

**Southern Natural Gas Company, L.L.C.**

**CONSOLIDATED FINANCIAL STATEMENTS**  
With Independent Auditor's Report

For the Year Ended  
December 31, 2012 and 2011



**SOUTHERN NATURAL GAS COMPANY, L.L.C.**  
**TABLE OF CONTENTS**

	<b><u>Page Number</u></b>
Independent Auditor's Report .....	1
Consolidated Financial Statements	
Consolidated Statements of Income .....	3
Consolidated Balance Sheets .....	4
Consolidated Statements of Cash Flows.....	5
Consolidated Statements of Member's Equity .....	6
Notes to Consolidated Financial Statements.....	7



## **Independent Auditor's Report**

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

We have audited the accompanying consolidated financial statements of Southern Natural Gas Company, L.L.C. (the "Company") and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of income, of member's equity and of cash flows for the year then ended.

### ***Management's Responsibility for the 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 audit. We conducted our audit 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 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 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 Company and its subsidiaries at December 31, 2012, and the results of their operations and their cash flows for the year ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.



***Other Matters***

The consolidated financial statements of the Company and its subsidiaries as of December 31, 2011 and for the year then ended were audited by other auditors whose report dated February 27, 2012 expressed an unqualified opinion on those statements.

*Pricewaterhouse Coopers LLP*

April 22, 2013

**SOUTHERN NATURAL GAS COMPANY, L.L.C.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(In Millions)

	<u>Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Revenues.....	\$ 584	\$ 563
Operating Costs and Expenses		
Operation and maintenance .....	154	162
Depreciation and amortization.....	63	62
Taxes, other than income taxes .....	34	30
Total Operating Costs and Expenses .....	<u>251</u>	<u>254</u>
Operating income .....	<u>333</u>	<u>309</u>
Other Income (Expense)		
Earnings from equity investment .....	13	14
Other income, net .....	7	9
Interest and debt expense, net.....	<u>(79)</u>	<u>(72)</u>
Total Other Expense .....	<u>(59)</u>	<u>(49)</u>
Net income.....	<u>\$ 274</u>	<u>\$ 260</u>

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

**SOUTHERN NATURAL GAS COMPANY, L.L.C.**  
**CONSOLIDATED BALANCE SHEETS**  
(In Millions)

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents .....	\$ 1	\$ 3
Accounts and note receivable, net .....	71	68
Inventories .....	18	16
Assets held for sale .....	—	50
Regulatory assets .....	34	16
Other .....	1	—
Total current assets .....	125	153
Property, plant and equipment, net .....	2,501	2,533
Investment .....	58	57
Note receivable from affiliate .....	215	197
Regulatory assets .....	75	88
Other .....	10	17
Total Assets .....	<b>\$ 2,984</b>	<b>\$ 3,045</b>
<b>LIABILITIES AND MEMBER'S EQUITY</b>		
Current liabilities		
Accounts payable .....	\$ 37	\$ 67
Accrued interest .....	19	19
Accrued taxes .....	7	6
Contractual deposits .....	4	7
Asset retirement obligation .....	—	12
Accrued other current liabilities .....	4	1
Total current liabilities .....	71	112
Long-term liabilities and deferred credits		
Long-term debt .....	1,210	1,210
Other long-term liabilities and deferred credits .....	20	30
Total long-term liabilities and deferred credits .....	1,230	1,240
Total Liabilities .....	1,301	1,352
Commitments and Contingencies (Note 5 and 8)		
Member's Equity .....	1,683	1,693
Total Liabilities and Member's Equity .....	<b>\$ 2,984</b>	<b>\$ 3,045</b>

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

**SOUTHERN NATURAL GAS COMPANY, L.L.C.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In Millions)

	<u>Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Cash Flows From Operating Activities		
Net income.....	\$ 274	\$ 260
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	63	62
Earnings from equity investment.....	(13)	(14)
Distributions from equity investment.....	12	13
Other.....	9	(2)
Changes in component of working capital:		
Accounts receivable, net.....	(38)	(4)
Accounts payable.....	(25)	12
Regulatory assets.....	(12)	4
Regulatory liabilities.....	—	1
Accrued taxes.....	1	(7)
Other, net.....	(1)	2
Other long-term assets and liabilities.....	<u>13</u>	<u>(4)</u>
Net Cash Provided by Operating Activities.....	<u>283</u>	<u>323</u>
Cash Flows From Investing Activities		
Capital expenditures.....	(66)	(187)
Net change in note receivable from affiliate.....	16	(231)
Proceeds from sale of assets.....	50	—
Other.....	<u>(1)</u>	<u>—</u>
Net Cash Used in Investing Activities.....	<u>(1)</u>	<u>(418)</u>
Cash Flows From Financing Activities		
Net change in note payable to affiliate.....	—	(12)
Issuance of debt.....	—	300
Debt issue costs.....	—	(3)
Contributions from partners.....	—	60
Distributions to members.....	<u>(284)</u>	<u>(251)</u>
Net Cash (Used in) Provided by Financing Activities.....	<u>(284)</u>	<u>94</u>
Net decrease in Cash and Cash Equivalents.....	(2)	(1)
Cash and Cash equivalents, beginning of period.....	<u>3</u>	<u>4</u>
Cash and Cash equivalents, end of period.....	<u>\$ 1</u>	<u>\$ 3</u>
Supplemental Cash Flow Information		
Cash paid during the period for interest (net of capitalized interest).....	\$ 74	\$ 66

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

**SOUTHERN NATURAL GAS COMPANY, L.L.C.**  
**CONSOLIDATED STATEMENTS OF MEMBER'S EQUITY**  
(In Millions)

January 1, 2011.....	\$	1,624
Net income.....		260
Contributions .....		60
Distributions .....		<u>(251)</u>
December 31, 2011.....		1,693
Net income.....		274
Distributions .....		<u>(284)</u>
December 31, 2012.....	\$	<u><u>1,683</u></u>

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



## **SOUTHERN NATURAL GAS COMPANY, L.L.C.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **1. General**

We are a Delaware limited liability company, originally formed in 1935 as a corporation. When we refer to “us,” “we,” “our,” “ours,” “the Company,” or SNG we are describing Southern Natural Gas Company, L.L.C and/or our subsidiaries. We are wholly owned by El Paso Pipeline Partners Operating Company, L.L.C., a wholly owned subsidiary of El Paso Pipeline Partners, L.P. (EPB), a master limited partnership of El Paso LLC (formerly El Paso Corporation) (El Paso). El Paso became a wholly owned subsidiary of Kinder Morgan, Inc. (KMI) when it was acquired by KMI on May 25, 2012.

We own a pipeline system which extends from the supply basins in Texas, Louisiana, Mississippi, Alabama and the Gulf of Mexico to market areas in Louisiana, Mississippi, Alabama, Florida, Georgia, South Carolina and Tennessee, including the metropolitan areas of Atlanta and Birmingham. We own pipeline facilities servicing the southeastern markets in Alabama, Georgia and South Carolina. We own 100% of the Muldon storage facility in Monroe County, Mississippi and a 50% interest in Bear Creek Storage Company, L.L.C. (Bear Creek) in Bienville Parish, Louisiana. In addition, we operate both the Muldon and Bear Creek storage facilities which have a combined working natural gas storage capacity of approximately 60 Billion cubic feet (Bcf) and peak withdrawal capacity of 1.2 Bcf per day. Bear Creek is a joint venture equally owned by us and our affiliate, Tennessee Gas Pipeline Company, L.L.C. (TGP).

We have evaluated subsequent events through April 22, 2013, 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 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. In this report, we refer to the Financial Accounting Standards Board as the FASB and the FASB Accounting Standards Codification as the Codification.

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

##### ***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***

The amounts reported as "Accounts and note receivable, net" on our accompanying Consolidated Balance Sheets at December 31, 2012 and 2011 primarily consist of \$66 million and \$32 million, respectively, due from third party payors (unrelated entities). For information on receivables due to us from related parties, see Note 7.

We establish provisions for losses on accounts receivable and for natural gas imbalances 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 and related provision for bad debt expense was not significant for the years ended December 31, 2012 and 2011.

#### ***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 or storage facility differs from the scheduled amount of gas to be delivered or received. We value these imbalances due to or from shippers and operators at current index prices. Imbalances are settled in cash or in-kind, subject to the terms of our tariff. Imbalances due from others are reported in the Consolidated Balance Sheets as "Accounts and note receivable, net." Imbalances owed to others are reported in the Consolidated Balance Sheets as "Accounts payable." We classify all imbalances as current as we expect them to be settled 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 (group) method to depreciate property, plant and equipment. Under this method, assets with similar lives and characteristics are grouped and depreciated as one asset. The depreciation rate, accepted by the Federal Energy Regulatory Commission (FERC) is applied to the total cost of the group until its net book value equals its 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 their salvage value. We do not recognize a gain or loss unless we sell or retire an entire operating unit, as determined by the FERC. We generally include gains or losses on dispositions of operating units in "Operation and maintenance" expense in our Consolidated Statements of Income. In those instances where we receive recovery in rates related to losses on dispositions of operating units, we record a regulatory asset for the estimated recoverable amount. See Note 3 for information related to a regulatory asset we recorded associated with the sale of certain of our assets.

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 Consolidated Statements of Income or defer the loss as a regulatory asset on our balance sheet 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. Interest costs capitalized are included as a reduction to "Interest and debt expense, net" on our Consolidated Statements of Income. The equity portion is calculated based on the most recent FERC approved rate of return. Equity amounts capitalized are included in "Other income, net" on our Consolidated Statements of 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 assets because these assets have indeterminate lives.

We continue to evaluate our asset retirement obligations and future developments could impact the amounts we record. As of December 31, 2012 and 2011, our net asset retirement obligation was less than \$1 million and \$13 million, respectively.

#### ***Asset and Investment Divestitures/Impairments***

We evaluate our assets and investments 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 values based on either (i) the long-lived asset's ability to generate future cash flows on an undiscounted basis or (ii) the fair value of the investment in an unconsolidated affiliate. 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.

We classify assets (or groups of assets) to be disposed of as held for sale when specific criteria have been met. The lower of the carrying value or the estimated fair value less cost to sell of those assets is considered to determine if recognition of impairment is required. We cease depreciation and amortization of the assets in the period they are considered held for sale.

#### ***Equity Method of Accounting***

We account for investments, which we do not control but do have the ability to exercise significant influence, by the equity method of accounting. Under this method, our equity investments are carried originally at our acquisition costs, increased by our proportionate share of the investee's net income and by contributions made, and decreased by our proportionate share of the investee's net losses and by distributions received.

We operate and have a 50% ownership interest in Bear Creek, a joint venture equally owned with TGP, our affiliate. We account for our investment in Bear Creek using the equity method of accounting. We and TGP provide storage services to our customers utilizing the Bear Creek storage facility.

### ***Revenue Recognition***

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 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.

We are subject to FERC regulations and, as a result, revenues we collect may be subject to refund in a rate proceeding. We had no reserves for potential refunds at December 31, 2012.

### ***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 8.

### ***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 identify specific litigation that is expected to continue for a significant period of time, is reasonably possible to occur, and may require substantial expenditures, we identify a range of possible costs expected to be required to litigate the matter to a conclusion or reach an acceptable settlement, and we accrue for such amounts. 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. In general, we expense legal costs as incurred and all recorded legal liabilities are revised as better information becomes available. For more information on our legal disclosure, see Note 8.

### ***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 a 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. This plan requires us to make contributions to fund the benefits to be paid under the plan. These contributions are invested until the benefits

are paid to plan participants. The net benefit cost of this plan is recorded in our Consolidated Statements of 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 6.

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 as a regulatory asset or liability until those gains or losses are recognized on our Consolidated Statements of Income.

### ***Income Taxes***

We, as a limited liability company, do not pay federal or state income taxes. Accordingly, no provision for federal or state income taxes has been recorded in our financial statements. The tax effects of our activities accrue to our sole member, whose activities accrue to EPB who reports on its individual federal income tax returns its share of revenues and expenses but who, as a partnership, also does not pay federal or state income taxes.

### ***Regulated Operations***

Our natural gas pipeline and storage operations are subject to the jurisdiction of the FERC and follow the FASB's 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 employee benefit plan costs, losses on reacquired debt, losses on the sale of certain long lived assets, taxes related to an equity return component on regulated capital projects in periods prior to 2007 when we changed our legal structure to a general partnership, and certain costs related to gas not used in operations and other costs included in, or expected to be included in, future rates.

### **3. Divestiture**

In September 2011, we entered into an agreement to sell certain offshore and onshore assets (including pipeline, platforms and other related assets located in the Gulf of Mexico and Louisiana) for approximately \$50 million. At December 31, 2011, we classified these assets as held for sale at fair value which approximated the sales price. The fair value was based on observable market data which is a Level 2 measurement. At December 31, 2011, we deferred the estimated loss of approximately \$38 million as a regulatory asset. On June 21, 2012, the FERC issued an order approving the sale, which occurred on November 1, 2012. The regulatory asset balance of \$36 million at December 31, 2012 represents the difference between the net book value and the \$50 million sales price amortized by a fixed monthly rate, with the final accounting and recovery period dependent upon the outcome of the rate case. We believe it is probable that we will receive an acceptable FERC approval and recover the regulatory asset in future rates.

#### 4. Property, Plant and Equipment

##### *Classes of Assets and Depreciation Rates*

As of December 31, 2012 and 2011, our property, plant and equipment consisted of the following (in millions, except for %):

	Annual Depreciation Rates (%)	December 31,	
		2012	2011
Transmission and storage facilities.....	0.9 - 1.6	\$ 3,398	\$ 3,306
General plant .....	3.3 - 20.0	26	36
Intangible plant.....	2.8 - 10.0	62	79
Other .....		133	148
Accumulated depreciation and amortization <sup>(1)</sup> .....		<u>(1,145)</u>	<u>(1,133)</u>
		2,474	2,436
Land .....		12	13
Construction work in progress.....		15	84
Property, plant and equipment, net .....		<u>\$ 2,501</u>	<u>\$ 2,533</u>

(1) The composite weighted average depreciation rate for each year ended December 31, 2012 and 2011 was 1.7%.

##### *Capitalized Costs During Construction*

The allowance for debt interest amounts capitalized during the years ended December 31, 2012 and 2011 were \$1 million and \$2 million, respectively. The allowance for equity amounts capitalized during the years ended December 31, 2012 and 2011 were \$2 million and \$6 million, respectively.

#### 5. Debt

We classify our debt based on the contractual maturity dates of the underlying debt instruments. We defer costs associated with debt issuance over the applicable term. These costs are then amortized as interest expense in our Consolidated Statements of Income. The following table summarizes the net carrying value of our outstanding debt as of December 31 (in millions):

	2012	2011
5.90% Notes due April 2017 .....	\$ 500	\$ 500
4.40% Notes due June 2021.....	300	300
7.35% Notes due February 2031 .....	153	153
8.00% Notes due March 2032 .....	<u>258</u>	<u>258</u>
	1,211	1,211
Less: Unamortized discount .....	<u>1</u>	<u>1</u>
Total long-term debt .....	<u>\$1,210</u>	<u>\$1,210</u>

In June 2011, we and our wholly owned subsidiary, Southern Natural Issuing Corporation (SNIC) issued \$300 million aggregate principal amount of senior unsecured notes at 4.4%, due June 15, 2021. The net proceeds of \$297 million from this offering were advanced to EPB under its cash management program and were subsequently utilized to fund our growth capital expenditures and for general corporate purposes.

Under the indentures, we are subject to a number of restrictions and covenants. The most restrictive of these include limitations on the incurrence of liens. As of December 31, 2012 and 2011, we were in compliance with our debt-related covenants.

SNIC, as the co-issuer of the debt securities, is jointly and severally liable for the obligation. SNIC has no material assets, operations, revenues or cash flows other than those related to its service as a co-issuer of our debt securities. Accordingly, it has no ability to service obligations on our debt securities.

## 6. Retirement Benefits

### *Pension and Retirement Savings Plans*

KMI maintains a pension plan and a retirement savings plan covering substantially all of its United States 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 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. Employees in this group who retire after June 30, 2000 continue to receive limited postretirement life insurance benefits. Our postretirement benefit plan costs are prefunded to the extent these costs are recoverable through our rates. We expect to contribute \$1 million to our postretirement benefit plan in 2013. Contributions of approximately \$1 million were made to the post retirement benefit plan for each of the years ended December 31, 2012 and 2011.

### *Accumulated Postretirement Benefit Obligation, Plan Assets and Funded Status*

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 as a regulatory asset or liability as allowed by the FERC.

The table below provides information about our postretirement benefit plan (in millions):

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
Change in accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation - beginning of period.....	\$ 50	\$ 58
Interest cost .....	2	3
Participant contributions .....	1	—
Actuarial loss (gain) .....	10	(7)
Benefits paid <sup>(1)</sup> .....	<u>(4)</u>	<u>(4)</u>
Accumulated postretirement benefit obligation - end of period.....	<u>\$ 59</u>	<u>\$ 50</u>
Change in plan assets:		
Fair value of plan assets - beginning of period .....	\$ 56	\$ 55
Actual return on plan assets .....	7	4
Employer contributions.....	1	1
Participant contributions .....	1	—
Benefits paid .....	<u>(4)</u>	<u>(4)</u>
Fair value of plan assets - end of period.....	<u>\$ 61</u>	<u>\$ 56</u>
Reconciliation of funded status:		
Fair value of plan assets .....	\$ 61	\$ 56
Less: accumulated postretirement benefit obligation .....	<u>59</u>	<u>50</u>
Net asset at December 31 <sup>(2)</sup> .....	<u>\$ 2</u>	<u>\$ 6</u>

(1) Amounts shown net of a subsidy of less than \$1 million for each of the years ended December 31, 2012 and 2011 related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

(2) Net asset amounts are included in "Other" noncurrent assets in our Consolidated Balance Sheets.

*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 65% equity and 35% fixed income securities. We may invest plan assets in a manner that replicates, to the extent feasible, the Russell 3000 Index and the Barclays Capital Aggregate Bond Index to achieve equity and fixed income diversification, respectively.

We use various methods to determine the fair values of the assets in our other postretirement benefit plan, 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, 2012, assets were comprised of an exchange-traded mutual fund with a fair value of \$2 million and common/collective trust funds with a fair value of \$59 million. As of December 31, 2011, assets were comprised of an exchange-traded mutual fund with a fair value of \$2 million and common/collective trust funds with a fair value of \$54 million. Our exchange-traded 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. Our 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. There have been no changes in the methodologies used at December 31, 2012 and 2011.

*Expected Payment of Future Benefits*

As of December 31, 2012, we expect the following benefit payments under our plan (in millions):

<u>Year Ending December 31,</u>	<u>Expected Payments<sup>(1)</sup></u>
2013 .....	\$ 4
2014 .....	4
2015 .....	4
2016 .....	4
2017 .....	4
2018 – 2022 .....	19

(1) Includes a reduction of approximately \$1 million in each of the years 2013 – 2017 and approximately \$4 million in aggregate for 2018 – 2022 for an expected subsidy related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.



### 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's obligations and net benefit costs.

	<u>2012</u>	<u>2011</u>
	(%)	
Assumptions related to benefit obligations at December 31:		
Discount rate.....	3.49	4.45
Assumptions related to benefit costs for the year ended December 31:		
Discount rate <sup>(1)(2)</sup> .....	4.27	4.92
Expected return on plan assets <sup>(3)</sup> .....	7.50	7.75

- (1) 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.
- (2) The discount rates related to benefit costs were 4.45% for the period from January 1, 2012 to May 24, 2012 and 4.14% for the period from May 25, 2012 to December 31, 2012.
- (3) 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 22% for 2012 and a rate of 35% for 2011.

Actuarial estimates for our postretirement benefits 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. Assumed health care cost trends can have a significant effect on the amounts reported for our postretirement benefit plan. A one-percentage point change would not have had a significant effect on interest costs in 2012 or 2011. A one-percentage point change in assumed health care cost trends would have the following effect as of December 31 (in millions):

	<u>2012</u>	<u>2011</u>
One percentage point increase:		
Accumulated postretirement benefit obligation.....	\$ 6	\$ 5
One percentage point decrease:		
Accumulated postretirement benefit obligation.....	\$ (5)	\$ (4)

#### Components of Net Benefit Cost (Income)

For each of the years ended December 31, the components of net benefit cost (income) are as follows (in millions):

	<u>2012</u>	<u>2011</u>
Interest cost.....	\$ 2	\$ 3
Expected return on plan assets.....	(4)	(3)
Net benefit (income) expense.....	<u>\$ (2)</u>	<u>\$ —</u>

## 7. Related Party Transactions

### Distributions and Contributions

We are required to make distributions to our owner as defined in our limited liability company agreement on a quarterly basis. During 2012 and 2011, we paid cash distributions of approximately \$284 million and \$251 million to our member/partners. During 2011, we received cash contributions of approximately \$60 million from our partners to fund our expansion projects. In January 2013, we paid a cash distribution of \$88 million to our member.

### Cash Management Program

We participate in EPB's cash management program which matches our short-term cash surpluses and needs of participating affiliates, thus minimizing our total borrowings from outside sources. EPB uses the cash management program to settle intercompany transactions between participating affiliates. At December 31, 2012 and 2011, we

had a note receivable from EPB of approximately \$215 million and \$231 million, respectively. At December 31, 2011, we classified \$34 million of this receivable under “Accounts and note receivable, net” on our Consolidated Balance Sheets. The interest rate on this note is variable and was 2.0% and 2.3% at December 31, 2012 and 2011, respectively.

### ***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 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 the officers of KMI and its affiliates. Under an omnibus agreement with El Paso and other policies with KMI and its affiliates, we reimburse KMI and its affiliates without a profit component 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 to us. Prior to KMI’s acquisition of El Paso, we were allocated costs from TGP, our affiliate, associated with our pipeline services. These allocations were based on the estimated level of effort devoted to our operations and the relative size of our earnings before interest expense, gross property and payroll.

The following table summarizes our other affiliate balances on our Consolidated Balance Sheets (in millions):

	<u>December 31,</u>	
	<u>2012</u>	<u>2011</u>
Accounts receivable.....	\$ 5	\$ 2
Accounts payable.....	5	19
Contractual deposits .....	—	1

The following table shows revenues, expenses and reimbursements from our affiliates for the years ended December 31 (in millions):

	<u>2012</u>	<u>2011</u>
Revenues.....	\$ 8	\$ 9
Operation expenses <sup>(1)</sup> .....	104	120
Reimbursements of operating expenses.....	1	4

(1) The 2012 period includes severance costs of \$15 million allocated to us from El Paso as a result of KMI’s acquisition of El Paso.

## **8. Litigation, Environmental and Other Contingencies**

### ***Legal Matters***

We and our affiliates are named defendants in numerous lawsuits and governmental proceedings and claims that arise in the ordinary course of our business. There are also other regulatory rules and orders in various stages of adoption, review and/or implementation. For each of these matters, we evaluate the merits of the case or claim, our exposure to the matter, possible legal or settlement strategies and the likelihood of an unfavorable outcome. If we determine that an unfavorable outcome is probable and can be estimated, we establish the necessary accruals. While the outcome of these matters cannot be predicted with certainty, and there are still uncertainties related to the costs we may incur, based upon our evaluation and experience to date, we believe we have established appropriate reserves for these matters. It is possible, however, that new information or future developments could require us to reassess our potential exposure related to these matters and adjust our accruals accordingly, and these adjustments could be material.

At December 31, 2012 and 2011, we had approximately \$2 million accrued in each period for our outstanding legal proceedings. We do not have any other litigation or claim contingency matters assessed as probable or reasonably possible that would require disclosure in the financial statements.

### ***Environmental Matters***

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require us to remove or remedy the effect of the disposal or release of specified substances at our operating site. As of December 31, 2012 and 2011, our accrual was less than \$1 million in each period for our environmental matters.

Our recorded environmental liabilities reflect our current estimates of amounts we will expend on remediation projects in various stages of completion. However, depending on the stage of completion or assessment, the ultimate extent of contamination or remediation required may not be known. As additional assessments occur or remediation efforts continue, we may incur additional liabilities.

### ***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 one active site. 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.

It is possible that new information or future developments could require us to reassess our potential exposure related to environmental matters. We may incur significant costs and liabilities in order to comply with existing environmental laws and regulations. It is also possible that other developments, such as increasingly strict environmental laws, regulations and orders of regulatory agencies, as well as claims for damages to property and the environment or injuries to other persons resulting from our current or past operations, could result in substantial costs and liabilities in the future. As this information becomes available, or other relevant developments occur, we will adjust our accrual amounts accordingly. While there are still uncertainties related to the ultimate costs we may incur, based upon our evaluation and experience to date, we believe our reserves are adequate.

### ***Other Commitments***

#### ***Capital Commitments***

At December 31, 2012, we had capital commitments of approximately \$4 million related to Southeast Supply Header (SESH), all of which will be spent in 2013. During 2009, we entered into a \$57 million letter of credit associated with our estimated construction costs related to our SESH Expansion project. As invoices are paid under the contract, we are able to reduce the value of the letter of credit. At December 31, 2012, the letter or credit has been reduced to approximately \$8 million. In September 2012, this letter of credit was assumed by EPB and is supported by its credit revolver. We also have commitments for the purchase of plant, property and equipment of \$7 million, which we expect to spend during 2013. We have other planned capital and investment 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 system. Currently, our obligations under these easements are not material to our results of operations.

#### ***Storage Commitments***

We have entered into storage capacity contracts totaling \$10 million at December 31, 2012, of which \$8 million are related to storage capacity contracts with our affiliate, Bear Creek. Our annual obligations under these agreements are approximately \$9 million in 2013 and \$1 million in 2014.

### Operating Leases

We lease property, facilities and equipment under various operating leases. Our primary commitment under operating leases is the lease of our office space in Birmingham, Alabama. KMI guarantees our obligations under these lease agreements. Our minimum future annual rental commitments under our operating leases at December 31, 2012, are as follows (in millions):

<u>Year Ending December 31,</u>		
2013 .....		\$ 2
2014 .....		2
2015 .....		2
2016 .....		2
2017 .....		1
Thereafter .....		<u>21</u>
Total .....		<u>\$ 30</u>

Rent expense on our lease obligations for each of the years ended December 31, 2012 and 2011 was \$3 million and is reflected in “Operation and maintenance” expense on our Consolidated Statements of Income.

### 9. Fair Value

The following table reflects the carrying amount and estimated fair value of our financial instruments as of December 31 (in millions):

	<u>2012</u>		<u>2011</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Long-term debt .....	\$1,210	\$1,494	\$1,210	\$1,381

As of December 31, 2012 and 2011, the carrying amounts of cash and cash equivalents, current receivables and payables represent fair value because of the short-term nature of these instruments.

As of December 31, 2012 and 2011, our financial instruments measured at fair value consisted of our long-term debt. 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 estimate the fair values of our long-term 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 years ended December 31, 2012 and 2011, there were no changes to the inputs and valuation techniques used to measure fair value, the types of instruments, or the levels in which they were classified.

We are exposed to changes in interest income or expense based on changes to the variable interest rate of our interest bearing note receivable from EPB as discussed in Note 7. The fair value of this note approximates its carrying value due to the note being due on demand and the market-based nature of the interest rate.

## 10. Regulatory Assets and Liabilities

Our regulatory asset and liability balances are recoverable or reimbursable over various periods. Below are the details of our regulatory assets and liabilities at December 31 (in millions):

	<u>2012</u>	<u>2011</u>
Current regulatory assets		
Difference between gas retained and gas consumed in operations .....	\$ 20	\$ 8
Unamortized loss on sale of assets .....	13	6
Other .....	<u>1</u>	<u>2</u>
Total current regulatory assets.....	<u>34</u>	<u>16</u>
Non-current regulatory assets		
Taxes on capitalized funds used during construction .....	27	28
Unamortized loss on reacquired debt.....	23	26
Unamortized loss on sale of assets .....	23	32
Other .....	<u>2</u>	<u>2</u>
Total non-current regulatory assets.....	<u>75</u>	<u>88</u>
Total regulatory assets .....	<u>\$ 109</u>	<u>\$ 104</u>
Current regulatory liabilities		
Other .....	<u>\$ 1</u>	<u>\$ 1</u>
Total current regulatory liabilities <sup>(1)</sup> .....	<u>1</u>	<u>1</u>
Non-current regulatory liabilities		
Postretirement benefits .....	10	17
Other .....	<u>6</u>	<u>8</u>
Total non-current regulatory liabilities <sup>(2)</sup> .....	<u>16</u>	<u>25</u>
Total regulatory liabilities.....	<u>\$ 17</u>	<u>\$ 26</u>

(1) Included in "Accrued other current liabilities" on our Consolidated Balance Sheets.

(2) Included in "Other long-term liabilities and deferred credits" on our Consolidated Balance Sheets.

Substantially all of our regulatory assets as of December 31, 2012 are being recovered as cost of service in our rates. These assets are expected to be recovered in rates over a period of approximately one year to thirty-nine years.

Our 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 in subsequent fuel filing periods.

### *Taxes on capitalized funds used during construction*

These regulatory asset balances were established in periods prior to 2007 when we changed our legal structure to a general partnership, to offset the deferred tax for the equity component of the allowance for funds used during the construction of 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.

### *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 original life of the debt issue, or in the case of refinanced debt, over the life of the new debt issue.

### *Unamortized loss on sale of asset*

Amount represents the deferred and unamortized portion of losses on our sale of offshore assets, as discussed in Note 3. The recovery is expected to occur at a fixed monthly rate until our next rate case, with the final recovery period dependent upon the outcome of the rate case.

### *Postretirement Benefits*

Represents unrecognized gains or losses related to our postretirement benefit plan.

## **11. Transactions with Major Customers**

For the year ended December 31, 2012, revenues from three non-affiliate customers were approximately \$160 million, \$100 million and \$59 million, each of which exceeded 10% of our operating revenues. For the year ended December 31, 2011, revenues from three non-affiliate customers were approximately \$162 million, \$75 million and \$59 million, each of which exceeded 10% of our operating revenues.

## **12. 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 \$25 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 are short-term assets that generally settle 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).

	<u>Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Accounts receivable sold to the third-party financial institution <sup>(1)</sup> .....	\$ 250	\$ 602
Cash received for accounts receivable sold under the program.....	140	358
Deferred purchase price related to accounts receivable sold .....	110	244
Cash received related to the deferred purchase price.....	123	239

(1) During the years ended December 31, 2012 and 2011, losses recognized on the sale of accounts receivable were immaterial.

	<u>As of</u>
	<u>December 31,</u>
	<u>2011</u>
Accounts receivable sold and held by third-party financial institution.....	\$ 60
Uncollected deferred purchase price related to accounts receivable sold <sup>(1)(2)</sup> .....	31

(1) Initially recorded at an amount which approximated its fair value using observable inputs other than quoted prices in active markets, a Level 2 fair value measurement.

(2) 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.

The deferred purchase price related to the accounts receivable sold is reflected as “Accounts and note receivable, net” in our Consolidated Balance Sheets. 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 “Cash Provided by Operating Activities” on our Statements of Cash Flows. 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 years ended December 31, 2012 and 2011.

## **12. Regulatory Matters**

### *Bear Creek*

In November 2011, Bear Creek, our unconsolidated affiliate, received an order from the FERC related to an investigation into the rates charged to customers. The FERC ordered Bear Creek to file a full cost and revenue study within 75 days of the order. Bear Creek filed the cost and revenue study in January 2012. In June 2012, Bear Creek filed an uncontested settlement which resolved all of the issues in the proceedings. Under the settlement, Bear Creek agreed to reduce its rates to its two customers including us and TGP, our affiliate. The settlement was approved by the FERC on August 15, 2012. The impact of the settlement is not expected to materially affect our financial statements.

### *Rate Case*

On January 31, 2013, the FERC approved our request to amend our January 2010 settlement. The amendment extended the required filing date for our rate case from February 28, 2013 to no later than May 31, 2013. If we file a settlement before May 31, 2013, we would not be required to file a rate case and the new rates would be effective as of September 1, 2013. However, if we file a rate case on May 31, 2013, the new rates would likely become effective as of December 1, 2013.