EL PASO NATURAL GAS CO
Form 10-Q
November 08, 2010

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from to

Commission File Number 1-2700

El Paso Natural Gas Company
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	74-0608280 (I.R.S. Employer Identification No.)
El Paso Building 1001 Louisiana Street Houston, Texas (Address of Principal Executive Offices)	77002 (Zip Code)

Telephone Number: (713) 420-2600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R 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 £ Accelerated filer £ Non-accelerated filer R Smaller reporting company £
(Do not check if a 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 R

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

Common stock, par value $1 per share. Shares outstanding on November 5, 2010: 1,000

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

EL PASO NATURAL GAS COMPANY

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* We have not included a response to this item in this document since no response is required pursuant to the reduced disclosure format permitted by General Instruction H to Form 10-Q.

Below is a list of terms that are common to our industry and used throughout this document:

/d	= per day	BBtu	= billion British thermal units

When we refer to cubic feet measurements, all measurements are at a pressure of 14.73 pounds per square inch.

When we refer to "us," "we," "our," "ours," "the company" or "EPNG," we are describing El Paso Natural Gas Company and our subsidiaries.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO NATURAL GAS COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In millions)
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Operating revenues	$ 122	$ 145	$ 393	$ 446
Operating expenses				
Operation and maintenance	49	51	140	147
Depreciation and amortization	22	21	65	63
Taxes, other than income taxes	8	7	24	22
	79	79	229	232
Operating income	43	66	164	214
Other income, net	1	1	2	2
Interest and debt expense	(23)	(23)	(70)	(69)
Affiliated interest income, net	4	4	12	14
Income before income taxes	25	48	108	161
Income taxes	10	18	42	61
Net income	$ 15	$ 30	$ 66	$ 100

See accompanying notes.

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EL PASO NATURAL GAS COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)
(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ —	$ —
Accounts and notes receivable		
Customer, net of allowance of $2 in 2010 and 2009	5	56
Affiliates	6	111
Other	18	3
Materials and supplies	47	47
Deferred income taxes	9	35
Prepaids	1	15
Other	8	11
Total current assets	94	278
Property, plant and equipment, at cost	3,951	3,899
Less accumulated depreciation and amortization	1,469	1,409
Total property, plant and equipment, net	2,482	2,490
Other assets		
Note receivable from affiliate	811	886
Other	108	110
	919	996
Total assets	$ 3,495	$ 3,764
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities		
Accounts payable		
Trade	$ 68	$ 83
Affiliates	23	42
Other	11	14
Current maturities of long-term debt	—	54
Taxes payable	48	103
Accrued interest	28	21
Accrued liabilities	24	82
Regulatory liabilities	7	17
Other	21	30
Total current liabilities	230	446
Long-term debt	1,113	1,113
Other liabilities		
Deferred income taxes	410	408
Other	75	71
	485	479

Commitments and contingencies (Note 4)				
Stockholder's equity				
Common stock, par value $1 per share; 1,000 shares authorized, issued and outstanding		—		—
Additional paid-in capital		1,268		1,268
Retained earnings		399		458
Total stockholder's equity		1,667		1,726
Total liabilities and stockholder's equity	$	3,495	$	3,764

See accompanying notes.

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EL PASO NATURAL GAS COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2010	2009
Cash flows from operating activities		
Net income	$ 66	$ 100
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	65	63
Deferred income taxes	28	—
Other non-cash income items	20	(1)
Asset and liability changes	(127)	143
Net cash provided by operating activities	52	305
Cash flows from investing activities		
Capital expenditures	(57)	(91)
Net change in note receivable from affiliate	178	(225)
Proceeds from disposal of property	4	14
Other	2	(3)
Net cash provided by (used in) investing activities	127	(305)
Cash flows from financing activities		
Payments to retire long-term debt	(54)	—
Dividend paid to parent	(125)	—
Net cash used in financing activities	(179)	—
Net change in cash and cash equivalents	—	—
Cash and cash equivalents		
Beginning of period	—	—
End of period	$ —	$ —

See accompanying notes.

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EL PASO NATURAL GAS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

We are an indirect wholly owned subsidiary of El Paso Corporation (El Paso). We prepared this Quarterly Report on Form 10-Q under the rules and regulations of the United States Securities and Exchange Commission. Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by U.S. generally accepted accounting principles. You should read this report along with our 2009 Annual Report on Form 10-K, which contains a summary of our significant accounting policies and other disclosures. The financial statements as of September 30, 2010, and for the quarters and nine months ended September 30, 2010 and 2009, are unaudited. We derived the condensed consolidated balance sheet as of December 31, 2009, from the audited balance sheet filed in our 2009 Annual Report on Form 10-K. In our opinion, we have made adjustments, all of which are of a normal, recurring nature to fairly present our interim period results. Due to the seasonal nature of our business, information for interim periods may not be indicative of our operating results for the entire year.

Significant Accounting Policies

The following is an update of our significant accounting policies and accounting pronouncements issued and adopted during the nine months ended September 30, 2010.

Transfers of Financial Assets. On January 1, 2010, we adopted an accounting standards update for financial asset transfers. Among other items, this update requires the sale of an entire financial asset or a proportionate interest in a financial asset in order to qualify for sale accounting. These changes were effective for sales of financial assets occurring on or after January 1, 2010. In February 2010, we entered into an accounts receivable sales program under which we sell certain accounts receivable in their entirety to a third party financial institution (through a wholly-owned special purpose entity). The transfer of these receivables qualifies for sale accounting under the provisions of this accounting standards update. We present the cash flows related to the accounts receivable sales program as operating cash flows in our statements of cash flows. For further information, see Note 5.

Variable Interest Entities. On January 1, 2010, we adopted an accounting standards update for variable interest entities that revises how companies determine the primary beneficiary of these entities, among other changes. Companies are now required to use a qualitative approach based on their responsibilities and power over the entities' operations, rather than a quantitative approach in determining the primary beneficiary as previously required. The adoption of this accounting standards update did not have a material impact on our financial statements.

2. Fair Value of Financial Instruments

At September 30, 2010 and December 31, 2009, the carrying amounts of cash and cash equivalents and current receivables and payables represented fair value because of the short-term nature of these instruments. At September 30, 2010 and December 31, 2009, we had an interest bearing note receivable from El Paso of approximately $0.8 billion and $1.0 billion due upon demand, with a variable interest rate of 1.5% in both periods. While we are exposed to changes in interest income based on changes to the variable interest rate, the fair value of this note receivable

approximates its carrying value due to the note being due on demand and the market-based nature of the interest rate.

In addition, the carrying amounts of our long-term debt and their estimated fair values, which are based on quoted market prices for the same or similar issues, are as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In millions)			
Long-term debt, including current maturities	$ 1,113	$ 1,295	$ 1,167	$ 1,300

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3. Debt

During the third quarter of 2010, we repaid approximately $54 million on our 7.625% notes due in August 2010.

4. Commitments and Contingencies

Legal Proceedings

Bank of America. We are a named defendant, along with Burlington Resources, Inc. (Burlington), now a subsidiary of ConocoPhillips Company, in a class action lawsuit styled Bank of America, et al. v. El Paso Natural Gas and Burlington Resources Oil and Gas Company, L.P., filed in October 2003 in the District Court of Kiowa County, Oklahoma asserting royalty underpayment claims related to specified shallow wells in Oklahoma, Texas and New Mexico. The Plaintiffs assert that royalties were underpaid starting in the 1980s when the purchase price of gas was lowered below the Natural Gas Policy Act maximum lawful prices. The Plaintiffs assert that royalties were further underpaid by Burlington as a result of post-production cost deductions taken starting in the late 1990s. This action was transferred to Washita County District Court in 2004. A tentative settlement reached in November 2005 was rejected by the court in June 2007. A class certification hearing occurred in April 2009. The court certified a Texas and Oklahoma class of royalty owners. The class certification has been appealed to the Oklahoma Court of Appeals. Our costs and legal exposure related to this lawsuit are not currently determinable.

In addition to the above proceeding, we and our affiliates are named defendants in numerous legal proceedings and claims that arise in the ordinary course of our business. For each of these matters, we evaluate the merits of the case or claim, our exposure to the matter, possible legal or settlement strategies and the likelihood of an unfavorable outcome. If we determine that an unfavorable outcome is probable and can be estimated, we establish the necessary accruals. While the outcome of these matters, including those discussed above, cannot be predicted with certainty, and there are still uncertainties related to the costs we may incur, based upon our evaluation and experience to date, we believe we have established appropriate reserves for these matters. It is possible, however, that new information or future developments could require us to reassess our potential exposure related to these matters and adjust our accruals accordingly, and these adjustments could be material. As of September 30, 2010, we had approximately $5 million accrued, which has not been reduced by $4 million of related insurance receivables, for our outstanding legal proceedings.

Environmental Matters

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require us to remove or remedy the effect of the disposal or release of specified substances at current and former operating sites. At September 30, 2010 and December 31, 2009, we had accrued approximately $16 million and $19 million for expected remediation costs and associated onsite, offsite and groundwater technical studies and for related environmental legal costs; however, we estimate that our exposure could be as high as $31 million at September 30, 2010. Our accrual at September 30, 2010 includes $15 million for environmental contingencies related to properties we previously owned.

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

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

For the remainder of 2010, we estimate that our total remediation expenditures will be approximately $2 million, most of which will be expended under government directed clean-up plans. In addition, we expect to make capital expenditures for environmental matters of $1 million in the aggregate for the remainder of 2010 through 2014. Included in this amount is less than $1 million to be expended from 2010 to 2013 associated with the impact of the Environmental Protection Agency (EPA) rule related to emissions of hazardous air pollutants from reciprocating internal combustion engines which was finalized in August 2010. Our engines that are subject to the regulations have to be in compliance by October 2013.

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

Rates and Regulatory Matters

EPNG Rate Case. In April 2010, the Federal Energy Regulatory Commission (FERC) approved an uncontested partial offer of settlement which increased our base tariff rates, effective January 1, 2009. As part of the settlement, we made an initial refund of approximately $23 million to our customers in April 2010, and paid the remaining refunds of approximately $53 million, plus interest, in August 2010. The settlement resolved all but four issues in the proceeding. A hearing on the remaining issues was completed in June 2010 and the outcome is not currently determinable. We believe our accruals established for this matter are adequate.

In September 2010, we filed a new rate case with the FERC proposing an increase in base tariff rates as permitted under the settlement of the previous rate case. In October 2010, the FERC issued an order accepting and suspending the effective date of the proposed rates to April 1, 2011, subject to refund, the outcome of a hearing and other proceedings. At this time, the outcome of this matter is not currently determinable.

Mojave Pipeline Company (Mojave) Rate Case. In August 2010, we filed a petition with the FERC to (i) amend our filing requirement previously approved by the FERC and (ii) approve an uncontested rate case settlement that, among other things, would establish new base transportation rates. Under the terms of the agreement, we may not file a new rate case to be effective any earlier than September 1, 2012, but must file a rate case to be effective no later than September 1, 2014. The FERC approved this settlement in October 2010 with an effective date of December 1, 2010.

Other Matter

Tuba City Uranium Milling Facility. For a period of approximately ten years beginning in the mid to late 1950s, Rare Metals Corporation of America, a historical affiliate, conducted uranium mining and milling operations in the vicinity of Tuba City, Arizona, under a contract with the United States government as part of the Cold War nuclear program. The site of the Tuba City uranium mill, which is on land within the Navajo Indian Reservation, reverted to the Navajo Nation after the mill closed in 1966. The tailings at the mill site were encapsulated and a ground water remediation system was installed by the U.S. Department of Energy (DOE) under the Federal Uranium Mill Tailings Radiation Control Act of 1978. In May 2007, we filed suit against the DOE and other federal agencies requesting a judicial determination that the DOE was fully and legally responsible for any remediation of any waste associated with historical uranium production activity at two sites in the vicinity of the mill facilities near Tuba City, Arizona. In March 2009, the United States District Court for the District of Columbia issued an opinion dismissing one of our claims. We have appealed this opinion to the Court of Appeals for the D.C. Circuit. Also in March 2009, following our close cooperation with the Navajo Nation in joint legislative efforts, President Obama signed the Fiscal Year 2009 Omnibus Appropriations Act, which appropriated $5 million toward the final remediation by the DOE of one of the two sites that are the subject of our lawsuit. The DOE has assigned to the Navajo Nation the obligation to remediate the site. We anticipate that the Navajo Nation will perform the remediation in the near future, and we are continuing to

maintain the interim exposure control measures we have installed at the site. Additionally, the EPA and Bureau of Indian Affairs (BIA) have entered into an administrative order of consent, pursuant to which the BIA will conduct a remedial investigation/feasibility study at the second site involved in the lawsuit. Finally, the EPA is currently assessing the environmental condition of all former uranium mines on the Navajo Indian Reservation to determine the need for further environmental response activities. There are approximately 500 abandoned uranium mine sites on the Navajo Indian Reservation, 16 of which were operated by the historical affiliate.

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While the outcome of these matters cannot be predicted with certainty, based on current information, we do not expect the ultimate resolution of these matters to have a material adverse effect on our financial position, operating results or cash flows. It is possible that new information or future developments could require us to reassess our potential exposure related to these matters. The impact of these changes may have a material effect on our results of operations, our financial position, and our cash flows in the periods these events occur.

Guarantees

We are or have been involved in various ownership and other contractual arrangements that sometimes require us to provide additional financial support that results in the issuance of financial and performance guarantees that are not recorded in our financial statements. During the third quarter of 2010, our financial and performance guarantees with a maximum exposure of approximately $11 million were terminated.

5. Accounts Receivable Sales Program

In the first quarter of 2010, we entered into an accounts receivable sales program to sell accounts receivable to a third party financial institution that qualify for sale accounting under the updated accounting standards related to financial asset transfers. Under this program, we sell receivables in their entirety to a third party financial institution (through a wholly-owned special purpose entity). As of September 30, 2010, the third-party financial institution held $38 million of the accounts receivable we sold under the program. In connection with our accounts receivable sales, we receive a portion of the sales proceeds up front and receive an additional amount upon the collection of the underlying receivables. Our ability to recover this additional amount is based solely on the collection of the underlying receivables. During the quarter and nine months ended September 30, 2010, we received $80 million and $255 million of cash up front from the sale of the receivables and received an additional $43 million and $141 million of cash upon the collection of the underlying receivables. As of September 30, 2010, we had not collected approximately $12 million related to our accounts receivable sales, which is reflected as other accounts receivable on our balance sheet (and was initially recorded at an amount which approximates its fair value using observable inputs other than quoted prices in active markets). We recognized a loss of less than $1 million on our accounts receivable sales during the quarter and nine months ended September 30, 2010. Because the cash received up front and the cash received as the underlying receivables are collected relate to the sale or ultimate collection of the underlying receivables, and are not subject to significant other risks given their short term nature, we reflect all cash flows under the new accounts receivable sales programs as operating cash flows on our statement of cash flows.

Under the accounts receivable sales program, we service the underlying receivables for a fee. The fair value of this servicing agreement as well as the fees earned were not material to our financial statements for the periods ended September 30, 2010.

The third party financial institution involved in this accounts receivable sales program acquires interests in various financial assets and issues commercial paper to fund those acquisitions. We do not consolidate the third party financial institution because we do not have the power to direct its overall activities since our receivables do not comprise a significant portion of its operations.

6. Transactions with Affiliates

Cash Management Program. We participate in El Paso's cash management program which matches short-term cash surpluses and needs of participating affiliates, thus minimizing total borrowings from outside sources. El Paso uses

the cash management program to settle intercompany transactions between participating affiliates. We have historically advanced cash to El Paso in exchange for an affiliated note receivable that is due upon demand. At September 30, 2010 and December 31, 2009, we had a note receivable from El Paso of approximately $0.8 billion and $1.0 billion. At September 30, 2010 and December 31, 2009, we have classified approximately $0.8 billion of our note receivable as non-current on our balance sheet as we do not anticipate using them in the next twelve months considering available cash sources and needs. The interest rate on this variable rate note was 1.5% at September 30, 2010 and December 31, 2009.

During 2009, we utilized $200 million of our note receivable from the cash management program to pay a dividend to our parent. During the third quarter of 2010, we utilized $125 million of our notes receivable from the cash management program to pay a dividend to our parent.

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Income Taxes. El Paso files consolidated U.S. federal and certain state tax returns which include our taxable income. In certain states, we file and pay taxes directly to the state taxing authorities. At September 30, 2010 and December 31, 2009, we had federal and state income taxes payable of $26 million and $90 million. The majority of these balances, as well as our deferred income taxes, will become payable to El Paso.

Other Affiliate Balances. At September 30, 2010 and December 31, 2009, we had contractual deposits from our affiliates of $9 million and $8 million included in other current liabilities on our balance sheets.

Affiliate Revenues and Expenses. We enter into transactions with our affiliates within the ordinary course of business. For a further discussion of our affiliated transactions, see our 2009 Annual Report on Form 10-K. The following table shows revenues and charges from our affiliates for the periods ended September 30:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In millions)			
Revenues from affiliates	$ 5	$ 5	$ 14	$ 15
Operation and maintenance expenses from affiliates	19	15	55	46
Reimbursement of operating expenses charged to affiliates	3	6	8	17

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

The information required by Item 2 is presented in a reduced disclosure format pursuant to General Instruction H to Form 10-Q. In addition, Item 2 updates, and should be read in conjunction with the information disclosed in our 2009 Annual Report on Form 10-K, and the financial statements and notes presented in Item 1 of this Quarterly Report on Form 10-Q.

Results of Operations

Our management uses earnings before interest expense and income taxes (EBIT) as a measure to assess the operating results and effectiveness of our business. We believe EBIT is useful to investors to provide them with the same measure used by El Paso to evaluate our performance. We define EBIT as net income adjusted for items such as (i) interest and debt expense, (ii) affiliated interest income, and (iii) income taxes. We exclude interest and debt expense from this measure so that investors may evaluate our operating results without regard to our financing methods. EBIT may not be comparable to measures used by other companies. Additionally, EBIT should be considered in conjunction with net income, income before income taxes and other performance measures such as operating income or operating cash flows. Below is a reconciliation of our EBIT to net income, our throughput volumes and an analysis and discussion of our results for the nine months ended September 30, 2010 compared with the same period in 2009.

Operating Results:

	2010	2009
	(In millions, except for volumes)	
Operating revenues	$393	$446
Operating expenses	(229)	(232)
Operating income	164	214
Other income, net	2	2
EBIT	166	216
Interest and debt expense	(70)	(69)
Affiliated interest income, net	12	14
Income taxes	(42)	(61)
Net income	$66	$100
Throughput volumes (BBtu/d)(1)	3,360	3,983

(1) Throughput volumes exclude throughput transported by the Mojave system on behalf of EPNG.

EBIT Analysis:

	Operating Revenue	Operating Expense	Total
	Favorable/(Unfavorable) (In millions)		
Reservation and other services revenues	$(53)	$—	$(53)
Operating and general and administrative expenses	—	7	7
Other(1)	—	(4)	(4)
Total impact on EBIT	$(53)	$3	$(50)

(1) Consists of individually insignificant items.

Reservation and Other Services Revenues. Reservation and other services revenues were lower for the nine months ended September 30, 2010 compared to 2009, primarily due to lower rates realized on the sale of transportation

capacity on our EPNG system and lower throughput volumes. During 2010, we have experienced a decrease in natural gas and electric generation demand due to weak macroeconomic conditions in the southwestern U.S., increased competition in our California and Arizona market areas and reduced basis differentials.

Although approximately 87 percent of our revenues are derived from reservation charges, lower throughput can affect our short-term results. Since a material portion of our revenues are derived from firm reservation charges, throughput can be an indication of the risks we may face when seeking to recontract or renew any of our existing firm transportation contracts. Continuing negative economic impacts on demand, as well as adverse shifting sources of supply, could negatively impact basis differentials and our ability to renew firm transportation contracts that are expiring on our system or our ability to renew such contracts at current rates. Additionally, we may be required to further discount certain transportation rates in order to renew certain firm transportation contracts should these conditions continue. If we determine there is sufficient change in our revenues, costs or billing determinants, we have the option to file a new rate case with the FERC to provide an opportunity to recover our prudently incurred costs. In September 2010, we filed a new rate case with the FERC proposing an increase in base tariff rates due, in part, to a change in our billing determinants. The change in gas flows, contractual commitments and the outcome of our rate case can impact the financial performance of our pipeline.

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Operating and General and Administrative Expenses. During the nine months ended September 30, 2010, our operating and general and administrative expenses decreased primarily as a result of decreased payroll related costs partially offset by higher allocated costs from our affiliates related to our shared pipeline services.

Regulatory Matters

EPNG Rate Case. In April 2010, the FERC approved an uncontested partial offer of settlement which increased our base tariff rates, effective January 1, 2009. As part of the settlement we made an initial refund of approximately $23 million to our customers in April 2010, and paid the remaining refunds of approximately $53 million, plus interest, in August 2010. The settlement resolved all but four issues in the proceeding. A hearing on the remaining issues was completed in June 2010 and the outcome is not currently determinable. We believe our accruals established for this matter are adequate.

In September 2010, we filed a new rate case with the FERC proposing an increase in base tariff rates as permitted under the settlement of the previous rate case. These new base tariff rates would increase revenue by approximately $100 million annually over previously effective tariff rates. In October 2010, the FERC issued an order accepting and suspending the effective date of the proposed rates to April 1, 2011, subject to refund, the outcome of a hearing and other proceedings. At this time, the outcome of this matter is not currently determinable.

Mojave Rate Case. In August 2010, we filed a petition with the FERC to (i) amend our filing requirement previously approved by the FERC and (ii) approve an uncontested rate case settlement that, among other things, would establish new base transportation rates. Under the terms of the agreement, we may not file a new rate case to be effective any earlier than September 1, 2012, but must file a rate case to be effective no later than September 1, 2014. The FERC approved this settlement in October 2010 with an effective date of December 1, 2010.

Although these rate cases are intended to address significant factors leading to the loss in revenues or increased costs, they will not eliminate all ongoing business risks.

Affiliated Interest Income, Net

The following table shows the average advances due from El Paso and the average short-term interest rates for the nine months ended September 30:

	2010		2009	
	(In billions, except for rates)			
Average advance due from El Paso	$ 1.1		$ 1.1	
Average short-term interest rate	1.5	%	1.8	%

Income Taxes

Our effective tax rates of 39 percent and 38 percent for the nine months ended September 30, 2010 and 2009 were higher than the statutory rate of 35 percent primarily due to the effect of state income taxes.

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Liquidity and Capital Resources

Our primary sources of liquidity are cash flows from operating activities and amounts available to us under El Paso's cash management program. At September 30, 2010, we had a note receivable from El Paso of approximately $0.8 billion. We do not intend to settle this note within the next twelve months and therefore, classified it as non-current on our balance sheet. During the third quarter of 2010, we utilized $125 million of our note receivable from the cash management program to pay a dividend to our parent. See Item 1, Financial Statements, Note 6, for a further discussion of El Paso's cash management program. During the third quarter of 2010, we repaid approximately $54 million of our 7.625% notes due in August 2010. Our primary uses of cash are for working capital, capital expenditures and debt service requirements. For the nine months ended September 30, 2010 compared to the same period in 2009, our operating cash flows decreased by approximately $250 million primarily due to the payment of income taxes during the third quarter of 2010 versus the fourth quarter of 2009, lower reservation revenues and payments of rate refunds. Our cash capital expenditures for the nine months ended September 30, 2010 were approximately $57 million and our estimated capital expenditures for the remainder of this year to maintain our systems are approximately $43 million.

Although financial market conditions have improved since late 2008 and early 2009, volatility in the remainder of 2010 and beyond in the financial markets could impact our longer-term access to capital for future growth projects as well as the cost of such capital. Additionally, although the impacts are difficult to quantify at this point, a prolonged recovery of the global economy could have adverse impacts on natural gas consumption and demand. However, we believe our exposure to changes in natural gas consumption and demand is largely mitigated by a revenue base that is significantly comprised of long-term contracts that are based on firm demand charges and are less affected by a potential reduction in the actual usage or consumption of natural gas.

We believe we have adequate liquidity available to us to meet our capital requirements and our existing operating needs through cash flows from operating activities and amounts available to us under El Paso's cash management program. In addition to the cash management program above, we are eligible to borrow amounts available under El Paso's $1.5 billion credit agreement and are only liable for amounts we directly borrow. As of September 30, 2010, El Paso had approximately $1.1 billion of capacity remaining and available to us and our affiliates under this credit agreement, and none of the amount outstanding under the facility was issued or borrowed by us. For a further discussion of this credit agreement, see our 2009 Annual Report on Form 10-K. While we do not anticipate a need to directly access the financial markets in the remainder of 2010 for any of our operating activities or expansion capital needs based on liquidity available to us, market conditions may impact our ability to act opportunistically.

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Commitments and Contingencies

Below is a summary of certain climate change, energy policies and pipeline integrity legislation recently enacted or proposed that, if enacted, will likely impact our business. For a further discussion of our commitments and contingencies, see Item 1, Financial Statements, Note 4, which is incorporated herein by reference.

Climate Change Legislation and Regulation. Legislative and regulatory efforts to address climate change and greenhouse gas (GHG) emissions are in various phases of discussions or implementation at international, federal, regional and state levels. We believe that legislation that either limits or sets a price on carbon emissions will increase demand for natural gas depending on the legislative provisions ultimately adopted. However, we also believe it is reasonably likely that the federal legislation being contemplated, as well as recently adopted and proposed federal regulations, would increase our cost of environmental compliance by requiring us to purchase emission allowances or offset credits, install additional equipment or change work practices, and could materially increase the cost of goods and services we purchase from suppliers due to their increased compliance costs. Although we believe that many of these costs should be recoverable in our rates, recovery through these mechanisms is still uncertain at this time.

The EPA has adopted regulations that require us to monitor and report certain GHG emissions from our operations on an annual basis. The EPA has proposed to further expand the monitoring and reporting requirements to additional natural gas transmission sources which could materially increase the costs of our operations. Our preliminary estimate of the first year cost to our company is approximately $1 million.

The EPA has also adopted regulations that will require permits to be obtained under the Clean Air Act for GHG emissions above certain thresholds. Depending on the thresholds ultimately established by the EPA, these permit requirements could have a material impact upon the cost of our operations, could require us to install new equipment to control emissions from our facilities and could result in delays and negative impacts on our ability to obtain permits and other regulatory approvals with regard to new and existing facilities. The EPA's regulations are being challenged in the federal courts; however, pending such judicial reviews, the thresholds that have been established by the EPA through at least 2016 are not expected to have a material impact on our operations or financial results.

It is uncertain what federal or state legislation or regulations will ultimately be adopted and whether adopted regulations will withstand likely legal challenges. Therefore, the potential impact on our operations and construction projects remains uncertain.

Energy Legislation. In conjunction with these climate change proposals, there have been various federal and state legislative and regulatory proposals that would create additional incentives to move to a less carbon intensive "footprint." Although it is reasonably likely that many of these proposals will be enacted over the next few years, we cannot predict the form of any laws and regulations that might be enacted, the timing of their implementation, or the precise impact on our operations or demand for natural gas. However, such proposals if enacted could impact natural gas demand over the longer term.

Air Quality Regulations. In February 2010, the EPA promulgated a new one-hour National Ambient Air Quality Standard (NAAQS) for oxides of nitrogen (NO2). The new standard is in addition to the existing annual NAAQS which was not changed. While it is uncertain how the EPA and the states will apply the new one-hour NAAQS, the new NAAQS may impact our ability to obtain permits and other regulatory approvals with regard to existing and new facilities and may cause us to incur costs to install additional controls on existing and new facilities. The EPA's new

rule is being challenged in the federal courts. While the new NAAQS, if upheld, could have a material impact on our cost of operations and our cost to install new facilities, we are unable, at this point, to estimate its financial impact.

Pipeline Integrity Legislation. Several ruptures on third party pipelines have occurred recently. In response, various legislative and regulatory reforms associated with pipeline safety and integrity issues have been proposed, including reforms that would require increased periodic inspections, installation of additional valves and other equipment on our pipelines and subjecting additional pipelines (including gathering facilities) to more stringent regulation. It is uncertain what reforms, if any, will be adopted and what impact they might ultimately have on our operations or financial results.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Omitted from this report pursuant to the reduced disclosure format permitted by General Instruction H to Form 10-Q.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of September 30, 2010, we carried out an evaluation under the supervision and with the participation of our management, including our President and Chief Financial Officer (CFO), as to the effectiveness, design and operation of our disclosure controls and procedures. This evaluation considered the various processes carried out under the direction of our disclosure committee in an effort to ensure that information required to be disclosed in the U.S. Securities and Exchange Commission reports we file or submit under the Securities Exchange Act of 1934, as amended (Exchange Act) is accurate, complete and timely. Our management, including our President and CFO, does not expect that our disclosure controls and procedures or our internal controls will prevent and/or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objective and our President and CFO concluded that our disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) were effective as of September 30, 2010.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the third quarter of 2010 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

CAUTIONARY STATEMENTS FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on assumptions or beliefs that we believe to be reasonable; however, assumed facts almost always vary from actual results, and differences between assumed facts and actual results can be material, depending upon the circumstances. Where, based on assumptions, 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 stated expectation or belief will occur, be achieved or accomplished. The words "believe," "expect," "estimate," "anticipate," and similar expressions will generally identify forward-looking statements. All of our forward-looking statements, whether written or oral, are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements. In addition, we disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this report.

Important factors that could cause actual results to differ materially from estimates or projections contained in forward-looking statements are described in our 2009 Annual Report on Form 10-K under Part I, Item 1A, Risk Factors. There have been no material changes in these risk factors since that report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Omitted from this report pursuant to the reduced disclosure format permitted by General Instruction H to Form 10-Q.

Item 3. Defaults Upon Senior Securities

Omitted from this report pursuant to the reduced disclosure format permitted by General Instruction H to Form 10-Q.

Item 4. (Removed and Reserved)

Item 5. Other Information

None.

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Item 6. Exhibits

The Exhibit Index is incorporated herein by reference.

The agreements included as exhibits to this report are intended to provide information regarding their terms and not to provide any other factual or disclosure information about us or the other parties to the agreements. The agreements may contain representations and warranties by the parties to the agreements, including us, solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- may have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a way that is different from what may be viewed as material to certain investors; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time.

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SIGNATURES

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

EL PASO NATURAL GAS COMPANY

Date: November 5, 2010

/s/ James J. Cleary
James J. Cleary
President
(Principal Executive Officer)

Date: November 5, 2010

/s/ John R. Sult
John R. Sult
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

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EL PASO NATURAL GAS COMPANY

EXHIBIT INDEX

Each exhibit identified below is filed as a part of this report.

Exhibit Number	Description
31.A	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.B	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.A	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.B	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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