

EL PASO NATURAL GAS COMPANY, L.L.C.

CONSOLIDATED FINANCIAL STATEMENTS
With Independent Auditor's Reports

As of December 31, 2013 and 2012,
for the year ended December 31, 2013, and
for the periods of January 1, 2012 to May 24, 2012,
and May 25, 2012 to December 31, 2012

EL PASO NATURAL GAS COMPANY, L.L.C. AND SUBSIDIARIES
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Report of Independent Auditors

To the Member and Management of El Paso Natural Gas Company, L.L.C.:

In our opinion, the accompanying consolidated statements of income and of comprehensive income, of member's equity and of cash flows for the period from January 1, 2012 to May 24, 2012, present fairly, in all material respects, the results of operations and cash flows of El Paso Natural Gas Company, L.L.C. and its subsidiaries (the "Predecessor Company") for the period from January 1, 2012 to May 24, 2012, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Predecessor Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, in connection with the acquisition of El Paso Corporation by Kinder Morgan, Inc., a new basis of accounting was established as of May 25, 2012.

PricewaterhouseCoopers LLP

April 26, 2013



Independent Auditor's Report

To the Member and Management of El Paso Natural Gas Company, L.L.C.:

We have audited the accompanying consolidated financial statements of El Paso Natural Gas Company, L.L.C. and its subsidiaries (the "Successor Company"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012 and the related consolidated statements of income and comprehensive income, of member's equity and of cash flows for the year ended December 31, 2013 and for the period from May 25, 2012 to December 31, 2012.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Successor Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Successor Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Successor Company at December 31, 2013 and 2012 and the results of their operations and their cash flows for the year ended December 31, 2013 and for the period from May 25, 2012 to December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.



Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, in connection with the acquisition of El Paso Corporation by Kinder Morgan, Inc., a new basis of accounting was established as of May 25, 2012. Our opinion is not modified with respect to this matter.

PricewaterhouseCoopers LLP

April 18, 2014

EL PASO NATURAL GAS COMPANY, L.L.C. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In Millions)

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Revenues.....	\$ 519	\$ 301	\$ 190
Operating Costs and Expenses			
Operations and maintenance.....	168	113	80
Depreciation and amortization.....	91	54	33
Taxes, other than income taxes.....	24	17	13
Total Operating Costs and Expenses.....	<u>283</u>	<u>184</u>	<u>126</u>
Operating Income	<u>236</u>	<u>117</u>	<u>64</u>
Other Income (Expense)			
Interest expense, net.....	(90)	(53)	(35)
Affiliated interest income, net	—	7	9
Other, net	3	2	1
Total Other Income (Expense).....	<u>(87)</u>	<u>(44)</u>	<u>(25)</u>
Income Before Income Taxes.....	149	73	39
Income tax expense	<u>(1)</u>	<u>(1)</u>	<u>(15)</u>
Net Income	148	72	24
Other Comprehensive Income			
Adjustments to postretirement benefit plan.....	32	9	—
Comprehensive Income	<u>\$ 180</u>	<u>\$ 81</u>	<u>\$ 24</u>

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

EL PASO NATURAL GAS COMPANY, L.L.C. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Millions)

	Successor	
	December 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ —	\$ 9
Accounts receivable, net	51	44
Note receivable from affiliate, net	53	17
Inventories.....	44	45
Prepaid expenses.....	18	16
Regulatory assets	21	6
Other current assets.....	14	4
Total current assets	201	141
Property, plant and equipment, net.....	2,260	2,325
Goodwill	565	564
Note receivable from affiliate.....	35	—
Regulatory assets	57	63
Deferred charges and other assets.....	300	283
Total Assets.....	\$ 3,418	\$ 3,376
LIABILITIES AND MEMBER'S EQUITY		
Current liabilities		
Accounts payable	\$ 45	\$ 44
Accrued taxes, other than income	4	5
Accrued interest	24	21
Regulatory liabilities.....	4	9
Contractual deposits.....	9	11
Rate liabilities	122	10
Other current liabilities	17	10
Total current liabilities.....	225	110
Long-term liabilities and deferred credits		
Long-term debt.....	1,115	1,115
Debt fair value adjustments	218	237
Rate liabilities	—	84
Other long-term liabilities and deferred credits.....	85	87
Total Liabilities.....	1,643	1,633
Commitments and Contingencies (Notes 2 and 9)		
Member's Equity	1,734	1,734
Accumulated other comprehensive income.....	41	9
Total Member's Equity.....	1,775	1,743
Total Liabilities and Member's Equity.....	\$ 3,418	\$ 3,376

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

EL PASO NATURAL GAS COMPANY, L.L.C. SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Millions)

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Cash Flows From Operating Activities			
Net income.....	\$ 148	\$ 72	\$ 24
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization.....	91	54	33
Deferred income tax expense.....	—	1	15
Other non-cash items.....	1	3	(3)
Changes in components of working capital:			
Accounts receivable.....	(6)	(27)	10
Accounts payable.....	1	25	(13)
Accrued taxes, other than income.....	(2)	(37)	—
Other current assets and liabilities.....	3	(32)	(12)
Other long-term assets and liabilities.....	11	11	50
Net Cash Provided by Operating Activities.....	247	70	104
Cash Flows From Investing Activities			
Capital expenditures.....	(32)	(40)	(27)
Net change in note receivable from affiliate.....	(72)	39	(3)
Other.....	(4)	(3)	—
Net Cash Used in Investing Activities.....	(108)	(4)	(30)
Cash Flows From Financing Activities			
Distributions to Member.....	(154)	(71)	(60)
Contribution from Member.....	6	—	—
Net Cash Used in Financing Activities.....	(148)	(71)	(60)
Change in Cash and Cash Equivalents.....	(9)	(5)	14
Cash and Cash Equivalents, beginning of period.....	9	14	—
Cash and Cash Equivalents, end of period.....	\$ —	\$ 9	\$ 14
Supplemental Cash Flow Information			
Cash paid during the period for interest (net of capitalized interest).....	\$ 83	\$ 54	\$ 29
Income tax payments.....	—	53	—

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

EL PASO NATURAL GAS COMPANY, L.L.C. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF MEMBER'S EQUITY

(In Millions, except share amounts)

	Common Stock		Additional	Retained	Accumulated	Total	Member's	Accumulated	Total
	Shares	Amount	Paid-in	Earnings	Other	Stockholder's	Equity	Other	Member's
			Capital		Comprehensive	Equity		Comprehensive	Equity
					Income (Loss)			Income (Loss)	
Predecessor									
Balance at December 31, 2011.....	1,000	\$ —	\$ 1,268	\$ 432	\$ 3	\$ 1,703	\$ —	\$ —	\$ —
Net income.....				24		24			—
Distributions to parent.....				(60)		(60)			—
Balance at May 24, 2012.....	<u>1,000</u>	<u>\$ —</u>	<u>\$ 1,268</u>	<u>\$ 396</u>	<u>\$ 3</u>	<u>\$ 1,667</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Successor									
Balance at May 25, 2012.....	1,000	\$ —	\$ 2,175	\$ —	\$ —	\$ 2,175	\$ —	\$ —	\$ —
May 25 - July 31, 2012									
Net income.....				4		4			—
Other comprehensive income ..					1	1			—
Conversion to limited liability company (August 13, 2012).....	(1,000)		(2,175)	(4)	(1)	(2,180)	2,179	1	2,180
August 1 - December 31, 2012									
Net income.....							68		68
Other comprehensive loss.....								8	8
Distributions to Member.....							(71)		(71)
Non-cash distribution to Member.....							(442)		(442)
Balance at December 31, 2012.....	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,734</u>	<u>9</u>	<u>1,743</u>
Net income.....							148		148
Other comprehensive income								32	32
Distributions to Member.....							(154)		(154)
Contributions from Member							6		6
Balance at December 31, 2013.....	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,734</u>	<u>\$ 41</u>	<u>\$ 1,775</u>

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

EL PASO NATURAL GAS COMPANY, L.L.C. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

We are a Delaware limited liability company, originally formed in 1928 as a corporation. We converted our legal structure to a limited liability company on August 1, 2012 and changed our name to El Paso Natural Gas Company, L.L.C. When we refer to “us,” “we,” “our,” “ours,” “the company,” or “EPNG” we are describing El Paso Natural Gas Company, L.L.C. and/or our subsidiaries. On August 1, 2012, Kinder Morgan Energy Partners, L.P. (KMP), a master limited partnership, acquired a 50% interest in us from Kinder Morgan, Inc. (KMI), with KMI retaining the remaining 50% ownership interest. On March 1, 2013, KMP acquired the remaining 50% interest in us from KMI and we became an indirect wholly owned subsidiary of KMP. KMP is controlled by its general partner, Kinder Morgan G.P., Inc., a wholly owned subsidiary of KMI. Our operations are regulated by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act of 1938, the Natural Gas Policy Act of 1978 and the Energy Policy Act of 2005. The FERC approves tariffs that establish rates, cost recovery mechanisms and other terms and conditions of service to our customers.

Our primary business consists of the interstate transportation and storage of natural gas. We are the sole owner of (i) the EPNG natural gas pipeline system and (ii) the Mojave Pipeline Company, L.L.C., the sole owner of the Mojave natural gas pipeline system. The EPNG system consists of approximately 10,141 miles of pipeline with a design capacity of 5.65 billion cubic feet per day for natural gas. The EPNG system extends from the San Juan, Permian and Anadarko basins to California, its single largest market, as well as markets in Arizona, Nevada, New Mexico, Oklahoma, Texas and northern Mexico. Its design capacity for natural gas reflects winter sustainable west-flow capacity of 4.85 billion cubic feet per day and approximately 800 million cubic feet per day of east-end delivery capacity. The Mojave system consists of approximately 562 miles of pipeline with a design capacity of approximately 0.4 billion cubic feet per day. The Mojave system connects with other pipeline systems including (i) the EPNG system near Cadiz, California; (ii) the EPNG and Transwestern Pipeline Company, LLC systems at Topock, Arizona; and (iii) the Kern River Gas Transmission Company system in California. The Mojave system also extends to customers in the vicinity of Bakersfield, California. The portion of the total design capacity of the Mojave system attributable the Mojave Pipeline Company, LLC, reflecting total east to west flow activity from Topock to Daggett. The east to west capacity from Topock to the Cadiz interconnect with EPNG is 456 million cubic feet per day. In addition to our two pipeline systems, we utilize our Washington Ranch underground natural gas storage facility located in New Mexico to manage transportation needs and to offer interruptible storage services. This storage facility has up to 44 billion cubic feet of underground working natural gas storage capacity.

We made a revision of \$17 million in our previously reported “Accounts receivable, net” and “Accounts payable” balances on our Consolidated Balance Sheet as of December 31, 2012 to correctly classify certain affiliate payable amounts from affiliate accounts receivable to affiliate accounts payable. We also made a revision of \$17 million on our Consolidated Statement of Cash Flows for the successor period from May 25, 2012 to December 31, 2012 to correctly reflect the activity within the “Change in notes receivable from affiliate” included in the Net Cash Used in Investing Activities Cash Flows instead of activity within Net Cash Provided by Operating Activities on the accompanying Statement of Cash Flows. Management believes these corrections are not material to the previously issued financial statements.

Management has evaluated subsequent events through April 18, 2014, the date the financial statements were available to be issued.

2. Summary of Significant Accounting Policies

Basis of Presentation

We have prepared our accompanying consolidated financial statements in accordance with the accounting principles contained in the Financial Accounting Standards Board's Accounting Standards Codification, the single source of generally accepted accounting principles in the United States of America (GAAP) and referred to in this report as the

Codification. Under such rules and regulations, all significant intercompany items have been eliminated in consolidation. Additionally, certain amounts from prior years have been reclassified to conform to the current presentation.

On May 25, 2012, our senior unsecured notes and debentures were deregistered with the United States Securities and Exchange Commission (SEC) and our reporting obligation to the SEC was terminated.

Business Combination Accounting

KMI's May 25, 2012 acquisition of El Paso Holdco LLC (El Paso) was accounted for by KMI using business combination accounting. Under this method, the purchase price paid by the acquirer is allocated to the assets acquired and liabilities assumed as of the acquisition date based on their fair value. By the application of "push-down" accounting, our assets, liabilities and equity were accordingly adjusted to fair value on May 25, 2012. Determining the fair value of certain assets and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions. See Note 3 for a discussion of the estimated fair values of assets and liabilities recorded in connection with KMI's acquisition of El Paso.

Due to the application of "push-down" accounting, our financial statements and certain footnote disclosures are presented in two distinct periods to indicate the application of two different bases of accounting. The period prior to May 25, 2012 is identified herein as "Predecessor," while the periods subsequent to KMI's acquisition of El Paso are identified as "Successor." As a result of the change in the basis of accounting from historical cost to reflect KMI's purchase cost, the financial statements for Predecessor period are not comparable to the Successor periods.

Principles of Consolidation

We consolidate entities when we have the ability to control or direct the operating and financial decisions of the entity or when we have a significant interest in the entity that gives us the ability to direct the activities that are significant to that entity. The determination of our ability to control, direct or exert significant influence over an entity involves the use of judgment.

Use of Estimates

Certain amounts included in or affecting our financial statements and related disclosures must be estimated, requiring us to make certain assumptions with respect to values or conditions which cannot be known with certainty at the time our financial statements are prepared. These estimates and assumptions affect the amounts we report for certain assets and liabilities, our revenues and expenses during the reporting period, and our disclosure of contingent assets and liabilities at the date of our financial statements. We evaluate these estimates on an ongoing basis, utilizing historical experience, consultation with experts and other methods we consider reasonable in the particular circumstances. Nevertheless, actual results may differ significantly from our estimates. Any effects on our business, financial position or results of operations resulting from revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known.

In addition, we believe that certain accounting policies are of more significance in our financial statement preparation process than others. Below are the principal accounting policies we apply in the preparation of our consolidated financial statements.

Cash Equivalents

We consider short-term investments with an original maturity of less than three months to be cash equivalents.

Accounts Receivable

We establish provisions for losses on accounts receivable due from shippers and operators if we determine that we will not collect all or part of the outstanding balance. We regularly review collectability and establish or adjust our allowance as necessary using the specific identification method. The allowance for doubtful accounts as of December 31, 2013 and 2012 and the bad debt expense for the years ended December 31, 2013 and 2012 were not significant.

Inventories

Our inventories, which consist of materials and supplies, are valued at the lower of cost or market value with cost determined using the average cost method.

Natural Gas Imbalances

Natural gas imbalances occur when the amount of natural gas delivered from or received by a pipeline system differs from the scheduled amount of gas delivered or received. We value these imbalances due to or from shippers and operators at current index prices. Imbalances are settled in cash or made up in-kind, subject to the terms of the applicable FERC tariff. Imbalances due from customers and affiliates are reported in our Consolidated Balance Sheets as "Other current assets." Imbalances owed to customers and affiliates are reported in our Consolidated Balance Sheets as "Other current liabilities." We classify all imbalances as current as we expect to settle them within a year.

Property, Plant and Equipment

Our property, plant and equipment is recorded at its original cost of construction or, upon acquisition, at either the fair value of the assets acquired or the cost to the entity that first placed the asset in service. For constructed assets, we capitalize all construction-related direct labor and material costs, as well as indirect construction costs. Our indirect construction costs primarily include an interest and equity return component (as more fully described below) and labor and related costs of departments associated with supporting construction activities. The indirect capitalized labor and related costs are based upon estimates of time spent supporting construction projects.

We use the composite method to depreciate regulated property, plant and equipment. Under this method, assets with similar lives and characteristics are grouped and depreciated as one asset. The FERC-accepted depreciation rate is applied to the total cost of the group until the net book value equals the salvage value. For certain general plant, the asset is depreciated to zero. We re-evaluate depreciation rates each time we redevelop our transportation and storage rates to file with the FERC for an increase or decrease in rates. When property, plant and equipment is retired, accumulated depreciation and amortization is charged for the original cost of the assets in addition to the cost to remove, sell or dispose of the assets, less salvage value. We do not recognize gains or losses unless we sell or retire land or an entire operating unit, as determined by the FERC. We generally include gains or losses on dispositions of land and operating units in "Operations and maintenance" in our Consolidated Statements of Income and Comprehensive Income.

Included in our property balances are base gas and working gas at our storage facilities. We periodically evaluate natural gas volumes at our storage facilities for gas losses. When events or circumstances indicate a loss has occurred, we recognize a loss in our income statement or defer the loss as a regulatory asset on our balance sheets if deemed probable of recovery through future rates charged to customers.

We capitalize a carrying cost (an allowance for funds used during construction or AFUDC) on debt and equity funds related to the construction of long-lived assets. This carrying cost consists of a return on the investment financed by debt and a return on the investment financed by equity. The debt portion is calculated based on the average cost of debt. The equity portion is calculated based on the most recent FERC approved rate of return. Interest and equity amounts capitalized are included as a reduction to "Interest expense, net" and "Other, net", respectively, on our Consolidated Statements of Income and Comprehensive Income. The amount of capitalized AFUDC was not significant for the periods presented in our accompanying Consolidated Statements of Income and Comprehensive Income.

Asset Retirement Obligations

We record liabilities for obligations related to the retirement and removal of long-lived assets used in our businesses. We record, as liabilities, the fair value of asset retirement obligations on a discounted basis when they are incurred and can be reasonably estimated, which is typically at the time the assets are installed or acquired. Amounts recorded for the related assets are increased by the amount of these obligations. Over time, the liabilities increase due to the change in their present value, and the initial capitalized costs are depreciated over the useful lives of the related assets. The liabilities are eventually extinguished when the asset is taken out of service.

We are required to operate and maintain our natural gas pipelines and storage systems, and intend to do so as long as supply and demand for natural gas exists, which we expect for the foreseeable future. Therefore, we believe that we cannot reasonably estimate the asset retirement obligation for the substantial majority of our natural gas pipeline system assets because these assets have indeterminate lives. We continue to evaluate our asset retirement obligations and future developments could impact the amounts we record. Our asset retirement obligations were not significant as of December 31, 2013 and 2012.

Asset Impairments

We evaluate our assets for impairment when events or circumstances indicate that their carrying values may not be recovered. These events include market declines that are believed to be other than temporary, changes in the manner in which we intend to use a long-lived asset, decisions to sell an asset or investment and adverse changes in the legal or business environment such as adverse actions by regulators. If an event occurs, which is a determination that involves judgment, we evaluate the recoverability of our carrying value based on the long-lived asset's ability to generate future cash flows on an undiscounted basis. If an impairment is indicated, or if we decide to sell a long-lived asset or group of assets, we adjust the carrying value of the asset downward, if necessary, to its estimated fair value.

Our fair value estimates are generally based on assumptions market participants would use, including market data obtained through the sales process or an analysis of expected discounted cash flows.

Goodwill

Goodwill represents the excess of the cost of an acquisition price over the fair value of acquired net assets and such amounts are reported separately as "Goodwill" on our Consolidated Balance Sheets. Our total goodwill, which resulted from the application of "push-down" accounting associated with KMI's acquisition of El Paso on May 25, 2012, was \$565 million and \$564 million as of December 31, 2013 and 2012, respectively. During the second quarter of 2013, we made an \$1 million final purchase price allocation adjustment related to our pre-acquisition sales and use tax liability, resulting in an increase in goodwill. Goodwill is not amortized, but instead is tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset had decreased below its carrying value.

We perform our goodwill impairment test on May 31 of each year. There were no impairment charges resulting from our May 31, 2013 impairment testing and no event indicating an impairment has occurred subsequent to May 31, 2013. During 2012, we performed a qualitative assessment and determined there were no indicators of impairment during the period from the May 25, 2012 acquisition date to our May 31, 2012 impairment assessment date.

Revenue Recognition

We are subject to FERC regulations, therefore fees and rates established under our tariff are a function of our cost of providing services to our customers, including a reasonable return on our invested capital. Our revenues are primarily generated from natural gas transportation and storage services and include estimates of amounts earned but unbilled. We estimate these unbilled revenues based on contract data, regulatory information, and preliminary throughput and allocation measurements, among other items. Revenues for all services are based on the thermal quantity of gas delivered or subscribed at a price specified in the contract. For our transportation services and storage services, we recognize reservation revenues on firm contracted capacity ratably over the contract period regardless of the amount of natural gas that is transported or stored. For interruptible or volumetric-based services, we record revenues when physical deliveries of natural gas are made at the agreed upon delivery point or when gas is injected or withdrawn from the storage facility. For contracts with step-up or step-down rate provisions that are not related to changes in levels of service, we recognize reservation revenues ratably over the contract life. The revenues we collect may be subject to refund in a rate proceeding. We establish reserves for these potential refunds. As of December 31, 2013 and 2012, we had \$122 million and \$94 million, respectively, in reserves for potential refunds pursuant to the rate case settlements filed with FERC. See Note 11 for further discussion of our regulatory matters.

Environmental Matters

We expense or capitalize, as appropriate, environmental expenditures that relate to current operations. We expense expenditures that relate to an existing condition caused by past operations, which do not contribute to current or future revenue generation. We generally do not discount environmental liabilities to a net present value, and we record environmental liabilities when environmental assessments and/or remedial efforts are probable and we can reasonably estimate the costs. Generally, our recording of these accruals coincides with our completion of a feasibility study or our commitment to a formal plan of action. We recognize receivables for anticipated associated insurance recoveries when such recoveries are deemed to be probable.

We routinely conduct reviews of potential environmental issues and claims that could impact our assets or operations. These reviews assist us in identifying environmental issues and estimating the costs and timing of remediation efforts. We also routinely adjust our environmental liabilities to reflect changes in previous estimates. In making environmental liability estimations, we consider the material effect of environmental compliance, pending legal actions against us, and potential third-party liability claims. Often, as the remediation evaluation and effort progresses, additional information is obtained, requiring revisions to estimated costs. These revisions are reflected in our income in the period in which they are reasonably determinable. For more information on our environmental disclosures, see Note 9.

Legal

We are subject to litigation and regulatory proceedings as the result of our business operations and transactions. We utilize both internal and external counsel in evaluating our potential exposure to adverse outcomes from orders, judgments or settlements. When we determine a loss is probable of occurring and is reasonably estimable, we accrue an undiscounted liability for such litigation based on our best estimate using information available at that time. If the estimated loss is a range of potential outcomes and there is no better estimate within the range, we accrue the amount at the low end of the range. To the extent that actual outcomes differ from our estimates, or additional facts and circumstances cause us to revise our estimates, our earnings will be affected. For more information on our legal disclosures, see Note 9.

Other Contingencies

We recognize liabilities for other contingencies when we have an exposure that indicates it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. Where the most likely outcome of a contingency can be reasonably estimated, we accrue an undiscounted liability for that amount. Where the most likely outcome cannot be estimated, a range of potential losses is established and if no one amount in that range is more likely than any other, the low end of the range is accrued.

Postretirement Benefits

We maintain a postretirement benefit plan covering certain of our former employees. The plan requires us to make contributions to fund the benefits to be paid out under the plan. These contributions are invested until the benefits are paid out to plan participants. The net benefit cost of this plan is recorded in our Consolidated Statements of Income and Comprehensive Income and is a function of many factors including benefits earned during the year by plan participants (which is a function of factors such as the level of benefits provided under the plan, actuarial assumptions and the passage of time), expected returns on plan assets and amortization of certain deferred gains and losses. For a further discussion of our policies with respect to our postretirement benefit plans, see Note 7.

In accounting for our postretirement benefit plan, we record an asset or liability based on the difference between the fair value of the plan's assets and the plan's benefit obligations. Any deferred amounts related to unrecognized gains and losses or changes in actuarial assumptions are recorded on our Consolidated Balance Sheets as "Accumulated Other comprehensive income" until those gains or losses are recognized on the Consolidated Statements of Income and Comprehensive Income.

Income Taxes

Prior to KMI's acquisition of El Paso, El Paso maintained a tax accrual policy to record both regular and alternative minimum taxes for companies included in its consolidated federal and state income tax returns. The policy provided, among other things, that (i) each company in a taxable income position would accrue a current expense equivalent to its federal and state income taxes, and (ii) each company in a tax loss position would accrue a benefit to the extent its deductions, including general business credits, could be utilized in the consolidated returns. El Paso paid all consolidated U.S. federal and state income taxes directly to the appropriate taxing jurisdictions and, under a separate tax billing agreement, El Paso could bill or refund its subsidiaries for their portion of these income tax payments. Prior to our conversion to a limited liability company which is further discussed below, we filed and paid taxes directly to certain state taxing authorities.

Effective August 1, 2012, we converted into a limited liability company and settled our current and deferred tax balances with El Paso with recoveries of our note receivable from KMI under its cash management program. Effective with KMP's acquisition of a 50% ownership interest in us from KMI on August 1, 2012, we are no longer subject to either federal income taxes or generally to state income taxes. See Notes 4 and 8 for further discussion of our income taxes.

Prior to our conversion date, we recorded current income taxes based on our taxable income and we provided for deferred income taxes to reflect estimated future tax payments and receipts. Deferred taxes represented the tax impacts of differences between the financial statement and tax bases of assets and liabilities and carryovers as of each year end. We accounted for tax credits under the flow-through method, which reduced the provision for income taxes in the year the tax credits first became available. We reduced deferred tax assets by a valuation allowance when, based on our estimates, it was more likely than not that a portion of those assets would not be realized in a future period. The estimates utilized in the recognition of deferred tax assets were subject to revision, either up or down, in future periods based on new facts or circumstances.

Regulated Operations

Our natural gas pipeline and storage operations are subject to the jurisdiction of the FERC and follow the Financial Accounting Standards Board accounting standards for regulated operations. Under these standards, we record regulatory assets and liabilities that would not be recorded for non-regulated entities. Regulatory assets and liabilities represent probable future revenues or expenses associated with certain charges or credits that are expected to be recovered from or refunded to customers through the rate making process. Items to which we apply regulatory accounting requirements include certain postretirement benefit plan costs, loss on reacquired debt, taxes related to an equity return component on regulated capital projects in periods prior to August 1, 2012 when we changed our legal structure to a non-taxable entity, and certain costs related to gas not used in operations and other costs included in, or expected to be included in, future rates. See Note 11 for additional information related to our regulatory assets and liabilities.

3. KMI's Acquisition of El Paso

KMI's acquisition of El Paso was effective on May 25, 2012. The acquisition was accounted for using business combination accounting under applicable accounting principles. Business combination accounting requires, among other things, that assets acquired and liabilities assumed be recognized on the balance sheet at their fair values as of the acquisition date.

The purchase price allocation was finalized in the second quarter of 2013, at which time, we made an \$1 million final purchase price allocation adjustment related to our pre-acquisition sales and use tax liability, resulting in an increase in goodwill. We used appraisers to assist in the determination of the fair value of certain assets. The table below represents the fair value of our tangible and intangible assets and liabilities as of May 25, 2012 (in millions):

Current assets.....	\$ 100
Property, plant and equipment, net (a).....	2,391
Goodwill (b)	565
Other noncurrent assets (c).....	1,222
Long-term debt (d)	(1,363)
Deferred income taxes(e)	(410)
Other liabilities	(330)
Total purchase price.....	<u>\$ 2,175</u>

- (a) Property, plant and equipment includes a \$49 million reduction to record our business at its regulatory value in conformity with our accounting policy.
- (b) Goodwill of \$0.6 billion represents the excess of consideration paid over the fair value of the assets acquired and liabilities assumed.
- (c) Other non-current assets include a purchase price adjustment of \$249 million to record a deferred charge offset to the fair value of debt purchase price adjustment described in footnote (4) below.
- (d) Our long-term debt assumed in the acquisition was recorded at its fair market value resulting in a \$249 million purchase price adjustment. This purchase price adjustment has been reported as “Debt fair value adjustments” on our Consolidated Balance Sheets.
- (e) Deferred income taxes include a purchase price reduction adjustment of \$34 million which primarily consisted of an adjustment to reduce deferred tax liabilities associated with the tax effects of purchase price adjustments described herein.

The goodwill resulting from the acquisition is primarily due to expected commercial and operational synergies and is not deductible for tax purposes.

Expenses Related to KMI's acquisition of El Paso

We incurred acquisition-related expenses of \$7 million and \$29 million in the Successor periods in 2013 and 2012, respectively, primarily related to allocated severance costs which are included in “Operations and maintenance” in our Consolidated Statements of Income and Comprehensive Income.

4. Income Taxes

Effective with KMP’s acquisition of a 50% ownership interest in us from KMI on August 1, 2012, we are no longer subject to either federal income taxes or generally to state income taxes. As a result of this acquisition, we settled our current and deferred income tax balances of \$431 million with recoveries of our note receivable from KMI.

Components of Income Tax Expense

The following table reflects the components of income tax expense included in net income for each of the periods presented below (in millions):

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Current			
Federal.....	\$ —	\$ —	\$ —
State.....	1	—	—
	<u>1</u>	<u>—</u>	<u>—</u>
Deferred			
Federal.....	—	1	13
State.....	—	—	2
	<u>—</u>	<u>1</u>	<u>15</u>
Total income tax expense.....	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 15</u>

Effective Tax Rate Reconciliation

Our income tax expense differs from the amount computed by applying the statutory federal income tax rate of 35 percent for the following reasons for each of the periods presented below (in millions, except for tax rates):

	Successor		Predecessor
	For the Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Income tax expense at the statutory federal rate of 35%	\$ 52	\$ 25	\$ 14
Increase (decrease)			
Non-taxable earnings	(52)	(24)	—
State income taxes, net of federal income tax effect	1	—	1
Income tax expense.....	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 15</u>
Effective tax rate.....	<u>1%</u>	<u>2%</u>	<u>38%</u>

5. Property, Plant and Equipment

Classes of Assets and Depreciation Rates

As of December 31, 2013 and 2012, our property, plant and equipment consisted of the following (in millions, except for %):

	Annual Depreciation Rates (%)	Successor	
		December 31, 2013	December 31, 2012
Transmission and storage facilities	1.09 - 33.3	\$ 2,248	\$ 2,188
General plant	1.6 - 33.0	52	54
Intangible plant.....	4.0 - 15.0	15	17
Other		54	71
Accumulated depreciation and amortization (a)		(131)	(50)
		2,238	2,280
Construction work in progress		22	45
Property, plant and equipment, net.....		\$ 2,260	\$ 2,325

(a) The composite weighted average depreciation rates for the year ended December 31, 2013, the Successor period in 2012 and the Predecessor period in 2012 were approximately 2.5%, 2.4% and 2.4%, respectively.

6. Debt

We classify our debt based on the contractual maturity dates of the underlying debt instruments. The following table summarizes the net carrying value of our outstanding debt, excluding debt fair value adjustments, as of December 31 (in millions):

	Successor	
	2013	2012
5.95% Notes due April 2017	\$ 355	\$ 355
8.625% Debentures due January 2022	260	260
7.50% Debentures due November 2026.....	200	200
8.375% Notes due June 2032	300	300
Total long-term debt	\$ 1,115	\$ 1,115

Debt Covenants

Under our various financing documents, we are subject to a number of restrictions and covenants. The most restrictive of these include limitations on the incurrence of liens and limitations on sale-leaseback transactions. For the year ended December 31, 2013 and the Successor and Predecessor periods in 2012, we were in compliance with our debt-related covenants.

7. Retirement Benefits

Pension and Retirement Savings Plans

KMI maintains a pension plan and a retirement savings plan covering substantially all of its U.S. employees, including our former employees. The benefits under the pension plan are determined under a cash balance formula. Under its retirement savings plan, KMI contributes an amount equal to 5% of participants' eligible compensation per year. KMI is responsible for benefits accrued under its plans and allocates the related costs based on a benefit allocation rate applied on payroll charged to its affiliates.

Postretirement Benefits Plan

We provide postretirement medical benefits for a closed group of retirees. These benefits may be subject to deductibles, co-payment provisions, and other limitations and dollar caps on the amount of employer costs and are subject to further benefit changes by KMI, the plan sponsor. Effective January 1, 2014, the plan was amended to provide a fixed subsidy to post-age 65 Medicare eligible participants to purchase coverage through a retiree Medicare exchange.

In addition, certain former employees continue to receive limited postretirement life insurance benefits. Our postretirement benefit plan costs are prefunded and were recoverable under prior rate case settlements. Currently, there is no cost recovery or related funding that is required as part of our current FERC approved rates, however, we can seek to recover any funding shortfall that may be required in the future. We do not expect to make any contributions to our postretirement benefit plan in 2014. We made no contributions in the Successor and Predecessor periods in 2013 and 2012.

Accumulated Postretirement Benefit Obligation, Plan Assets and Funded Status

Our postretirement benefit obligations and net benefit costs are primarily based on actuarial calculations. We use various assumptions in performing these calculations, including those related to the return that we expect to earn on our plan assets, the estimated cost of health care when benefits are provided under our plan and other factors. A significant assumption we utilize is the discount rates used in calculating the benefit obligations. We select our discount rate by matching the timing and amount of our expected future benefit payments for our postretirement benefit obligation to the average yields of various high-quality bonds with corresponding maturities.

In accounting for our postretirement benefit plan, we record an asset or liability based on the overfunded or underfunded status. Any deferred amounts related to unrecognized gains and losses or changes in actuarial assumptions are recorded in “Accumulated other comprehensive income,” a component of “Member's equity,” until those gains and losses are recognized in our Consolidated Statements of Income and Comprehensive Income.

The table below provides information about our postretirement benefit plan for each of the periods presented (in millions):

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Change in accumulated postretirement benefit obligation:			
Accumulated postretirement benefit obligation — beginning of period	\$ 44	\$ 52	\$ 51
Interest cost	1	1	1
Actuarial gain	—	(5)	—
Participant contributions	2	—	—
Plan amendments	(17)	(1)	—
Benefits paid (a)	(7)	(3)	(2)
Accumulated postretirement benefit obligation — end of period	\$ 23	\$ 44	\$ 50
Change in plan assets:			
Fair value of plan assets — beginning of period	\$ 88	\$ 84	\$ 84
Actual return on plan assets	21	7	2
Participant contributions	2	—	—
Benefits paid	(7)	(3)	(2)
Fair value of plan assets — end of period	\$ 104	\$ 88	\$ 84
Reconciliation of funded status:			
Fair value of plan assets	\$ 104	\$ 88	
Less: accumulated postretirement benefit obligation	23	44	
Net asset at December 31 (b)	\$ 81	\$ 44	

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- (a) Amounts shown are net of a subsidy of \$1 million in 2013 and less than \$1 million for both the successor and predecessor periods in 2012 presented above related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.
 - (b) Net asset amounts are included in “Deferred charges and other assets” on our Consolidated Balance Sheets.

Components of Accumulated Other Comprehensive Income

The amounts recognized in “Accumulated other comprehensive income” as of December 31, 2013 and 2012 of \$41 million and \$9 million, respectively, is primarily related to unrecognized gains. We anticipate that \$4 million of “Accumulated other comprehensive income” will be recognized as part of our net periodic benefit income in 2014.

Plan Assets

The primary investment objective of our plan is to ensure that, over the long-term life of the plan, an adequate pool of sufficiently liquid assets exists to meet the benefit obligations to retirees and beneficiaries. Investment objectives are long-term in nature covering typical market cycles. Any shortfall of investment performance compared to investment objectives is generally the result of economic and capital market conditions. Although actual allocations vary from time to time from our targeted allocations, the target allocations of our postretirement plan’s assets are 70% equity and 30% fixed income securities.

We use various methods to determine the fair values of the assets in our other postretirement benefit plans, which are impacted by a number of factors, including the availability of observable market data over the contractual term of the underlying assets. We separate these assets into three levels (Level 1, 2 and 3) based on our assessment of the availability of this market data and the significance of non-observable data used to determine the fair value of these assets. As of December 31, 2013, assets were comprised of domestic securities with a fair value of \$3 million, a fixed income mutual fund with a fair value of \$4 million, common/collective trust funds with a fair value of \$85 million and limited partnership funds with equity strategies with a fair value of \$12 million. For the domestic securities, mutual fund and \$7 million of the limited partnership funds, the fair value (which is considered a Level 1 measurement) is determined based on the price quoted for the investment in actively traded markets. For the common/collective trust funds, which are invested in approximately 70% equity and 30% fixed income securities, and \$5 million of the limited partnership funds, the fair value (which is considered a Level 2 measurement) is determined primarily based on the net asset value reported by the issuer, which is based on similar assets in active markets. As of December 31, 2012, assets were comprised of a mutual fund with a fair value of \$2 million and common/collective trust funds with a fair value of \$86 million. The mutual fund invests primarily in dollar-denominated securities, and its fair value (which is considered a Level 1 measurement) is determined based on the price quoted for the fund in actively traded markets. The common/collective trust funds are invested in approximately 65% equity and 35% fixed income securities, and their fair values (which are considered Level 2 measurements) are determined primarily based on the net asset value reported by the issuer, which is based on similar assets in active markets. Certain restrictions on withdrawals exist for these common/collective trust funds where the issuer reserves the right to temporarily delay withdrawals in certain situations such as market conditions or at the issuer’s discretion. We do not have any assets that are considered Level 3 measurements. The methods described above may produce a fair value that may not be indicative of net realizable value or reflective of future fair values, and there have been no changes in the methodologies used as of December 31, 2013 and 2012.

Expected Payment of Future Benefits

As of December 31, 2013, we expect the following benefit payments under our plan (in millions):

Year Ending December 31,	Successor Expected Payments
2014.....	\$ 3
2015.....	3
2016.....	3
2017.....	2
2018.....	2
2019 - 2023	8

Actuarial Assumptions and Sensitivity Analysis

Accumulated postretirement benefit obligations and net benefit costs are based on actuarial estimates and assumptions. The following table details the weighted average actuarial assumptions used in determining our postretirement plan obligations and net benefit costs:

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
	(%)		(%)
Assumptions related to benefit obligations at period end:			
Discount rate	3.86	3.14	4.16
Assumptions related to benefit costs for the period:			
Discount rate (a).....	3.34	3.81	4.16
Expected return on plan assets (b)	7.50	7.50	7.50

- (a) We select our discount rate by matching the timing and amount of our expected future benefit payments for our postretirement benefit obligation to the average yields of various high-quality bonds with corresponding maturities.
- (b) The expected return on plan assets listed in the table above is a pre-tax rate of return based on our portfolio of investments. We utilize an after-tax expected return on plan assets to determine our benefit costs, which is based on unrelated business income taxes with a weighted average rate of 24% for 2013 and a rate of 22% for calendar year 2012.

Actuarial estimates for our postretirement benefit plan assumed a weighted average annual rate of increase in the per capita costs of covered health care benefits of 7%, gradually decreasing to 5% by the year 2019. A one-percentage point change would not have had a significant effect on interest costs for the year ended December 31, 2013 or in the Successor or Predecessor periods in 2012. A one-percentage point change in assumed health care cost trends would not have a significant effect on the accumulated postretirement benefit obligation as of December 31, 2013 and would have the following effect as of December 31, 2012 (in millions):

	Successor 2012
One percentage point increase:	
Accumulated postretirement benefit obligation.....	\$ 4
One percentage point decrease:	
Accumulated postretirement benefit obligation.....	\$ (3)

Components of Net Benefit Income

For each of the periods presented, the components of net benefit cost (income) are as follows (in millions):

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Interest cost	\$ 1	\$ 1	\$ 1
Expected return on plan assets	(8)	(4)	(2)
Net benefit income	<u>\$ (7)</u>	<u>\$ (3)</u>	<u>\$ (1)</u>

8. Related Party Transactions

Income Taxes

Effective August 1, 2012, we converted into a limited liability company as discussed in Note 1 and settled our current and deferred income tax balances of approximately \$431 million with El Paso with recoveries of our note receivable from KMI under its cash management program. Effective with KMP's acquisition of a 50% ownership interest in us from KMI on August 1, 2012, we are no longer subject to either federal income taxes or generally to state income taxes.

Prior to our conversion into a limited liability company, El Paso filed consolidated U.S. federal and certain state tax returns which include our taxable income. In certain states, we file and pay taxes directly to the state taxing authorities.

Cash Management Program

We participate in the cash management program with KMI and its affiliates (and El Paso's prior to KMI's acquisition of El Paso) which matched short-term cash surpluses and needs of participating affiliates, thus minimizing total borrowings from outside sources. KMI and its affiliates use the cash management program to settle intercompany transactions between participating affiliates. As of December 31, 2013 and 2012, we had a net note receivable from KMI and its affiliates of \$88 million and \$17 million, respectively. The interest rate on this note was variable and was 0.3% and 0.5% as of December 31, 2013 and 2012, respectively. In conjunction with KMP's acquisition of a 50% ownership interest in us in August 2012, we settled our current and deferred income tax balances of approximately \$431 million with recoveries of our note receivable from KMI. In addition, we made non-cash distributions totaling \$442 million to KMP and KMI, which eliminated the remaining note receivable balance from KMI.

Other Affiliate Balances

We enter into transactions with our affiliates within the ordinary course of business and the services are based on the same terms as non-affiliates, including natural gas transportation services to and from affiliates under long-term contracts and various operating agreements.

We do not have employees. Employees of KMI and its affiliates provide services to us and our subsidiaries. We are managed and operated by officers of KMI and its affiliates. Under policies with KMI and its affiliates, we reimburse KMI and its affiliates without a profit component for the provision of various general and administrative services for our benefit and for direct expenses incurred by KMI or its affiliates on our behalf. KMI bills us directly for certain general and administrative costs and allocates a portion of its general and administrative costs without a profit component to us. Prior to KMI's acquisition of El Paso, we were allocated costs from El Paso and Tennessee Gas Pipeline Company, L.L.C. (TGP), our affiliate, for services provided to us. We also allocated costs to Colorado Interstate Gas Company, our affiliate, for its share of our pipeline services. The allocations from El Paso and TGP are based on the estimated level of effort devoted to our operations and the relative size of our earnings before interest expense and income taxes,

gross property and payroll. The costs allocated from KMI, El Paso and their affiliates are included in "Operations and maintenance" on our Consolidated Statements of Income and Comprehensive Income.

The following table summarizes our other balance sheet affiliate balances as of December 31, 2013 and 2012 (in millions):

	Successor	
	2013	2012
Accounts receivable.....	\$ —	\$ 1
Natural gas imbalance receivable.....	1	—
Accounts payable.....	16	17
Natural gas imbalance payable.....	1	—

The following table shows revenues, expenses and reimbursements from our affiliates for the each of the periods presented (in millions):

	Successor		Predecessor
	Year Ended December 31, 2013	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Revenues.....	\$ 20	\$ 12	\$ 8
Operation and maintenance expense (a).....	81	52	29
Reimbursement of operating expense.....	—	2	4

(a) Includes severance costs of \$7 million and \$29 million for the successor periods ended December 31, 2013 and 2012, respectively, allocated to us from El Paso as a result of KMI's acquisition of El Paso.

9. Litigation, Environmental and Other Contingencies

We are party to various legal, regulatory and other matters arising from the day-to-day operations of our business that may result in claims against us. Although no assurance can be given, we believe, based on experiences to date and taking into account established reserves, that the ultimate resolution of such items will not have a material adverse impact on our business, financial position, results of operations or cash flows. We believe we have meritorious defenses to the matters to which we are a party and intend to vigorously defend these matters. When we determine a loss is probable of occurring and is reasonably estimable, we accrue an undiscounted liability for such contingencies based on our best estimate using information available at that time. If the estimated loss is a range of potential outcomes and there is no better estimate within the range, we accrue the amount at the low end of the range. We disclose contingencies where an adverse outcome may be material, or in the judgment of management, we conclude the matter should otherwise be disclosed.

Legal Proceedings

Bank of America

We are a named defendant, along with Burlington Resources, Inc. (Burlington), now a subsidiary of ConocoPhillips Company, in a class action lawsuit styled *Bank of America, et al. v. El Paso Natural Gas and Burlington Resources Oil and Gas Company, L.P.*, filed in October 2003 in the District Court of Kiowa County, Oklahoma asserting royalty underpayment claims related to specified shallow wells in Oklahoma, Texas and New Mexico. The Plaintiffs assert that royalties were underpaid starting in the 1980s when the purchase price of gas was lowered below the Natural Gas Policy Act maximum lawful prices. The Plaintiffs have only alleged an amount of damages against our co-defendant, Burlington. We believe that our actions in the 1980s were proper in light of a declining market. We also contend that we are entitled to an indemnity from Burlington under our 1992 separation agreement for all claims related to royalty payments, which Burlington denies. The Plaintiffs assert that royalties were further underpaid by Burlington as a result of post-production cost deductions taken starting in the late 1990s. We have no liability for the post-production claims

as they pertain to periods after our separation from Burlington. This action was transferred to Washita County District Court in 2004. A tentative settlement reached in November 2005 was rejected by the court in June 2007. A class certification hearing occurred in April 2009. The court certified a Texas and Oklahoma class of royalty owners and stayed the claims pertaining to New Mexico wells. The class certification was upheld by the Oklahoma Court of Appeals, and a petition for review was denied by the Oklahoma Supreme Court. The Plaintiffs have proceeded with discovery of the post-production claims against Burlington. The Plaintiffs' motion to certify a class of New Mexico royalty owners was granted, but a motion to reconsider has been filed. Our costs and legal exposure related to this lawsuit are not currently determinable.

General

We had no accruals for any outstanding legal proceedings as of December 31, 2013. As of December 31, 2012, our total reserve for legal proceedings amounted to less than \$1 million.

Environmental Matters

We are subject to environmental cleanup and actions from time to time. Our operations are subject to federal, state and local laws and regulations relating to protection of the environment. Although we believe our operations are in substantial compliance with applicable environmental law and regulations, risks of additional costs and liabilities are inherent in our operations, and there can be no assurance that we will not incur significant costs and liabilities. Our insurance may not cover all environmental risks and costs and/or may not provide sufficient coverage in the event an environmental claim is made against us. Moreover, it is possible that other developments, such as increasingly stringent environmental laws, regulations and enforcement policies under the terms of authority of those laws, and claims for damages to property or persons resulting from our operations, could result in substantial costs and liabilities to us.

General

Although it is not possible to predict the ultimate outcomes, we believe that the resolution of the environmental matters set forth in this note, and other matters to which we are a party, will not have a material adverse effect on our business, financial position, results of operations or cash flows. As of December 31, 2013 and 2012, we have accrued a total reserve for environmental liabilities in the amount of \$38 million and \$41 million, respectively.

For 2014, we estimate that our total remediation expenditures will be approximately \$3 million, most of which will be expended under government directed clean-up plans. In addition, we expect to make capital expenditures for environmental matters of approximately \$7 million in the aggregate for the years of 2014 through 2018, including capital expenditures associated with air permitting and compliance at the state and federal level.

Superfund Matters

Included in our recorded environmental liabilities are projects where we have received notice that we have been designated or could be designated as a Potentially Responsible Party (PRP) under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), commonly known as Superfund, or state equivalents for three active sites. Liability under the federal CERCLA statute may be joint and several, meaning that we could be required to pay in excess of our pro rata share of remediation costs. We consider the financial strength of other PRPs in estimating our liabilities.

Uranium Mines in Vicinity of Cameron, Arizona

In the 1950s and 1960s, Rare Metals, Inc., a historical subsidiary, operated approximately twenty uranium mines in the vicinity of Cameron, Arizona, many of which are located on the Navajo Indian Reservation. The mining activities were in response to numerous incentives provided to industry by the U.S. to locate and produce domestic sources of uranium to support the Cold War-era nuclear weapons program. In May 2012, we received a general notice letter from the EPA notifying us of the EPA's investigation of certain sites and its determination that the EPA considers us to be a potentially responsible party within the meaning of CERCLA. In August 2013, we and the EPA entered into an Administrative Order on Consent and Scope of Work, pursuant to which we will conduct a radiological assessment of

the surface of the mines. We are also seeking contribution from the applicable federal government agencies toward the cost of environmental activities associated with the mines, given its pervasive control over all aspects of the nuclear weapons program.

Other Commitments

Capital Commitments

As of December 31, 2013, we have commitments for purchases of plant, property and equipment of \$5 million, which we expect to spend during 2014. We have other planned capital projects that are discretionary in nature, with no substantial contractual capital commitments made in advance of the actual expenditures.

Other Commercial Commitment

We hold cancelable easements or rights-of-way arrangements from landowners permitting the use of land for the construction and operation of our pipeline systems. Our obligations under these easements are not material to our results of operations.

Operating Leases

We lease property, facilities and equipment under various operating leases. Future minimum annual rental commitments under our operating leases as of December 31, 2013, were as follows (in millions):

<u>Year</u>	<u>Commitment</u>
2014.....	\$ 1
2015.....	1
2016 and Thereafter	1
Total.....	<u>\$ 3</u>

Rental expense on our lease obligations for the the year ended December 31, 2013, the Successor period in 2012, and the Predecessor period in 2012 was approximately \$24 million, \$14 million and \$10 million, respectively, and is reflected in "Operations and maintenance" on our Consolidated Statements of Income and Comprehensive Income. Included in our rental expense is approximately \$23 million, \$11 million and \$9 million of expense associated with right-of-way and other arrangements for the year ended December 31, 2013, the Successor period in 2012 and the Predecessor period in 2012, respectively, principally related to a long-term commitment which extends through 2025.

10. Fair Value

The following table reflects the carrying amount and estimated fair value of our long-term debt (in millions):

	<u>Successor</u>			
	<u>December 31, 2013</u>		<u>December 31, 2012</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Total debt (a).....	\$ 1,333	\$ 1,361	\$ 1,352	\$ 1,450

(a) As of December 31, 2013 and 2012, carrying amounts include \$218 million and \$237 million, respectively of unamortized excess fair value adjustment resulting from the application of "push down" accounting associated with KMI's acquisition of El Paso on May 25, 2012.

We separate the fair values of our financial instruments into levels based on our assessment of the availability of observable market data and the significance of non-observable data used to determine the estimated fair value. We estimated the fair values of our debt primarily based on quoted market prices for the same or similar issues, a Level 2 fair value measurement. Our assessment and classification of an instrument within a level can change over time based

on the maturity or liquidity of the instrument and this change would be reflected at the end of the period in which the change occurs. During the year ended December 31, 2013 and the Predecessor and Successor periods in 2012, there were no changes to the inputs and valuation techniques used to measure fair value of these instruments or the levels in which they were classified.

As of December 31, 2013 and 2012, the carrying amounts of cash and cash equivalents, accounts receivable and accounts payable represent their fair values based on the short-term nature of these instruments. The carrying amount of our affiliate note receivable approximates its fair value due to the note being on demand and its market based interest rate.

11. Accounting for Regulatory Activities

Regulatory assets and liabilities represent probable future revenues or expenses associated with certain charges and credits that will be recovered from or refunded to customers through the ratemaking process. As of December 31, 2013, substantially all of our regulatory assets are being recovered as cost of service in our rates over a period of approximately 1 year to 24 years. Below are the details of our regulatory assets and liabilities as of December 31 (in millions):

	Successor	
	2013	2012
Current regulatory assets		
Difference between gas retained and gas consumed in operations	\$ 20	\$ 4
Other	1	2
Total current regulatory assets	21	6
Non-current regulatory assets		
Taxes on capitalized funds used during construction.....	20	21
Unamortized loss on reacquired debt.....	23	27
Postretirement benefits.....	4	6
Other	10	9
Total non-current regulatory assets.....	57	63
Total regulatory assets.....	\$ 78	\$ 69
Current regulatory liabilities		
Property and plant depreciation	\$ 1	\$ 1
Difference between gas retained and gas consumed in operations.....	—	7
Other	3	1
Total current regulatory liabilities.....	4	9
Non-current regulatory liabilities		
Property and plant depreciation	34	28
Postretirement benefits.....	9	8
Other	2	2
Total non-current regulatory liabilities (a).....	45	38
Total regulatory liabilities.....	\$ 49	\$ 47

(a) Included in “Other long-term liabilities and deferred credits” on our Consolidated Balance Sheets.

The significant regulatory assets and liabilities include:

Difference between gas retained and gas consumed in operations. These amounts reflect the value of the volumetric difference between the gas retained and consumed in our operations. These amounts are not included in the rate base,

but given our tariffs, are expected to be recovered from our customers or returned to our customers in subsequent fuel filing periods.

Taxes on capitalized funds used during construction. These regulatory asset balances were established to offset the deferred tax for the equity component of AFUDC capitalized in long-lived assets. Taxes on capitalized funds used during construction and the offsetting deferred income taxes are included in the rate base and are recovered over the depreciable lives of the long lived asset to which they relate. These balances were established on our pipeline prior to our conversion to a non-taxable entity.

Unamortized loss on reacquired debt. Amount represents the deferred and unamortized portion of losses on reacquired debt which are recovered through the cost of service over the life of the new debt issue, or in the case of refinanced debt, over the life of the new debt issue.

Postretirement benefits. Represents differences in postretirement benefit costs expensed and the amounts previously recovered in rates. Prior to our 2011 rate case settlement, these balances also included unrecognized gains and losses or changes in actuarial assumptions related to our postretirement benefit plan. As part of our rate case settlement, we no longer include these costs in our rates and during the third quarter of 2011, we reclassified \$6 million (net of income taxes of \$4 million) to "Accumulated other comprehensive income."

Property and plant depreciation. Represents the deferral of customer-funded amounts for costs of future asset retirements and costs previously collected in our rates for the depreciation of certain assets in excess of normal depreciation rates.

Regulatory Matters

Below is a brief description of our ongoing regulatory matters, including any material developments that occurred during the year ended December 31, 2013 and the Predecessor and Successor periods in 2012.

Rate Cases

The tariffs and rates charged by us are subject to two ongoing FERC proceedings (the "2008 rate case" and the "2010 rate case"). With respect to the 2008 rate case, the FERC issued its decision ("Opinion 517") in May 2012. We implemented certain aspects of that decision and believe we have an adequate reserve related to the findings in Opinion 517. We have sought rehearing on Opinion 517. With respect to the 2010 rate case, the FERC issued its decision ("Opinion 528") on October 17, 2013. The FERC ordered us to file within 60 days of issuance of Opinion 528 revised pro forma recalculated rates consistent with the terms of Opinion 528. The FERC has ordered additional proceedings concerning one of the issues in Opinion 528. We have filed for rehearing on certain issues in Opinion 528. We have evaluated all recent decisions and believe our reserve is appropriate.

Norte Crossing Project (Docket No. CP12-96-00)

In March 2012, we filed an application seeking Section 3 authorization and a Presidential Permit for the siting, construction, connection, operation and maintenance of natural gas export facilities (Norte Crossing) at the international boundary between the United States and Mexico in El Paso County, Texas. The cost of these border crossing facilities along with additional metering facilities is approximately \$10 million. The FERC approved this application on August 31, 2012 and the new border crossing facilities were placed in-service in July 2013.

Willcox Lateral Expansion Project (Docket No. CP12-6)

In October 2011, we filed an application seeking authorization to expand the Willcox Lateral facilities by reconfiguring its Willcox Compressor Station from mainline service to lateral service by completing certain piping and facility modifications to the station and existing delivery meter stations in Cochise County, Arizona. The cost of the expansion facilities is approximately \$23 million. The FERC approved this application on October 12, 2012 and the expansion facilities were placed in-service in April 2013.

12. Transactions with Major Customers

For the year ended December 31, 2013, revenues from two non-affiliate customers were approximately \$64 million and \$57 million, each of which exceeded 10% of our operating revenues. For the Successor period in 2012, revenue from one non-affiliate customer was approximately \$47 million, which exceeded 10% of our operating revenues. For the Predecessor period in 2012, revenues from three non-affiliate customers were approximately \$30 million, \$29 million and \$25 million, each of which exceeded 10% of our operating revenues.

13. Accounts Receivable Sales Program

We participated in an accounts receivable sales program where we sold receivables in their entirety to a third-party financial institution (through a wholly owned special purpose entity). On June 20, 2012, we terminated the accounts receivable sales program and paid \$23 million to the third-party financial institution, which consisted of sales proceeds received up front and servicing fees. The sale of these accounts receivable (which were short-term assets that generally settled within 60 days) qualified for sale accounting. The third-party financial institution involved in our accounts receivable sales program acquired interests in various financial assets and issued commercial paper to fund those acquisitions. We did not consolidate the third-party financial institution because we did not have the power to control, direct or exert significant influence over its overall activities since our receivables did not comprise a significant portion of its operations.

In connection with our accounts receivable sales, we received a portion of the sales proceeds up front and received an additional amount upon the collection of the underlying receivables (which we referred to as a deferred purchase price). Our ability to recover the deferred purchase price was based solely on the collection of the underlying receivables. The tables below contain information related to our accounts receivable sales program (in millions):

	Successor	Predecessor
	Period from Acquisition May 25, 2012 to December 31, 2012	Period from January 1, 2012 to May 24, 2012
Accounts receivable sold to the third-party financial institution (a).....	\$ 34	\$ 190
Cash received for accounts receivable sold under the program.....	24	103
Deferred purchase price related to accounts receivable sold (b)	9	87
Cash received related to the deferred purchase price.....	—	99
Cash paid in conjunction with terminated program.....	23	—

(a) During the Predecessor and Successor periods in 2012, losses recognized on the sale of accounts receivable were immaterial.

(b) There were no balances outstanding as of December 31, 2012, since all balances were settled in June 2012 when the accounts receivable sales program was terminated.

Because the cash received up front and the deferred purchase price related to the sale or ultimate collection of the underlying receivables, and were not subject to significant other risks given their short term nature, we reflected all cash flows under the accounts receivable sales program as “Net Cash Provided by Operating Activities” on our Consolidated Statement of Cash Flow for 2012. Under the accounts receivable sales program, we serviced the underlying receivables for a fee. The fair value of these servicing agreements, as well as the fees earned, were not material to our financial statements for the Predecessor and Successor periods in 2012.