

SOUTHWEST GAS STORAGE COMPANY

Comparative Balance Sheet
(Unaudited)

Line No.	Description	April 30	
		2006 (a)	2007 (b)
Assets and Other Debits			
Utility Plant:			
1	Utility Plant	\$ 151,705,456	\$ 153,376,229
2	Construction Work in Progress	113,093	2,083,498
3	Total Utility Plant	151,818,549	155,459,727
4	(Less) Accum Provision for Depreciation & Amort	113,355,343	118,753,050
5	Net Utility Plant	38,463,206	36,706,677
6	Nuclear Fuel	-	-
7	(Less) Accum Provision for Amort. of Nuclear Fuel Assem	-	-
8	Nuclear Fuel	-	-
9	Net Utility Plant	38,463,206	36,706,677
10	Utility Plant Adjustments	-	-
11	Gas Stored - Base Gas	86,246,101	86,246,101
12	System Balancing Gas	-	425,565
13	Gas Stored in Reservoirs and Pipelines-Noncurrent	-	-
14	Gas Owned to System Gas	-	-
Other Property and Investments:			
15	Nonutility Property	-	-
16	(Less) Accum Provision for Depreciation & Amort	-	-
17	Investments in Associated Companies	28,966,803	6,431,123
18	Investments in Subsidiary Companies	-	-
19	Noncurrent Portion of Allowances	-	-
20	Other Investments	-	-
21	Sinking Funds	-	-
22	Depreciation Fund	-	-
23	Amortization Fund - Federal	-	-
24	Other Special Funds	-	-
25	Long-Term Portion of Derivative Assets	-	-
26	Long-term Portion of Derivative Assets - Hedges	-	-
27	Total Other Property and Investments	28,966,803	6,431,123
Current and Accrued Assets:			
28	Cash	-	-
29	Special Deposits	-	-
30	Working Funds	-	-
31	Temporary Cash Investments	-	-
32	Notes Receivable	-	-
33	Customer Accounts Receivable	-	-
34	Other Accounts Receivable	-	-
35	(Less) Accum Provision for Uncollectible Accounts	-	-
36	Notes Receivable from Associated Companies	-	-
37	Accounts Receivable from Associated Companies	3,691,625	3,811,157
38	Fuel Stock	-	-
39	Fuel Stock Expenses Undistributed	-	-
40	Residuals (Elec) and Extracted Products (Gas)	-	-
41	Plant Materials and Operating Supplies	110,539	108,531
42	Merchandise	-	-
43	Other Materials and Supplies	-	-
44	Nuclear Materials Held for Sale	-	-
45	Allowances	-	-
46	(Less) Noncurrent Portion of Allowances	-	-
47	Stores Expense Undistributed	-	-
48	Gas Stored Underground - Current	-	-
49	Liquefied Natural Gas Stored and held for Processing	-	-
50	Prepayments	52,063	42,979

(See Notes to Financial Statement)

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Line No.	Description	April 30	
		2006 (a)	2007 (b)
51	Advances for Gas	-	-
52	Interest and Dividends Receivable	-	-
53	Rents Receivable	-	-
54	Accrued Utility Revenues	-	-
55	Miscellaneous Current and Accrued Assets	-	-
56	Derivatives Instrument Assets	-	-
57	(Less) Long-Term Portion of Derivative Instrument Assets	-	-
58	Derivatives Instrument Assets-Hedges	-	-
59	(Less) Long-Term Portion of Derivative Instrument Assets - Hedg	-	-
60	Total Current and Accrued Assets	<u>3,854,227</u>	<u>3,962,667</u>
	Deferred Debits:		
61	Unamortized Debt Expense	-	-
62	Extraordinary Property Losses	-	-
63	Unrecovered Plant and Regulatory Study Costs	-	-
64	Other Regulatory Assets	1,315,057	187,108
65	Preliminary Survey and Investigation Charges (Electric)	-	-
66	Preliminary Survey and Investigation Charges (Gas)	-	1,117
67	Clearing Account	-	-
68	Temporary Facilities	-	-
69	Miscellaneous Deferred Debits	25,372	24,188
70	Drfd Losses from Disposition of Utility Plant	-	-
71	Research, Development & Demonstration Exp	-	-
72	Unamortized Loss on Reacquired Debt	-	-
73	Accumulated Deferred Income Taxes	14,500,000	14,044,000
74	Unrecovered Purchased Gas Costs	-	-
75	Total Deferred Debits	<u>15,840,429</u>	<u>14,256,413</u>
76	Total Assets and Other Debits	<u>\$ 173,370,766</u>	<u>\$ 148,028,546</u>
	Liabilities and Other Credits		
	Proprietary Capital:		
77	Common Stock Issued	\$ -	\$ -
78	Preferred Stock Issued	-	-
79	Capital Stock Subscribed	-	-
80	Stock Liability for Conversion	-	-
81	Premium of Capital Stock	-	-
82	Other Paid-In Capital	163,068,697	139,904,287
83	Installments Received on Capital Stock	-	-
84	(Less) Discount on Capital Stock	-	-
85	(Less) Capital Stock Expense	-	-
86	Retained Earnings	-	-
87	Unappropriated Undistributed Sub Earnings	-	-
88	(Less) Reacquired Capital Stock	-	-
89	Accumulated Other Comprehensive Income	-	-
90	Total Proprietary Capital	<u>163,068,697</u>	<u>139,904,287</u>
	Long-Term Debt:		
91	Bonds	-	-
92	(Less) Reacquired Bonds	-	-
93	Advances From Associated Companies	-	-
94	Other Long-Term Debt	-	-
95	Unamortized Premium on Long-Term Debt	-	-
96	(Less) Unamortized Discount on Long-Term Debt	-	-
97	(Less) Current Portion of Long-Term Debt	-	-
98	Total Long-Term Debt	<u>-</u>	<u>-</u>

(See Notes to Financial Statement)

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(Unaudited)

Line No.	Description	April 30	
		2006 (a)	2007 (b)
	Other Noncurrent Liabilities:		
99	Obligations Under Capital Leases	-	-
100	Accumulated Provision for Property Insurance	-	-
101	Accum Provision for Injuries and Damages	-	-
102	Accum Provision for Pensions and Benefits	-	-
103	Accum Miscellaneous Operating Provisions	-	-
104	Accumulated Provision for Rate Refunds	-	-
105	Long-Term Portion of Derivative Instrument Liabilities	-	-
106	Long-Term Portion of Derivative Instrument Liabilities - Hedges	-	-
107	Asset Retirement Obligations	-	-
108	Total Other Noncurrent Liabilities	-	-
	Current and Accrued Liabilities:		
109	Current Portion of Long-Term Debt	-	-
110	Notes Payable	-	-
111	Accounts Payable	259,901	1,465,749
112	Notes Payable to Associated Companies	-	-
113	Accounts Payable to Associated Companies	-	20,305
114	Customer Deposits	-	-
115	Taxes Accrued	2,821,793	2,213,947
116	Interest Accrued	-	-
117	Dividends Declared	-	-
118	Matured Long-Term Debt	-	-
119	Matured Interest	-	-
120	Tax Collections Payable	-	-
121	Miscellaneous Current and Accrued Liabilities	205,134	271,081
122	Obligations Under Capital Leases	-	-
123	Derivatives Instruments Liabilities	-	-
124	(Less) Long-Term Portion of Derivative Instrument Liabilities	-	-
125	Derivatives Instruments Liabilities - Hedges	-	-
126	(Less) Long-Term Portion of Derivative Instrument Liabilities - He	-	-
127	Total Current and Accrued Liabilities	3,286,828	3,971,082
	Deferred Credits:		
128	Customer Advances for Construction	-	-
129	Accumulated Deferred Investment Tax Credits	-	-
130	Dfrd Gains from Disposition of Utility Plant	-	-
131	Other Deferred Credits	252,292	251,813
132	Other Regulatory Liabilities	3,125,949	2,693,364
133	Unamortized Gain on Reacquired Debt	-	-
134	Accumulated Deferred Income Taxes - Accelerated Amortization	-	-
135	Accumulated Deferred Income Taxes - Other Property	2,272,000	1,093,000
136	Accumulated Deferred Income Taxes - Other	1,365,000	115,000
137	Total Deferred Credits	7,015,241	4,153,177
138	Total Liabilities and Other Credits	\$ 173,370,766	\$ 148,028,546

(See Notes to Financial Statement)

SOUTHWEST GAS STORAGE COMPANY

Condensed Notes to Financial Statements April 30, 2007 and 2006 (Unaudited)

Financial Statements

The accompanying unaudited reports of Southwest Gas Storage Company (Southwest), compiled from separate company ledgers and reports, are intended for rate filing purposes only. Certain information and notes which are normally included in financial statements have been condensed or omitted, although Southwest believes the disclosures are adequate for the interim information presented herein.

1. Corporate Structure

Pan Gas Storage, LLC (*Pan Gas*), a direct wholly-owned subsidiary of Panhandle Eastern Pipe Line Company, LP (*PEPL*), is a Delaware single member limited liability company "doing business as" Southwest Gas Storage Company. Southwest is engaged in interstate storage of natural gas, and, as such, is subject to the rules, regulations and accounting requirements of the Federal Energy Regulatory Commission (*FERC*).

On June 11, 2003, Southern Union Company (*SU*) acquired *PEPL* and all of its subsidiaries (collectively, *Panhandle*), including Southwest (*the Panhandle Acquisition*), from CMS Gas Transmission Company (*CMS Gas Transmission*), a subsidiary of CMS Energy Corporation (together with CMS Gas Transmission, *CMS*).

The *Panhandle Acquisition* was treated as an asset acquisition for tax purposes pursuant to Section 338(h) (10) election of the Internal Revenue Code of 1986, as amended, which gave rise to a new tax basis in Southwest's net assets equal to their purchase price. *SU* also structured the *Panhandle Acquisition* in a manner intended to qualify as a like-kind exchange of property under Section 1031 of the Internal Revenue Code of 1986, as amended. As a result of the like-kind exchange, the new tax basis is reduced by the amount of the deferred gain associated with the like-kind exchange.

Southwest converted from a corporation to a Delaware limited liability company on December 1, 2001. As a result of the conversion, capital stock and retained earnings were reclassified in 2004 as member capital to follow the Accounting Standards Executive Committee (*AcSEC*) of the AICPA's guidance as to the preferable reporting for a limited liability company. There was no effect on Southwest's results of operations (including income taxes), cash flows or financial position.

2. Summary of Significant Accounting Policies and Other Matters

Basis of Presentation. The financial statements presented herein are prepared in accordance with the accounting requirements of the *FERC*, as set forth in the applicable Uniform System of Accounts and published accounting releases, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (*GAAP*). The most significant differences between *GAAP* and the financial statements presented herein are: (1) the classification of certain accounts on the balance sheet, statement of income and the statement of cash flows, (2) classification of certain purchase accounting related impacts from the acquisition by Southern Union Company (*SU*) on June 11, 2003 including purchase cost allocations which are not reflected in the financial statements presented herein in the same accounts as in *GAAP* based statements, (3) discontinuance of Statement of Financial Accounting Standard (*SFAS*) No. 71 in 1999, which results in differences versus *GAAP* financial statements for items such as regulatory asset amortization, depreciation, and allowance for

funds used during construction (AFUDC), (4) classification of intercompany loans and advances, which may be different for GAAP purposes.

Use of Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions include, but are not specifically limited to: useful lives for depreciation and amortization, interest rates, inflation rates, areas of FERC regulations, future cash flows associated with assets, impact of new accounting standards, future costs associated with long-term contractual obligations and future compliance costs associated with environmental regulations. Although these estimates are based on management's knowledge of current and expected future events, actual results could differ from those estimates.

Cash and Cash Equivalents. All liquid investments with maturities of three months or less at the date of purchase are considered cash equivalents. The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of these investments.

Plant Materials and Operating Supplies. Plant materials and operating supplies are carried at the weighted-average cost.

Fuel Tracker. Regulatory assets are recorded for net volumes of fuel gas owed by customers, collectively. Liability amounts are maintained for net volumes of fuel gas owed to customers collectively. The fuel reimbursement is in-kind and non-discountable.

Gas Stored-Base Gas. Base gas is recorded using the weighted-average cost inventory method. Balances at April 30, 2007 and 2006 were \$86.2 million.

Utility Plant. Utility Plant is stated at original cost. Southwest capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. The cost of renewals and betterments that extend the useful life of utility plant is also capitalized. The cost of repairs and replacements of minor items of utility plant is charged to expense as incurred.

When utility plant is retired, the original cost plus cost of removal less salvage is charged to accumulated depreciation and amortization. When entire regulated operating units of utility plant are sold or non-regulated properties are sold, the property and related accumulated depreciation and amortization accounts are reduced, and any gain or loss is recorded in income.

Depreciation of Utility Plant included in Net Utility Operating Income is generally computed using the straight-line method based on FERC-approved depreciation rates.

Computer software, which is a component of utility plant, is stated at cost and is generally amortized on a straight-line basis over its useful life on a product-by-product basis. The amortization period for computer software is between four and ten years. To the extent that related parties share computer software, the cost basis of the capitalized software may be allocated amongst those related parties benefiting

Asset Impairment. Southwest applies the provisions of Financial Accounting Standards Board (FASB) Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to account for impairments on long-lived assets. Impairment losses are recognized for long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows are not sufficient to recover the assets' carrying value. The amount of impairment is measured by comparing the fair value of the asset to its carrying amount.

Related Party Transactions. All of Southwest's storage revenues are with its parent company, PEPL. Related party expenses include payments for services provided by SU, as well as allocated employee

benefit plan costs. Expenses are generally charged based on either actual usage of services or allocated based on estimates of time spent working for the benefit of the various affiliated companies. Management and royalty fees charged to PEPL by SU are being allocated to Southwest based on a percentage applied to Southwest's gross revenue.

Revenues. Southwest's revenues from storage of natural gas are based on capacity reservation charges and commodity injection/withdrawal charges. Reservation revenues are based on contracted rates and capacity reserved by the customers and are recognized monthly. Revenues from commodity charges are also recognized monthly, based on the volumes injected and withdrawn from the storage facilities. Currently Southwest's only customer is its parent, PEPL.

Allowance for Funds Used During Construction (AFUDC). Southwest capitalizes the cost of funds used on major projects during construction. The rates used by Southwest are calculated pursuant to FERC rules, which include an allowance for the cost of debt and equity funds.

Income Taxes. For federal and certain state income tax purposes, Southwest is not treated as a separate taxpayer; instead, its income is directly taxable to SU. Pursuant to a tax sharing agreement with PEPL and SU, Southwest will pay its share of taxes based on its taxable income, which will generally equal the liability that Southwest would have incurred as a separate taxpayer.

Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates.

3. New Accounting Principles

FIN 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109" (FIN 48): Issued by the Financial Accounting Standards Board (FASB) in June 2006, the Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition and measurement threshold attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. FERC issued related guidance on May 25, 2007 in Docket No. AI07-2-000. Southwest's financial statements have not been materially impacted by the adoption of FIN 48 and related FERC guidance as of January 1, 2007.

Accounting Principles Not Yet Adopted.

FASB Statement No. 157, "Fair Value Measurements": Issued by the FASB in September 2006, this Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Where applicable, this Statement simplifies and codifies related guidance within generally accepted accounting principles. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Southwest is currently evaluating the impact of this Statement on its financial statements.

FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115": Issued by the FASB in February 2007, this Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. The Statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. The Statement is effective for fiscal years beginning after November 15, 2007. Southwest is currently evaluating the impact of this Statement on its financial statements.

4. Regulatory Matters

On October 25, 2006, a group including producers and various trade associations filed a complaint under Section 5 of the Natural Gas Act against Southwest requesting that FERC initiate an investigation into Southwest's rates, terms and conditions of service and grant immediate interim rate relief. FERC initiated a Section 5 proceeding on December 21, 2006, setting this issue for hearing. Pursuant to FERC order, Southwest filed a cost and revenue study with FERC on February 20, 2007, with a hearing scheduled for August 27, 2007. The ultimate resolution of the Southwest matter has many variables and potential outcomes and it is impossible to predict its timing or materiality at this time.

On January 26, 2007, Southwest filed an abandonment application to reduce the certificated storage capacity of its North Hopeton field by approximately 6 Bcf. This filing brings the certificated capacity in line with operational performance of the field. Southwest has entered into a third-party agreement to replace this storage capability effective April 1, 2007 with an initial term of two years.

5. Commitments and Contingencies

Litigation. Southwest is involved in legal, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business, some of which involve substantial amounts. Where appropriate, Southwest has made accruals in order to provide for such matters. Southwest believes the final disposition of these proceedings will not have a material adverse effect on its results of operations, financial position or cash flows.

Hope Land Mineral Corporation (Hope Land) claimed trespass and unjust enrichment in respect of the storage rights to property that contains a portion of Southwest's Howell storage field. Southwest filed an action for condemnation to obtain the storage rights from Hope Land. Trial before the Michigan Circuit Court commenced in April 2007, and on May 2, 2007, the jury awarded Hope Land total compensation of approximately \$91,000 in respect of condemnation and trespass and no recovery in respect of unjust enrichment. The matter was subsequently settled and an Order of Dismissal was entered in the court on July 3, 2007. The settlement of this matter had no material impact on Southwest's result of operations, financial position or cash flows.

Environmental Remediation. On July 10, 2006, Southwest identified the possible subsurface release of approximately 745 gallons of methanol from a tank located at the Howell compressor station. Subsequent testing of the tank and associated piping confirmed that a release had taken place. Impacted soils were excavated in accordance with state specific regulatory requirements. The impacted soils were transported to an authorized disposal facility. The appropriate federal and state environmental agencies were notified of this release. The Michigan Department of Environmental Quality (MDEQ) conducted an inspection of the remediation effort on October 17, 2006 and indicated that an appropriate response and remediation action had been implemented. A final remediation report was submitted to the MDEQ and the United States Environmental Protection Agency on January 25, 2007. Southwest believes the outcome of this matter will not have a material adverse effect on its financial position, results of operations or cash flows.

Controlled Group Pension Liabilities. SU (including certain of its divisions) sponsors a number of defined benefit pension plans for employees. Under applicable pension and tax laws, upon being acquired by SU, Southwest became a member of SU's "controlled group" with respect to those plans, and, along with SU and any other members of that group, is jointly and severally liable for any failure by SU (along with any other persons that may be or become a sponsor of any such plan) to fund any of these pension plans or to pay any unfunded liabilities that these plans may have if they are ever terminated. In addition, if any of the obligations of any of these pension plans is not paid when due, a lien in favor of that plan or the Pension Benefit Guaranty Corporation may be created against the assets of each member of SU's controlled group, including Southwest. Based on the latest actuarial information available as of December 31, 2006, SU's aggregate amount of the projected benefit obligations of these pension plans was approximately \$163 million and the estimated fair value of all of the assets of these plans was approximately \$109 million.