
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2003

OR

**[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 1-2700

El Paso Natural Gas Company

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

74-0608280
(I.R.S. Employer
Identification No.)

El Paso Building
1001 Louisiana Street
Houston, Texas
(Address of Principal Executive Offices)

77002
(Zip Code)

Telephone Number: (713) 420-2600

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$1 per share. Shares outstanding on May 14, 2003: 1,000

**EL PASO NATURAL GAS COMPANY MEETS THE CONDITIONS OF GENERAL
INSTRUCTION H(1)(a) and (b) OF FORM 10-Q AND IS THEREFORE FILING THIS REPORT
WITH A REDUCED DISCLOSURE FORMAT AS PERMITTED BY SUCH INSTRUCTION.**

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO NATURAL GAS COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In millions)
(Unaudited)

	Quarter Ended	
	March 31,	
	2003	2002
Operating revenues	<u>\$132</u>	<u>\$152</u>
Operating expenses		
Operation and maintenance	34	50
Depreciation, depletion and amortization	17	13
Gain on long-lived assets	—	(1)
Taxes, other than income taxes	<u>8</u>	<u>8</u>
	<u>59</u>	<u>70</u>
Operating income	73	82
Other income	1	—
Interest and debt expense	(20)	(16)
Affiliated interest income, net	<u>3</u>	<u>6</u>
Income before income taxes	57	72
Income taxes	<u>22</u>	<u>28</u>
Net income	<u>\$ 35</u>	<u>\$ 44</u>

See accompanying notes.

EL PASO NATURAL GAS COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)
(Unaudited)

	March 31, 2003	December 31, 2002
ASSETS		
Current assets		
Cash and cash equivalents	\$ —	\$ 3
Accounts and notes receivable		
Customer, net of allowance of \$18 in 2003 and 2002	77	79
Affiliates	431	432
Other	7	13
Materials and supplies	43	43
Deferred income taxes	36	36
Other	26	27
Total current assets	<u>620</u>	<u>633</u>
Property, plant and equipment, at cost	3,042	3,060
Less accumulated depreciation, depletion and amortization	<u>1,151</u>	<u>1,152</u>
Total property, plant and equipment, net	<u>1,891</u>	<u>1,908</u>
Notes receivable from affiliate	608	565
Other	84	83
Total assets	<u><u>\$3,203</u></u>	<u><u>\$3,189</u></u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities		
Accounts payable		
Trade	\$ 34	\$ 43
Affiliates	7	33
Other	2	11
Short-term borrowings (including current maturities of long-term debt)	200	200
Accrued interest	23	15
Taxes payable	127	133
Contractual deposits	33	35
Western Energy Settlement	100	100
Other	50	53
Total current liabilities	<u>576</u>	<u>623</u>
Long-term debt, less current maturities	<u>758</u>	<u>758</u>
Other liabilities		
Deferred income taxes	252	221
Western Energy Settlement	316	312
Other	119	122
	<u>687</u>	<u>655</u>
Commitments and contingencies		
Stockholder's equity		
Preferred stock, 8%, par value \$0.01 per share; authorized 1,000,000 shares; issued and outstanding 500,000 shares; stated at liquidation value	350	350
Common stock, par value \$1 per share; authorized and issued 1,000 shares	—	—
Additional paid-in capital	715	715
Retained earnings	117	88
Total stockholder's equity	<u>1,182</u>	<u>1,153</u>
Total liabilities and stockholder's equity	<u><u>\$3,203</u></u>	<u><u>\$3,189</u></u>

See accompanying notes.

EL PASO NATURAL GAS COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Quarter Ended March 31,	
	<u>2003</u>	<u>2002</u>
Cash flows from operating activities		
Net income	\$ 35	\$ 44
Adjustments to reconcile net income to net cash from operating activities		
Depreciation, depletion and amortization	17	13
Deferred income tax expense	31	9
Net gain on long-lived assets	—	(1)
Risk-sharing revenue	(8)	(8)
Bad debt expense	—	8
Other non-cash income items	5	—
Working capital changes	(44)	(2)
Non-working capital changes	<u>12</u>	<u>9</u>
Net cash provided by operating activities	<u>48</u>	<u>72</u>
Cash flows from investing activities		
Additions to property, plant and equipment	(38)	(37)
Net proceeds from the sale of assets	30	1
Net change in affiliate advances receivable	<u>(43)</u>	<u>58</u>
Net cash provided by (used in) investing activities	<u>(51)</u>	<u>22</u>
Cash flows from financing activities		
Net short-term borrowings	—	121
Payments to retire long-term debt	<u>—</u>	<u>(215)</u>
Net cash used in financing activities	<u>—</u>	<u>(94)</u>
Net change in cash and cash equivalents	(3)	—
Cash and cash equivalents		
Beginning of period	<u>3</u>	<u>—</u>
End of period	<u>\$ —</u>	<u>\$ —</u>

See accompanying notes.

EL PASO NATURAL GAS COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

We are an indirect wholly owned subsidiary of El Paso Corporation (El Paso). We prepared this Quarterly Report on Form 10-Q under the rules and regulations of the United States Securities and Exchange Commission (SEC). Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by generally accepted accounting principles. You should read it along with our 2002 Form 10-K, which includes a summary of our significant accounting policies and other disclosures. The financial statements as of March 31, 2003, and for the quarters ended March 31, 2003 and 2002, are unaudited. We derived the balance sheet as of December 31, 2002, from the audited balance sheet filed in our 2002 Form 10-K. In our opinion, we have made all adjustments, all of which are of a normal, recurring nature, to fairly present our interim period results. Due to the seasonal nature of our business, information for interim periods may not necessarily indicate the results of operations for the entire year. In addition, prior period information presented in these financial statements includes reclassifications which were made to conform to the current period presentation. These reclassifications have no effect on our previously reported net income or stockholder's equity.

Our accounting policies are consistent with those discussed in our Form 10-K, except as discussed below:

Accounting for Costs Associated with Exit or Disposal Activities. As of January 1, 2003, we adopted Statement of Financial Accounting Standards (SFAS) No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires that we recognize costs associated with exit or disposal activities when they are incurred rather than when we commit to an exit or disposal plan. There was no initial financial statement impact of adopting this standard.

Accounting for Guarantees. On January 1, 2003, we adopted Financial Accounting Standards Board Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN No. 45 requires that we record a liability for all guarantees, including financial performance and fair value guarantees, issued after December 31, 2002, at fair value when they are issued. There was no initial financial statement impact of adopting this standard.

Accounting for Regulated Operations. We continue to evaluate the application of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, for changes in the competitive environment and our operating cost structures. See a further discussion of our accounting for regulated operations in our 10-K.

2. Western Energy Settlement

On March 20, 2003, we and our affiliates entered into an agreement in principle with a number of public and private claimants, including the states of California, Washington, Oregon and Nevada, to resolve the principal litigation, claims and regulatory proceedings against us and our affiliates relating to the sale or delivery of natural gas and electricity from September 1996 to the date of the Western Energy Settlement (referred to as the Western Energy Settlement). The settlement, as discussed in our 2002 Form 10-K and Note 4, will include payments of cash, delivery of El Paso's common stock and availability of capacity for five years at our California delivery points.

The portion of the Western Energy Settlement allocated to us by El Paso Corporation was initially \$412 million. This amount represented the settlement amount of \$665 million, less a discount (based on a discount rate of 10 percent) of \$253 million. During the quarter ended March 31, 2003, we recorded \$4 million of amortization expense on the discount associated with the settlement obligation which increased our overall obligation to \$416 million as of March 31, 2003. This amortization was reflected as an operation and maintenance expense in our income statement.

This calculation of our portion of the settlement obligation required us to use estimates and assumptions based on currently available information. These estimates included the discount rate, the timing of final settlement and the timing of payments made to satisfy obligations. As a result, our estimates and assumptions used may change.

3. Debt and Other Credit Facilities

In April 2003, El Paso entered into a new \$3 billion revolving credit facility, with a \$1.5 billion letter of credit sublimit, which matures in June 2005. This facility replaces the previous \$3 billion, 364-day revolving credit facility. El Paso's existing \$1 billion revolving credit facility, which matures in August 2003, and approximately \$1 billion of other financing arrangements (including leases, letters of credit and other facilities) were also amended to conform El Paso's obligations to the new \$3 billion revolving credit facility. We, along with our affiliates, ANR Pipeline Company, Tennessee Gas Pipeline Company (TGP) and El Paso, are borrowers under the \$3 billion revolving credit facility, and we, TGP and El Paso are borrowers under the \$1 billion revolving credit facility.

El Paso's equity in several of its subsidiaries, including us and our equity in Mojave Pipeline Company, collateralizes the revolving credit facility and the other financing arrangements. We will remain jointly and severally liable under the \$3 billion revolving credit facility through August 19, 2003. After that date, we will only be liable for the amounts we borrow under the facility. We are also jointly and severally liable for any amounts outstanding under the \$1 billion revolving credit facility until it matures in August 2003.

The revolving credit facilities have a borrowing cost of LIBOR plus 350 basis points and letter of credit fees of 350 basis points. A key financial covenant of the facilities is the requirement for El Paso to maintain debt to total capitalization, as defined in the revolving credit facilities, not to exceed 75 percent. In addition, we and the other pipeline company borrowers cannot incur incremental debt if the incurrence of debt would cause our debt to EBITDA ratio, as defined in the revolving credit facilities, to exceed 5 to 1. The proceeds from the issuance of debt by the pipeline company borrowers can be used only for maintenance and expansion capital expenditures or investments in other FERC-regulated assets, and to refinance existing debt. As of March 31, 2003, \$1.5 billion was outstanding under the \$3 billion facility, none of which was borrowed by us, and \$500 million was outstanding and \$456 million in letters of credit were issued under the \$1 billion facility, none of which was borrowed by us.

On January 8, 2003, Mojave paid approximately \$3 million to the preferred interest members of Trinity River. See our 2002 Form 10-K for a discussion of Mojave's obligations under the Trinity River financing arrangement. In March 2003, El Paso entered into a \$1.2 billion 2-year term loan and the proceeds were used to retire the outstanding balance under the Trinity River financing agreement.

4. Commitments and Contingencies

Legal Proceedings

Western Energy Settlement. On March 20, 2003, we and our affiliates entered into an agreement in principle (the Western Energy Settlement) with various public and private claimants, including the states of California, Washington, Oregon, and Nevada, to resolve the principal litigation, claims, and regulatory proceedings, which are more fully described below, against us and our affiliates relating to the sale or delivery of natural gas and electricity from September 1996 to the date of the Western Energy Settlement. Among other things, the components of the settlement include:

- a cash payment of \$100 million;
- a \$2 million cash payment from El Paso's officer bonus pool;
- the issuance of approximately 26.4 million shares of El Paso common stock;
- delivery to the California border by our affiliate of \$45 million worth of natural gas annually for 20 years beginning in 2004;
- a reduction of the pricing of our affiliate's long-term power supply contracts with the California Department of Water Resources of \$125 million over the remaining term of those contracts, which run through the end of 2005;
- payments of \$22 million per year for 20 years;
- for a period of five years, EPNG will make available at its California delivery points 3,290 MMcf per day of capacity on a primary delivery point basis;
- for a period of five years, our affiliates will be subject to restrictions in subscribing for new capacity on the EPNG system; and
- no admission of wrongdoing.

The Western Energy Settlement resulted in an after-tax charge to us of approximately \$262 million in the fourth quarter of 2002 for the component of the settlement allocated to us.

The agreement in principle is subject to the negotiation of a formal settlement agreement, portions of which will then be filed with the courts and the FERC for approval. Upon approval, the parties will release us from covered claims that they may have against us and our affiliates for the period covered by the Western Energy Settlement, and the litigation, claims, and regulatory proceedings against us and our affiliates will be dismissed with prejudice.

California Lawsuits. We have been named as a defendant in fifteen purported class action, municipal or individual lawsuits, filed in California state courts. These suits contend that we acted improperly to limit the construction of new pipeline capacity to California and/or to manipulate the price of natural gas sold into the California marketplace. Specifically, the plaintiffs argue that our conduct violates California's antitrust statute (Cartwright Act), constitutes unfair and unlawful business practices prohibited by California statutes, and amounts to a violation of California's common law restrictions against monopolization. In general, the plaintiffs are seeking (i) declaratory and injunctive relief regarding allegedly anticompetitive actions, (ii) restitution, including treble damages, (iii) disgorgement of profits, (iv) prejudgment and postjudgment interest, (v) costs of prosecuting the actions and (vi) attorney's fees. All fifteen cases have been consolidated before a single judge, under two omnibus complaints, one of which has been set for trial in September 2003. All of the class action lawsuits and all but one of the individual lawsuits will be resolved upon finalization and approval of the Western Energy Settlement. As to the remaining individual lawsuit, on May 8, 2003, a settlement agreement between the plaintiffs and defendants in that case became effective and resolved all disputes between the parties in return for a single payment by El Paso. Pursuant to the settlement, the plaintiffs action will be dismissed with prejudice.

The California cases discussed above are five filed in the Superior Court of Los Angeles County (*Continental Forge Company, et al v. Southern California Gas Company, et al*, filed September 25, 2000*; *Berg v. Southern California Gas Company, et al*, filed December 18, 2000*; *County of Los Angeles v. Southern California Gas Company, et al*, filed January 8, 2002*; *The City of Los Angeles, et al v. Southern California Gas Company, et al* and *The City of Long Beach, et al v. Southern California Gas Company, et al*, both filed March 20, 2001*); two filed in the Superior Court of San Diego County (*John W.H.K. Phillip v. El Paso Merchant Energy*; and *John Phillip v. El Paso Merchant Energy*, both filed December 13, 2000*); and two filed in the Superior Court of San Francisco County (*Sweetie's et al v. El Paso Corporation, et al*, filed March 22, 2001*; and *California Dairies, Inc., et al v. El Paso Corporation, et al*, filed May 21, 2001); and one filed in the Superior Court of the State of California, County of Alameda (*Dry Creek Corporation v. El Paso Natural Gas Company, et al* filed December 10, 2001*); and five filed in the Superior Court of Los Angeles County (*The City of San Bernardino v. Southern California Gas Company, et al*; *The City of Vernon v. Southern California Gas Company*; *The City of Upland v. Southern California Gas Company, et al*; *Edgington Oil Company v. Southern California Gas Company, et al*; *World Oil Corp. v. Southern California Gas Company, et al*, filed December 27, 2002*).

In November 2002, a lawsuit titled *Gus M. Bustamante v. The McGraw-Hill Companies* was filed in the Superior Court of California, County of Los Angeles by several individuals, including Lt. Governor Bustamante acting as a private citizen, against numerous defendants, including us, alleging the creation of artificially high natural gas index prices via the reporting of false price and volume information. This purported class action on behalf of California consumers alleges various unfair business practices and seeks restitution, disgorgement of profits, compensatory and punitive damages, and civil fines. This lawsuit will be resolved upon finalization and approval of the Western Energy Settlement.

In January 2003, a lawsuit titled *IMC Chemicals v. EPME, et al.* was filed in California state court against us, El Paso and EPME. The suit arises out of a gas supply contract between IMC Chemicals (IMCC) and EPME and seeks to void the Gas Purchase Agreement between IMCC and EPME for gas purchases until December 2003. IMCC contends that EPME and its affiliates manipulated market prices for natural gas and, as part of that manipulation, induced IMCC to enter into the contract. In furtherance of its attempt to void the contract, IMCC repeats the allegations and claims of the California lawsuits described above. EPME intends to enforce the terms of the contract and counterclaim for contract damages. This case was removed to Federal Court. A hearing was held on April 21, 2003 on the respective motions of the El Paso defendants to dismiss, as well as IMCC's motions to remand. Our costs and legal exposure related to these lawsuits and claims are not currently determinable.

In September 2001, we received a civil document subpoena from the California Attorney General, seeking information said to be relevant to the Department's ongoing investigation into the high electricity prices in California. We are continuing to cooperate in responding to their discovery requests. This proceeding will be resolved upon finalization and approval of the Western Energy Settlement.

Other Energy Market Lawsuits. The state of Nevada and two individuals filed a class action lawsuit in Nevada state court naming us and a number of our affiliates as defendants. The allegations are similar to those in the California cases. The suit seeks monetary damages and other relief under Nevada antitrust and consumer protection laws. This proceeding will be resolved upon finalization and approval of the Western Energy Settlement.

A purported class action suit titled *Henry W. Perlman et. al. v. Southern California Gas Company, San Diego Gas & Electric; Sempra Energy, El Paso Corporation, El Paso Natural Gas Company and El Paso Merchant Energy, L.P.* was filed in federal court in New York City in December 2002 alleging that the defendants manipulated California's natural gas market by manipulating the spot market of gas traded on the NYMEX. Our costs and legal exposure related to this lawsuit are not currently determinable.

* Cases to be dismissed upon finalization and approval of the Western Energy Settlement.

In March 2003, the State of Arizona sued us, our affiliates and other unrelated entities on behalf of Arizona consumers. The suit alleges that the defendants conspired to artificially inflate prices of natural gas and electricity during 2000 and 2001. Making factual allegations similar to those alleged in the California cases, the suit seeks relief similar to the California cases as well, but under Arizona antitrust and consumer fraud statutes. Our costs and legal exposure related to these lawsuits and claims are not currently determinable.

On April 21, 2003, Sierra Pacific Resources and its subsidiary, Nevada Power Company filed a lawsuit titled *Sierra Pacific Resources et al. v. El Paso Corporation et al.*, in the U.S. District Court for the District of Nevada against El Paso Corporation, EPNG, El Paso Tennessee Pipeline, EPME and four other non-El Paso defendants. The lawsuit alleges that the defendants conspired to manipulate supplies and prices of natural gas in the California-Arizona border market from 1996 through 2001. The allegations are similar to those raised in the several cases that are the subject of the Western Energy Settlement described above. The plaintiffs allege that they entered into contracts at inappropriately high prices and hedging transactions because of the alleged manipulated prices. They allege that the defendants' activities constituted (1) a violation of the Nevada Unfair Trade Practices Act; (2) fraud; (3) both a conspiracy to violate and a violation of Nevada's RICO act; and (4) a civil conspiracy. The complaint seeks \$150 million in actual damages from all the defendants, plus an additional \$450 million in trebled damages. The El Paso defendants were served with the complaint on May 5, 2003.

Shareholder Class Action Suit. In November 2002, we were named as a defendant in a shareholder derivative suit titled *Marilyn Clark v. Byron Allumbaugh, David A. Arledge, John M. Bissell, Juan Carlos Braniff, James F. Gibbons, Anthony W. Hall, Ronald L. Kuehn, J. Carleton MacNeil, Thomas McDade, Malcolm Wallop, William Wise, Joe B. Wyatt, El Paso Natural Gas Company and El Paso Merchant Energy Company* filed in state court in Houston. This shareholder derivative suit generally alleges that manipulation of California gas supply and gas prices exposed our parent, El Paso, to claims of antitrust conspiracy, FERC penalties and erosion of share value. The plaintiffs have not asked for any relief with regards to us. Our costs and legal exposure related to this proceeding are not currently determinable.

Carlsbad. In August 2000, a main transmission line owned and operated by us ruptured at the crossing of the Pecos River near Carlsbad, New Mexico. Twelve individuals at the site were fatally injured. On June 20, 2001, the U.S. Department of Transportation's Office of Pipeline Safety issued a Notice of Probable Violation and Proposed Civil Penalty to us. The Notice alleged five violations of DOT regulations, proposed fines totaling \$2.5 million and proposed corrective actions. We have fully accrued for these fines. The alleged five probable violations of the regulations of the Department of Transportation's Office of Pipeline Safety are: (1) failure to develop an adequate internal corrosion control program, with an associated proposed fine of \$500,000; (2) failure to investigate and minimize internal corrosion, with an associated proposed fine of \$1,000,000; (3) failure to conduct continuing surveillance on our pipeline and consider, and respond appropriately to, unusual operating and maintenance conditions, with an associated proposed fine of \$500,000; (4) failure to follow company procedures relating to investigating pipeline failures and thereby to minimize the chance of recurrence, with an associated proposed fine of \$500,000; and (5) failure to maintain elevation profile drawings, with an associated proposed fine of \$25,000. On October 2001, we filed a response with the Office of Pipeline Safety disputing each of the alleged violations. If we are required to pay the proposed fines, it will not have a material adverse effect on our financial position, operations results or cash flows.

On February 11, 2003, the National Transportation Safety Board (NTSB) conducted a public hearing on its investigation of the Carlsbad rupture at which the NTSB adopted Findings, Conclusions and Recommendation based upon its investigation. In April 2003, the NTSB published its final report. The NTSB stated that it had determined that the probable cause of the August 19, 2000 rupture was a significant reduction in pipe wall thickness due to severe internal corrosion, which occurred because our corrosion control program "failed to prevent, detect, or control internal corrosion" in the pipeline. The NTSB also determined that ineffective federal preaccident inspections contributed to the accident by not identifying deficiencies in our internal corrosion control program.

On November 1, 2002, we received a federal grand jury subpoena for documents relating to the rupture and we are cooperating fully with the grand jury.

A number of personal injury and wrongful death lawsuits were filed against us in connection with the rupture. All but one of these suits have been settled, with settlement payments fully covered by insurance. The remaining case is *Geneva Smith, et al. vs. EPEC and EPNG* filed October 23, 2000 in Harris County, Texas. Trial is set to begin on August 11, 2003. In connection with the settlement of the cases, we contributed \$10 million to a charitable foundation as a memorial to the families involved. The contribution was not covered by insurance.

Parties to four settled lawsuits have since filed an additional lawsuit titled *Diane Heady et al. v. EPEC and EPNG* in Harris County, Texas on November 20, 2002 seeking an additional \$85 million based upon their interpretation of earlier agreements. Parties to another of the settled lawsuits have filed a lawsuit titled *In the Matter of Jennifer Smith*, in Eddy County, New Mexico, on May 7, 2003, seeking an additional \$86 million based upon their interpretation of earlier agreements. In addition, plaintiffs' counsel for the settled New Mexico state court cases have notified us that they intend to file suit on behalf of about twenty-three firemen and EMS personnel who responded to the fire and who allegedly have suffered psychological trauma. We have not been served with such a lawsuit. Our costs and legal exposure related to these lawsuits and claims are currently not determinable. However, we believe these matters will be fully covered by insurance.

Grynberg. In 1997, we and a number of our affiliates were named defendants in actions brought by Jack Grynberg on behalf of the U.S. Government under the False Claims Act. Generally, these complaints allege an industry-wide conspiracy to underreport the heating value as well as the volumes of the natural gas produced from federal and Native American lands, which deprived the U.S. Government of royalties. The plaintiff in this case seeks royalties that he contends the government should have received had the volume and heating value of natural gas produced from royalty properties been differently measured, analyzed, calculated and reported, together with interest, treble damages, civil penalties, expenses and future injunctive relief to require the defendants to adopt allegedly appropriate gas measurement practices. No monetary relief has been specified in this case. These matters have been consolidated for pretrial purposes (In re: Natural Gas Royalties *Qui Tam* Litigation, U.S. District Court for the District of Wyoming, filed June 1997). In May 2001, the court denied the defendants' motions to dismiss. Discovery is proceeding. Our costs and legal exposure related to these lawsuits and claims are currently not determinable.

Will Price (formerly Quinque). We and a number of our affiliates were named defendants in *Quinque Operating Company et al v. Gas Pipelines and Their Predecessors, et al*, filed in 1999 in the District Court of Stevens County, Kansas. Quinque has been dropped as a plaintiff and Will Price has been added. This class action complaint alleges that the defendants mismeasured natural gas volumes and heating content of natural gas on non-federal and non-Native American lands. The plaintiff in this case seeks certification of a nationwide class of natural gas working interest owners and natural gas royalty owners to recover royalties that the plaintiff contends these owners should have received had the volume and heating value of natural gas produced from their properties been differently measured, analyzed, calculated and reported, together with prejudgment and postjudgment interest, punitive damages, treble damages, attorney's fees, costs and expenses, and future injunctive relief to require the defendants to adopt allegedly appropriate gas measurement practices. No monetary relief has been specified in this case. Plaintiff's motion for class certification was denied on April 10, 2003. Our costs and legal exposure related to these lawsuits and claims are currently not determinable.

In addition to the above matters, we and our subsidiaries and affiliates are named defendants in numerous lawsuits and governmental proceedings that arise in the ordinary course of our business.

For each of our outstanding legal matters, we evaluate the merits of the case, our exposure in 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. As of March 31, 2003, we had accrued approximately \$419 million for all outstanding legal matters.

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 on the environment of the disposal or release of specified substances at current and former operating sites. As of March 31, 2003, we had accrued approximately \$28 million for expected remediation costs at current and former sites and associated onsite, offsite and groundwater technical studies and for related environmental legal costs, which we anticipate incurring through 2027. Our reserve estimates range from a low estimate of approximately \$27 million to a high estimate of approximately \$54 million. Our accrual at March 31, 2003 was based on the probability of the range of reasonably possible outcomes. Below is a reconciliation of our accrued liability as of March 31, 2003 (in millions).

Balance as of January 1	\$29
Additions/adjustments for remediation activities	<u>(1)</u>
Balance as of March 31	<u>\$28</u>

In addition, we expect to make capital expenditures for environmental matters of approximately \$3 million in the aggregate for the years 2003 through 2008. These expenditures primarily relate to compliance with clean air regulations. For 2003, we estimate that our total remediation expenditures will be approximately \$1 million, which primarily will be expended under government directed clean-up plans.

CERCLA Matters. We have received notice that we could be designated, or have been asked for information to determine whether we could be designated, as a Potentially Responsible Party (PRP) with respect to four active sites under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) or state equivalents. We have sought to resolve our liability as a PRP at these sites through indemnification by third parties and settlements which provide for payment of our allocable share of remediation costs. As of March 31, 2003, we have estimated our share of the remediation costs at these sites to be between \$14 million and \$18 million. Since the clean-up costs are estimates and are subject to revision as more information becomes available about the extent of remediation required, and because in some cases we have asserted a defense to any liability, our estimates could change. Moreover, liability under the federal CERCLA statute is joint and several, meaning that we could be required to pay in excess of our pro rata share of remediation costs. Our understanding of the financial strength of other PRPs has been considered, where appropriate, in determining our estimated 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 and regulations and claims for damages to property, employees, other persons and the environment 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 relating to the ultimate costs we may incur, based upon our evaluation and experience to date, we believe the reserves are adequate.

Rates and Regulatory Matters

CPUC Complaint Proceeding. In April 2000, the CPUC filed a complaint under Section 5 of the Natural Gas Act (NGA) with the FERC alleging that our sale of approximately 1.2 billion cubic feet per day of capacity to our affiliate, El Paso Merchant Energy Company (EPME), raised issues of market power and violation of FERC's marketing affiliate regulations and asked that the contracts be voided. Although the FERC held that we did not violate its marketing affiliate requirements, it established a hearing before an ALJ to address the market power issue. In the spring and summer of 2001, two hearings were held before the ALJ to address the market power issue and, at the request of the ALJ, the affiliate issue. In October 2001, the ALJ issued an initial decision on the two issues, finding that the record did not support a finding that either we or EPME had exercised market power and that accordingly the market power claims against us should be

dismissed. The ALJ found, however, that we had violated FERC's marketing affiliate rule. We and other parties filed briefs on exceptions and briefs opposing exceptions to the October initial decision.

Also, in October 2001, the FERC's Office of Market Oversight and Enforcement filed comments stating that the record at the hearings was inadequate to conclude that we had complied with FERC regulations in the transportation of gas to California. In December 2001, the FERC remanded the proceeding to the ALJ for a supplemental hearing on the availability of capacity at our California delivery points. On September 23, 2002, the ALJ issued his initial decision, again finding that there was no evidence that EPME had exercised market power during the period at issue to drive up California gas prices and therefore recommending that the complaint against EPME be dismissed. However, the ALJ found that we had withheld at least 345 MMcf/d of capacity (and perhaps as much as 696 MMcf/d) from the California market during the period from November 1, 2000 through March 31, 2001. The ALJ found that this alleged withholding violated our certificate obligations and was an exercise of market power that increased the gas price to California markets. He therefore recommended that the FERC initiate penalty procedures against us. We and others filed briefs on exceptions to the initial decision on October 23, 2002; briefs opposing exceptions were filed on November 12, 2002. This proceeding will be resolved upon finalization and approval of the Western Energy Settlement.

Systemwide Capacity Allocation Proceeding. In July 2001, several of our contract demand or CD customers filed a complaint against us at the FERC claiming, among other things, that our full requirements contracts or FR contracts (contracts with no volumetric limitations) should be converted to CD contracts, and that we should be required to expand our system and give demand charge credits to CD customers when we are unable to meet their full contract demands. In July 2001, several of our FR customers filed a complaint alleging that we had violated the Natural Gas Act and our contractual obligations to them by not expanding our system, at our cost, to meet their increased requirements.

On May 31, 2002, the FERC issued an order on the complaints in which it required that (i) FR service, for all FR customers except small volume customers, be converted to CD service; (ii) firm customers be assigned specific receipt point rights in lieu of their existing systemwide receipt point rights; (iii) reservation charge credits be given to all firm customers for failure to schedule confirmed volumes except in cases of force majeure; (iv) no new firm contracts be executed until we have demonstrated there is adequate capacity on the system; and (v) a process be implemented to allow existing CD customers to turn back capacity for acquisition by FR customers in which process we would remain revenue neutral. These changes were to be made effective November 1, 2002. The order also stated that the FERC expected us to file for certificate authority to add compression to Line 2000 to increase our system capacity by 320 MMcf/d without cost coverage until our next rate case (i.e. January 1, 2006). We had previously informed the FERC that we were willing to add compression to Line 2000 provided we were assured of rate coverage in the next rate case. On July 1, 2002, we and other parties filed for clarification and/or rehearing of the May 31 order.

On September 20, 2002, at the urging of the FR shippers, the FERC issued an order postponing until May 1, 2003 the effective date of the FR conversions. That order also required us to allocate among our FR customers (i) the 320 MMcf/d of capacity that will be available from the addition of compression to Line 2000, and (ii) any firm capacity that expires under existing contracts between May 31, 2002, and May 1, 2003, thereby precluding us from reselling that capacity. In total, the September 20 order requires that our FR customers pay only their current aggregate reservation charges for existing unsubscribed capacity, for the 230 MMcf/d of capacity made available in November 2002 by our Line 2000 project, for the 320 MMcf/d of capacity from the addition of compression to Line 2000, and for all capacity subject to contracts expiring before May 1, 2003.

On April 14, 2003, the FERC issued an order granting a motion by the FR shippers for deferral of the May 1 implementation date pending FERC review of the Western Energy Settlement. The order reset the implementation date to September 1, 2003. Beginning on that date and subject to the substantive requirements of the September 20, 2002 order, we will be required to pay reservation charge credits when we are unable to schedule confirmed volumes except in cases of force majeure. Until September 1, 2003, we are required to pay partial reservation charge credits to CD customers when we are unable to schedule 95 percent

of their monthly confirmed volumes except for reasons of force majeure and provided that there is no capacity available from other supply basins on our system.

Several pleadings have been filed in response to the September 20 order, including rehearing requests and requests by several customers to modify the order based on the ALJ's decision in the CPUC Complaint Proceeding discussed above. All such pleadings remain pending before the FERC.

On October 7, 2002, we filed tariff sheets in compliance with the September 20 order to implement a partial demand charge credit for the period November 1, 2002 to May 6, 2003, and to allow California delivery points to be used as secondary receipt points to the extent of our backhaul displacement capabilities. We proposed both a reservation and a usage charge for this service. On December 26, 2002, the FERC issued an order (i) denying our request to charge existing CD customers a reservation rate for California receipt service for the remaining term of the settlement, *i.e.*, through December 31, 2005; (ii) allowing us to charge our maximum IT rate for the service; (iii) approving our proposed usage rate for the service until our next rate case; and (iv) requiring us to make a showing that capacity is available for any new shippers utilizing this service. We made a revised tariff filing on January 10, 2003, in compliance with the December 26 order. On January 27, 2003, we filed a request for rehearing on certain aspects of the December 26 order. That request is pending.

Rate Settlement. Our current rate settlement establishes our base rates through December 31, 2005. Under the settlement, our base rates began escalating annually in 1998 for inflation. We have the right to increase or decrease our base rates if changes in laws or regulations result in increased or decreased costs in excess of \$10 million a year. In addition, all of our settling customers participate in risk sharing provisions. Under these provisions, we will receive cash payments in total of \$295 million for a portion of the risk we assumed from capacity relinquishments by our customers (primarily capacity turned back to us by Southern California Gas Company and Pacific Gas & Electric Company which represented approximately one-third of the capacity of our system) during 1996 and 1997. The cash we received was deferred, and we recognize this amount in revenues ratably over the risk sharing period. As of March 31, 2003, we had unearned risk sharing revenues of approximately \$24 million and had \$10 million remaining to be collected from customers under this provision. Amounts received for relinquished capacity sold to customers, above certain dollar levels specified in our rate settlement, obligate us to refund a portion of the excess to customers. Under this provision, we refunded a total of \$46 million of 2002 revenues to customers during 2002 and the first quarter of 2003. During 2003, we established an additional refund obligation of \$10 million. Both the risk and revenue sharing provisions of the rate settlement extend through 2003.

Line 2000 Project. On July 31, 2000, we applied with the FERC for a certificate of public convenience and necessity for our Line 2000 project, which was designed to replace old compression on the system with a converted oil pipeline, resulting in no increase in system capacity. In response to demand conditions on our system, however, we filed in March 2001 to amend our application to convert the project to an expansion project of 230 MMcf/d. On May 7, 2001, the FERC authorized the amended Line 2000 project. We placed the line in service in November 2002 at an approximate capital cost of \$185 million. The cost of the Line 2000 conversion will not be included in our rates until our next rate case, which will be effective on January 1, 2006.

On October 3, 2002, pursuant to the FERC's May 31 and September 20 orders in the systemwide capacity allocation proceeding, we filed with the FERC for a certificate of public convenience and necessity to add compression to our Line 2000 project to increase the capacity of that line by an additional 320 MMcf/d at an estimated capital cost of approximately \$173 million for all phases. That application has been protested, and remains pending. In our request for clarification of the September 20 order, we have asked for assurances from the FERC that we will be able to begin cost recovery for this project at the time our next rate case becomes effective. That request remains pending.

Marketing Affiliate NOPR. In September 2001, the FERC issued a Notice of Proposed Rulemaking (NOPR). The NOPR proposes to apply the standards of conduct governing the relationship between interstate pipelines and marketing affiliates to all energy affiliates. The proposed regulations, if adopted by the FERC, would dictate how we conduct business and interact with our energy affiliates. In December 2001, we filed comments with the FERC addressing our concerns with the proposed rules. A public hearing was held on

May 21, 2002, providing an opportunity to comment further on the NOPR. Following the conference, additional comments were filed by El Paso's pipelines and others. At this time, we cannot predict the outcome of the NOPR, but adoption of the regulations in their proposed form would, at a minimum, place additional administrative and operational burdens on us.

Negotiated Rate NOI. In July 2002, the FERC issued a Notice of Inquiry (NOI) that seeks comments regarding its 1996 policy of permitting pipelines to enter into negotiated rate transactions. We have entered into these transactions over the years, and the FERC is now reviewing whether negotiated rates should be capped, whether or not the "recourse rate" (a cost-of-service based rate) continues to safeguard against a pipeline exercising market power and other issues related to negotiated rate programs. On September 25, 2002, El Paso's pipelines and others filed comments. Reply comments were filed on October 25, 2002. At this time, we cannot predict the outcome of this NOI.

Cash Management NOPR. On August 1, 2002, the FERC issued a NOPR requiring that all cash management or money pool arrangements between a FERC regulated subsidiary (like us) and a non-FERC regulated parent must be in writing, and set forth the duties and responsibilities of cash management participants and administrators; the methods of calculating interest and for allocating interest income and expenses; and the restrictions on deposits or borrowings by money pool members. The NOPR also requires specified documentation for all deposits into, borrowings from, interest income from, and interest expenses related to, these arrangements. Finally, the NOPR proposed that as a condition of participating in a cash management or money pool arrangement, the FERC regulated entity maintain a minimum proprietary capital balance of 30 percent, and the FERC regulated entity and its parent maintain investment grade credit ratings. On August 28, 2002, comments were filed. The FERC held a public conference on September 25, 2002, to discuss the issues raised in the comments. Representatives of companies from the gas and electric industries participated on a panel and uniformly agreed that the proposed regulations should be revised substantially and that the proposed capital balance and investment grade credit rating requirements would be excessive. At this time, we cannot predict the outcome of this NOPR.

Also on August 1, 2002, the FERC's Chief Accountant issued an Accounting Release, which was effective immediately. The Accounting Release provides guidance on how companies should account for money pool arrangements and the types of documentation that should be maintained for these arrangements. However, it did not address the proposed requirements that the FERC regulated entity maintain a minimum proprietary capital balance of 30 percent and that the entity and its parent have investment grade credit ratings. Requests for rehearing were filed on August 30, 2002. The FERC has not yet acted on the rehearing requests.

Emergency Reconstruction of Interstate Natural Gas Facilities NOPR. On January 17, 2003, FERC issued a NOPR proposing, in emergency situations, to (1) expand the scope of construction activities authorized under a pipeline's blanket certificate to allow replacement of mainline facilities; (2) authorize a pipeline to commence reconstruction of the affected system without a waiting period; and (3) authorize automatic approval of construction that would be above the normal cost ceiling. Comments on the NOPR were filed on February 27, 2003. At this time, we cannot predict the outcome of this rulemaking.

Pipeline Safety Notice of Proposed Rulemaking. On January 28, 2003, the U.S. Department of Transportation issued a NOPR proposing to establish a rule requiring pipeline operators to develop integrity management programs to comprehensively evaluate their pipelines, and take measures to protect pipeline segments located in what the notice refers to as "high consequence areas." The proposed rule resulted from the enactment of the Pipeline Safety Improvement Act of 2002, a new bill signed into law in December 2002. Comments on the NOPR were filed on April 30, 2003. At this time, we cannot predict the outcome of this rulemaking.

Other Matters

Enron Bankruptcy. In December 2001, Enron Corp. and a number of its subsidiaries, including Enron North America Corp. and Enron Power Marketing, Inc., filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York. Enron North America had

transportation contracts on our system. The transportation contracts have now been rejected and we have filed a proof of claim in the amount of approximately \$128 million, which included \$18 million for amounts due for services provided through the date the contracts were rejected and \$110 million for damage claims arising from the rejection of its transportation contracts. The September 20 order capacity allocation proceeding discussed in *Rates and Regulatory Matters* above currently prohibits us from remarketing Enron capacity that was not remarketed prior to May 31, 2002. We have sought rehearing of the September 20 order. We have fully reserved for all amounts due from Enron through the date the contracts were rejected, and we have not recognized any amounts under these contracts since the rejection date.

While the outcome of our outstanding legal matters, environmental matters, and rates and regulatory matters cannot be predicted with certainty, based on current information and our existing accruals, we do not expect the ultimate resolution of these matters to have a material adverse effect on our financial position, operating results or cash flows. However, it is possible that new information or future developments could require us to reassess our potential exposure related to these matters. It is also possible that these matters could impact our debt rating and the credit rating of our parent. Further, for environmental matters, it is also possible that other developments, such as increasingly strict environmental laws and regulations and claims for damages to property, employees, other persons and the environment resulting from our current or past operations, could result in substantial costs and liabilities in the future. As new information for our outstanding legal matters, environmental matters and rates and regulatory matters becomes available, or relevant developments occur, we will review our accruals and make any appropriate adjustments. The impact of these changes may have a material effect on our results of operations, our financial position, and on our cash flows in the period the event occurs.

5. Related Party Transactions

We participate in El Paso's cash management program which matches short-term cash surpluses and need requirements of participating affiliates, thus minimizing total borrowings from outside sources. Our continued participation in the program may be dependent on any final rule issued by the FERC in connection with its cash management notice of proposed rulemaking discussed in Note 4. As of March 31, 2003 and December 31, 2002, we had advanced to El Paso \$1,033 million and \$990 million. The market rate of interest at March 31, 2003 and December 31, 2002, was 1.3% and 1.5%. As of March 31, 2003 and December 31, 2002, we have classified \$608 million and \$565 million of these advances as non-current notes receivable from affiliates. These receivables were due upon demand; however, we do not anticipate settlement within the next twelve months.

At March 31, 2003 and December 31, 2002, we had other accounts receivable from related parties of \$6 million and \$7 million. Accounts payable to affiliates was \$7 million at March 31, 2003, versus \$33 million at December 31, 2002. These balances arose in the normal course of business.

As of March 31, 2003, we had accrued \$7 million in dividends associated with our preferred stock. On April 3, 2003, El Paso contributed its 500,000 shares of our 8% preferred stock to us, including the accrued dividends.

The following table shows revenues and charges from our affiliates for the quarters ended March 31:

	<u>2003</u>	<u>2002</u>
	<u>(In millions)</u>	
Revenues from affiliates	\$ 4	\$13
Operations and maintenance from affiliates	18	17
Reimbursement for operating expenses from affiliates	4	1

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

The information contained in Item 2 updates, and should be read in conjunction with, the information disclosed in our 2002 Form 10-K in addition to the financial statements and notes presented in Item 1, Financial Statements, of this Form 10-Q.

Results of Operations

We use earnings before interest and income taxes (EBIT) to assess the operating results and effectiveness of our business. EBIT is operating income adjusted to include miscellaneous non-operating income. Items that are not included in this measure are financing costs, including interest and debt expense and income taxes. We believe this measurement is useful to our investors because it allows them to evaluate the effectiveness of our businesses and operations and our investments from an operational perspective, exclusive of the costs to finance those activities and exclusive of income taxes. This measurement may not be comparable to measurements used by other companies and should not be used as a substitute for net income or other performance measures such as operating income or operating cash flow. Presented below is a reconciliation of our operating income to EBIT and EBIT to net income, and a discussion of our results of operations were as follows for the quarters ended March 31:

	2003	2002
	(In millions, except volume amounts)	
Operating revenues	\$ 132	\$ 152
Operating expenses	(59)	(70)
Operating income	73	82
Other income	1	—
EBIT	74	82
Interest and debt expense	(20)	(16)
Affiliated interest income, net	3	6
Income taxes	(22)	(28)
Net income	\$ 35	\$ 44
Throughput volumes (BBtu/d) ⁽¹⁾	4,069	4,203

⁽¹⁾ BBtu/d means billion British thermal units per day.

First Quarter 2003 Compared to First Quarter 2002

Operating revenues for the quarter ended March 31, 2003, were \$20 million lower than the same period in 2002. A decrease of \$15 million was due to capacity contracts that have expired which we are prohibited from remarketing due to our September 20, 2002 FERC order. For further discussion of this order, see Item 1, Note 4. Also contributing to the decrease was a \$6 million fuel settlement related to our Mojave Pipeline rate case settled in the first quarter of 2002. These decreases were partially offset by \$2 million of higher throughput-based revenues from transportation to interconnecting pipelines serving markets in the midwest and east due to colder weather in 2003.

Operating expenses for the quarter ended March 31, 2003, were \$11 million lower than the same period in 2002. A decrease of \$9 million was due to bad debt expense recorded in 2002 related to the bankruptcy of Enron Corp. Also contributing to the decrease was a \$4 million decrease in our estimated purchase power costs in 2003, \$2 million due to the periodic revaluation of natural gas imbalances due to higher natural gas prices in 2003 and \$1 million related to an insurance settlement for environmental claims received in 2003. These decreases were partially offset by a \$4 million expense related to the amortization of the discount associated with the Western Energy Settlement obligation and a \$2 million unfavorable fuel variance due to lower pipeline fuel recoveries.

Interest and Debt Expense

Below is the analysis of our interest expense for the quarter ended March 31 (in millions):

	<u>2003</u>	<u>2002</u>
Long term debt, including current maturities	\$20	\$14
Commercial paper	—	4
Other interest	1	—
Less: capitalized interest	<u>(1)</u>	<u>(2)</u>
Total interest expense	<u>\$20</u>	<u>\$16</u>

Interest and debt expense for the quarter ended March 31, 2003, was \$4 million higher than the same period in 2002. The increase was primarily due to a \$6 million increase in interest related to the issuance of \$300 million of long-term debt in June 2002, which was partially offset by lower interest expense of \$4 million due to the discontinuation of commercial paper activities in the fourth quarter of 2002.

Affiliated Interest Income

Affiliated interest income for the quarter ended March 31, 2003, was \$3 million lower than the same period in 2002 due to lower short-term interest rates in 2003 and lower average balances advanced to El Paso under our cash management program. The average short-term interest rates for the first quarter decreased from 1.9% in 2002 to 1.4% in 2003. The average advance balance decreased in the first quarter from \$1.3 billion in 2002 to \$1.0 billion in 2003.

Income Taxes

The income tax expense for the quarters ended March 31, 2003 and 2002, was \$22 million and \$28 million, resulting in effective tax rates of 39 percent for both periods. Our effective tax rates were different from the statutory rate of 35 percent primarily due to state income taxes.

Commitments and Contingencies

See Item 1, Financial Statements, Note 4, which is incorporated herein by reference.

CAUTIONARY STATEMENT FOR PURPOSES OF THE “SAFE HARBOR” PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report contains or incorporates by reference forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Where any forward-looking statement includes a statement of the assumptions or bases underlying the forward-looking statement, we caution that, while we believe these assumptions or bases to be reasonable and to be made in good faith, assumed facts or bases almost always vary from the actual results, and the differences between assumed facts or bases and actual results can be material, depending upon the circumstances. Where, in any forward-looking statement, we or our management express an expectation or belief as to future results, that expectation or belief is expressed in good faith and is believed to have a reasonable basis. We cannot assure you, however, that the statement of expectation or belief will result or be achieved or accomplished. The words “believe,” “expect,” “estimate,” “anticipate” and similar expressions will generally identify forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

This information updates, and you should read it in conjunction with, information disclosed in Part II, Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2002, in addition to the information presented in Items 1 and 2 of this Quarterly Report on Form 10-Q.

There are no material changes in our quantitative and qualitative disclosures about market risks from those reported in our Annual Report on Form 10-K for the year ended December 31, 2002.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures. Under the supervision and with the participation of management, including our principal executive officers and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (Disclosure Controls) and internal controls (Internal Controls) within 90 days of the filing date of this Quarterly Report pursuant to Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (Exchange Act).

Definition of Disclosure Controls and Internal Controls. Disclosure Controls are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified under the Exchange Act. Disclosure Controls include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. Internal Controls are procedures which are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

Limitations on the Effectiveness of Controls. El Paso Natural Gas Company’s management, including the principal executive officer and principal financial officer, does not expect that our Disclosure Controls and Internal Controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become

inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

No Significant Changes in Internal Controls. We have sought to determine whether there were any “significant deficiencies” or “material weaknesses” in El Paso Natural Gas Company’s Internal Controls, or whether the company had identified any acts of fraud involving personnel who have a significant role in El Paso Natural Gas Company’s Internal Controls. This information was important both for the controls evaluation generally and because the principal executive officer and principal financial officer are required to disclose that information to our Board and our independent auditors and to report on related matters in this section of the Quarterly Report. The principal executive officer and principal financial officer note that, from the date of the controls evaluation to the date of this Quarterly Report, there have been no significant changes in Internal Controls or in other factors that could significantly affect Internal Controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

Effectiveness of Disclosure Controls. Based on the controls evaluation, our principal executive officer and principal financial officer have concluded that, subject to the limitations discussed above, the Disclosure Controls are effective to ensure that material information related to El Paso Natural Gas Company and its consolidated subsidiaries is made known to management, including the principal executive officer and principal financial officer, particularly during the period when our periodic reports are being prepared.

Officer Certifications. The certifications from the principal executive officer and principal financial officer required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 have been included herein, or as Exhibits to this Quarterly Report, as appropriate.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

See Part I, Item 1, Financial Statements, Note 4, which is incorporated herein by reference.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security-Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

Each exhibit identified below is filed as a part of this report. Exhibits not incorporated by reference to a prior filing are designated by an “*”; all exhibits not so designated are incorporated herein by reference to a prior filing as indicated.

<u>Exhibit Number</u>	<u>Description</u>
10.A	\$3,000,000,000 Revolving Credit Agreement dated as of April 16, 2003 among El Paso Corporation, El Paso Natural Gas Company, Tennessee Gas Pipeline Company and ANR Pipeline Company, as Borrowers, the Lenders Party thereto, and JPMorgan Chase Bank, as Administrative Agent, ABN Amro Bank N.V. and Citicorp North America, Inc., as Co-Document Agents, Bank of America, N.A. and Credit Suisse First Boston, as Co-Syndication Agents, J.P. Morgan Securities Inc. and Citigroup Global Markets Inc., as Joint Bookrunners and Co-Lead Arrangers. (Exhibit 99.1 to El Paso Corporation’s Form 8-K filed April 18, 2003, Commission File No. 1-2700).
10.B	\$1,000,000,000 Amended and Restated 3-Year Revolving Credit Agreement dated as of April 16, 2003 among El Paso Corporation, El Paso Natural Gas Company and Tennessee Gas Pipeline Company, as Borrowers, The Lenders Party thereto, and JPMorgan Chase Bank, as Administrative Agent, ABN Amro Bank N.V. and Citicorp North America, Inc., as Co-Document Agents, Bank of America, N.A., as Syndication Agent, J.P. Morgan Securities Inc. and Citigroup Global Markets Inc., as Joint Bookrunners and Co-Lead Arrangers. (Exhibit 99.2 to El Paso Corporation’s Form 8-K filed April 18, 2003, Commission File No. 1-2700).
10.C	Security and Intercreditor Agreement dated as of April 16, 2003 among El Paso Corporation, the persons referred to therein as Pipeline Company Borrowers, the persons referred to therein as Grantors, each of the Representative Agents, JPMorgan Chase Bank, as Credit Agreement Administrative Agent and JPMorgan Chase Bank, as Collateral Agent, Intercreditor Agent, and Depository Bank. (Exhibit 99.3 to El Paso Corporation’s Form 8-K filed April 18, 2003, Commission File No. 1-2700).
*99A	Certification of Chief Executive Officer pursuant to 18 U.S.C. § 1350 as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.
*99B	Certification of Chief Financial Officer pursuant to 18 U.S.C. § 1350 as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002.

Undertaking

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4)(iii), to furnish to the U.S. Securities and Exchange Commission, upon request, all constituent instruments defining the rights of holders of our long-term debt not filed herewith for the reason that the total amount of securities authorized under any of such instruments does not exceed 10 percent of our total consolidated assets.

b. Reports on Form 8-K

We filed a Current Report on Form 8-K dated March 21, 2003 announcing information regarding the Western Energy Settlement.

We filed a Current Report on Form 8-K dated April 18, 2003 announcing amendments to our financing facilities.

We filed a Current Report on Form 8-K dated April 24, 2003 of our Computation of Ratio of Earnings to Fixed Charges for the five years ended December 31, 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EL PASO NATURAL GAS COMPANY

Date: May 14, 2003

/s/ JOHN W. SOMERHALDER II

John W. Somerhalder II
Chairman of the Board,
Chief Executive Officer and Director
(Principal Executive Officer)

Date: May 14, 2003

/s/ GREG G. GRUBER

Greg G. Gruber
Senior Vice President,
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

CERTIFICATION

I, John W. Somerhalder II, certify that:

1. I have reviewed this quarterly report on Form 10-Q of El Paso Natural Gas Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ JOHN W. SOMERHALDER II

John W. Somerhalder II
*Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)*
El Paso Natural Gas Company

CERTIFICATION

I, Greg G. Gruber, certify that:

1. I have reviewed this quarterly report on Form 10-Q of El Paso Natural Gas Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrants and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ GREG G. GRUBER

Greg G. Gruber
*Senior Vice President,
Chief Financial Officer and Treasurer
(Principal Financial Officer)*
El Paso Natural Gas Company