EL PASO CORP/DE
Form 10-Q
May 09, 2008

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

o **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 1-14365

El Paso Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**76-0568816**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
El Paso Building 1001 Louisiana Street Houston, Texas	**77002**
(Address of Principal Executive Offices)	*(Zip Code)*

Telephone Number: (713) 420-2600

Internet Website: www.elpaso.com

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 þ No o

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. (Check one):

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

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

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 $3 per share. Shares outstanding on May 6, 2008: 702,325,215

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Caption **Page**

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

/d	= per day	Mcfe	= thousand cubic feet of natural gas equivalents
Bbl	= barrels	MMBtu	= million British thermal units
BBtu	= billion British thermal units	MMcf	= million cubic feet
Bcf	= billion cubic feet	MMcfe	= million cubic feet of natural gas equivalents
LNG	= liquefied natural gas	NGL	= natural gas liquids
MBbls	= thousand barrels	TBtu	= trillion British thermal units
Mcf	= thousand cubic feet		

When we refer to natural gas and oil in equivalents, we are doing so to compare quantities of oil with quantities of natural gas or to express these different commodities in a common unit. In calculating equivalents, we use a generally recognized standard in which one Bbl of oil is equal to six Mcf of natural gas. Also, 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 El Paso , we are describing El Paso Corporation and/or subsidiaries.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In millions, except per common share amounts)
(Unaudited)

	Quarter Ended March 31, 2008	Quarter Ended March 31, 2007
Operating revenues	$ 1,269	$ 1,022
Operating expenses		
Cost of products and services	56	55
Operation and maintenance	271	301
Depreciation, depletion and amortization	313	271
Taxes, other than income taxes	79	60
	719	687
Operating income	550	335
Earnings from unconsolidated affiliates	37	37
Loss on debt extinguishment		(201)
Other income, net	22	46
Minority interest	(9)	(1)
Interest and debt expense	(233)	(283)
Income (loss) before income taxes from continuing operations	367	(67)
Income taxes	148	(19)
Income (loss) from continuing operations	219	(48)
Discontinued operations, net of income taxes		677
Net income	219	629
Preferred stock dividends	19	9
Net income available to common stockholders	$ 200	$ 620
Basic and diluted earnings per common share		
Income (loss) from continuing operations	$ 0.29	$ (0.08)
Discontinued operations, net of income taxes		0.97
Net income per common share	$ 0.29	$ 0.89
Dividends declared per common share	$ 0.08	$ 0.04

See accompanying notes.

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

	March 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 498	$ 285
Accounts and notes receivable		
Customers, net of allowance of $17 in 2008 and 2007	691	468
Affiliates	150	196
Other	172	201
Inventory	132	131
Assets from price risk management activities	45	113
Deferred income taxes	285	191
Other	155	127
Total current assets	2,128	1,712
Property, plant and equipment, at cost		
Pipelines	16,925	16,750
Natural gas and oil properties, at full cost	18,616	19,048
Other	307	530
	35,848	36,328
Less accumulated depreciation, depletion and amortization	17,071	16,974
Total property, plant and equipment, net	18,777	19,354
Other assets		
Investments in unconsolidated affiliates	1,846	1,614
Assets from price risk management activities	326	302
Other	1,589	1,597
	3,761	3,513
Total assets	$ 24,666	$ 24,579

See accompanying notes.

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EL PASO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except for share amounts)
(Unaudited)

	March 31, 2008	December 31, 2007
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable		
Trade	$ 445	$ 460
Affiliates	9	5
Other	432	502
Current maturities of long-term financing obligations	366	331
Liabilities from price risk management activities	440	267
Accrued interest	230	195
Other	748	653
Total current liabilities	2,670	2,413
Long-term financing obligations, less current maturities	12,322	12,483
Other		
Liabilities from price risk management activities	896	931
Deferred income taxes	1,337	1,157
Other	1,565	1,750
	3,798	3,838
Commitments and contingencies (Note 8)		
Minority interest	547	565
Stockholders equity		
Preferred stock, par value $0.01 per share; authorized 50,000,000 shares; issued 750,000 shares of 4.99% convertible perpetual stock; stated at liquidation value	750	750
Common stock, par value $3 per share; authorized 1,500,000,000 shares; issued 709,548,833 shares in 2008 and 709,192,605 shares in 2007	2,129	2,128
Additional paid-in capital	4,639	4,699
Accumulated deficit	(1,610)	(1,834)
Accumulated other comprehensive loss	(387)	(272)
Treasury stock (at cost); 8,699,603 shares in 2008 and 8,656,095 shares in 2007	(192)	(191)
Total stockholders equity	5,329	5,280
Total liabilities and stockholders equity	$ 24,666	$ 24,579

See accompanying notes.

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EL PASO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Quarter Ended March 31, 2008	Quarter Ended March 31, 2007
Cash flows from operating activities		
Net income	$ 219	$ 629
Less income from discontinued operations, net of income taxes		677
Income (loss) from continuing operations	219	(48)
Adjustments to reconcile net income to net cash from operating activities		
Depreciation, depletion and amortization	313	271
Deferred income tax expense (benefit)	146	(18)
Earnings from unconsolidated affiliates, adjusted for cash distributions	23	37
Loss on debt extinguishment		201
Other non-cash income items	15	(2)
Asset and liability changes	(82)	(93)
Cash provided by continuing activities	634	348
Cash used in discontinued activities		(35)
Net cash provided by operating activities	634	313
Cash flows from investing activities		
Capital expenditures	(531)	(528)
Cash paid for acquisitions	(295)	(255)
Net proceeds from the sale of assets and investments	598	38
Other	37	2
Cash used in continuing activities	(191)	(743)
Cash provided by discontinued activities		3,678
Net cash provided by (used in) investing activities	(191)	2,935
Cash flows from financing activities		
Net proceeds from issuance of long-term debt	1,240	1,424
Payments to retire long-term debt and other financing obligations	(1,430)	(4,654)
Dividends paid	(38)	(37)
Contributions from discontinued operations		3,360
Other	(2)	(3)
Cash provided by (used in) continuing activities	(230)	90
Cash used in discontinued activities		(3,643)

Net cash used in financing activities	(230)	(3,553)
Change in cash and cash equivalents	213	(305)
Cash and cash equivalents		
Beginning of period	285	537
End of period	$ 498	$ 232

See accompanying notes.

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EL PASO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)
(Unaudited)

	Quarter Ended March 31, 2008	Quarter Ended March 31, 2007
Net income	$ 219	$ 629
Pension and postretirement obligations:		
Unrealized actuarial losses arising during period (net of income taxes of $1 in 2008)	(2)	
Reclassification adjustments (net of income taxes of $2 in 2008 and $3 in 2007)	5	6
Cash flow hedging activities:		
Unrealized mark-to-market losses arising during period (net of income taxes of $70 in 2008 and $47 in 2007)	(123)	(83)
Reclassification adjustments for changes in initial value to the settlement date (net of income taxes of $1 in 2008 and $15 in 2007)	2	(25)
Investments available for sale:		
Unrealized gains on investments available for sale arising during period (net of income taxes of $2 in 2007)		3
Other comprehensive loss	(118)	(99)
Comprehensive income	$ 101	$ 530

See accompanying notes.

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EL PASO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

We prepared this Quarterly Report on Form 10-Q under the rules and regulations of the United States Securities and Exchange Commission (SEC). Because this is an interim period filing presented using a condensed format, it does not include all of the disclosures required by U.S. generally accepted accounting principles. You should read this Quarterly Report on Form 10-Q along with our 2007 Annual Report on Form 10-K, which contains a summary of our significant accounting policies and other disclosures. The financial statements as of March 31, 2008, and for the quarters ended March 31, 2008 and 2007, are unaudited. We derived the condensed consolidated balance sheet as of December 31, 2007, from the audited balance sheet filed in our 2007 Annual Report on Form 10-K. In our opinion, we have made all adjustments which are of a normal, recurring nature to fairly present our interim period results. Due to the seasonal nature of our businesses, information for interim periods may not be indicative of our operating results for the entire year. Our financial statements for prior periods include reclassifications that were made to conform to the current period presentation. Those reclassifications did not impact our reported net income or stockholders equity.

Significant Accounting Policies

The information below provides an update of our significant accounting policies and accounting pronouncements issued but not yet adopted as discussed in our 2007 Annual Report on Form 10-K.

Fair Value Measurements. On January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, for our financial assets and liabilities. We elected to defer the adoption of SFAS No. 157 for our non-financial assets and liabilities until January 1, 2009. The impact of adopting SFAS No. 157 was both a pre-tax increase to operating revenues of $6 million and to other comprehensive income of $4 million, and a reduction of our liabilities of $10 million, which represented the impact of the consideration of our credit standing in determining the value of our price risk management liabilities.

Measurement Date of Postretirement Benefits. Effective January 1, 2008, we adopted the measurement date provisions of SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106, and 132(R)* and changed the measurement date of our postretirement benefit plans from September 30 to December 31. We recorded a $5 million decrease, net of income taxes of $2 million, to the January 1, 2008 accumulated deficit and a $3 million decrease, net of income taxes of $2 million, to the January 1, 2008 accumulated other comprehensive loss upon the adoption of the measurement date provisions of this standard to reflect an additional three months of net periodic benefit cost based on our September 30, 2007 measurement.

Derivative Instruments. In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*, which requires expanded disclosures about derivative instruments. This standard requires companies to disclose their purpose for using derivative instruments, how those derivatives are accounted for under SFAS No. 133, and where the impacts of those derivatives are reflected in the financial statements. The provisions of this standard are effective for fiscal years beginning after November 15, 2008, and we are currently evaluating the impact that the adoption of this standard will have on our financial statement disclosures.

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2. Acquisitions and Divestitures

Acquisitions

Gulf LNG. In February 2008, we paid $295 million to complete the acquisition of a 50 percent interest in the Gulf LNG Clean Energy Project, an LNG terminal which is currently under construction in Pascagoula, Mississippi. The terminal is expected to be placed in service in late 2011 at an estimated total cost of $1.1 billion. In addition, we have a commitment to loan Gulf LNG up to $150 million under which we had advanced $1 million as of March 31, 2008. Our partner in this project has commitment to loan up to $64 million. We account for our investment in Gulf LNG using the equity method.

South Texas properties. In January 2007, we acquired operated natural gas and oil producing properties and undeveloped acreage in south Texas for approximately $254 million.

Divestitures

Under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we classify assets to be disposed of as held for sale or, if appropriate, discontinued operations when they have received appropriate approvals to be disposed of by our management or Board of Directors and when they meet other criteria. Cash flows from our discontinued businesses are reflected as discontinued operating, investing, and financing activities in our statement of cash flows. To the extent these operations do not maintain separate cash balances, we reflect the net cash flows generated from these businesses as a contribution to our continuing operations in cash from continuing financing activities.

Continuing operations asset sales. During the first quarter of 2008, we completed the sale of certain non-core Gulf of Mexico, Onshore and Texas Gulf Coast natural gas and oil properties for net cash proceeds of approximately $600 million.

Discontinued Operations. The following is a description of our discontinued operations and summarized results of these operations for the quarter ended March 31, 2007. As of March 31, 2008, all our assets and liabilities related to our discontinued operations and assets held for sale had been sold.

In February 2007, we sold ANR, our Michigan storage assets and our 50 percent interest in Great Lakes Gas Transmission for approximately $3.7 billion. During the first quarter of 2007, we recorded a gain on the sale of $651 million, net of taxes of $356 million. Included in the net assets of these discontinued operations as of the date of sale were net deferred tax liabilities assumed by the purchaser. Below is summarized income statement information regarding our discontinued operations:

	ANR and Related Operations (In millions)
Quarter Ended March 31, 2007	
Revenues	$ 101
Costs and expenses	(43)
Other expense	(7)
Interest and debt expense	(10)
Income taxes	(15)
Income from operations	26
Gain on sale, net of income taxes of $356 million	651
Net income from discontinued operations	$ 677

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3. Income Taxes

Income taxes included in our income from continuing operations for the quarters ended March 31 were as follows:

	2008	2007
	(In millions, except rates)	
Income taxes	$ 148	$ (19)
Effective tax rate	40%	28%

We compute interim period income taxes by applying an anticipated annual effective tax rate to our year-to-date income or loss, except for significant unusual or infrequently occurring items. Significant tax items are recorded in the period that the item occurs.

During the first quarter of 2008, our effective tax rate was higher than the statutory rate primarily due to the tax impact of adjusting our postretirement benefit obligations (See Note 9). During the first quarter of 2007, our overall effective tax rate on continuing operations was lower than the statutory rate of 35 percent primarily due to earnings from unconsolidated affiliates where we anticipate receiving dividends and state income taxes (net of federal tax benefit) .

4. Earnings Per Share

We calculated basic and diluted earnings per common share as follows for the quarters ended March 31:

	2008 [1]		2007	
	Basic	Diluted	Basic	Diluted
	(In millions, except per share amounts)			
Income (loss) from continuing operations	$ 219	$ 219	$ (48)	$ (48)
Convertible preferred stock dividends	(19)[1]	(19)[1]	(9)	(9)
Income (loss) from continuing operations available to common stockholders	200	200	(57)	(57)
Discontinued operations, net of income taxes			677	677
Net income available to common stockholders	$ 200	$ 200	$ 620	$ 620
Weighted average common shares outstanding	697	697	694	694
Effect of dilutive securities:				
Options and restricted stock		4		
Weighted average common shares outstanding and dilutive securities	697	701	694	694
Earnings per common share:				
Income (loss) from continuing operations	$ 0.29	$ 0.29	$ (0.08)	$ (0.08)
Discontinued operations, net of income taxes			0.97	0.97
Net income	$ 0.29	$ 0.29	$ 0.89	$ 0.89

[1] Includes dividends declared in February 2008 and March 2008 (see Note 10).

We exclude potentially dilutive securities (such as employee stock options, restricted stock, convertible preferred stock and trust preferred securities) from the determination of diluted earnings per share when their impact on income from continuing operations per common share is antidilutive. For the quarter ended March 31, 2008, certain of our employee stock options, our convertible preferred stock, and our trust preferred securities were antidilutive. For the quarter ended March 31, 2007, we incurred losses from continuing operations and accordingly excluded all of our potentially dilutive securities from the determination of diluted earnings per share as their impact on loss per common share was antidilutive. For a further discussion of our potentially dilutive securities, see our 2007 Annual Report on Form 10-K.

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5. Fair Value Measurements

On January 1, 2008, we adopted the provisions of SFAS No. 157, *Fair Value Measurements*, and SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, for our financial assets and liabilities. SFAS No. 157 expands the disclosure requirements for financial instruments and other derivatives recorded at fair value, and also requires that a company s own credit risk be considered in determining the fair value of those instruments. The adoption of SFAS No. 157 resulted in a $6 million increase in operating revenues, a $4 million pre-tax increase in other comprehensive income, and a $10 million reduction of our liabilities to reflect the consideration of our credit risk on our liabilities that are recorded at fair value. SFAS No. 159 provided us the option to record most financial assets and liabilities at fair value on an instrument-by-instrument basis with changes in their fair value reported through the income statement. The adoption of SFAS No. 159 had no impact on our financial statements as we elected not to adopt fair value accounting at the present time for our applicable financial assets and liabilities.

We use various methods to determine the fair values of our financial instruments and other derivatives which depend on a number of factors, including the availability of observable market data over the contractual term of the underlying instrument. For some of our instruments, the fair value is calculated based on directly observable market data or data available for similar instruments in similar markets. For other instruments, the fair value may be calculated based on these inputs as well as other assumptions related to estimates of future settlements of these instruments. We separate our financial instruments and other derivatives into three levels (Levels 1, 2 and 3) based on our assessment of the availability of observable market data and the significance of non-observable data used to determine the fair value of our instruments. Our assessment of an instrument can change over time based on the maturity or liquidity of the instrument, which could result in a change in the classification of the instruments between levels. Each of these levels and our corresponding instruments classified by level are further described below:

Level 1 instruments fair values are based on quoted prices in actively traded markets. Included in this level are our marketable securities invested in non-qualified compensation plans whose fair value is determined using quoted prices of these instruments.

Level 2 instruments fair values are based on pricing data representative of quoted prices for similar assets and liabilities in active markets (or identical assets and liabilities in less active markets). Included in this level are our production-related natural gas and oil derivatives and certain of our other natural gas derivatives (such as natural gas supply arrangements) whose fair values are based on commodity pricing data obtained from an independent pricing source.

Level 3 instruments fair values are partially calculated using pricing data that is similar to Level 2 above, but their fair value also reflects adjustments for being in less liquid markets or having longer contractual terms. For these instruments, we use available pricing data adjusted for liquidity and/or contractual terms to develop an estimate of forward price curves. The curves are then used to estimate the value of settlements in future periods based on contractual settlement quantities and dates. Our valuation of these instruments considers specific contractual terms, statistical and simulation analysis, present value concepts and other internal assumptions related to (i) contract maturities that extend beyond the periods in which quoted market prices are available; (ii) the uniqueness of the contract terms and (iii) the lack of viable market participants. Since a significant portion of the fair value of our power-related derivatives, interest rate and foreign currency swaps and certain of our remaining natural gas derivatives with longer terms or in less liquid markets than similar Level 2 derivatives, rely on the techniques discussed above, we classify these instruments as Level 3 instruments.

Listed below are our financial instruments classified in each level and a description of the significant inputs utilized to determine their fair value at March 31, 2008 follows (in millions):

	Level 1	Level 2	Level 3