers to file complaints with state regulators in an effort to resolve grievances relating to natural gas gathering access and rate discrimination. Our gathering operations could be adversely affected should they be subject in the future to the application of state or federal regulation of rates and services. Our gathering operations also may be or become subject to safety and operational regulations relating to the design, installation, testing, construction, operation, replacement and management of gathering facilities. Additional rules and legislation pertaining to these matters are considered or adopted from time to time. We cannot predict what effect, if any, such changes might have on our operations, but the industry could be required to incur additional

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capital expenditures and increased costs depending on future legislative and regulatory changes.

Sales of Natural Gas. Sales for resale of natural gas in interstate commerce made by intrastate pipelines or their affiliates are subject to FERC regulation unless the gas is produced by the pipeline or affiliate. Under current federal rules, however, the price at which we sell natural gas currently is not regulated, insofar as the interstate market is concerned and, for the most part, is not subject to state regulation. Effective as of January 12, 2004, the FERC's rules require pipelines (including intrastate pipelines) and their affiliates who sell gas in interstate commerce subject to FERC's jurisdiction to adhere to a code of conduct prohibiting market manipulation and transactions that have no legitimate business purpose or result in prices not reflective of legitimate forces of supply and demand. Those who violate such code of conduct may be subject to suspension or loss of authorization to perform such sales, disgorgement of unjust profits, or other appropriate non-monetary remedies imposed by FERC. FERC denied rehearing of these rules on May 19, 2004, but the rules are still subject to possible court appeals. We cannot predict the outcome of these further proceedings, but do not believe we will be affected materially differently from other intrastate gas pipelines and their affiliates. In addition, our sales of natural gas are affected by the availability, terms and cost of pipeline transportation. As noted above, the price and terms of access to pipeline transportation are subject to extensive federal and state regulation. FERC is continually proposing and implementing new rules and regulations affecting those segments of the natural gas industry, most notably interstate natural gas transmission companies, that remain subject to FERC's jurisdiction. These initiatives also may affect the intrastate transportation of natural gas under certain circumstances. The stated purpose of many of these regulatory changes is to promote competition among the various sectors of the natural gas industry and these initiatives generally reflect more light-handed regulation. We cannot predict the ultimate impact of these regulatory changes to our natural gas marketing operations, and we note that some of FERC's more recent proposals may adversely affect the availability and reliability of interruptible transportation service on interstate pipelines. We do not believe that it will be affected by any such FERC action materially differently than other natural gas marketers with whom it competes.

Pipeline Safety. The states in which we conduct operations administer federal pipeline safety standards under the Natural Gas Pipeline Safety Act of 1968, as amended, which requires certain pipelines to comply with safety standards in constructing and operating the pipelines and subjects the pipelines to regular inspections. Failure to comply with the Act may result in the imposition of administrative, civil and criminal remedies. The rural gathering exemption under the Natural Gas Pipeline Safety Act of 1968 presently exempts substantial portions of our gathering facilities from jurisdiction under that statute. The portions of our facilities that are exempt include those portions located outside of cities, towns or any area designated as residential or commercial, such as a subdivision or shopping center. The rural gathering exemption, however, may be restricted in the future, and it does not apply to our intrastate natural gas pipelines.

Propane Segments

Products, Services and Marketing

We distribute propane through a nationwide retail distribution network consisting of 310 customer service locations in 32 states. Our operations are concentrated in large part in the western, upper midwestern, northeastern and southeastern regions of the United States. We serve more than 650,000 active customers. Historically, approximately two-thirds of Heritage's retail propane volumes and in excess of 90% of its EBITDA, as adjusted, (please read footnote (c) under Item 6 Selected Historical Financial Data and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations for a more detailed discussion of EBITDA, as adjusted) were attributable to sales during the six-month peak-heating season from October through March, as many customers use propane for heating purposes. Consequently, sales and operating profits are normally concentrated in the first and second fiscal quarters, while cash flows from operations are generally greatest during the second and third fiscal quarters when customers pay for propane purchased during the six-month peak season. To the extent necessary, we will reserve cash from peak

periods for distribution to Unitholders during the warmer seasons.

Typically, customer service locations are found in suburban and rural areas where natural gas is not readily available. Generally, such locations consist of a one to two acre parcel of land, an office, a