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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2002

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 1-9864

El Paso Tennessee Pipeline Co.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

76-0233548
(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 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 \$0.01 per share. Shares outstanding on May 15, 2002: 1,971

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO TENNESSEE PIPELINE CO.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions)

(Unaudited)

	Quarter Ended March 31,	
	2002	2001
Operating revenues	\$ 8,273	\$10,182
Operating expenses		
Cost of products and services	7,867	9,561
Operation and maintenance	239	193
Merger-related costs	—	29
Asset impairments	342	—
Depreciation, depletion and amortization	60	74
Taxes, other than income taxes	22	24
	<u>8,530</u>	<u>9,881</u>
Operating income (loss)	<u>(257)</u>	<u>301</u>
Other income		
Earnings from unconsolidated affiliates	4	21
Other, net	10	24
	<u>14</u>	<u>45</u>
Income (loss) before interest, income taxes and other charges	<u>(243)</u>	<u>346</u>
Non-affiliated interest and debt expense	39	41
Affiliated interest expense, net	18	65
Minority interest	6	—
Income taxes	<u>(102)</u>	<u>72</u>
	<u>(39)</u>	<u>178</u>
Income (loss) before cumulative effect of accounting change	<u>(204)</u>	<u>168</u>
Cumulative effect of accounting change, net of income taxes	<u>97</u>	<u>—</u>
Net income (loss)	<u>\$ (107)</u>	<u>\$ 168</u>

See accompanying notes.

EL PASO TENNESSEE PIPELINE CO.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)
(Unaudited)

	<u>March 31, 2002</u>	<u>December 31, 2001</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 115	\$ 197
Accounts and notes receivable, net		
Customer	3,233	2,723
Affiliates	436	271
Other	286	600
Inventory	37	79
Assets from price risk management activities	1,678	2,529
Margin deposits on energy trading activities	527	379
Other	333	318
Total current assets	<u>6,645</u>	<u>7,096</u>
Property, plant and equipment, at cost		
Pipelines	2,831	2,824
Gathering and processing systems	1,011	2,199
Power facilities	572	563
Other	99	99
	<u>4,513</u>	<u>5,685</u>
Less accumulated depreciation, depletion and amortization	754	1,040
	<u>3,759</u>	<u>4,645</u>
Additional acquisition costs assigned to utility plant, net of accumulated amortization	<u>2,263</u>	<u>2,271</u>
Total property, plant and equipment, net	<u>6,022</u>	<u>6,916</u>
Other assets		
Investments in unconsolidated affiliates	2,375	2,825
Assets from price risk management activities	2,260	2,156
Other	999	1,002
	<u>5,634</u>	<u>5,983</u>
Total assets	<u><u>\$18,301</u></u>	<u><u>\$19,995</u></u>

See accompanying notes.

EL PASO TENNESSEE PIPELINE CO.
CONDENSED CONSOLIDATED BALANCE SHEETS — (Continued)
(In millions, except share amounts)
(Unaudited)

	March 31, 2002	December 31, 2001
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts and notes payable		
Trade	\$ 3,020	\$ 2,927
Affiliates	3,218	2,932
Other	182	308
Short-term borrowings and other financing obligations	618	567
Liabilities from price risk management activities	1,702	2,089
Margin deposits from customers on energy trading activities	47	649
Other	405	557
Total current liabilities	<u>9,192</u>	<u>10,029</u>
Long-term debt and other financing obligations	<u>1,451</u>	<u>1,563</u>
Other liabilities		
Deferred income taxes	1,779	1,971
Liabilities from price risk management activities	1,271	1,236
Other	850	996
	<u>3,900</u>	<u>4,203</u>
Commitments and contingencies		
Minority interests	<u>356</u>	<u>356</u>
Stockholders' equity		
Preferred stock, authorized; 20,000,000 shares Series A, no par; issued		
6,000,000 shares; stated at liquidation value	300	300
Common stock, par value \$0.01 per share; authorized 100,000 shares; issued		
1,971 shares	—	—
Additional paid-in capital	1,992	1,973
Retained earnings	1,197	1,641
Accumulated other comprehensive income	(87)	(70)
Total stockholders' equity	<u>3,402</u>	<u>3,844</u>
Total liabilities and stockholders' equity	<u>\$18,301</u>	<u>\$19,995</u>

See accompanying notes.

EL PASO TENNESSEE PIPELINE CO.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Quarter Ended March 31,	
	<u>2002</u>	<u>2001</u>
Cash flows from operating activities		
Net income (loss)	\$(107)	\$ 168
Adjustments to reconcile net income (loss) to net cash from operating activities		
Non-cash gains from trading and power activities	(16)	(7)
Non-cash portion of asset impairments	342	—
Depreciation, depletion and amortization	60	74
Undistributed earnings of unconsolidated affiliates	7	(3)
Deferred income tax expense (benefit)	(125)	80
Cumulative effect of accounting change	(97)	—
Other non-cash income items	32	(1)
Working capital changes	(702)	1,011
Non-working capital changes and other	<u>(24)</u>	<u>(35)</u>
Net cash provided by (used in) operating activities	<u>(630)</u>	<u>1,287</u>
Cash flows from investing activities		
Additions to property, plant and equipment	(87)	(147)
Net proceeds from the sale of assets	1	14
Additions to investments	(8)	(49)
Net proceeds from investments	9	2
Net change in other affiliated advances receivable	7	(374)
Repayment of notes receivable from unconsolidated affiliates	8	—
Other	<u>1</u>	<u>—</u>
Net cash used in investing activities	<u>(69)</u>	<u>(554)</u>
Cash flows from financing activities		
Net borrowings of commercial paper	103	39
Payments to retire long-term debt	(2)	(317)
Net change in other affiliated advances payable	588	(428)
Repayment of notes payable	(8)	—
Dividends paid	<u>(64)</u>	<u>(6)</u>
Net cash provided by (used in) financing activities	<u>617</u>	<u>(712)</u>
Increase (decrease) in cash and cash equivalents	(82)	21
Cash and cash equivalents		
Beginning of period	<u>197</u>	<u>179</u>
End of period	<u>\$ 115</u>	<u>\$ 200</u>

See accompanying notes.

EL PASO TENNESSEE PIPELINE CO.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)
(Unaudited)

	Quarter Ended March 31,	
	<u>2002</u>	<u>2001</u>
Net income (loss)	\$(107)	\$ 168
Foreign currency translation adjustments	—	(8)
Unrealized net gains (losses) from cash flow hedging activity		
Cumulative-effect transition adjustment (net of tax of \$66)	—	(154)
Unrealized mark-to-market losses arising during period (net of tax of \$3 in 2002 and \$145 in 2001)	(9)	(283)
Reclassification adjustments for changes in initial value to settlement date (net of tax of \$4 in 2002 and \$61 in 2001)	(8)	116
Other comprehensive loss	(17)	(329)
Comprehensive loss	<u>\$(124)</u>	<u>\$ (161)</u>

See accompanying notes.

EL PASO TENNESSEE PIPELINE CO.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Our 2001 Annual Report on Form 10-K includes a summary of our significant accounting policies and other disclosures. You should read it in conjunction with this Quarterly Report on Form 10-Q. The financial statements as of March 31, 2002, and for the quarters ended March 31, 2002 and 2001, are unaudited. The balance sheet as of December 31, 2001, is derived from the audited balance sheet filed in our Form 10-K. These financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission and do not include all disclosures required by accounting principles generally accepted in the United States. In our opinion, we have made all adjustments, all of which are of a normal, recurring nature (except for merger-related costs, asset impairments and a cumulative effect of accounting change, all discussed below), to fairly present our interim period results. Information for interim periods may not necessarily indicate the results of operations for the entire year due to the seasonal nature of our businesses. The prior period information includes reclassifications which were made to conform to the current presentation. These reclassifications have no effect on our reported net income or stockholders' equity.

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

Goodwill and Other Intangible Assets

Our intangible assets consist primarily of goodwill recognized from acquisitions. On January 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. These standards require that we recognize goodwill separately from other intangible assets. In addition, goodwill and indefinite-lived intangibles are no longer amortized. Rather, goodwill is tested periodically for impairment, at least on an annual basis, or whenever events or circumstances indicate that an impairment may have occurred. SFAS No. 141 requires that upon adoption of SFAS No. 142, any negative goodwill should be written off as a cumulative effect of a change in accounting. Prior to adoption of the standards, we amortized goodwill, negative goodwill and other intangibles using the straight-line method over periods ranging from 5 to 40 years. As a result of our adoption of these standards on January 1, 2002, we recognized a \$97 million gain, net of income taxes, related to the write-off of negative goodwill as a cumulative effect of an accounting change in our income statement. Our initial periodic tests for impairment were completed during the first quarter of 2002, and did not indicate any impairment of our goodwill. In addition, we stopped amortizing goodwill and negative goodwill that was estimated to be approximately \$2 million, net of income taxes, for the quarter ended March 31, 2002. If we had adopted SFAS No. 141 and 142 on January 1, 2001, for the quarter ended March 31, 2001, we would have reported net income of \$170 million.

Asset Impairments

On January 1, 2002, we adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The provisions of this statement supersede SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. There was no initial financial statement impact of adopting this standard.

2. Divestitures

In March 2001, we sold natural gas liquids transportation and fractionation assets acquired in our December 2000 acquisition of Pacific Gas & Electric's (PG&E's) Texas midstream operations to our affiliate, El Paso Energy Partners, L.P., a publicly traded master limited partnership, for approximately \$133 million.

In April 2002, we sold midstream assets to El Paso Energy Partners. Net proceeds from this sale were approximately \$140 million in cash, a \$119 million note payable to us that was subsequently paid and common units of El Paso Energy Partners with a fair value of \$6 million. No gain or loss was recognized on the sale of these midstream assets.

3. Merger-Related Costs

During the quarter ended March 31, 2001, we incurred merger-related costs of \$29 million associated with El Paso Corporation's (El Paso) merger with The Coastal Corporation. These charges consist of \$4 million in employee severance, retention and transition costs which include direct payments to, and benefit costs for, severed employees and early retirees that occurred as a result of El Paso's merger-related workforce reduction and consolidation. These costs were expensed as incurred and were paid in the first quarter of 2001. In addition, we recorded \$25 million of make-whole commitments related to a series of payments we will make to El Paso Energy Partners in connection with the Federal Trade Commission's (FTC) ordered divestiture of interests in assets owned by the partnership in connection with the Coastal merger. These will be paid quarterly through 2003.

4. Asset Impairments

During the first quarter of 2002, we recognized an asset impairment charge in our Merchant Energy segment of \$342 million related to several of our investments in Argentina. During the latter part of 2001, economic conditions in Argentina deteriorated and the Argentine government defaulted on its public debt obligations. In the first quarter of 2002, the government changed several Argentine laws, including: (i) repealing the one-to-one exchange rate for the Argentine Peso with U.S. dollar; (ii) mandating that all Argentine contracts and obligations previously denominated in U.S. dollars be re-negotiated and denominated in Argentine Pesos; and (iii) imposing a tax on crude oil exports. The Argentine Peso devaluation combined with these new law changes effectively converted our projects' contracts and sources of revenue from U.S. dollars to Argentine Pesos and resulted in the impairment charge, which represents the full amount of each of the investments impacted by these law changes. We have a remaining investment in a pipeline project in Argentina with an aggregate investment of approximately \$40 million. We continue to monitor the situation closely. However, should these conditions persist, or new unfavorable developments occur, we may also be required to evaluate our remaining investment for impairment.

5. Financial Instruments and Price Risk Management Activities

The following table summarizes the carrying value of our trading and non-trading price risk management assets and liabilities as of March 31, 2002 and December 31, 2001:

	March 31, 2002	December 31, 2001
	(In millions)	
Net assets (liabilities)		
Trading price risk management activities ⁽¹⁾⁽²⁾	\$970	\$1,337
Non-trading price risk management activities	(5)	23
	<u>\$965</u>	<u>\$1,360</u>

⁽¹⁾ Trading activities represent those that qualify for accounting under Emerging Issues Task Force Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*.

⁽²⁾ Impacting our trading balance at March 31, 2002, was a charge to earnings of approximately \$61 million related to our revised estimate of the fair value of long term positions in our trading price risk management activities. As a result of diminished liquidity in the marketplace for natural gas and power transactions in excess of ten years, we no longer recognize gains from the fair value of trading positions with third parties beyond ten years.

6. Inventory

Our inventory consisted of the following:

	March 31, 2002	December 31, 2001
	(In millions)	
Natural gas in storage	\$ 1	\$41
Materials and supplies and other.....	<u>36</u>	<u>38</u>
	<u>\$37</u>	<u>\$79</u>

7. Debt and Other Credit Facilities

At March 31, 2002, our weighted average interest rate on our commercial paper and short-term borrowings was 2.7% and at December 31, 2001, it was 3.2%. We had the following short-term borrowings and other financing obligations:

	March 31, 2002	December 31, 2001
	(In millions)	
Commercial paper	\$527	\$424
Notes payable	73	75
Current maturities of long-term debt and other financing obligations ..	<u>18</u>	<u>68</u>
	<u>\$618</u>	<u>\$567</u>

During the first quarter of 2002, we distributed several of our midstream business entities which had \$180 million of long-term debt to our parent, El Paso.

8. Commitments and Contingencies

Legal Proceedings

Several of our subsidiaries and affiliates were named defendants in eleven purported class action, municipal or individual lawsuits, filed in California state courts (a list of the *California* cases is included in Part II, Item 1, Legal Proceedings). The eleven suits contend that the defendants 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. The lawsuits are at the preliminary pleading stages with trial not anticipated until late 2003 at the earliest.

In September 2001, we received a civil document subpoena from the California Department of Justice, seeking information said to be relevant to the Department's ongoing investigation into the high electricity prices in California. We have produced and expect to continue to produce materials pursuant to this subpoena.

In 1997, a number of our subsidiaries 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 under report 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. 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.

A number of our subsidiaries 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. 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 Quinque complaint was transferred to the same court handling the Grynberg complaint and has now been sent back to Kansas State Court for further proceedings. A motion to dismiss this case is pending.

In addition, 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 these matters, we evaluate the merits of the case, our exposure to the matter and 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 make the necessary accruals. As new information becomes available, our estimates may change. The impact of these changes may have a material effect on our results of operations. As of March 31, 2002, we had reserves totaling \$61 million for all outstanding legal matters.

While the outcome of the matters discussed above cannot be predicted with certainty, based on information known to date and our existing accruals, we do not expect the ultimate resolution of these matters will have a material adverse effect on our financial position, operating results or cash flows.

Environmental Matters

We are subject to extensive 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, 2002, we had a reserve of approximately \$128 million for expected remediation costs. In addition, we expect to make capital expenditures for environmental matters of approximately \$93 million in the aggregate for the years 2002 through 2007. These expenditures primarily relate to compliance with clean air regulations.

Since 1988, our subsidiary, Tennessee Gas Pipeline Company (TGP) has been engaged in an internal project to identify and deal with the presence of polychlorinated biphenyls (PCBs) and other substances, including those on the Environmental Protection Agency's (EPA) List of Hazardous Substances, at compressor stations and other facilities it operates. While conducting this project, TGP has been in frequent contact with federal and state regulatory agencies, both through informal negotiation and formal entry of consent orders, to ensure that its efforts meet regulatory requirements. TGP executed a consent order in 1994 with the EPA, governing the remediation of the relevant compressor stations and is working with the EPA, and the relevant states regarding those remediation activities. TGP is also working with the Pennsylvania and New York environmental agencies regarding remediation and post-remediation activities at the Pennsylvania and New York stations.

In November 1988, the Kentucky environmental agency filed a complaint in a Kentucky state court alleging that TGP discharged pollutants into the waters of the state and disposed of PCBs without a permit. The agency sought an injunction against future discharges, an order to remediate or remove PCBs and a civil penalty. TGP entered into agreed orders with the agency to resolve many of the issues raised in the complaint and received water discharge permits from the agency for its Kentucky compressor stations. The relevant Kentucky compressor stations are being characterized and remediated under the 1994 consent order with the EPA. Despite these remediation efforts, the agency may raise additional technical issues or require additional remediation work in the future.

In May 1995, following negotiations with its customers, TGP filed a stipulation and agreement with the Federal Energy Regulatory Commission (FERC) that established a mechanism for recovering a substantial portion of the environmental costs identified in its internal remediation project. The stipulation and agreement was effective July 1, 1995. Refunds may be required to the extent actual eligible expenditures are less than amounts collected.

We have been designated and 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 6 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 CERCLA sites, as appropriate, through indemnification by third parties and settlements which provide for payment of our allocable share of remediation costs. As of March 31, 2002, we have estimated our share of the remediation costs at these sites to be between \$1 million and \$2 million and have provided reserves that we believe are adequate for such costs. 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 the determination of our estimated liabilities. We presently believe that based on our existing reserves, and information known to date, the impact of the costs associated with these CERCLA sites will not have a material adverse effect on our financial position, operating results or cash flows.

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 on our evaluation and experience to date, we believe the recorded reserves are adequate.

Rates and Regulatory Matters

In April 2000, the California Public Utilities Commission (CPUC) filed a complaint with the FERC alleging that the sale of approximately 1.2 billion cubic feet per day of California capacity by El Paso Natural Gas Company (EPNG), our affiliate, to El Paso Merchant Energy Company, our subsidiary, was anticompetitive and an abuse of the affiliate relationship under the FERC's policies. Other parties in the proceeding requested that the original complaint be set for hearing and that Merchant Energy pay back any profits it earned under the contract. In March 2001, the FERC established a hearing, before an administrative law judge, to address the issue of whether EPNG and/or Merchant Energy had market power and, if so, had exercised it. In October 2001, a FERC administrative law judge issued a proposed decision finding that El Paso did not exercise market power and that the market power portion of the CPUC's complaint should be dismissed. The decision further found that El Paso had violated the FERC's marketing affiliate regulations. In October 2001, the Market Oversight and Enforcement (MOE) section of the FERC's Office of the General Counsel filed comments in this proceeding stating that record development at the trial was inadequate to conclude that EPNG and Merchant Energy complied with the FERC's regulation. We filed a motion to strike the MOE's pleading, but in December 2001, the FERC denied our motion and remanded the proceeding to the administrative law judge for a supplemental hearing on the availability of capacity at El Paso's California delivery points. The hearing commenced on March 21, 2002 and concluded on April 4, 2002. Oral argument was held on April 10, 2002, and post-hearing briefing is to be completed by June 5, 2002.

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 all our energy affiliates conduct business and interact with our interstate pipelines. In December 2001, we filed comments with the FERC addressing our concerns with proposed rules. In April 2002, the FERC Staff issued a notice of a public conference to be held on May 21, 2002, at which interested parties will be given an opportunity to comment further on the NOPR. We cannot predict the outcome of the NOPR, but adoption of the regulations in substantially the form proposed would, at a minimum, place additional administrative and operational burdens on us.

While we cannot predict with certainty the final outcome or the timing of the resolution of all of our rates and regulatory matters discussed above, we believe the ultimate resolution of these issues, based on information known to date, will not have a material adverse effect on our financial position, results of operations or cash flows.

In June 2001, the Western Australia regulators issued a draft rate decision at lower than expected levels for the Dampier-to-Bunbury pipeline owned by EPIC Energy Australia Trust, in which we have a 33 percent ownership interest and a total investment, including financial guarantees, of approximately \$195 million. EPIC Energy Australia has appealed a variety of issues related to the draft decision to the Western Australia Supreme Court. The appeal was heard at the Western Australia Supreme Court in November 2001, and a decision from the court is expected in the middle of 2002. If the draft decision rates are implemented, the new rates will adversely impact future operating results, liquidity and debt capacity, possibly reducing the value of our investment by up to \$135 million.

Other Matters

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. We, through our subsidiaries, had contracts with Enron North America and Enron Power Marketing for the trading of physical gas, power and financial derivatives and for transportation capacity on our pipeline systems. We have established reserves for potential losses related to the receivables under these contracts that we believe are adequate. In addition, we have terminated most of our trading related contracts and Enron has rejected most of its capacity contracts on our pipeline system. We continue to analyze our damage claims arising from Enron's bankruptcy proceedings.

9. Segment Information

We segregate our business activities into three distinct operating segments: Pipelines, Merchant Energy and Field Services. These segments are strategic business units that provide a variety of energy products and services. They are managed separately as each business unit requires different technology and marketing strategies. We measure segment performance using earnings before interest expense and income taxes (EBIT). The following are our results as of and for the quarters ended March 31, 2002 and 2001:

	2002				
	Pipelines	Merchant Energy	Field Services	Other ⁽¹⁾	Total
			(In millions)		
Revenues from external customers	\$ 168	\$ 7,890	\$ 214	\$ 1	\$ 8,273
Intersegment revenues	20	(3)	152	(169)	—
Asset impairments	—	342	—	—	342
Operating income (loss)	76	(354)	20	1	(257)
EBIT	81	(352)	27	1	(243)
Segment assets	5,069	11,565	1,120	547	18,301

	2001				
	Pipelines	Merchant Energy	Field Services	Other ⁽¹⁾	Total
			(In millions)		
Revenues from external customers	\$ 199	\$ 9,586	\$ 397	\$ —	\$10,182
Intersegment revenues	20	20	77	(117)	—
Merger-related costs	1	—	28	—	29
Operating income (loss)	111	191	(1)	—	301
EBIT	113	232	1	—	346

⁽¹⁾ Includes Corporate and eliminations.

The reconciliations of EBIT to income (loss) before cumulative effect of accounting change are presented below for the quarters ended March 31:

	<u>2002</u>	<u>2001</u>
	<u>(In millions)</u>	
Total EBIT	\$(243)	\$346
Non-affiliated interest and debt expense	39	41
Affiliated interest expense, net	18	65
Minority interest	6	—
Income taxes	<u>(102)</u>	<u>72</u>
Income (loss) before cumulative effect of accounting change	<u>\$(204)</u>	<u>\$168</u>

10. Investments in Unconsolidated Affiliates and Related Party Transactions

We hold investments in various affiliates which we account for using the equity method of accounting. Summarized financial information for our proportionate share of these unconsolidated affiliates is as follows:

	<u>2002</u>	<u>2001</u>
	<u>(In millions)</u>	
Operating results data		
Revenues and other income	\$170	\$240
Costs and expenses	\$167	\$190
Income (loss) from continuing operations	\$ (1)	\$ 31
Net income (loss)	\$ (1)	\$ 23

El Paso Energy Partners

In March 2001, we sold natural gas liquids transportation and fractionation assets acquired in our December 2000 acquisition of PG&E's Texas midstream operations to El Paso Energy Partners, for approximately \$133 million.

In April 2002, we sold midstream assets to El Paso Energy Partners. Net proceeds from this sale were approximately \$140 million in cash, a \$119 million note payable to us that was subsequently paid and common units of El Paso Energy Partners with a fair value of \$6 million. No gain or loss was recognized on the sale of these midstream assets.

Other

We participate in El Paso's cash management program which matches short-term cash surpluses and needs of its participating affiliates, thus minimizing total borrowings from outside sources. We had net borrowings of \$2,915 million at March 31, 2002, at a market rate of interest which was 1.9% and \$2,364 million at December 31, 2001, at a market interest rate of 2.1%. In addition, we had demand note receivables with El Paso of \$47 million at March 31, 2002, with an interest rate of 2.4% and \$40 million at December 31, 2001, with interest rates that ranged from 2.7% to 3.1%. We also had a note payable to El Paso of \$72 million and \$35 million at March 31, 2002 and December 31, 2001, at a current market rate.

At March 31, 2002, we had current accounts and notes receivable from other related parties of \$389 and \$231 million at December 31, 2001. In addition, we had current accounts payable to other related parties of \$231 million and \$533 million at March 31, 2002 and December 31, 2001. These balances arose in the normal course of business. We also had a note receivable of \$93 million at March 31, 2002 that was included in non-current assets.

In January 2002, El Paso contributed gathering and processing assets to us with a net book value of \$19 million. In March 2002, we distributed through a dividend to El Paso, a majority of PG&E's Texas midstream operations at their net book value of \$330 million.

11. New Accounting Pronouncements Not Yet Adopted

Accounting for Asset Retirement Obligations

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. This Statement requires companies to record a liability relating to the retirement and removal costs of assets used in their business. The liability is discounted to its present value, and the related asset value is increased by the amount of the resulting liability. Over the life of the asset, the liability will be accreted to its future value and eventually extinguished when the asset is taken out of service. Capitalized retirement and removal costs will be depreciated over the useful life of the related asset. The provisions of this Statement are effective for fiscal years beginning after June 15, 2002. We are currently evaluating the effects of this pronouncement.

Derivatives Implementation Group Issue C-16.

In September 2001, the Derivatives Implementation Group of the FASB cleared guidance on Issue C-16, *Scope Exceptions: Applying the Normal Purchases and Normal Sales Exception to Contracts that Combine a Forward Contract and a Purchased Option Contract*. This guidance impacts the accounting for fuel supply contracts that require delivery of a contractual minimum quantity of a fuel other than electricity at a fixed price and have an option that permits the holder to take specified additional amounts of fuel at the same fixed price at various times. We use fuel supply contracts such as these in our power producing operations and currently do not reflect them in our balance sheet since they are considered normal purchases that are not classified as derivative instruments under SFAS No. 133. This guidance becomes effective in the second quarter of 2002, and we will be required to account for these contracts as derivative instruments under SFAS No. 133. We are currently evaluating the financial impact of this guidance on our financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ⁽¹⁾

The information contained in Item 2 updates, and you should read it in conjunction with, information disclosed in our Annual Report on Form 10-K filed March 25, 2002, in addition to the financial statements and notes presented in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

Results of Operations

For the quarter ended March 31, 2002, we had a net loss of \$107 million versus net income of \$168 million for the quarter ended March 31, 2001. The 2002 results include asset impairments of \$342 million, or \$227 million after taxes. In addition, we recorded a cumulative effect of accounting change of \$97 million, net of income taxes. The 2001 results included merger-related costs totaling \$29 million, or \$20 million after taxes, related to El Paso's merger with Coastal. Net income, excluding the effects of merger-related costs, asset impairments and cumulative effect of accounting change, would have been \$23 million in 2002 and \$188 million in 2001.

Segment Results

Our three segments: Pipelines, Merchant Energy and Field Services are strategic business units that offer a variety of different energy products and services; each requires different technology and marketing strategies. We evaluate our segment performance based on EBIT. Operating revenues and expenses by segment include intersegment revenues and expenses which are eliminated in consolidation. Because changes in energy commodity prices have a similar impact on both our operating revenues and cost of products sold from period to period, we believe that gross margin (revenue less cost of sales) provides a more accurate and meaningful basis for analyzing operating results for the trading portion of Merchant Energy and for the Field Services segment. For a further discussion of our individual segments, see Item 1, Financial Statements, Note 9, as well as our Annual Report on Form 10-K for the year ended December 31, 2001. The segment EBIT results for the quarters ended March 31 presented below include the charges discussed above:

	<u>2002</u>	<u>2001</u>
	<u>(In millions)</u>	
Pipelines	\$ 81	\$113
Merchant Energy	(352)	232
Field Services	27	1
Segment total	(244)	346
Corporate expenses, net	1	—
Consolidated EBIT	<u><u>\$(243)</u></u>	<u><u>\$346</u></u>

⁽¹⁾ Below is a list of terms that are common to our industry and used throughout our Management's Discussion and Analysis:

Btu	=	British thermal unit
BBtu/d	=	billion British thermal units per day
BBtue/d	=	billion British thermal unit equivalents per day
MBbls	=	thousand barrels
MMBtu	=	million British thermal units
MMWh	=	thousand megawatt hours

Pipelines

Our Pipelines segment holds our interstate transmission businesses. Results of our Pipelines segment operations were as follows for the quarters ended March 31:

	<u>2002</u>	<u>2001</u>
	<u>(In millions, except volume amounts)</u>	
Operating revenues	\$ 188	\$ 219
Operating expenses	(112)	(108)
Other income	<u>5</u>	<u>2</u>
EBIT	<u>\$ 81</u>	<u>\$ 113</u>
Throughput volumes (BBtu/d) ⁽¹⁾	<u>5,126</u>	<u>5,364</u>

⁽¹⁾ Throughput volumes for 2001 exclude Midwestern Gas Transmission system sold in connection with the FTC order related to El Paso's merger with Coastal.

Operating revenues for the quarter ended March 31, 2002, were \$31 million lower than the same period in 2001. The decrease was primarily due to lower natural gas prices on excess natural gas recoveries and lower transportation revenues from capacity sold under short-term contracts in the first quarter of 2002, as well as the sale of the Midwestern Gas Transmission system in April 2001 and lower throughput due to milder weather in 2002.

Operating expenses for the quarter ended March 31, 2002, were \$4 million higher than the same period in 2001. The increase was primarily due to higher amortization of additional acquisition cost assigned to utility plant in 2002, higher 2002 corporate overhead allocations and lower project development costs in the first quarter of 2001. The increase was partially offset by reduced operating and depreciation expenses due to the sale of the Midwestern system in April 2001.

Other income for the quarter ended March 31, 2002, was \$3 million higher than the same period in 2001 primarily due to higher equity earnings resulting from reduced losses on our investment in Australia in 2002.

Merchant Energy

Our Merchant Energy segment conducts our customer origination, trading and power activities.

Trading Price Risk Management Activities

As of March 31, 2002, the fair value of our trading-related price risk management activities was \$970 million, and total margins generated from these activities during the quarters ended March 31, 2002 and 2001 were \$26 million and \$254 million.

The following table details the fair value of Merchant Energy's trading price risk management activities by year of maturity and valuation methodology as of March 31, 2002:

<u>Source of Fair Value</u>	<u>Maturity Less Than 1 Year</u>	<u>Maturity 1 to 3 Years</u>	<u>Maturity 4 to 5 Years</u>	<u>Maturity 6 to 10 Years</u>	<u>Maturity Beyond 10 Years</u>	<u>Total Fair Value</u>
Prices actively quoted.....	\$(43)	\$549	\$258	\$ 84	\$ 3	\$851
Prices based on models and other valuation methods	<u>77</u>	<u>54</u>	<u>18</u>	<u>(30)</u>	<u>—</u>	<u>119</u>
Total net trading assets	<u>\$ 34</u>	<u>\$603</u>	<u>\$276</u>	<u>\$ 54</u>	<u>\$ 3</u>	<u>\$970</u>

A reconciliation of our trading price risk management activities for the quarter ended March 31, 2002, is as follows (in millions):

Fair value of trading contracts outstanding at December 31, 2001	<u>\$1,337</u>
Fair value of contracts settled during the period	(517)
Initial recorded value of new contracts	7
Change in fair value of contracts	102
Changes in fair value attributable to changes in valuation techniques	(69)
Other	<u>110</u>
Net change in trading contracts outstanding during the period	<u>(367)</u>
Fair value of trading contracts outstanding at March 31, 2002	<u>\$ 970</u>

Included in "Changes in fair value attributable to changes in valuation techniques" is a charge of approximately \$61 million related to our revised estimate of the fair value of long-term positions with third parties in our trading price risk management activities. Specifically, we have recently experienced diminished liquidity in the marketplace for natural gas and power transactions in excess of ten years. Because we do not expect this condition to change in the foreseeable future, we no longer recognize gains from third parties from the fair value of trading positions beyond ten years. Included in "Other" are option premiums and storage capacity transactions.

Results of Operations

Below are Merchant Energy's operating results and an analysis of these results for the quarters ended March 31:

	<u>2002</u>	<u>2001</u>
	<u>(In millions, except volume amounts)</u>	
Trading gross margin	\$ 31	\$ 190
Operating and other revenues	106	107
Operating expenses	(491)	(106)
Other income	<u>2</u>	<u>41</u>
EBIT	<u>\$(352)</u>	<u>\$ 232</u>
Volumes		
Physical		
Natural gas (BBtue/d)	13,221	10,390
Power (MMWh)	105,698	36,198
Other energy commodities (MBbls)	6,303	1,292
Financial settlements (BBtue/d)	157,116	169,493

Trading gross margin consists of revenue from commodity trading and origination activities less the cost of commodities sold, and the impact of power contract restructuring activities. For the quarter ended

March 31, 2002, these gross margins were \$159 million lower than the same period in 2001. The decrease was due to lower trading margins primarily in natural gas and power resulting from higher volatility in the first quarter of 2001, primarily in the western United States. Partially offsetting the decrease was a power plant contract restructuring in the first quarter of 2002.

Operating and other revenues consist of revenues from domestic and international power generation facilities and investments, including our management fee from Chaparral and revenues from EnCap and our other financial services businesses. For the quarter ended March 31, 2002, operating and other revenues were \$1 million lower than the same period in 2001. The decrease resulted from lower income from financial services activities in the first quarter of 2002 as a result of the sale of several investments in 2001, largely offset by higher 2002 management fees from Chaparral.

Operating expenses for the quarter ended March 31, 2002, were \$385 million higher than the same period in 2001. The increase was primarily a result of the impairment of our power investments in Argentina. Also contributing to the increase was a turbine forfeiture fee for a cancelled power project during 2002 and an increase in corporate overhead allocated to Merchant Energy in 2002.

Other income for the quarter ended March 31, 2002, was \$39 million lower than the same period in 2001. The decrease was the result of lower equity earnings from unconsolidated investments, primarily Chaparral.

Field Services

Our Field Services segment conducts our midstream activities. Results of our Field Services segment operations were as follows for the quarters ended March 31:

	<u>2002</u>	<u>2001</u>
	<u>(In millions, except</u>	<u>volumes and prices)</u>
Total gross margins	\$ 85	\$ 110
Operating expenses	(65)	(111)
Other income	<u>7</u>	<u>2</u>
EBIT	<u>\$ 27</u>	<u>\$ 1</u>
Volume and prices		
Gathering and treating		
Volumes (BBtu/d)	<u>4,221</u>	<u>5,170</u>
Prices (\$/MMBtu)	<u>\$ 0.16</u>	<u>\$ 0.14</u>
Processing		
Volumes (inlet BBtu/d)	<u>1,907</u>	<u>1,946</u>
Prices (\$/MMBtu)	<u>\$ 0.11</u>	<u>\$ 0.20</u>

Total gross margins for the quarter ended March 31, 2002, were \$25 million lower than the same period in 2001. The decrease was primarily a result of lower processing and natural gas liquids marketing margins due to lower average prices in 2002. Processing margins also decreased due to lower volumes in south Texas and costs associated with a new processing arrangement at the Chaco processing facility entered into in the fourth quarter of 2001 with El Paso Energy Partners. Gathering and treating margins were also lower due to lower natural gas prices in the San Juan Basin and the distribution, through a dividend in March 2002 to our parent, of a majority of the assets acquired in our acquisition of PG&E's Texas midstream operations. Partially offsetting the lower gathering and treating margins were the favorable resolution of fuel, rate and volume matters in the first quarter of 2002 and higher realized transportation rates from the pipeline system acquired in our acquisition of PG&E's Texas midstream operations prior to their distribution to El Paso.

Operating expenses for the quarter ended March 31, 2002, were \$46 million lower than the same period in 2001. The decrease was primarily due to merger-related costs arising from payments to El Paso Energy Partners in 2001 related to the FTC ordered sales of assets owned by the partnership, and merger-related

employee relocation expenses in 2001 following the El Paso merger with Coastal. Also contributing to the decrease were lower operations and depreciation expenses due to our sale of transportation and fractionation assets to El Paso Energy Partners in March 2001 and the distribution of additional assets to El Paso in March 2002.

Other income for the quarter ended March 31, 2002, was \$5 million higher than the same period in 2001 primarily due to higher earnings in 2002 from our interests in El Paso Energy Partners.

Interest and Debt Expense

Non-affiliated Interest and Debt Expense

Non-affiliated interest and debt expense for the quarter ended March 31, 2002, was \$2 million lower than the same period in 2001 primarily due to payments on third party debt in 2001 reducing average debt balances, offset by higher interest expense on over-the-counter and broker margins in the first quarter of 2002.

Affiliated Interest Expense, Net

Affiliated interest expense, net for the quarter ended March 31, 2002, was \$47 million lower than the same period in 2001 due to lower short-term interest rates on average advances from El Paso under our cash management program.

Minority Interest

Minority interest expense for the quarter ended March 31, 2002, was \$6 million higher than the same period in 2001 due to minority interest balances resulting from the formation of Gemstone in November 2001.

Income Taxes

Income tax benefit for the quarter ended March 31, 2002, was \$102 million, resulting in an effective tax rate of 33 percent. Our effective tax rate was different than the statutory rate of 35 percent primarily due to the following:

- state income taxes; and
- foreign income taxed at different rates.

Income tax expense for the quarter ended March 31, 2001, was \$72 million, resulting in an effective tax rate of 30 percent. Our effective tax rate was different than the statutory tax rate of 35 percent primarily due to the following:

- state income taxes;
- earnings from unconsolidated affiliates where we anticipate receiving dividends; and
- foreign income taxed at different rates.

Liquidity and Capital Resources

Cash From Operating Activities

Net cash used in our operating activities was \$630 million for the quarter ended March 31, 2002, compared to net cash provided by operating activities of \$1,287 million for the same period in 2001. The decrease was primarily due to cash paid for broker and over-the-counter margins in 2002, as well as less cash generated through liquidations of price risk management assets. Also contributing to the decrease is the change in Merchant Energy payables attributable to lower prices in 2002 compared to last year.

Cash From Investing Activities

Net cash used in our investing activities was \$69 million for the quarter ended March 31, 2002. Our investing activities principally consisted of additions to our property, plant and equipment primarily in our Merchant Energy and Pipelines segments for expansion and construction projects.

Cash From Financing Activities

Net cash provided by our financing activities was \$617 million for the quarter ended March 31, 2002. Cash provided from our financing activities included borrowings of commercial paper and cash advances received from El Paso under our cash management program. Cash outflows consisted of dividends paid to our preferred and common shareholders, which primarily includes the cash associated with the midstream assets contributed to El Paso.

During the quarter ended March 31, 2002, we paid dividends of \$6 million on our Series A cumulative preferred stock, which is 8¹/₄% per annum (2.0625% per quarter).

We expect that future funding for our working capital needs, capital expenditures, acquisitions, other investing activities, long-term debt retirements, payments of dividends and other financing expenditures will be provided by internally generated funds, commercial paper issuances, available capacity under existing credit facilities, the issuance of new long-term debt or equity, and/or contributions from El Paso.

Commitments and Contingencies

See Item 1, Financial Statements, Note 8, which is incorporated herein by reference.

New Accounting Pronouncements Not Yet Adopted

See Item 1, Financial Statements, Note 11, 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

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, 2001, except as presented below:

Commodity Price Risk

The following table presents our potential one-day unfavorable impact on earnings before interest and income taxes as measured by Value-at-Risk using the historical simulation technique for our commodity and energy related contracts and is prepared based on a confidence level of 95 percent and a one-day holding period.

	March 31, 2002	December 31, 2001
	(In millions)	
Trading Value-at-Risk	\$10	\$18
Non-Trading Value-at-Risk	\$—	\$ 7
Portfolio Value-at-Risk ⁽¹⁾	\$10	\$14

⁽¹⁾ Portfolio Value-at-Risk represents the combined Value-at-Risk for the trading and non-trading (primarily hedging) price risk management activities. The separate calculation of Value-at-Risk for trading and non-trading commodity contracts ignores the natural correlation that exists between traded and non-traded commodity contracts and prices. As a result, the individually determined values will be higher than the combined Value-at-Risk in most instances. We manage our risks through a portfolio approach that balances both trading and non-trading risks.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

See Part I, Item 1, Financial Statements, Note 8, which is incorporated herein by reference.

The *California* cases 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; and *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); three filed in the Superior Court of San Francisco County (*Sweetie's, et al v. El Paso Corporation, et al*, filed March 22, 2001; *Philip Hackett, et al v. El Paso Corporation, et al*, filed May 9, 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).

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

None.

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 these instruments does not exceed 10 percent of our total consolidated assets.

b. Reports on Form 8-K

None.

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 TENNESSEE PIPELINE CO.

Date: May 15, 2002

/s/ H. BRENT AUSTIN

H. Brent Austin
*Executive Vice President,
Chief Financial Officer and
Director (Principal Financial Officer)*

Date: May 15, 2002

/s/ JEFFREY I. BEASON

Jeffrey I. Beason
*Senior Vice President, Controller and Director
(Principal Accounting Officer)*