Energy Transfer Partners, L.P.
Form 10-Q
May 11, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2009

OR

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

Commission file number 1-11727

ENERGY TRANSFER PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**73-1493906**
(state or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

3738 Oak Lawn Avenue, Dallas, Texas 75219

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (214) 981-0700

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

At May 7, 2009, the registrant had units outstanding as follows:

Energy Transfer Partners, L.P. 168,786,459 Common Units

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Energy Transfer Partners, L.P. and Subsidiaries

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Forward-Looking Statements

Certain matters discussed in this report, excluding historical information, as well as some statements by Energy Transfer Partners, L.P. (Energy Transfer Partners or the Partnership) in periodic press releases and some oral statements of Energy Transfer Partners officials during presentations about the Partnership, include certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements using words such as anticipate, believe, intend, project, plan, continue estimate, forecast, may, will, or similar expressions help identify forward-looking statements. Although the Partnership believes such forward-looking statements are based on reasonable assumptions and current expectations and projections about future events, no assurance can be given that every objective will be reached.

Actual results may differ materially from any results projected, forecasted, estimated or expressed in forward-looking statements since many of the factors that determine these results are subject to uncertainties and risks, difficult to predict, and beyond management s control. For additional discussion of risks, uncertainties and assumptions, see Part II Other Information Item 1A. Risk Factors in this Quarterly Report on Form 10-Q as well as the Partnership s Report on Form 10-K as of December 31, 2008 filed with the Securities and Exchange Commission on March 2, 2009.

Definitions

The following is a list of certain acronyms and terms generally used in the energy industry and throughout this document:

/d	per day
Btu	British thermal unit, an energy measurement
Capacity	Capacity of a pipeline, processing plant or storage facility refers to the maximum capacity under normal operating conditions and, with respect to pipeline transportation capacity, is subject to multiple factors (including natural gas injections and withdrawals at various delivery points along the pipeline and the utilization of compression) which may reduce the throughput capacity from specified capacity levels.
Dth	Million British thermal units (dekatherm). A therm factor is used by gas companies to convert the volume of gas used to its heat equivalent, and thus calculate the actual energy used.
Mcf	thousand cubic feet
MMBtu	million British thermal unit
MMcf	million cubic feet
Bcf	billion cubic feet
NGL	natural gas liquid, such as propane, butane and natural gasoline
Tcf	trillion cubic feet
LIBOR	London Interbank Offered Rate
NYMEX	New York Mercantile Exchange
Reservoir	A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is separate from other reservoirs.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

(unaudited)

	March 31, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 105,956	$ 91,902
Marketable securities	5,949	5,915
Accounts receivable, net of allowance for doubtful accounts	489,063	591,257
Accounts receivable from related companies	33,790	17,895
Inventories	144,607	272,348
Deposits paid to vendors	38,468	78,237
Exchanges receivable	23,900	45,209
Price risk management assets	3,170	5,423
Prepaid expenses and other current assets	56,429	75,215
Total current assets	901,332	1,183,401
PROPERTY, PLANT AND EQUIPMENT, net	8,432,979	8,296,085
ADVANCES TO AND INVESTMENTS IN AFFILIATES	129,840	10,110
GOODWILL	734,949	743,694
INTANGIBLES AND OTHER LONG-TERM ASSETS, net	400,519	394,199
Total assets	$ 10,599,619	$ 10,627,489

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

(unaudited)

	March 31, 2009	December 31, 2008
LIABILITIES AND PARTNERS CAPITAL		
CURRENT LIABILITIES:		
Accounts payable	$ 309,601	$ 381,135
Accounts payable to related companies	18,543	34,547
Exchanges payable	28,152	54,636
Customer advances and deposits	55,699	106,679
Accrued wages and benefits	59,735	64,692
Accrued capital expenditures	84,908	153,230
Accrued and other current liabilities	113,943	108,604
Price risk management liabilities	46,203	94,978
Interest payable	83,644	106,259
Deferred income taxes	258	589
Current maturities of long-term debt	44,496	45,198
Total current liabilities	845,182	1,150,547
LONG-TERM DEBT, less current maturities	5,587,915	5,618,549
DEFERRED INCOME TAXES	108,523	100,597
OTHER NON-CURRENT LIABILITIES	14,540	14,727
COMMITMENTS AND CONTINGENCIES (Note 14)		
	6,556,160	6,884,420
PARTNERS CAPITAL:		
General Partner	167,595	161,159
Limited Partners:		
Common Unitholders (159,011,459 and 152,102,471 units authorized, issued and outstanding at March 31, 2009 and December 31, 2008, respectively)	3,884,835	3,578,997
Class E Unitholders (8,853,832 units authorized, issued and outstanding - held by subsidiary and reported as treasury units)		
Accumulated other comprehensive income (loss)	(8,971)	2,913
Total partners capital	4,043,459	3,743,069
Total liabilities and partners capital	$ 10,599,619	$ 10,627,489

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per unit data)

(unaudited)

	Three Months Ended March 31, 2009	2008 As Adjusted (Note 2)
REVENUES:		
Natural gas operations	$ 1,111,955	$ 2,007,847
Retail propane	487,907	598,138
Other	30,238	33,386
Total revenues	1,630,100	2,639,371
COSTS AND EXPENSES:		
Cost of products sold - natural gas operations	732,113	1,577,268
Cost of products sold - retail propane	220,222	392,555
Cost of products sold - other	6,804	9,895
Operating expenses	181,773	178,970
Depreciation and amortization	72,603	58,828
Selling, general and administrative	55,732	48,369
Total costs and expenses	1,269,247	2,265,885
OPERATING INCOME	360,853	373,486
OTHER INCOME (EXPENSE):		
Interest expense, net of interest capitalized	(82,045)	(55,549)
Equity in earnings of affiliates	497	74
Loss on disposal of assets	(426)	(1,451)
Gains (losses) on non-hedged interest rate derivatives	13,726	(600)
Allowance for equity funds used during construction	20,427	9,888
Other, net	1,067	8,349
INCOME BEFORE INCOME TAX EXPENSE	314,099	334,197
Income tax expense	6,932	5,862
NET INCOME	307,167	328,335
GENERAL PARTNER S INTEREST IN NET INCOME	90,290	74,364
LIMITED PARTNERS INTEREST IN NET INCOME	$ 216,877	$ 253,971
BASIC NET INCOME PER LIMITED PARTNER UNIT	$ 1.37	$ 1.78

BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	157,009,238	142,762,265
DILUTED NET INCOME PER LIMITED PARTNER UNIT	$ 1.37	$ 1.77
DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	157,390,400	143,197,800

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(unaudited)

	Three Months Ended March 31, 2009	2008
Net income	$ 307,167	$ 328,335
Other comprehensive income (loss), net of tax:		
Reclassification to earnings of gains and losses on derivative instruments accounted for as cash flow hedges	(10,549)	(22,691)
Change in value of derivative instruments accounted for as cash flow hedges	(1,386)	(6,221)
Change in value of available-for-sale securities	51	(167)
	(11,884)	(29,079)
Comprehensive income	$ 295,283	$ 299,256

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF PARTNERS CAPITAL

FOR THE THREE MONTHS ENDED MARCH 31, 2009

(Dollars in thousands)

(unaudited)

	General Partner	Limited Partner Common Unitholders	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	$ 161,159	$ 3,578,997	$ 2,913	$ 3,743,069
Distributions to partners	(83,860)	(142,108)		(225,968)
Issuance of units in public offering		225,863		225,863
Capital contribution from General Partner	4,795			4,795
Contribution receivable from General Partner	(4,795)			(4,795)
Distributions on unvested unit awards		(952)		(952)
Tax effect of remedial income allocation from tax amortization of goodwill		(942)		(942)
Non-cash unit-based compensation expense, net of units tendered by employees for tax withholdings		6,793		6,793
Non-cash executive compensation expense	6	307		313
Other comprehensive loss, net of tax			(11,884)	(11,884)
Net income	90,290	216,877		307,167
Balance, March 31, 2009	$ 167,595	$ 3,884,835	$ (8,971)	$ 4,043,459

The accompanying notes are an integral part of this condensed consolidated financial statement.

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	$ 429,181	$ 374,056
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, net of cash acquired	(5,511)	(40,753)
Capital expenditures (excluding allowance for equity funds used during construction)	(255,876)	(482,742)
Contributions in aid of construction costs	1,877	39,970
(Advances to) repayments from affiliates, net	(119,850)	63,534
Proceeds from the sale of assets	2,925	10,433
Net cash used in investing activities	(376,435)	(409,558)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	487,388	2,995,405
Principal payments on debt	(525,802)	(2,658,498)
Net proceeds from issuance of Limited Partner Units	225,863	34,984
Distributions to partners	(225,968)	(251,557)
Debt issuance costs	(173)	(19,039)
Net cash provided by (used in) financing activities	(38,692)	101,295
INCREASE IN CASH AND CASH EQUIVALENTS	14,054	65,793
CASH AND CASH EQUIVALENTS, beginning of period	91,902	56,467
CASH AND CASH EQUIVALENTS, end of period	$ 105,956	$ 122,260

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular dollar amounts, except per unit data, are in thousands)

(unaudited)

1. OPERATIONS AND ORGANIZATION:

The accompanying condensed consolidated balance sheet as of December 31, 2008, which has been derived from audited financial statements, and the unaudited interim financial statements and notes thereto of Energy Transfer Partners, L.P., and subsidiaries (collectively, ETP , we or the Partnership) as of March 31, 2009 and for the three-month periods ended March 31, 2009 and 2008, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim consolidated financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all the information and footnotes required by GAAP for complete consolidated financial statements. However, management believes that the disclosures made are adequate to make the information not misleading. The results of operations for interim periods are not necessarily indicative of the results to be expected for a full year due to the seasonal nature of the Partnership s operations, maintenance activities and the impact of forward natural gas prices and differentials on certain derivative financial instruments that are accounted for using mark-to-market accounting.

In the opinion of management, all adjustments (all of which are normal and recurring) have been made that are necessary to fairly state the consolidated financial position of Energy Transfer Partners, L.P. and subsidiaries as of March 31, 2009, and the Partnership s results of operations and cash flows for the three-month periods ended March 31, 2009 and 2008. The unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto of Energy Transfer Partners presented in the Partnership s Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the SEC on March 2, 2009.

Certain prior period amounts have been reclassified to conform with the 2009 presentation. These reclassifications had no impact on net income or total partners capital.

Business Operations

In order to simplify the obligations of Energy Transfer Partners, L.P. under the laws of several jurisdictions in which we conduct business, our activities are primarily conducted through our subsidiary operating partnerships (collectively the Operating Partnerships) as follows:

La Grange Acquisition, L.P., dba Energy Transfer Company (ETC OLP), a Texas limited partnership engaged in midstream and intrastate transportation and storage natural gas operations. ETC OLP owns and operates, through its wholly and majority-owned subsidiaries, natural gas gathering systems, intrastate natural gas pipeline systems and gas processing plants and is engaged in the business of purchasing, gathering, transporting, processing, and marketing natural gas and NGLs in the states of Texas, Louisiana, Arizona, New Mexico, Utah and Colorado. Our intrastate transportation and storage operations focus on transporting natural gas through our Oasis pipeline, ET Fuel System, East Texas pipeline and HPL System. Our midstream operations focus on the gathering, compression, treating, conditioning, and processing of natural gas, primarily on or through our Southeast Texas System and North Texas System, and marketing activities. We also own and operate natural gas gathering pipelines and conditioning facilities in the Piceance-Uinta Basin of Colorado and Utah.

Energy Transfer Interstate Holdings, LLC (ET Interstate), the parent company of Transwestern Pipeline Company, LLC (Transwestern) and ETC Midcontinent Express Pipeline, L.L.C. (ETC MEP), all of which are Delaware limited liability companies engaged in interstate transportation of natural gas. Interstate revenues consist primarily of fees earned from natural gas transportation services and operational gas sales.

ETC Fayetteville Express Pipeline, LLC (ETC FEP   ), a Delaware limited liability company formed to engage in interstate transportation of natural gas.

ETC Tiger Pipeline, LLC (ETC Tiger), a Delaware limited liability company formed to engage in interstate transportation of natural gas.

Heritage Operating L.P. (HOLP), a Delaware limited partnership primarily engaged in retail propane operations. Our retail propane operations focus on sales of propane and propane-related products and services. The retail propane customer base includes residential, commercial, industrial and agricultural customers.

Titan Energy Partners, L.P. (Titan), a Delaware limited partnership also engaged in retail propane operations.

The Partnership, the Operating Partnerships, and their subsidiaries are collectively referred to in this report as we , us , ETP , Energy Transfer or the Partnership.

2. ESTIMATES, SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING STANDARDS:

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the accrual for and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The natural gas industry conducts its business by processing actual transactions at the end of the month following the month of delivery. Consequently, the most current month s financial results for the midstream and intrastate transportation and storage segments are estimated using volume estimates and market prices. Any differences between estimated results and actual results are recognized in the following month s financial statements. Management believes that the operating results estimated for the three months ended March 31, 2009 and 2008 represent the actual results in all material respects.

Some of the other significant estimates made by management include, but are not limited to, the timing of certain forecasted transactions that are hedged, allowances for doubtful accounts, the fair value of derivative instruments, useful lives for depreciation and amortization, purchase accounting allocations and subsequent realizability of intangible assets, fair value measurements used in goodwill impairment test, market value of inventory, estimates related to our unit-based compensation plans, deferred taxes, assets and liabilities resulting from the regulated ratemaking process, contingency reserves and environmental reserves. Actual results could differ from those estimates.

New Accounting Standards and Changes to Significant Accounting Policies

A retrospective adjustment has been made to prior period income per limited partner unit presented in our consolidated statement of operations to conform to current period presentation related to our adoption of EITF 07-4. EITF 07-4 and other recently adopted accounting standards are discussed below.

Emerging Issues Task Force Issue No. 07-4, *Application of the Two Class Method Under FASB Statement No. 128, to Master Limited Partnerships* (EITF 07-4). The FASB ratified the final consensus on EITF 07-4 on March 26, 2008. The key elements of the final consensus relate to: (a) the scope of the issue; (b) when Incentive Distribution Rights (IDRs) are considered participating securities under the two-class method for Earnings Per Share (EPS); (c) the calculation provisions; and (d) the transition and effective date. EITF 07-4 addresses how current period earnings of a master limited partnership (MLP) should be allocated to the general partner, limited partners, and, when applicable, the holder of IDRs when applying the two-class method under Statement 128. EITF 07-4 applies to MLPs that are required to make incentive distributions when certain thresholds have been met regardless of whether the IDR is a separate limited partner interest or embedded in the general partner interest. EITF 07-4 only addresses incentive distributions that are treated as equity distributions and does not address whether the incentive distributions are compensation or equity distributions. Specifically, if IDRs are separate from the general partner interest, then they are considered separate participating securities for purposes of applying the two-class method of determining EPS. Under this situation, the two-class method is used to determine EPS for the general partner interest, limited partner interest and the IDR holders interest. EITF 07-4 provides that when earnings for the period exceed distributions, the excess undistributed earnings are to be allocated to the general partner, limited partners and holders of the IDRs based on the terms of the partnership

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agreement related to the allocation of income. When distributions for the period exceed earnings, the income is first allocated equal to the actual distributions. The resulting deficit is allocated to the general partner, limited partners and holders of the IDRs based on the terms of the partnership agreement related to the allocation of losses. We recorded and disclosed EPS information following the previous GAAP until January 1, 2009. We adopted EITF 07-4 as required on January 1, 2009 and have applied EITF 07-4 retrospectively; therefore, earnings per unit amounts for prior periods have been restated.

Based on the terms of our partnership agreement, EITF 07-4 requires us to allocate any excess undistributed earnings to the general partner and limited partners based on their respective ownership interests, with none of the excess undistributed earnings allocated to the IDRs. Prior to the adoption of EITF 07-4, we allocated a portion of the excess undistributed earnings to the IDRs. Thus, for periods where earnings exceed distributions, EITF 07-4 will result in a higher income per limited partner unit than our previous approach. For periods where distributions exceed earnings, the calculation of income per limited partner unit under EITF 07-4 is consistent with our previous approach. Thus, the adoption of EITF 07-4 will not have an impact on those periods.

The following financial table sets forth the effect of the retrospective application of EITF 07-4 on income per limited partner unit for the three months ended March 31, 2008:

	Originally Reported	As Adjusted
Basic net income per limited partner unit	$ 1.34	$ 1.78
Diluted net income per limited partner unit	$ 1.34	$ 1.77

Statement of Financial Accounting Standards No. 141 (Revised 2007), *Business Combinations,* (SFAS 141R). On December 4, 2007, the Financial Accounting Standards Board (FASB) issued SFAS 141R, which significantly changes the accounting for business combinations. Under SFAS 141R, an acquiring entity is required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Statement 141R changes the accounting treatment for certain specific items, including:

Acquisition costs are generally expensed as incurred;

Noncontrolling interests (previously referred to as minority interests) are valued at fair value at the acquisition date;

In-process research and development is recorded at fair value as an indefinite-lived intangible asset at the acquisition date;

Restructuring costs associated with a business combination are generally expensed subsequent to the acquisition date; and

Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date are recorded in income taxes.

SFAS 141R also includes a substantial number of new disclosure requirements. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R has not been applied to any transactions presented in these condensed consolidated financial statements. Our adoption of SFAS 141R on January 1, 2009 did not have an immediate impact on our financial position or results of operations.

Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133* (SFAS 161). Issued in March 2008, SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities with the intent to provide users of financial statements with an enhanced understanding of (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting* *for Derivative Instruments and Hedging Activities* (SFAS 133) and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and

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disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 only affects disclosure requirements; therefore, our adoption of this statement effective January 1, 2009 did not impact our financial position or results of operations.

FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 was issued by the FASB on June 16, 2008. FSP EITF 03-6-1 clarifies that unvested share-based payment awards constitute participating securities, if such awards include nonforfeitable rights to dividends or dividend equivalents. Consequently, awards that are deemed to be participating securities must be allocated earnings in the computation of earnings per share under the two-class method. We adopted FSP EITF 03-6-1 effective January 1, 2009. Based on unvested unit awards outstanding at the time of adoption, application of FSP EITF 03-6-1 did not have a material impact on our computation of earnings per unit.

Emerging Issues Task Force Issue No. 08-6, *Equity Method Investment Accounting Considerations* (EITF 08-6). EITF 08-6 establishes the requirements for initial measurement of an equity method investment, including the accounting for contingent consideration related to the acquisition of an equity method investment. EITF 08-6 also clarifies the accounting for (1) an other-than-temporary impairment of an equity method investment and (2) changes in level of ownership or degree of influence with respect to an equity method investment. Our adoption of EITF 08-6 on January 1, 2009 did not have a material impact on our financial condition or results of operations.

Statement of Financial Accounting Standards Staff Position (FSP) SFAS 157-2, *Effective Date of FASB Statement No. 157 (FSP 157-2)*. FSP 157-2 deferred the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), such as impaired nonfinancial assets and certain assets and liabilities acquired in business combinations. Our adoption of FSP 157-2 on January 1, 2009 did not impact our financial condition or results of operations.

3. CASH, CASH EQUIVALENTS AND SUPPLEMENTAL CASH FLOW INFORMATION:

Cash and cash equivalents include all cash on hand, demand deposits, and investments with original maturities of three months or less. We consider cash equivalents to include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

We place our cash deposits and temporary cash investments with high credit quality financial institutions. At times, our cash and cash equivalents may be uninsured or in deposit accounts that exceed the Federal Deposit Insurance Corporation (FDIC) insurance limit.

The net change in operating assets and liabilities (net of acquisitions) included in cash flows from operating activities is comprised as follows:

	Three Months Ended March 31, 2009	2008
Net income	$ 307,167	$ 328,335
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	72,603	58,828
Amortization of finance costs charged to interest	1,990	1,074
Provision for loss on accounts receivable	1,312	1,204
Non-cash unit-based compensation expense	6,801	8,086
Non-cash executive compensation expense	313	312
Deferred income taxes	6,719	2,857
Loss on disposal of assets	426	1,451
Allowance for equity funds used during construction	(20,427)	(9,888)
Distributions on unvested awards	(952)	
Distributed earnings of affiliates, net	328	1,651
Other non-cash	611	
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	100,905	(248,114)
Accounts receivable from related companies	(15,895)	(12,805)
Inventories	127,742	248,217

Deposits paid to vendors	39,769	(18,202)
Exchanges receivable	21,309	(6,885)
Prepaid expenses and other	18,787	(2,824)
Intangibles and other long-term assets	(6,673)	(3,186)
Accounts payable	(59,795)	114,815
Accounts payable to related companies	(16,004)	(22,308)
Exchanges payable	(26,484)	3,150
Customer advances and deposits	(51,126)	(34,803)
Accrued wages and benefits	(4,985)	(11,814)
Accrued and other current liabilities	5,942	15,117
Interest payable	(22,629)	(18,047)
Other non-current liabilities	(187)	1,667
Price risk management liabilities, net	(58,386)	(23,832)
Net cash provided by operating activities	$ 429,181	$ 374,056

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Non-cash investing and financing activities and supplemental cash flow information are as follows:

	Three Months Ended March 31, 2009	2008
NON-CASH INVESTING ACTIVITIES:		
Investment in Calpine Corporation received in exchange for accounts receivable	$	$ 10,816
Capital expenditures accrued	$ 84,908	$ 152,954
NON-CASH FINANCING ACTIVITIES:		
Capital contribution receivable from general partner	$ 4,795	$ 747
Long-term debt assumed and non-compete agreement notes payable issued in acquisitions	$	$ 2,693
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest, net of interest capitalized	$ 108,461	$ 83,438
Cash received for income taxes	$ (24)	$ (353)

4. ACCOUNTS RECEIVABLE:

Accounts receivable consisted of the following:

	March 31, 2009	December 31, 2008
Midstream and intrastate transportation and storage	$ 333,676	$ 415,507
Interstate transportation	30,469	29,309
Propane	133,480	155,191
Less - allowance for doubtful accounts	(8,562)	(8,750)
Total, net	$ 489,063	$ 591,257

The activity in the allowance for doubtful accounts for the propane operations during the three months ended March 31, 2009 consisted of the following:

Balance, December 31, 2008	$ 8,750
Accounts receivable written off, net of recoveries	(1,500)
Provision for loss on accounts receivable	1,312
Balance, March 31, 2009	$ 8,562

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5. INVENTORIES:

Inventories consist principally of natural gas held in storage valued at the lower of cost or market utilizing the weighted-average cost method. Propane inventories are also valued at the lower of cost or market utilizing the weighted-average cost of propane delivered to the customer service locations, including storage fees and inbound freight costs. The cost of appliances, parts and fittings is determined by the first-in, first-out method.

Inventories consisted of the following:

	March 31, 2009	December 31, 2008
Natural gas and NGLs, excluding propane	$ 84,762	$ 184,727
Propane	36,390	63,967
Appliances, parts and fittings and other	23,455	23,654
Total inventories	$ 144,607	$ 272,348

During the three months ended March 31, 2009, we recorded a lower of cost or market adjustment of $44.6 million for natural gas inventory to reflect market values which were less than the weighted-average cost. No lower of cost or market adjustments were recorded for the three months ended March 31, 2008.

6. GOODWILL, INTANGIBLES AND OTHER LONG-TERM ASSETS:

Components and useful lives of intangibles and other long-term assets were as follows:

	March 31, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizable intangible assets:				
Non-compete agreements (3 to 15 years)	$ 40,301	$ (25,529)	$ 40,301	$ (24,374)
Customer lists (3 to 15 years)	153,234	(43,224)	144,337	(39,730)
Contract rights (6 to 15 years)	23,015	(4,217)	23,015	(3,744)
Other (10 years)	2,677	(2,439)	2,677	(2,244)
Total amortizable intangible assets	219,227	(75,409)	210,330	(70,092)
Non-amortizable intangible assets - Trademarks	75,503		75,667	
Total intangible assets	294,730	(75,409)	285,997	(70,092)
Other long-term assets:				
Financing costs (3 to 15 years)	59,281	(18,464)	59,108	(16,586)
Regulatory assets	106,503	(6,823)	98,560	(5,941)
Other	40,701		43,153	
Total intangibles and other long-term assets	$ 501,215	$ (100,696)	$ 486,818	$ (92,619)

Aggregate amortization expense of intangible and other long-term assets was as follows:

	Three Months Ended March 31, 2009	2008
Reported in depreciation and amortization	$ 4,709	$ 4,299
Reported in interest expense	$ 1,878	$ 1,282

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Estimated aggregate amortization expense for the next five years is as follows:

Years Ending December 31:	
2010	$ 25,680
2011	24,014
2012	20,429
2013	14,999
2014	14,409

We review amortizable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such a review should indicate that the carrying amount of amortizable intangible assets is not recoverable, we reduce the carrying amount of such assets to fair value. We review goodwill and non-amortizable intangible assets for impairment annually, or more frequently if circumstances dictate. Our annual impairment test is performed as of December 31 for our interstate segment and as of August 31 for all others. No impairment of intangible assets was required for the three months ended March 31, 2009 or 2008. In December 2008, we recorded an impairment of the entire goodwill balance of $11.4 million related to the Canyon Gathering System. No goodwill impairments were recorded during the periods presented.

A decrease in goodwill of $8.7 million was recorded during the three months ended March 31, 2009 in connection with purchase price allocation adjustments related to prior acquisitions of propane businesses.

7. INVESTMENTS IN AFFILIATES:

Midcontinent Express Pipeline LLC

We are party to an agreement with Kinder Morgan Energy Partners, L.P. (KMP) for a 50/50 joint development of Midcontinent Express pipeline (MEP), an approximately 500-mile interstate natural gas pipeline that will originate near Bennington, Oklahoma, be routed through Perryville, Louisiana, and terminate at an interconnect with Transco s interstate natural gas pipeline in Butler, Alabama. The first phase of the pipeline was placed in interim service in April 2009 and the second phase of the pipeline is expected to be in service by the third quarter of 2009. In July 2008, MEP completed an open season with respect to a capacity expansion of MEP from the original planned capacity of 1.5 Bcf/d to a total capacity of 1.8 Bcf/d for the main segment of the pipeline from north Texas to a planned interconnect location with the Columbia Gas Transmission Pipeline near Waverly, Louisiana. The additional 300 MMcf/d of capacity was fully subscribed as a result of this open season. The planned expansion of capacity would be added through the installation of additional compression on this segment of the pipeline and is pending approval from the Federal Energy Regulatory Commission (FERC).

On January 9, 2009, MEP filed an amended application to revise its initial transportation rates to reflect an increase in projected costs for the project; the amended application was approved by the FERC on March 25, 2009.

Fayetteville Express Pipeline LLC

We are party to an agreement with KMP for a 50/50 joint development of the Fayetteville Express pipeline, an approximately 187-mile natural gas pipeline that will originate in Conway County, Arkansas, continue eastward through White County, Arkansas and terminate at an interconnect with Trunkline Gas Company in Quitman County, Mississippi. FEP, the entity formed to own and operate this pipeline, initiated public review of the project pursuant to the FERC s National Environmental Policy Act (NEPA) pre-filing review process in November 2008. The pipeline is expected to have an initial capacity of 2.0 Bcf/d. Pending necessary regulatory approvals, the pipeline project is expected to be in service by early 2011. FEP has secured binding 10-year commitments for transportation of approximately 1.85 Bcf/d. The new pipeline will interconnect with Natural Gas Pipeline Company of America (NGPL) in White County, Arkansas, Texas Gas Transmission in Coahoma County, Mississippi and ANR Pipeline Company in Quitman County, Mississippi. NGPL is operated and partially owned by Knight, Inc. Knight owns the general partner of KMP. Pursuant to our agreement with KMP related to this project, we and KMP are each obligated to fund 50% of the equity necessary to construct the project.

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Capital Contributions to Affiliates

During the three months ended March 31, 2009, we contributed $119.9 million to our joint ventures ($111.0 million to MEP and $8.9 million to FEP). We expect that we will make capital contributions to MEP of between $345.0 million and $365.0 million and capital contributions to FEP of between $200.0 million and $220.0 million during the last nine months of 2009 to fund expenditures for the projects. If MEP obtains long-term financing in 2009 following completion of the base project, an additional capital contribution of $200.0 million to $250.0 million may be required.

8. FAIR VALUE MEASUREMENTS:

The following table summarizes the fair value of our financial assets and liabilities as of March 31, 2009 and December 31, 2008, based on inputs used to derive their fair values in accordance with SFAS 157:

Description	Fair Value Total	Fair Value Measurements at March 31, 2009 Using Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Fair Value Total	Fair Value Measurements at December 31, 2008 Using Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)
Assets						
Marketable securities	$ 5,949	$ 5,949	$	$ 5,915	$ 5,915	$
Commodity derivatives	3,211	1,046	2,165	111,513	106,090	5,423
Interest rate swap derivatives	1,005		1,005			
Liabilities						
Commodity derivatives	(20,565)	(12,132)	(8,433)	(43,336)		(43,336)
Interest rate swap derivatives	(37,770)		(37,770)	(51,642)		(51,642)
	$ (48,170)	$ (5,137)	$ (43,033)	$ 22,450	$ 112,005	$ (89,555)

9. INCOME TAXES:

The components of the federal and state income tax expense (benefit) of our taxable subsidiaries are summarized as follows:

	Three Months Ended March 31, 2009	2008
Current expense (benefit):		
Federal	$ (4,626)	$ (523)
State	3,492	3,272
Total	(1,134)	2,749
Deferred expense:		
Federal	7,391	2,834
State	675	279

Total	8,066	3,113
Total tax expense	$ 6,932	$ 5,862
Effective tax rate	2.2%	1.8%

The effective tax rate differs from the statutory rate due primarily to Partnership earnings that are not subject to federal and state income taxes at the Partnership level.

10. INCOME PER LIMITED PARTNER UNIT:

Our net income is allocated to the General Partner and Limited Partners in accordance with their respective partnership percentages, after giving effect to priority income allocations for incentive distributions, if any, to our General Partner, the holder of the Incentive Distribution Rights (IDRs) pursuant to the Partnership Agreement, which are declared and paid following the close of each quarter. The adoption of EITF 07-4 on January 1, 2009, as discussed in Note 2, required us to change our calculation of earnings per unit during periods where earnings

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exceeded distributions. Under EITF 07-4, earnings in excess of distributions are now allocated to the General Partner and Limited Partners based on their respective ownership interests. Previously, a portion of earnings in excess of distributions had been allocated to the General Partner with respect to the IDRs. We have applied EITF 07-4 retrospectively; therefore, earnings per unit amounts for prior periods have been restated.

A reconciliation of net income and weighted average units used in computing basic and diluted net income per unit is as follows:

	Three Months Ended March 31, 2009	2008
Net income	$ 307,167	$ 328,335
General Partner s interest in net income	90,290	74,364
Limited Partners interest in net income	216,877	253,971
Distributions on employee unit awards, net of allocation to General Partner	(1,004)	
Net income available to Limited Partners	$ 215,873	$ 253,971
Weighted average Limited Partner units basic	157,009,238	142,762,265
Basic net income per Limited Partner unit	$ 1.37	$ 1.78
Weighted average Limited Partner units	157,009,238	142,762,265
Dilutive effect of Unit Grants	381,162	435,535
Weighted average Limited Partner units, assuming dilutive effect of Unit Grants	157,390,400	143,197,800
Diluted net income per Limited Partner unit	$ 1.37	$ 1.77

11. DEBT OBLIGATIONS:

ETP Senior Notes

2009 ETP Notes

Subsequent to March 31, 2009, we completed a public offering of $350.0 million aggregate principal amount of our 8.50% Senior Notes due 2014 and $650.0 million aggregate principal amount of our 9.00% Senior Notes due 2019 (collectively the 2009 ETP Notes). The sale of the 2009 ETP Notes closed on April 7, 2009 and we used the net proceeds of approximately $993.6 million from the offering to repay all borrowings outstanding under the ETP Credit Facility and for general partnership purposes.

The 2009 ETP Notes are unsecured obligations of the Partnership and the obligation of the Partnership to repay the 2009 ETP Notes is not guaranteed by any of the Partnership s subsidiaries. As a result, the 2009 ETP Notes effectively rank junior to any future indebtedness of ours or our subsidiaries that is both secured and unsubordinated to the extent of the value of the assets securing such indebtedness, and the 2009 ETP Notes effectively rank junior to all indebtedness and other liabilities of our existing and future subsidiaries.

Revolving Credit Facilities

ETP Credit Facility

The ETP Credit Facility provides for $2.0 billion of revolving credit capacity that is expandable to $3.0 billion (subject to obtaining the approval of the administrative agent and securing lender commitments for the increased borrowing capacity, under the Amended and Restated Credit Agreement). The ETP Credit Facility matures on July 20, 2012, unless we elect the option of one-year extensions (subject to the approval of each such extension by the lenders holding a majority of the aggregate lending commitments). Amounts borrowed under the ETP Credit Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. The indebtedness under the ETP Credit Facility is prepayable at any time at the Partnership s option without penalty. The commitment fee payable on the unused portion of the ETP Credit Facility varies based on our credit rating and the fee is 0.11% based on our current rating with a maximum fee of 0.125%.

As of March 31, 2009, there was a balance outstanding on the ETP Credit Facility of $882.0 million in revolving credit loans and approximately $60.0 million in letters of credit. The weighted average interest rate on the total amount outstanding at March 31, 2009, was 1.86%. The total amount available under the ETP Credit Facility, as of March 31, 2009 which is reduced by any letters of credit, was approximately $1.06 billion.

HOLP Credit Facility

HOLP has a $75.0 million Senior Revolving Facility (the HOLP Credit Facility) available to HOLP through June 30, 2011, which may be expanded to $150.0 million. Amounts borrowed under the HOLP Credit Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. The commitment fee payable on the unused portion of the facility varies based on the Leverage Ratio, as defined, with a maximum fee of 0.50%. The agreement includes provisions that may require contingent prepayments in the event of dispositions, loss of assets, merger or change of control. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts of HOLP, and the capital stock of HOLP s subsidiaries secure the HOLP Credit Facility. At March 31, 2009, there was no outstanding balance in revolving credit loans and $1.0 million in outstanding letters of credit. The amount available as of March 31, 2009 was $74.0 million.

Covenants Related to Our Credit Agreements

We are in compliance with all requirements, tests, limitations, and covenants related to our debt agreements at March 31, 2009.

12. PARTNERS CAPITAL:

Common Units Issued

The change in Common Units during the three-month period ended March 31, 2009 is as follows:

	Number of Units
Balance, December 31, 2008	152,102,471
Common Units issued in connection with a public offering	6,900,000
Issuance of Common Units under equity incentive plans	8,988
Balance, March 31, 2009	159,011,459

On January 27, 2009, we closed a public offering of 6,900,000 Common Units at $34.05 per Common Unit. Net proceeds of approximately $225.9 million from the offering were used to repay outstanding borrowings under the ETP Credit Facility.

Subsequent to March 31, 2009, we closed a public offering of 8,500,000 Common Units representing limited partner interests at $37.55 per Common Unit. In connection with this public offering, we also granted the underwriters a 30-day option to purchase up to an aggregate of 1,275,000 additional Common Units on the same terms. The offering closed on April 21, 2009 and the underwriters exercised their option to purchase additional Common Units in full on April 24, 2009. Net proceeds of approximately $352.4 million from the offering will be used to fund capital expenditures and capital contributions to joint venture entities related to pipeline construction projects as well as for general partnership purposes. The units have been registered under the Securities Act of 1933, as amended, pursuant to a Registration Statement on Form S-3ASR.

Quarterly Distributions of Available Cash

On February 13, 2009, we paid a per unit cash distribution related to the three months ended December 31, 2008 of $0.89375 per Common Unit ($3.575 per Limited Partner Unit annualized) to Unitholders of record at the close of business on February 6, 2009. We paid $83.9 million in the aggregate for ETP GP s 2% general partner interest in the Partnership and its Incentive Distribution Rights for the three months ended December 31, 2008.

On April 28, 2009, we announced the declaration of a cash distribution for the three months ended March 31, 2009 of $0.89375 per Common Unit, or $3.575 annualized. This distribution will be paid on May 15, 2009 to Unitholders of record at the close of business on May 8, 2009.

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Total distributions declared (all from Available Cash from Operating Surplus) related to the three months ended March 31, 2009 were as follows:

Limited Partners -	
Common Units	$ 150,853
Class E Units	3,121
General Partners -	
2% Ownership	4,860
Incentive Distribution Rights	84,146
	$ 242,980

Accumulated Other Comprehensive Income

The following table presents the components of accumulated other comprehensive income (loss) (AOCI), net of tax:

	March 31, 2009	December 31, 2008
Net gain (loss) on commodity related hedges	$ (3,128)	$ 8,735
Net gain on interest rate hedges	89	161
Unrealized losses on available-for-sale securities	(5,932)	(5,983)
Total AOCI, net of tax	$ (8,971)	$ 2,913

13. <u>UNIT-BASED COMPENSATION PLANS</u>:

Employee Grants

The following table shows the activity of the awards granted during the three months ended March 31, 2009:

	Three-Year Performance Vesting (1)		Five-Year Service Vesting (2)		Other (3)		Total	
	Number of Units	Weighted Average Fair Value Per Unit	Number of Units	Weighted Average Fair Value Per Unit	Number of Units	Weighted Average Fair Value Per Unit	Number of Units	Weighted Average Fair Value Per Unit
Unvested awards as of December 31, 2008	150,852	$ 43.96	1,205,430	$ 35.87	8,976	$ 43.48	1,365,258	$ 36.81
Awards granted			35,850	34.60			35,850	34.60
Awards vested			(8,800)	46.00			(8,800)	46.00
Awards forfeited	(834)	40.69	(7,776)	37.10			(8,610)	37.45
Unvested awards as of March 31, 2009	150,018	$ 43.98	1,224,704	$ 35.75	8,976	$ 43.48	1,383,698	$ 36.69

(1) Includes awards subject to performance objectives and continued employment.

(2) Includes awards for which vesting is subject to continued employment.
(3) Includes special grants and awards issued with other vesting conditions.

As of March 31, 2009, a total of 4,759,630 ETP Common Units remain available to be awarded under the 2008 Incentive Plan.

We recognized non-cash compensation expense related to employee grants under our unit-based compensation plans of $6.8 million and $5.9 million for the three months ended March 31, 2009 and 2008, respectively. The total expected non-cash compensation expense to be recognized related to the unvested employee awards as of March 31, 2009 is:

Years Ending December 31:	
2009 (remainder)	$ 14,501
2010	10,516
2011	6,176
2012	3,235
2013	1,056

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Director Grants

There were no new Director Grants, or awards vested during the three months ended March 31, 2009.

We recognized non-cash compensation expense related to director grants under our unit-based compensation plans of $0.04 million for each of the three month periods ended March 31, 2009 and 2008.

Related Party Awards

During 2007 and 2008, a partnership (McReynolds Energy Partners, L.P.), the general partner of which is owned and controlled by the President of our General Partner, awarded to certain new officers of ETP certain rights related to units of Energy Transfer Equity, L.P. (ETE) previously issued by ETE to such officer. As of March 31, 2009, rights related to 695,000 unvested ETE units remained outstanding. For the three months ended March 31, 2009 and 2008, we recognized non-cash compensation expense, net of forfeitures, of $1.8 million and $2.2 million, respectively.

14. REGULATORY MATTERS, COMMITMENTS, CONTINGENCIES AND ENVIRONMENTAL LIABILITIES:

Regulatory Matters

On September 29, 2006, Transwestern filed revised tariff sheets under Section 4(e) of the Natural Gas Act (NGA) proposing a general rate increase to be effective on November 1, 2006. In April 2007, the FERC approved a Stipulation and Agreement of Settlement that resolved the primary components of the rate case. Transwestern s tariff rates and fuel charges are now final for the period of the settlement. Transwestern is not required to file a new rate case until October 1, 2011.

The Phoenix project, as filed with the FERC on September 15, 2006, includes the construction and operation of approximately 260 miles of 36-inch or larger diameter pipeline extending from Transwestern s existing mainline in Yavapai County, Arizona to delivery points in the Phoenix, Arizona area and certain looping on Transwestern s existing San Juan Lateral with approximately 25 miles of 36-inch diameter pipeline. On November 15, 2007, the FERC issued an order granting Transwestern its Certificate of Public Convenience and Necessity (Order). Pursuant to the Order, Transwestern filed its initial Implementation Plan on November 14, 2007 and accepted the Order on November 19, 2007. On December 17, 2007, two parties filed requests for rehearing of the Order and on December 20, 2007, one party filed a motion to stay the Order. On February 21, 2008, the FERC reaffirmed its decision in the Order; thus, Transwestern notified customers of the commencement of construction in January 2008. The San Juan Lateral portion of the project was placed in service effective July 2008 and the pipeline to the Phoenix area was placed in service in March 2009.

Guarantees

We have guaranteed 50% of the obligations of MEP under its $1.40 billion senior revolving credit facility (the MEP Facility), with the remaining 50% of MEP Facility obligations guaranteed by KMP. Subject to certain exceptions, our guarantee may be proportionately increased or decreased if our ownership percentage increases or decreases. The MEP Facility is unsecured and matures on February 28, 2011. The MEP Facility is syndicated among multiple financial institutions. As a result of the Lehman Brothers bankruptcy in 2008, the MEP Facility has effectively been reduced by the Lehman Brothers affiliate s commitment of approximately $100.0 million. However, the MEP Facility is not in default, and the commitments of the other lending banks remain unchanged.

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As of March 31, 2009, MEP had $1.22 billion of outstanding borrowings and $33.3 million of letters of credit issued under the MEP Facility. Our contingent obligations with respect to our 50% guarantee of MEP s outstanding borrowings and letters of credit were $609.1 million and $16.7 million, respectively, as of March 31, 2009.

Commitments

In the normal course of our business, we purchase, process and sell natural gas pursuant to long-term contracts and enter into long-term transportation and storage agreements. Such contracts contain terms that are customary in the industry. We have also entered into several propane purchase and supply commitments which are typically one year agreements with varying terms as to quantities, prices and expiration dates. We also have a long-term purchase contract for approximately 79.0 million gallons of propane per year that contains a two year cancellation provision and a seven year contract to purchase not less than 90.0 million gallons per year. We believe that the terms of these agreements are commercially reasonable and will not have a material adverse effect on our financial position or results of operations.

We have certain non-cancelable leases for property and equipment which require fixed monthly rental payments and expire at various dates through 2020. Rental expense under these operating leases has been included in operating expenses in the accompanying statements of operations and totaled approximately $6.0 million and $8.2 million for the three months ended March 31, 2009 and 2008, respectively.

Litigation and Contingencies

We may, from time to time, be involved in litigation and claims arising out of our operations in the normal course of business. Natural gas and propane are flammable, combustible gases. Serious personal injury and significant property damage can arise in connection with their transportation, storage or use. In the ordinary course of business, we are sometimes threatened with or named as a defendant in various lawsuits seeking actual and punitive damages for product liability, personal injury and property damage. We maintain liability insurance with insurers in amounts and with coverages and deductibles management believes are reasonable and prudent, and which are generally accepted in the industry. However, there can be no assurance that the levels of insurance protection currently in effect will continue to be available at reasonable prices or that such levels will remain adequate to protect us from material expenses related to product liability, personal injury or property damage in the future.

FERC/CFTC and Related Matters. On July 26, 2007, the FERC issued to us an Order to Show Cause and Notice of Proposed Penalties (the Order and Notice) that contains allegations that we violated FERC rules and regulations. The FERC has alleged that we engaged in manipulative or improper trading activities in the Houston Ship Channel, primarily on two dates during the fall of 2005 following the occurrence of Hurricanes Katrina and Rita, as well as on eight other occasions from December 2003 through August 2005, in order to benefit financially from our commodities derivatives positions and from certain of our index-priced physical gas purchases in the Houston Ship Channel. The FERC has alleged that during these periods we violated the FERC s then-effective Market Behavior Rule 2, an anti-market manipulation rule promulgated by the FERC under authority of the NGA. The FERC alleges that we violated this rule by artificially suppressing prices that were included in the Platts *Inside FERC* Houston Ship Channel index, published by McGraw-Hill Companies, on which the pricing of many physical natural gas contracts and financial derivatives are based. Additionally, the FERC has alleged that we manipulated daily prices at the Waha and Permian Hubs in west Texas on two dates. Finally, the FERC alleged that our Oasis pipeline, a pipeline that transports interstate natural gas pursuant to Natural Gas Policy Act (NGPA) Section 311 authority and is subject to the FERC-approved rates, terms and conditions of service, violated NGPA regulations from January 26, 2004 through June 30, 2006 by granting undue preference to its affiliates for interstate NGPA Section 311 pipeline service to the detriment of similarly situated non-affiliated shippers and by charging in excess of the FERC-approved maximum lawful rate for interstate NGPA Section 311 transportation. As discussed below, in January 2009 we entered into a settlement agreement with FERC Enforcement Staff pursuant to which all claims against Oasis were settled with no obligation for Oasis to pay any civil penalties to the FERC or make any other payment, and in February 2009, the FERC approved the terms of this settlement agreement in its entirety and without modification. The FERC also seeks to revoke, for a period of 12 months, our blanket marketing authority for sales of natural gas in interstate commerce at market-based prices, which activity accounted for less than 1.0% of our operating income for our 2008 year. If the FERC is successful in revoking our blanket marketing authority, our sales of natural gas at market-based prices would be limited to sales to retail customers (such as utilities and other end-users) and sales from our own production, and any other sales of natural gas by us would be required to be made at contract prices that would be subject to individual FERC approval.

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In its Order and Notice, the FERC specified that it was seeking $54.6 million in disgorgement of profits, plus interest, and $97.5 million in civil penalties relating to its market manipulation claims. The FERC has taken the position that, once it receives our response, it has several options as to how to proceed, including issuing an order on the merits, requesting briefs, or setting specified issues for a trial-type hearing before an administrative law judge. On August 27, 2007, ETP filed a request for rehearing of the Order and Notice. On December 20, 2007, the FERC issued an order denying rehearing and directed the FERC Enforcement Staff to file a brief recommending disposition of issues by order or by evidentiary hearing. ETP filed its response to the Order and Notice with the FERC on October 9, 2007, which response refuted the FERC s claims and requested a dismissal of the FERC proceeding. On February 14, 2008, the Enforcement Staff of the FERC filed a brief recommending that the FERC refer various matters relating to its market manipulation allegations for an evidentiary hearing before a FERC administrative law judge. The Enforcement Staff also recommended that the FERC pursue market manipulation claims related to ETP s trading activities in October 2005 for November 2005 monthly deliveries, a period not previously covered by FERC s allegations in the Order and Notice, and that ETP be assessed an additional civil penalty of $25.0 million and be required to disgorge approximately $7.3 million of alleged unjust profits related to this additional month. If the FERC pursues the claims related to this additional month, the total amount of civil penalties and disgorgement of profits sought by the FERC would be approximately $184.4 million. On March 31, 2008, we responded to the Enforcement Staff s brief.

On May 15, 2008, the FERC ordered hearings to be conducted by FERC administrative law judges with respect to the FERC s Oasis claims and market manipulation claims. The hearing related to the Oasis claims was scheduled to commence in December 2008 with the administrative law judge s initial decisions due by May 11, 2009; however, as discussed below, we entered into a settlement agreement with FERC Enforcement Staff in January 2009, and that agreement was approved by the FERC in its entirety and without modification on February 27, 2009. The hearing related to the market manipulation claims is now scheduled to commence in June 2009 with the administrative law judge s initial decision due by December 3, 2009. The FERC also ordered that, following the completion of the hearings, the administrative law judges make initial findings with respect to whether we engaged in market manipulation in violation of the NGA and FERC regulations. The FERC reserved for itself the issues of possible civil penalties, revocation of our blanket market certificate, and whether we would disgorge any unjust profits. Following the issuance of the administrative law judge s initial decision related to the market manipulation claims, the FERC would then issue an order with respect to each of these matters. On May 23, 2008, we requested rehearing and stay of the FERC s May 15, 2008 order establishing hearing, and we renewed those requests on June 26, 2008. On August 7, 2008, FERC denied rehearing of its May 15, 2008 order. On August 8, 2008, we filed a petition with the U.S. Court of Appeals for the Fifth Circuit to review and set aside FERC s May 15 and August 7, 2008 orders on the grounds that we are entitled to adjudicate FERC s claims in federal district court pursuant to the NGA and the NGPA. On August 28, 2008, we filed an amended petition seeking review of the Order and Notice and the December 20, 2007 order denying rehearing. On April 28, 2009, the Fifth Circuit issued an order dismissing our petition on the grounds that the issues presented in the petition are not ripe for adjudication at this time.

On November 18, 2008, the administrative law judge presiding over the Oasis claims granted our motion for summary disposition of the claim that Oasis unduly discriminated in favor of affiliates regarding the provision of Section 311(a)(2) interstate transportation service. We subsequently entered into an agreement with the Enforcement Staff to settle all of the claims related to Oasis. Pursuant to this agreement, Oasis will not pay any civil penalties to the FERC or make any other payments. On January 5, 2009, this agreement was submitted under seal to FERC by the presiding administrative law judge, for FERC s approval as an uncontested settlement of all Oasis claims. On February 27, 2009, the settlement agreement was approved by the FERC in its entirety and without modification, and the terms of the settlement were made public. As no person sought rehearing of the order approving the settlement within 30 days of such order, the FERC s order has become final and non-appealable. We believe the Oasis settlement, as approved by the FERC, will not have a material adverse effect on our business, financial condition or results of operations.

It is our position that our trading and transportation activities during the periods at issue complied in all material aspects with applicable law and regulations, and we intend to contest these cases vigorously. However, the laws and regulations related to alleged market manipulation are vague, subject to broad interpretation, and offer little guiding precedent, while at the same time the FERC holds substantial enforcement authority. At this time, we are unable to predict the final outcome of these matters.

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On July 26, 2007, the United States Commodity Futures Trading Commission (the CFTC) filed suit in United States District Court for the Northern District of Texas alleging that we violated provisions of the Commodity Exchange Act (CEA) by attempting to manipulate natural gas prices in the Houston Ship Channel. On March 17, 2008, we entered into a consent order with the CFTC (the Consent Order). Pursuant to the Consent Order, we agreed to pay the CFTC $10.0 million and the CFTC agreed to release us and our affiliates, directors and employees from all claims or causes of action asserted by the CFTC in this proceeding. The Consent Order provides that we are permanently enjoined from attempting to manipulate the price of any commodity in interstate commerce in violation of the CEA. By consenting to the entry of the Consent Order, we neither admitted nor denied the allegations made by the CFTC in this proceeding. The settlement reduced our existing accrual and was paid from cash flow from operations in March 2008.

In addition to the FERC legal action, third parties have asserted claims and may assert additional claims against us and ETE for damages related to these matters. In this regard, several natural gas producers and a natural gas marketing company have initiated legal proceedings in Texas state courts against us and ETE for claims related to the FERC claims. These suits contain contract and tort claims relating to alleged manipulation of natural gas prices at the Houston Ship Channel and the Waha Hub in West Texas, as well as the natural gas price indices related to these markets and the Permian Basin natural gas price index during the period from December 2003 through December 2006, and seek unspecified direct, indirect, consequential and exemplary damages. One of the suits against us and ETE contains an additional allegation that we and ETE transported gas in a manner that favored our affiliates and discriminated against the plaintiff, and otherwise artificially affected the market price of

gas to other parties in the market. We have moved to compel arbitration and/or contested subject-matter jurisdiction in some of these cases. One such case currently is on appeal before the Texas Supreme Court on, among other things, the issue of whether the dispute is arbitrable.

We have also been served with a complaint from an owner of royalty interests in natural gas producing properties, individually and on behalf of a putative class of similarly situated royalty owners, working interest owners and producer/operators, seeking arbitration to recover damages based on alleged manipulation of natural gas prices at the Houston Ship Channel. We filed an original action in Harris County state court seeking a stay of the arbitration on the ground that the action is not arbitrable, and the state court granted our motion for summary judgment on that issue. The claimants have filed a notice of appeal.

A consolidated class action complaint has been filed against us in the United States District Court for the Southern District of Texas. This action alleges that we engaged in intentional and unlawful manipulation of the price of natural gas futures and options contracts on the NYMEX in violation of the CEA. It is further alleged that during the class period December 29, 2003 to December 31, 2005, we had the market power to manipulate index prices, and that we used this market power to artificially depress the index prices at major natural gas trading hubs, including the Houston Ship Channel, in order to benefit our natural gas physical and financial trading positions, and that we intentionally submitted price and volume trade information to trade publications. This complaint also alleges that we violated the CEA by knowingly aiding and abetting violations of the CEA. The plaintiffs state that this allegedly unlawful depression of index prices by us manipulated the NYMEX prices for natural gas futures and options contracts to artificial levels during the class period, causing unspecified damages to the plaintiffs and all other members of the putative class who sold natural gas futures or who purchased and/or sold natural gas options contracts on NYMEX during the class period. The plaintiffs have requested certification of their suit as a class action and seek unspecified damages, court costs and other appropriate relief. On January 14, 2008, we filed a motion to dismiss this suit on the grounds of failure to allege facts sufficient to state a claim. On March 20, 2008, the plaintiffs filed a second consolidated class action complaint. In response to this new pleading, on May 5, 2008, we filed a motion to dismiss the complaint. On June 19, 2008, the plaintiffs filed a response opposing our motion to dismiss. We filed a reply in support of our motion on July 9, 2008. On March 26, 2009, the court issued an order dismissing this complaint, with prejudice, for failure to state a claim. On April 9, 2009, the plaintiff filed with the court a motion for reconsideration of this decision. The court has not taken any action with respect to this motion.

On March 17, 2008, a second class action complaint was filed against us in the United States District Court for the Southern District of Texas. This action alleges that we engaged in unlawful restraint of trade and intentional monopolization and attempted monopolization of the market for fixed-price natural gas baseload transactions at the Houston Ship Channel from December 2003 through December 2005 in violation of federal antitrust law. The complaint further alleges that during this period we exerted monopoly power to suppress the price for these transactions to non-competitive levels in order to benefit our own physical natural gas positions. The plaintiff has, individually and on behalf of all other similarly situated sellers of physical natural gas, requested certification of its suit as a class action and seeks unspecified treble damages, court costs and other appropriate relief. On May 19, 2008, we filed a motion to dismiss this complaint. On July 2, 2008 the plaintiffs filed a response opposing our motion to dismiss. We filed a reply in support of our motion on August 18, 2008. On March 26, 2009, the court issued an order dismissing this complaint for failure to state a claim in all causes of action and for failure to state an anti-trust injury but granted the plaintiffs leave to amend. On April 23, 2009, the plaintiff filed a motion with the court to seek permission to amend its petition in order to assert a claim for common law fraud. The court has not taken any action with respect to this motion.

We are expensing the legal fees, consultants fees and other expenses relating to these matters in the periods in which such expenses are incurred. In addition, our existing accruals for litigation and contingencies include an accrual related to these matters. At this time, we are unable to predict the outcome of these matters. However, it is possible that the amount we become obliged to pay as a result of the final resolution of these matters, whether on a negotiated settlement basis or otherwise, will exceed the amount of our existing accrual related to these matters. In accordance with applicable accounting standards, we will review the amount of our accrual related to these matters as developments related to these matters occur and we will adjust our accrual if we determine that it is probable that the amount we may ultimately become obliged to pay as a result of the final resolution of these matters is greater than the amount of our existing accrual for these matters. As our accrual amounts are non-cash, any cash payment of an amount in resolution of these matters would likely be made from cash from operations or borrowings, which payments would reduce our cash available to service our indebtedness either directly or as a result of increased principal and interest payments necessary to service any borrowings incurred to finance such payments. If these payments are substantial, we may experience a material adverse impact on our results of operations and our liquidity.

In re Natural Gas Royalties Qui Tam Litigation. MDL Docket No. 1293 (D. WY), Jack Grynberg, an individual, has filed actions against a number of companies, including Transwestern, now transferred to the U.S. District Court for the District of Wyoming, for damages for mis-measurement of gas volumes and Btu content, resulting in lower royalties to mineral interest owners. On October 20, 2006, the District Judge adopted in part the earlier recommendation of the Special Master in the case and ordered the dismissal of the case against Transwestern. Transwestern believes that its measurement practices conformed to the terms of its FERC Gas Tariff, which were filed with and approved by the FERC. As a result, Transwestern believes that is has meritorious defenses to these lawsuits (including FERC-related affirmative defenses, such as the filed rate/tariff doctrine, the primary/exclusive jurisdiction of the FERC, and the defense that Transwestern complied with the terms of its tariffs) and will continue to vigorously defend against them, including any appeal which may be taken from the dismissal of the Grynberg case. A hearing was held on April 24, 2007 regarding Transwestern s Supplemental Brief for Attorneys fees which was filed on January 8, 2007 and the issues are submitted and are awaiting a decision. Grynberg moved to have the cases he appealed remanded to the district court for consideration in light of a recently-issued Supreme Court case. The defendants/appellees opposed the motion. The Tenth Circuit motions panel referred the remand motion to the merits panel to be carried with the appeals. Grynberg s opening brief was filed on or about July 31, 2007. Appellee s opposition brief was filed on or about November 21, 2007. Appellee Transwestern filed its separate response brief on January 11, 2008 and Grynberg s reply brief was filed in June 2008 and the hearing on all briefs was held in September 2008. On March 17, 2009, the Tenth Circuit affirmed the District Court s dismissal. Transwestern does not believe the outcome of this case will have a material adverse effect on its financial position, results of operations or cash flows.

Houston Pipeline Cushion Gas Litigation. At the time of the HPL System acquisition, AEP Energy Services Gas Holding Company II, L.L.C., HPL Consolidation LP and its subsidiaries (the HPL Entities), their parent companies and American Electric Power Corporation (AEP), were engaged in ongoing litigation with Bank of America (B of A) that related to AEP s acquisition of HPL in the Enron bankruptcy and B of A s financing of cushion gas stored in the Bammel Storage Facility (Cushion Gas). This litigation is referred to as the Cushion Gas Litigation . Under the terms of the Purchase and Sale Agreement and the related Cushion Gas Litigation Agreement, AEP and its subsidiaries that were the sellers of the HPL Entities retained control of the Cushion Gas Litigation and have agreed to indemnify ETC OLP and the HPL Entities for any damages arising from the Cushion Gas Litigation and the loss of use of the Cushion Gas, up to a maximum of the amount paid by ETC OLP for the HPL Entities and the working gas inventory (approximately $1.00 billion in the aggregate). The Cushion Gas Litigation Agreement terminates upon final resolution of the Cushion Gas Litigation. In addition, under the terms of the Purchase and Sale Agreement, AEP retained control of additional matters relating to ongoing litigation and environmental remediation and agreed to bear the costs of or indemnify ETC OLP and the HPL Entities for the costs related to such matters. On December 18, 2007, the United States District Court for the

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Southern District of New York held that B of A is entitled to receive monetary damages from AEP and the HPL Entities of approximately $347.3 million less the monetary amount B of A would have incurred to remove 55 Bcf of natural gas from the Bammel Storage Facility. AEP is appealing the court decision. Based on the indemnification provisions of the Cushion Gas Litigation Agreement, ETP does not expect that it will be liable for any portion of this court award.

Other Matters. In addition to those matters described above, we or our subsidiaries are a party to various legal proceedings and/or regulatory proceedings incidental to our businesses. For each of these matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, the likelihood of an unfavorable outcome and the availability of insurance coverage. If we determine that an unfavorable outcome of a particular matter is probable, can be estimated and is not covered by insurance, we make an accrual for the matter. For matters that are covered by insurance, we accrue the related deductible. As new information becomes available, our estimates may change. The impact of these changes may have a significant effect on our results of operations in a single period.

The outcome of these matters cannot be predicted with certainty and it is possible that the outcome of a particular matter will result in the payment of an amount in excess of the amount accrued for the matter. As our accrual amounts are non-cash, any cash payment of an amount in resolution of a particular matter would likely be made from cash from operations or borrowings. If cash payments to resolve a particular matter substantially exceed our accrual for such matter, we may experience a material adverse impact on our results of operations, cash available for distribution and our liquidity.

As of March 31, 2009 and December 31, 2008, accruals of $21.0 million and $20.8 million, respectively, were recorded as accrued and other current liabilities and other non-current liabilities on our condensed consolidated balance sheets for our contingencies and current litigation matters, excluding accruals related to environmental matters.

Environmental

Our operations are subject to extensive federal, state and local environmental laws and regulations that require expenditures for remediation at operating facilities and waste disposal sites. Although we believe our operations are in substantial compliance with applicable environmental laws and regulations, risks of additional costs and liabilities are inherent in the natural gas p