BEAR STEARNS COMPANIES INC
Form 424B2
March 12, 2007

This preliminary pricing supplement relates to an effective registration statement under the Securities Act of 1933, but is not complete and may be changed. We may not sell these securities until we deliver a final pricing supplement. This preliminary pricing supplement, the accompanying prospectus supplement and prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any state where such an offer or sale would not be permitted.

Filed pursuant to Rule 424(b)(2)
Registration No. 333-136666
Subject to Completion, dated March 12, 2007
PRICING SUPPLEMENT
(To Prospectus dated August 16, 2006 and
Prospectus Supplement dated August 16, 2006)

The Bear Stearns Companies Inc.
$[n] Accelerated Market Participation Securities
Linked to the common stock of NYSE Group, Inc., due April [n], 2008

- The Notes are linked to the performance of the common stock of NYSE Group, Inc. (NYSE: NYX) (the "Reference Issuer") and are not principal protected. When we refer to Notes in this pricing supplement, we mean Notes with a principal amount of $1,000. On the Maturity Date, you will receive the "Cash Settlement Value," an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price.
- The "Initial Share Price" equals [n], the closing price of the Reference Share on March [n], 2007.
- The "Final Share Price" will be determined by the Calculation Agent and will equal the closing price of the Reference Share on the Calculation Date.
- If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the principal amount of the Note, plus the lesser of:
- [200.00]% of the percentage increase in the Reference Share, multiplied by the principal amount of the Note, and
- [38.00]% (the maximum return on the Notes) multiplied by the principal amount of the Note.

Thus, if the Final Share Price is greater than [119.00]% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, we will pay you $[1,380.00] per Note, which represents a maximum return of [38.00]% over the term of the Notes.

- If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than your initial investment in the Notes. In this case, the Cash Settlement Value is equal to, per Note:
- $1,000 multiplied by the amount, in percentage terms, equal to the Final Share Price divided by the Initial Share Price.
- The CUSIP number for the Notes is 073928V26.

INVESTMENT IN THE NOTES INVOLVES CERTAIN RISKS. THE NOTES ARE NOT PRINCIPAL PROTECTED. THEREFORE INVESTORS MAY RECEIVE LESS, AND POSSIBLY SIGNIFICANTLY LESS, THAN THEIR INITIAL INVESTMENT IN THE NOTES. THERE MAY NOT BE A SECONDARY MARKET IN THE NOTES, AND IF THERE WERE TO BE A SECONDARY MARKET, IT MAY NOT BE LIQUID. YOU SHOULD REFER TO "RISK FACTORS" BEGINNING ON PAGE PS-9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the Notes or determined that this pricing supplement, or the accompanying prospectus supplement and prospectus, is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Note	Total

Initial public offering price[1]	[n]%	$[n]
Agent's discount	[n]%	$[n]
Proceeds, before expenses, to us	[n]%	$[n]

[1]Investors who purchase an aggregate amount of at least $1,000,000 of Notes will be entitled to purchase such Notes for 99.00% of the principal amount.

Any additional reissuances will be offered at a price to be determined at the time of pricing of each offering of Notes, which will be a function of the prevailing market conditions and the price of the Reference Share at the time of the relevant sale.

We expect that the Notes will be ready for delivery in book-entry form only through the book-entry facilities of The Depository Trust Company in New York, New York, on or about March [n], 2007, against payment in immediately available funds. The distribution of the Notes will conform to the requirements set forth in Rule 2720 of the National Association of Securities Dealers, Inc. Conduct Rules.

We may grant our affiliate Bear, Stearns & Co. Inc. a 30-day option from the date of this pricing supplement to purchase from us up to an additional $[n] of Notes at the public offering price to cover any over-allotments.

Bear, Stearns & Co. Inc.

March [n], 2007

SUMMARY

This summary highlights selected information from the accompanying prospectus, prospectus supplement and this pricing supplement to help you understand the Notes linked to the Reference Share. You should carefully read this entire pricing supplement and the accompanying prospectus supplement and prospectus to fully understand the terms of the Notes, as well as certain tax and other considerations that are important to you in making a decision about whether to invest in the Notes. You should carefully review the section "Risk Factors" in this pricing supplement and "Risk Factors" in the accompanying prospectus supplement which highlight a number of significant risks, to determine whether an investment in the Notes is appropriate for you. All of the information set forth below is qualified in its entirety by the more detailed explanation set forth elsewhere in this pricing supplement and the accompanying prospectus supplement and prospectus. If information in this pricing supplement is inconsistent with the prospectus or prospectus supplement, this pricing supplement will supersede those documents. In this pricing supplement, the terms "we," "us" and "our" refer only to The Bear Stearns Companies Inc. excluding its consolidated subsidiaries.

The Bear Stearns Companies Inc. Medium-Term Notes, Series B, Accelerated Market Participation Securities ("AMPS"), Linked to the common stock of NYSE Group, Inc. (NYSE: NYX), due April [n], 2008 (the "Notes") are Notes whose return is tied or "linked" to the performance of the Reference Share. When we refer to Note or Notes in this pricing supplement, we mean $1,000 principal amount of Notes. The Notes are not principal protected. On the Maturity Date, you will receive the Cash Settlement Value, an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price. If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the principal amount of the Note, plus the lesser of (i) [200.00]% of the percentage increase in the Reference Share multiplied by the principal amount of the Note, and (ii) [38.00]% (the maximum return on the Notes) multiplied by the principal amount of the Note. Thus, if the Final Share Price is greater than [119.00]% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, we will pay you $[1,380.00] per Note, which represents a maximum return of [38.00]%. If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than your initial investment in the Notes. In this case, the Cash Settlement Value per Note will equal $1,000 multiplied by an amount, in percentage terms, equal to the Final Share Price divided by the Initial Share Price.

Selected Investment Considerations

- Growth potential—The return, if any, on the Notes is based upon whether the Final Share Price is greater than or equal to the Initial Share Price.

  - Potential leverage in the increase, if any, in the Reference Share—The Notes may be an attractive investment for investors who have a bullish view of the Reference Share in the short-term. If held to maturity, the Notes allow you to participate in [200.00]% of the potential increase in the Reference Share, not to exceed the maximum return of [38.00]%, representing a [19.00]% increase in the Initial Share Price.

- Taxes—The U.S. federal income tax consequences of an investment in the Notes are complex and uncertain. We intend to treat the Notes for all tax purposes as pre-paid cash-settled forward contracts linked to the price of the Reference Share and, where required, to file information returns with the Internal Revenue Service in accordance with such treatment. Prospective investors are urged to consult their tax advisors regarding the U.S. federal income tax consequences of an investment in the Notes. Assuming the Notes are treated as pre-paid cash-settled forward contracts, you should be required to recognize capital gain or loss to the extent that the cash you receive on the Maturity Date or upon a sale or exchange of the Notes prior to the Maturity Date differs from your tax basis on the Notes (which will generally be the amount you paid for the Notes). See "Certain U.S. Income Tax Considerations" herein.

Selected Risk Considerations

- ***Possible loss of principal—The Notes are not principal protected. If the Final Share Price is less than the Initial Share Price, there will be no principal protection on the Notes and the Cash Settlement Value you will receive will be less than the initial offering price in proportion to the percentage decline in the Reference Share. In that case, you will receive less, and possibly significantly less, than your initial investment in the Notes.***

- Maximum return of [38.00]%—You will not receive more than the maximum return of [38.00]% at maturity. Because the maximum return on the Notes is [38.00]%, the maximum Cash Settlement Value is $[1,380.00]. Therefore, the Cash Settlement Value will not reflect the increase in the value of the Notes if the Initial Share Price increases by more than [19.00]%.

- No interest, dividend or other payments—You will not receive any interest, dividend payments or other distributions on the Reference Share, nor will such payments be included in the calculation of the Cash Settlement Value you will receive at maturity.

- Not exchange listed—The Notes will not be listed on any securities exchange and we do not expect a trading market to develop, which may affect the price that you receive for your Notes upon any sale prior to maturity. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

- Liquidity—Because the Notes will not be listed on any securities exchange, we do not expect a trading market to develop, and, if such a market were to develop, it may not be liquid. Our subsidiary, Bear, Stearns & Co. Inc. ("Bear Stearns") has advised us that they intend under ordinary market conditions to indicate prices for the Notes on request. However, we cannot guarantee that bids for outstanding Notes will be made in the future; nor can we predict the price at which those bids will be made. In any event, Notes will cease trading as of the close of business on the Maturity Date.

KEY TERMS

Issuer: The Bear Stearns Companies Inc.

Reference Issuer: NYSE Group, Inc. (NYSE: NYX)

Reference Share: The common stock of NYSE Group, Inc.

Face amount: Each Note will be issued in minimum denominations of $1,000 and $1,000 multiples thereafter; provided, however, that the minimum purchase for any purchaser domiciled in a Member state of the European Economic Area shall be $100,000. The aggregate principal amount of the Notes being offered is $[n]. When we refer to “Note” or “Notes” in this pricing supplement, we mean Notes each with a principal amount of $1,000.

Further issuances: Under certain limited circumstances, and at our sole discretion, we may offer further issuances of the Notes. These further issuances, if any, will be consolidated to form a single series with the Notes and will have the same CUSIP number and will trade interchangeably with the Notes immediately upon settlement.

Cash Settlement Value: On the Maturity Date, you will receive the Cash Settlement Value, an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price. If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the lesser of:

, and

$[1,380.00].

Thus, if the Final Share Price is greater than [119.00]% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, we will pay you $[1,380.00] per Note, which represents a maximum return of [38.00]%.

If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than the principal you invested. In this case, the Cash Settlement Value is equal to, per Note:

Interest: The Notes will not bear interest.

Upside Participation Rate: [200.00]%

Initial Share Price: Equals [n], the closing price of the Reference Share on March [n], 2007.

Final Share Price: The Final Share Price will be determined by the Calculation Agent and will equal the closing price of the Reference Share on the Calculation Date.

Calculation Date: April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Calculation Date shall be the next Reference Share Business Day. The Calculation Date is subject to adjustment as described under “Description of the Notes - Market Disruption Events.”

Maturity Date:	The Notes are expected to mature on April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Maturity Date shall be the next Reference Share Business Day. If the Calculation Date is adjusted due to the occurrence of a Market Disruption Event, the Maturity Date will be three Reference Share Business Days following the adjusted Calculation Date.

Exchange listing:	The Notes will not be listed on any securities exchange.
Reference Share Business Day:	Means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

Offers and sales of the Notes are subject to restrictions in certain jurisdictions. The distribution of this pricing supplement, the accompanying prospectus supplement and prospectus and the offer or sale of the Notes in certain other jurisdictions may be restricted by law. Persons who come into possession of this pricing supplement, and the accompanying prospectus supplement and prospectus or any Notes must inform themselves about and observe any applicable restrictions on the distribution of this pricing supplement, the accompanying prospectus supplement and prospectus and the offer and sale of the Notes. Notwithstanding the minimum denomination of $1,000, the minimum purchase for any purchaser domiciled in a member state of the European Economic Area shall be $100,000.

QUESTIONS AND ANSWERS

What are the Notes?

The Notes are a series of our senior debt securities, the value of which is linked to the performance of the Reference Share. The Notes will not bear interest, and no other payments will be made prior to maturity. See the section "Risk Factors" for selected risk considerations prior to making an investment in the Notes.

The Notes will mature on April [n], 2008. The Notes do not provide for earlier redemption. When we refer to Notes in this pricing supplement, we mean Notes each with a principal amount of $1,000. You should refer to the section "Description of Notes" for a detailed description of the Notes prior to making an investment in the Notes.

The Notes are our unsecured, unsubordinated debt securities. However, the Notes differ from traditional debt securities in that the Notes are not principal protected and offer the opportunity to participate in [200.00]% of the positive performance of the Reference Share, if any, subject to a maximum return of [38.00]%. If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than your initial investment in the Notes.

Are the Notes principal protected?

No. The Notes are not principal protected and your principal investment in the Notes is at risk of loss. If the Final Share Price is less than the Initial Share Price, the Cash Settlement Value you will receive will be proportionally less than the initial offering price, in proportion to the percentage decline in the Reference Share. In this case your investment will result in a loss.

Are there any risks associated with my investment?

Yes. The Notes are subject to a number of risks. You should refer to the section "Risk Factors" in this pricing supplement and the section "Risk Factors" in the accompanying prospectus supplement.

What will I receive at maturity of the Notes?

The Notes are not principal protected. If the Final Share Price is less than the Initial Share Price, there will be no principal protection on the Notes and the Cash Settlement Value you will receive will be less than the initial offering price in proportion to the percentage decline in the Reference Share. In that case, you will receive less, and possibly significantly less, than your initial investment in the Notes. On the Maturity Date, you will receive the Cash

Settlement Value, an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price. At maturity, if the Final Share Price is less than the Initial Share Price, the Cash Settlement Value will be less than the initial offering price in proportion to the percentage decline in the Reference Share. In such a case, the principal amount of your investment is not protected and you will receive less, and possibly significantly less, than your initial investment in the Notes.

If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the lesser of:

, and

$[1,380.00].

Thus, if the Final Share Price is greater than [119.00]% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, we will pay you $[1,380.00] per Note, which represents a maximum return of [38.00]%.

If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than the principal you invested. In this case, the Cash Settlement Value, per Note is equal to:

The "Upside Participation Rate" equals [200.00]%.

The "Initial Share Price" equals [n], the closing price of the Reference Share on March [n], 2007.

The "Final Share Price" will be determined by the Calculation Agent and will equal the closing price of the Reference Share on the Calculation Date.

The "Calculation Date" will be April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Calculation Date shall be the next Reference Share Business Day. The Calculation Date is subject to adjustment as described under "Description of the Notes - Market Disruption Events".

The "Maturity Date" is expected to be April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Maturity Date shall be the next Reference Share Business Day. If the Calculation Date is adjusted due to the occurrence of a Market Disruption Event, the Maturity Date will be three Reference Share Business Days following the adjusted Calculation Date.

"Related Exchange" means each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to the Reference Share.

"Primary Exchange" means the primary exchange or market of trading of the Reference Share.

"Reference Share Business Day" means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

For more specific information about the Cash Settlement Value and for illustrative examples, you should refer to the section "Description of the Notes."

Will there be an additional offering of the Notes?

Under certain limited circumstances, and at our sole discretion, we may offer further issuances of the Notes. These further issuances, if any, will be consolidated to form a single series with the Notes and will have the same CUSIP number and will trade interchangeably with the Notes immediately upon settlement. Any additional issuance will increase the aggregate principal amount of the outstanding Notes of this series to include the aggregate principal amount of any Notes bearing the same CUSIP number that are issued pursuant to (i) any 30-day option we grant to

Bear, Stearns & Co. Inc., and (ii) any future issuances of Notes bearing the same CUSIP number. The price of any additional offerings will be determined at the time of pricing of each offering, which will be a function of the prevailing market conditions and price of the Reference Share at the time of the relevant sale.

Will I receive interest on the Notes?

You will not receive any periodic interest payments on the Notes. The only payment you will receive, if any, will be the Cash Settlement Value upon the maturity of the Notes.

What are the Reference Shares and how have they performed historically?

For a description of the Reference Share, see the section “Description of the Reference Share.” We have provided tables and graphs depicting the monthly performance of the Reference Share from March 2006 through February 2007. You can find these tables and graphs in the section “Description of the Reference Share - Historical Performance on the Reference Share.” We have provided this historical information to help you evaluate the behavior of the Reference Share in various economic environments; however, past performance is not indicative of the manner in which the Reference Share will perform in the future. You should refer to the section “Risk Factors - The historical performance of the Reference Share is not an indication of the future performance of the Reference Share.”

Will the Notes be listed on a securities exchange?

The Notes will not be listed on any securities exchange and we do not expect a trading market to develop, which may affect the price that you receive for your Notes upon any sale prior to maturity. Bear Stearns has advised us that they intend under ordinary market conditions to indicate prices for the Notes on request. However, we cannot guarantee that bids for outstanding Notes will be made in the future; nor can we predict the price at which those bids will be made. In any event, the Notes will cease trading as of the close of business on the Maturity Date. You should refer to the section “Risk Factors.” If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

What is the role of Bear Stearns & Co. Inc.?

Bear Stearns & Co. Inc. (“Bear Stearns”) will be our agent for the offering and sale of the Notes. After the initial offering, Bear Stearns intends to buy and sell the Notes to create a secondary market for holders of the Notes, and may stabilize or maintain the market price of the Notes during the initial distribution of the Notes. However, Bear Stearns will not be obligated to engage in any of these market activities or to continue them once they are begun.

Bear Stearns also will be our Calculation Agent for purposes of calculating the Cash Settlement Value. Under certain circumstances, these duties could result in a conflict of interest between Bear Stearns’ status as our subsidiary and its responsibilities as Calculation Agent. Bear Stearns is obligated to carry out its duties and functions as Calculation Agent in good faith, and using its reasonable judgment. Manifest error by the Calculation Agent, or any failure by it to act in good faith, in making a determination adversely affecting the payment of the Cash Settlement Value or interest on principal to the holders of the Notes would entitle the holders, or the Trustee (as defined herein) acting on behalf of the holders, to exercise rights and remedies available under the Indenture (as defined herein). If the Calculation Agent uses its discretion to make a determination, the Calculation Agent will notify us and the Trustee, who will provide notice to the holders. You should refer to “Risk Factors - The Calculation Agent is one of our affiliates, which could result in a conflict of interest.”

Can you tell me more about The Bear Stearns Companies Inc.?

We are a holding company that, through our broker-dealer and international bank subsidiaries, principally Bear Stearns, Bear, Stearns Securities Corp., Bear, Stearns International Limited (“BSIL”) and Bear Stearns Bank plc, is a leading investment banking, securities and derivatives trading, clearance and brokerage firm serving corporations, governments, institutional and individual investors worldwide. For more information about us, please refer to the section “The Bear Stearns Companies Inc.” in the accompanying prospectus. You should also read the other documents we have filed with the Securities and Exchange Commission, which you can find by referring to the section "Where You Can Find More Information" in the accompanying prospectus.

Who should consider purchasing the Notes?

Because the Notes are tied to the price performance of the Reference Share, they may be appropriate for investors with specific investment horizons who seek to participate in the potential price appreciation of the Reference Share. In particular, the Notes may be an attractive investment for investors who:

- want potential upside exposure to the Reference Share;
- believe that the Reference Share will increase over the term of the Notes and that such increase will not exceed [19.00]%;
- are willing to risk the possible loss of 100% of their investment in exchange for the opportunity to participate in [200.00]% of the appreciation, if any, in the Reference Share of up to [19.00]% (which represents a maximum return per Note of [38.00]%), and
- are willing to forgo interest payments on the Notes or dividend payments on the Reference Share.

The Notes may not be a suitable investment for you if:

- you seek principal protection;
- you seek current income or dividend payments from your investment;
- you seek an investment that offers the possibility to fully participate in the potential appreciation of the Reference Share (since the return on the Notes is capped at [38.00]%);
- you seek an investment with an active secondary market;
- you are unable or unwilling to hold the Notes until maturity; or
- you do not have a bullish view of the Reference Share over the term of the Notes.

What Are the U.S. federal income tax consequences of investing in the Notes?

The U.S. federal income tax consequences of an investment in the Notes are complex and uncertain. We intend to treat the Notes for all tax purposes as pre-paid cash-settled forward contracts linked to the value of the Reference Share and, where required, to file information returns with the Internal Revenue Service in accordance with such treatment. Prospective investors are urged to consult their tax advisors regarding the U.S. federal income tax consequences of an investment in the Notes. Assuming the Notes are treated as pre-paid cash-settled forward contracts, you should be required to recognize capital gain or loss to the extent that the cash you receive on the Maturity Date or upon a sale or exchange of the Notes prior to the Maturity Date differs from your tax basis on the Notes (which will generally be the amount you paid for the Notes). You should review the discussion under the section "Certain U.S. Federal Income Tax Considerations."

Does ERISA impose any limitations on purchases of the Notes?

An employee benefit plan subject to the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), a plan that is subject to Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code"), including individual retirement accounts, individual retirement annuities or Keogh plans, a governmental or other plan subject to any similar law or any entity the assets of which are deemed to be "plan assets" under ERISA, Section 4975 of the Code, any applicable regulations or otherwise, will be permitted to purchase, hold and dispose of the Notes, subject to certain conditions. Such investors should carefully review the discussion under "Certain ERISA Considerations" herein before investing in the Notes.

RISK FACTORS

Your investment in the Notes involves a degree of risk similar to investing in the Reference Share. However, your ability to participate in the appreciation of the Reference Share is limited. The maximum return on the Notes is [38.00]%. Therefore, the maximum Cash Settlement Value is $[1,380.00] and the Cash Settlement Value will not reflect the increase in the Reference Share if the Initial Share Price increases by more than [19.00]%. You will be subject to significant risks not associated with conventional fixed-rate or floating-rate debt securities. Prospective purchasers should recognize the possibility of a substantial loss with respect to their investment in the Notes. Prospective purchasers of the Notes should understand the risks of investing in the Notes and should reach an investment decision only after careful consideration, with their advisers, of the suitability of the Notes in light of their particular financial circumstances, the following risk factors and the other information set forth in this pricing supplement and the accompanying prospectus supplement and prospectus. These risks include the possibility that the Reference Share will fluctuate, and the possibility that you will receive a substantially lower amount of principal than the amount you invested. We have no control over a number of matters that may affect the value of the Notes, including economic, financial, regulatory, geographic, judicial and political events, and that are important in determining the existence, magnitude, and longevity of these risks and their influence on the value of, or the payment made on, the Notes.

The Notes are not principal protected. At maturity, the Notes may pay less than the principal amount.

The Notes are not principal protected. If the Final Share Price is less than the Initial Share Price, there will be no principal protection on the Notes and the cash equivalent of the Cash Settlement Value you will receive will be less than the initial offering price, in proportion to the percentage decline in the Reference Share. You may receive less, and possibly significantly less, than your initial investment in the Notes.

You will not receive any interest payments on the Notes. Your yield may be lower than the yield on a conventional debt security of comparable maturity.

You will not receive any periodic payments of interest or any other periodic payments on the Notes. On the Maturity Date, you will receive a payment per Note, if any, equal to the Cash Settlement Value. Thus, the overall return you earn on your Notes may be less than that you would have earned by investing in a non-indexed debt security of comparable maturity that bears interest at a prevailing market rate and is principal protected. For more specific information about the Cash Settlement Value and for illustrative examples, you should refer to the section "Description of the Notes."

You must rely on your own evaluation of the merits of an investment linked to the Reference Share.

In the ordinary course of our business, we may from time to time express views on expected movements in the Reference Share. These views may vary over differing time horizons and are subject to change without notice. Moreover, other professionals who deal in the equity markets may at any time have views that differ significantly than ours. In connection with your purchase of the Notes, you should investigate the Reference Share and not rely on our views with respect to future movements in these industries and stocks. You should make such investigation as you deem appropriate as to the merits of an investment linked to the Reference Share.

No Beneficial Interest in the Reference Shares.

You will not be a beneficial owner of the Reference Share and therefore will not be entitled to receive any dividends or similar amounts paid on the Reference Share. Moreover, you will not be entitled to any voting rights or other control rights that holders of the Reference Share may have with respect to the Reference Issuer. The Cash Settlement Value does not reflect the payment of dividends on the Reference Share. The return on the Notes will not reflect the return you would realize if you actually owned the Reference Share and received dividends, if any, paid on those securities.

There is Limited Antidilution Protection.

The Calculation agent will adjust the Initial Share Price, the Final Share Price the Cash Settlement Value, or any other variable (or combination thereof) for stock splits, reverse stock splits, stock dividends, extraordinary dividends and other corporate events that affect capital structure of the Reference Issuer, but only in the situations and in the manner described in "*Description of the Notes — Antidilution Adjustments*". The Calculation Agent is not required to make an adjustment for every corporate event that may affect the Reference Share. Those events or other actions by the Reference Issuer or a third party may nevertheless adversely affect the closing price of the Reference Share and, therefore, adversely affect the value of the Notes. The Reference Issuer or a third party could make an offering or exchange offer, or the Reference Issuer could take any other action, that adversely affects the value of the Reference Share and the Notes but does not result in an adjustment. Furthermore, some corporate events may lead to an acceleration of the Maturity Date.

Risks Relating to the Reference Share.

The Notes are subject to the risks of any investment in shares of a company, including the risk that general prices of shares may decline. The future performance of the Reference Share can not be predicted based on its historical performance. The closing price of the Reference Share will be influenced by both complex and interrelated political, economic, financial and other factors that can affect the capital markets generally and the equity trading markets on which the Reference Share is traded, and the various circumstances that can influence the closing price of the Reference Share in a specific market segment. It is impossible to predict what effect these factors will have on the price of the Reference Share and thus, the return on the Notes.

The Issuer Has No Affiliation with the Reference Issuer.

The Reference Issuer is not an affiliate of the Issuer and is not involved in the offering of the Notes in any way. Consequently, we have no control of the actions of the Reference Issuer, including any corporate actions of the type that would require the Calculation Agent to adjust the payment to you at maturity. The Reference Issuer has no obligation to consider your interest as an investor in the Notes in taking any corporate actions that might affect the value of your Notes and may take actions that could adversely affect the value of the Notes. None of the money you pay for the Notes will go to the Reference Issuer.

Your return on the Notes will not exceed [38.00]% over the term of the Notes, regardless of the positive percentage increase of the Final Share Price over the Initial Share Price.

If the Final Share Price appreciates by more than [19.00]%, the Cash Settlement Value will equal the principal amount of the Notes, plus the product of the principal amount of Notes and [38.00]%. Under these circumstances, the Cash Settlement Value you receive at maturity will not fully reflect the performance of the Reference Share.

Because the treatment of the Notes is uncertain, the material U.S. federal income tax consequences of an investment in the Notes are uncertain.

Although we intend to treat the Notes for all tax purposes as pre-paid cash-settled forward contracts linked to the Reference Share, there is no direct legal authority as to the proper tax treatment of the Notes, and therefore significant aspects of the tax treatment of the Notes are uncertain. In particular, it is possible that you will be required to recognize income for U.S. federal tax purposes with respect to the Notes prior to the sale, exchange or maturity of the Notes, and it is possible that any gain or income recognized with respect to the Notes will be treated as ordinary income rather than capital gain. Prospective investors are urged to consult their tax advisors regarding the U.S. federal income tax consequences of an investment in the Notes. Please read carefully the section "Certain U.S. Federal Income Tax Considerations."

Equity market risks may affect the trading value of the Notes and the amount you will receive at maturity.

We expect that the price of the Reference Share will fluctuate in accordance with changes in the financial condition of the Reference Issuer and other factors. The financial condition of the Reference Issuer may become impaired or the general condition of the equity market may deteriorate, either of which may cause a decrease in the price of the Reference Share and thus in the value of the Notes. Common stocks are susceptible to general equity market fluctuations and to volatile increases and decreases in value, as market confidence in and perceptions regarding the Reference Issuer. Investor perceptions regarding the Reference Issuer are based on various and unpredictable factors, including expectations regarding government, economic, monetary and fiscal policies, inflation and interest rates, economic expansion or contraction, and global or regional political, economic, and banking crises. The price of the Reference Share is expected to fluctuate until maturity.

The historical performance of the Reference Share is not an indication of the future performance of the Reference Share.

The historical performance of the Reference Share, which is included in this pricing supplement, should not be taken as an indication of the future performance of the Reference Share. It is impossible to predict whether the price of the Reference Share will fall or rise. The price of the Reference Share will be influenced by the complex and interrelated economic, financial, regulatory, geographic, judicial, political and other factors that can affect the capital markets generally and the equity trading markets on which the underlying common stocks are traded, and by various circumstances that can influence the price of the Reference Share.

The price at which you will be able to sell your Notes prior to maturity will depend on a number of factors, and may be substantially less than the amount you had originally invested.

If you wish to liquidate your investment in the Notes prior to maturity, your only alternative would be to sell them. At that time, there may be an illiquid market for Notes or no market at all. Even if you were able to sell your Notes, there are many factors outside of our control that may affect their trading value. We believe that the value of your Notes will be affected by the price and volatility of the Reference Share, whether the price of the Reference Share is greater than or equal to the Initial Share Price, changes in U.S. interest rates, the supply of and demand for the Notes and a number of other factors. Some of these factors are interrelated in complex ways; as a result, the effect of any one factor may be offset or magnified by the effect of another factor. The price, if any, at which you will be able to sell your Notes prior to maturity may be substantially less than the amount you originally invested if, at such time, the price of the Reference Share is less than, equal to or not sufficiently above the Initial Share Price. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes. The following paragraphs describe the manner in which we expect the trading value of the Notes will be affected in the event of a change in a specific factor, assuming all other conditions remain constant.

- *Reference Share performance*. We expect that the value of the Notes prior to maturity will depend substantially on whether the Final Share Price is greater than the Initial Share Price. If you decide to sell your Notes when the price of the Reference Share exceeds the Initial Share Price, you may nonetheless receive substantially less than the amount that would be payable at maturity based on that Reference Share price because of expectations that the Reference Share price will continue to fluctuate until the Final Share Price is determined. Economic, financial, regulatory, geographic, judicial, political and other developments may affect the Reference Share and, thus, the value of the Notes.

- *Volatility of the Reference Share*. Volatility is the term used to describe the size and frequency of market fluctuations. If the volatility of the Reference Share increases or decreases, the trading value of the Notes may be adversely affected. This volatility may increase the risk that the price of the Reference Share will decline, which could negatively affect the trading value of Notes. The effect of the volatility of the Reference Share on the trading value of the Notes may not necessarily decrease over time during the term of the Notes.

- *Interest rates*. We expect that the trading value of the Notes will be affected by changes in U.S. interest rates. In general, if U.S. interest rates increase, the value of the Notes may decrease, and if U.S. interest rates decrease, the value of the Notes is expected to increase. Interest rates may also affect the economy and, in turn, the price of the Reference Share, which (for the reasons discussed above) would affect the value of the Notes. Rising interest rates may lower the price of the Reference Share and, thus, the value of the Notes. Falling interest rates may increase the price of the Reference Share and, thus, the value of the Notes.

- *Our credit ratings, financial condition and results of operations*. Actual or anticipated changes in our current credit ratings, A1 by Moody's Investor Service, Inc. and A+ by Standard & Poor's Rating Services, as well as our financial condition or results of operations may significantly affect the trading value of the Notes. However, because the return on the Notes is dependent upon factors in addition to our ability to pay our obligations under the Notes, such as the price of the Reference Share, an improvement in our credit ratings, financial condition or results of operations is not expected to have a positive effect on the trading value of the Notes.

- *Time remaining to maturity*. As the time remaining to maturity of the Notes decreases, the "time premium" associated with the Notes will decrease. A "time premium" results from expectations concerning the price of the Reference Share during the period prior to the maturity of the Notes. As the time remaining to the maturity of the Notes decreases, this time premium will likely decrease, potentially adversely affecting the trading value of the Notes. As the time remaining to maturity decreases, the trading value of the Notes and the supplemental return may be less sensitive to the volatility of the Reference Share.

- *Dividend yield*. The value of the Notes may also be affected by the dividend yield on the Reference Share. In general, because the Cash Settlement Value does not incorporate the value of dividend payments, higher dividend yields is expected to reduce the value of the Notes and, conversely, lower dividend yields is expected to increase the value of the Notes.

- *Events involving the Reference Issuer*. General economic conditions and earnings results of the Reference Issuer, and real or anticipated changes in those conditions or results, may affect the trading value of the Notes. For example, the Reference Issuer may be affected by mergers and acquisitions, which can contribute to volatility of the Reference Share. As a result of a merger or acquisition, the Reference Issuer may be replaced with a surviving or acquiring entity's securities. The surviving or acquiring entity's securities may not have the same characteristics as the Reference Share.

- *Size and liquidity of the trading market*. The Notes will not be listed on any securities exchange and we do not expect a trading market to develop. There may not be a secondary market in the Notes, which may affect the price that you receive for your Notes upon any sale prior to maturity. If a trading market does develop, there can be no assurance that there will be liquidity in the trading market. If the trading market for the Notes is limited, there may be a limited number of buyers for your Notes if you do not wish to hold your investment until maturity. This may affect the price you receive upon any sale of the Notes prior to maturity. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

Bear Stearns has advised us that they intend under ordinary market conditions to indicate prices for the Notes on request. However, we cannot guarantee that bids for outstanding Notes will be made in the future, nor can we predict the price at which any such bids will be made.

We want you to understand that the effect of one of the factors specified above, such as an increase in interest rates, may offset some or all of any change in the value of the Notes attributable to another factor, such as an increase in the price of the Reference Share.

The Calculation Agent is one of our affiliates, which could result in a conflict of interest.

Bear Stearns will act as the Calculation Agent. The Calculation Agent will make certain determinations and judgments in connection with calculating the Final Share Price, or deciding whether a Market Disruption Event (as defined herein) has occurred. You should refer to the sections "Description of the Notes - Antidilution Adjustments" and "Description of the Notes - Market Disruption Events." Because Bear Stearns is our affiliate, conflicts of interest may arise in connection with Bear Stearns performing its role as Calculation Agent. Rules and regulations regarding broker-dealers (such as Bear Stearns) require Bear Stearns to maintain policies and procedures regarding the handling and use of confidential proprietary information, and such policies and procedures will be in effect throughout the term of the Notes. Bear Stearns is obligated to carry out its duties and functions as Calculation Agent in good faith, and using its reasonable judgment. See the section "Description of the Notes - Calculation Agent."

Our affiliates, including Bear Stearns, may, at various times, engage in transactions involving the Reference Share for their proprietary accounts, and for other accounts under their management. These transactions may influence the price of the Reference Share. BSIL, an affiliate of Bear Stearns, or one of its subsidiaries will also be the counterparty to the hedge of our obligations under the Notes. You should refer to the section "Use of Proceeds and Hedging." Accordingly, under certain circumstances, conflicts of interest may arise between Bear Stearns' responsibilities as Calculation Agent with respect to the Notes and its obligations under our hedge.

We cannot control actions by the Reference Issuer.

We are not affiliated with the Reference Issuer. Actions by the Reference Issuer may have an adverse effect on the price of its stock, the Final Share Price, and the trading value of the Notes. The Reference Issuer is not involved in this offering and has no obligations with respect to the Notes, including any obligation to take our or your interests into consideration for any reason. The Reference Issuer will not receive any of the proceeds of this offering and is not responsible for, and has not participated in, the determination of the timing of, prices for, or quantities of, the Notes to be issued. The Reference Issuer is not involved with the administration, marketing or trading of the Notes and has no obligations with respect to the amount to be paid to you under the Notes on the Maturity Date.

We are not affiliated with the Reference Issuer and are not responsible for any disclosure by the Reference Issuer. However, we may currently, or in the future, engage in business with such companies. Neither we nor any of our affiliates, including Bear Stearns, assumes any responsibility for the adequacy or accuracy of any publicly available information about the Reference Share or the Reference Issuer. You should make your own investigation into the Reference Share and the Reference Issuer.

Trading and other transactions by us or our affiliates could affect the price of the Reference Share, the trading value of the Notes or the amount you may receive at maturity.

We and our affiliates may from time to time buy or sell the Reference Share or derivative instruments related to the Reference Share for our own accounts in connection with our normal business practices or in connection with hedging our obligations under the Notes and other instruments. These trading activities may present a conflict of interest between your interest in the Notes and the interests we and our affiliates may have in our proprietary accounts, in facilitating transactions, including block trades, for our other customers and in accounts under our management. The transactions could affect the price of the Reference Share in a manner that would be adverse to your investment in the Notes. See the section "Use of Proceeds and Hedging."

The original issue price of the Notes includes the cost of hedging our obligations under the Notes. Such cost includes BSIL's expected cost of providing such hedge and the profit BSIL expects to realize in consideration for assuming the risks inherent in providing such hedge. As a result, assuming no change in market conditions or any other relevant factors, the price, if any, at which Bear Stearns will be willing to purchase Notes from you in secondary market transactions, if at all, will likely be lower than the original issue price. In addition, any such prices may differ from values determined by pricing models used by Bear Stearns as a result of transaction costs. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

Hedging activities we or our affiliates may engage in may affect the price of the Reference Share, including the Final Share Price, and, accordingly, increase or decrease the trading value of the Notes prior to maturity and the Cash Settlement Value you would receive at maturity. To the extent that we or any of our affiliates has a hedge position in the Reference Share, or derivative or synthetic instruments related to the Reference Share, we or any of our affiliates may liquidate a portion of such holdings at or about the time of the maturity of the Notes. Depending on, among other things, future market conditions, the aggregate amount and the composition of such hedge positions are likely to vary over time. Profits or losses from any of those positions cannot be ascertained until the position is closed out and any offsetting position or positions are taken into account. Although we have no reason to believe that any of those activities will have a material effect on the price of the Reference Share, we cannot assure you that these activities will not affect such price and the trading value of the Notes prior to maturity or the Cash Settlement Value payable at maturity.

In addition, we or any of our affiliates may purchase or otherwise acquire a long or short position in the Notes. We or any of our affiliates may hold or resell the Notes. We or any of our affiliates may also take positions in other types of appropriate financial instruments that may become available in the future.

Research reports and other transactions may create conflicts of interest between you and us.

We or one or more of our affiliates have published, and may in the future publish, research reports on the Reference Issuer. This research may be modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the Notes. Any of these activities may affect the market price of the Reference Share and, therefore, the Final Share Price and the value of the Notes.

We or any of our affiliates may also issue, underwrite or assist unaffiliated entities in the issuance or underwriting of other securities or financial instruments with returns indexed to the Reference Share. By introducing competing products into the marketplace in this manner, we or our affiliates could adversely affect the value of the Notes.

We and our affiliates, at present or in the future, may engage in business with the Reference Issuer, including making loans to, equity investments in, or providing investment banking, asset management or other advisory services to the Reference Issuer. In connection with these activities, we may receive information about the Reference Issuer that we will not divulge to you or other third parties.

The Cash Settlement Value you receive on the Notes may be delayed or reduced upon the occurrence of a Market Disruption Event, or an Event of Default.

If the Calculation Agent determines that, on the Calculation Date, a Market Disruption Event has occurred or is continuing, the determination of the price of the Reference Share by the Calculation Agent may be deferred. You should refer to the section “Description of the Notes - Market Disruption Events.”

If the Calculation Agent determines that an Event of Default (as defined below) has occurred, a holder of the Notes will only receive an amount equal to the trading value of the Notes on the date of such Event of Default, adjusted by an amount equal to any losses, expenses and costs to us of unwinding any underlying hedging or funding arrangements, all as determined by the Calculation Agent. You should refer to the section “Description of the Notes—Event of Default and Acceleration.”

You should decide to purchase the Notes only after carefully considering the suitability of the Notes in light of your particular financial circumstances. You should also carefully consider the tax consequences of investing in the Notes. You should refer to the section “Certain U.S. Federal Income Tax Considerations” and discuss the tax implications with your own tax advisor.

DESCRIPTION OF THE NOTES

The following description of the Notes supplements the description of the Notes in the accompanying prospectus supplement and prospectus. This is a summary and is not complete. You should read the indenture, dated as of May 31, 1991, as amended (the "Indenture"), between us and The Bank of New York as successor in interest to JPMorgan Chase Bank, N.A., as trustee (the "Trustee"). A copy of the Indenture is available as set forth under the section of the prospectus "Where You Can Find More Information."

General

The Notes are part of a single series of debt securities under the Indenture described in the accompanying prospectus supplement and prospectus designated as Medium-Term Notes, Series B. The Notes are unsecured and will rank equally with all of our unsecured and unsubordinated debt, including the other debt securities issued under the Indenture. Because we are a holding company, the Notes will be structurally subordinated to the claims of creditors of our subsidiaries.

The aggregate principal amount of the Notes will be $[n]. The Notes are expected to mature on April [n], 2008 and do not provide for earlier redemption. The Notes will be issued only in fully registered form, and in minimum denominations of $1,000; provided, however, that the minimum purchase for any purchaser domiciled in a member state of the European Economic Area shall be $100,000. Initially, the Notes will be issued in the form of one or more global securities registered in the name of DTC or its nominee, as described in the accompanying prospectus supplement and prospectus. When we refer to Note or Notes in this pricing supplement, we mean $1,000 principal amount of Notes. The Notes will not be listed on any securities exchange.

You should refer to the section "Certain U.S. Federal Income Tax Considerations," for a discussion of certain federal income tax considerations to you as a holder of the Notes.

Interest

We will not make any periodic payments of interest on the Notes. The only payment you will receive, if any, will be the Cash Settlement Value upon the maturity of the Notes.

Payment at Maturity

Your investment may result in a loss because the Notes are not principal protected. On the Maturity Date you will receive the Cash Settlement Value, an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price. At maturity, if the Final Share Price is less than the Initial Share Price, the Cash Settlement Value will be less than the initial offering price, in proportion to the percentage decline in the Reference Share. In such a case, the principal amount of your investment is not protected and you will receive less, and possibly significantly less, than the initial public offering price of $1,000 per Note.

If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the lesser of:

, and

$[1,380.00].

Thus, if the Final Share Price is greater than [119.00]% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, the Cash Settlement Value will equal $[1,380.00] per Note, which represents a maximum return of [38.00]%.

If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than your initial investment in the Notes. In this case, the Cash Settlement Value is equal to, per Note:

The "Upside Participation Rate" is [200.00]%.

The "Initial Share Price" equals [n], the closing price of the Reference Share on March [n], 2007.

The "Final Share Price" will be determined by the Calculation Agent and will equal the closing price of the Reference Share on the Calculation Date.

The "Calculation Date" will be April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Calculation Date shall be the next Reference Share Business Day. The Calculation Date is subject to adjustment as described under "Description of the Notes - Market Disruption Events".

The "Maturity Date" is expected to be April [n], 2008 unless such date is not an Reference Share Business Day, in which case the Maturity Date shall be the next Reference Share Business Day. If the Calculation Date is adjusted due to the occurrence of a Market Disruption Event, the Maturity Date will be three Reference Share Business Days following the adjusted Calculation Date.

"Related Exchange" means each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to the Reference Share.

"Primary Exchange" means the primary exchange or market of trading of the Reference Share.

"Reference Share Business Day" means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

Illustrative Examples

The following tables and graphs are for illustrative purposes and are not indicative of the future performance of the Reference Share or the future value of the Notes.

Because the price of the Reference Share may be subject to significant fluctuation over the term of the Notes, it is not possible to present a chart or table illustrating the complete range of all possible Cash Settlement Values. Therefore, the examples do not purport to be representative of every possible scenario concerning increases or decreases in the Reference Share. You should not construe these examples or the data included in table and graph as an indication or assurance of the expected performance of the Notes.

You can review the historical prices of the Reference Share in the section of this pricing supplement called "Description of the Reference Share." The historical performance of the Reference Share included in this pricing supplement should not be taken as an indication of the future performance of the Reference Share during the term of the Notes. It is impossible to predict whether the Final Share Price will be greater than or less than the Initial Share Price.

The examples demonstrating the hypothetical Cash Settlement Value of a Note are based on the following assumptions:

- Investor purchases $1,000 aggregate principal amount of Notes at the initial public offering price of $1,000.

- Investor holds the Notes to maturity.
- The Initial Share Price is equal to 85.00.

- The Upside Participation Rate is [200.00]%
- The maximum return on the Notes is [38.00]%
- All returns are based on a 13-month term; pre-tax basis.
- No Market Disruption Events occur during the term of the Notes.

Example 1: The Final Share Price is greater than the Initial Share Price.

In this example, the Reference Share rises over the term of the Notes. On the Calculation Date, the Final Share Price is 87.55, representing a 3.00% gain from the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal $1,060.00.

Example 2: The Final Share Price is greater than [119.00]% of the Initial Share Price, exceeding the maximum return on the Notes of [38.00]%.

In this example, the Reference Share rises over the term of the Notes. On the Calculation Date, the Final Share Price is 114.75 representing a 35.00% increase from the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal $1,380.00.

Example 3: The Final Share Price is equal to the Initial Share Price.

In this example, the Reference Share remains unchanged over the term of the Notes. On the Calculation Date, the Final Share Price is 85.00, equal to the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal $1,000.00.

Example 4: The Final Share Price is less than the Initial Share Price.

In this example, the Reference Share declines over the term of the Notes. On the Calculation Date, the Final Share Price is 63.75, representing a 25.00% decrease in the price of the Reference Share from the Initial Share Price. The Cash Settlement Value, using the formula below, will equal $750.00.

Summary of Examples 1 Through 4
Reflecting the Cash Settlement Value

	Example 1	Example 2	Example 3	Example 4
Initial Share Price	85.00	85.00	85.00	85.00
Hypothetical Final Share Price	87.55	114.75	85.00	63.75
Value of Final Share Price relative to the Initial Share Price	Higher	Higher	Equal	Lower
Principal fully repaid?	Yes	Yes	Yes	No
Cash Settlement Value per Note	$1,060.00	$1,380.00	$1,000.00	$750.00

Table of Hypothetical Cash Settlement Values

Initial Share Price	Final Share Price	Percentage Change in Reference Share	Cash Settlement Value Per Note	Return if Held to Maturity	Initial Share Price	Final Share Price	Percentage Change in Reference Share	Cash Settlement Value Per Note	Return if Held to Maturity
85.00	141.00	+65.88%	$ 1,380.00	38.00%	85.00	83.00	-2.35%	$ 976.47	-2.35%
85.00	139.00	+63.53%	$ 1,380.00	38.00%	85.00	81.00	-4.71%	$ 952.94	-4.71%
85.00	137.00	+61.18%	$ 1,380.00	38.00%	85.00	79.00	-7.06%	$ 929.41	-7.06%
85.00	135.00	+58.82%	$ 1,380.00	38.00%	85.00	77.00	-9.41%	$ 905.88	-9.41%
85.00	133.00	+56.47%	$ 1,380.00	38.00%	85.00	75.00	-11.76%	$ 882.35	-11.76%
85.00	131.00	+54.12%	$ 1,380.00	38.00%	85.00	73.00	-14.12%	$ 858.82	-14.12%
85.00	129.00	+51.76%	$ 1,380.00	38.00%	85.00	71.00	-16.47%	$ 835.29	-16.47%
85.00	127.00	+49.41%	$ 1,380.00	38.00%	85.00	69.00	-18.82%	$ 811.76	-18.82%
85.00	125.00	+47.06%	$ 1,380.00	38.00%	85.00	67.00	-21.18%	$ 788.24	-21.18%
85.00	123.00	+44.71%	$ 1,380.00	38.00%	85.00	65.00	-23.53%	$ 764.71	-23.53%
85.00	121.00	+42.35%	$ 1,380.00	38.00%	85.00	63.00	-25.88%	$ 741.18	-25.88%
85.00	119.00	+40.00%	$ 1,380.00	38.00%	85.00	61.00	-28.24%	$ 717.65	-28.24%
85.00	117.00	+37.65%	$ 1,380.00	38.00%	85.00	59.00	-30.59%	$ 694.12	-30.59%
85.00	115.00	+35.29%	$ 1,380.00	38.00%	85.00	57.00	-32.94%	$ 670.59	-32.94%
85.00	113.00	+32.94%	$ 1,380.00	38.00%	85.00	55.00	-35.29%	$ 647.06	-35.29%
85.00	111.00	+30.59%	$ 1,380.00	38.00%	85.00	53.00	-37.65%	$ 623.53	-37.65%
85.00	109.00	+28.24%	$ 1,380.00	38.00%	85.00	51.00	-40.00%	$ 600.00	-40.00%
85.00	107.00	+25.88%	$ 1,380.00	38.00%	85.00	49.00	-42.35%	$ 576.47	-42.35%
85.00	105.00	+23.53%	$ 1,380.00	38.00%	85.00	47.00	-44.71%	$ 552.94	-44.71%
85.00	103.00	+21.18%	$ 1,380.00	38.00%	85.00	45.00	-47.06%	$ 529.41	-47.06%
85.00	101.00	+18.82%	$ 1,376.47	37.65%	85.00	43.00	-49.41%	$ 505.88	-49.41%
85.00	99.00	+16.47%	$ 1,329.41	32.94%	85.00	41.00	-51.76%	$ 482.35	-51.76%
85.00	97.00	+14.12%	$ 1,282.35	28.24%	85.00	39.00	-54.12%	$ 458.82	-54.12%
85.00	95.00	+11.76%	$ 1,235.29	23.53%	85.00	37.00	-56.47%	$ 435.29	-56.47%
85.00	93.00	+9.41%	$ 1,188.24	18.82%	85.00	35.00	-58.82%	$ 411.76	-58.82%
85.00	91.00	+7.06%	$ 1,141.18	14.12%	85.00	33.00	-61.18%	$ 388.24	-61.18%
85.00	89.00	+4.71%	$ 1,094.12	9.41%	85.00	31.00	-63.53%	$ 364.71	-63.53%
85.00	87.00	+2.35%	$ 1,047.06	4.71%	85.00	29.00	-65.88%	$ 341.18	-65.88%
85.00	**85.00**	**0.00%**	**$ 1,000.00**	**0.00%**	85.00	27.00	-68.24%	$ 317.65	-68.24%

Market Disruption Events

If the Calculation Date is not a Reference Share Business Day (as defined below), the closing price of the Reference Share will be determined on the first following day that is a Reference Share Business Day. To the extent a Disrupted Day (as defined below) exists on a day on which the Final Share Price is to be determined, the closing price of the Reference Share will be determined on the first following Reference Share Business Day on which a Disrupted Day does not exist with respect to the Reference Share, provided that if a Disrupted Day exists on three consecutive Reference Share Business Days, the third Reference Share Business Day shall be the Calculation Date. The Calculation Agent shall determine the Final Share Price as of any such postponed date. In the event that the Calculation Date is postponed, the Maturity Date shall also be postponed to the third Reference Share Business Day following the postponed Calculation Date.

A “Disrupted Day” is any Reference Share Business Day on which the Primary Exchange or any Related Exchange fails to open for trading during its regular trading session or on which a Market Disruption Event has occurred and is continuing, in both cases, which the Calculation Agent determines is material, where:

· “Market Disruption Event” means, with respect to the Reference Share:

(a) the occurrence or existence of a condition specified below:

(i) any suspension of or limitation imposed on trading by the Primary Exchange or any Related Exchange or otherwise, and whether by reason of movements in price exceeding limits permitted by the Primary Exchange or any Related Exchanges or otherwise, (A) relating to the Reference Share or (B) in futures or options contracts relating to the Reference Share, on any Related Exchange; or

(ii) any event (other than an event described in (b) below) that disrupts or impairs (as determined by the Calculation Agent) the ability of market participants in general (A) to effect transactions in, or obtain market values for the Reference Share or (B) to effect transactions in, or obtain market values for, futures or options contracts relating to the Reference Share, on any Related Exchange; or

(b) the closure on any Reference Share Business Day of the Primary Exchange or any Related Exchange prior to its Scheduled Closing Time unless such earlier closing time is announced by the Primary Exchange or such Related Exchange at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on the Primary Exchange or such Related Exchange on such Reference Share Business Day for the Primary Exchange or such Related Exchange and (ii) the submission deadline for orders to be entered into the Primary Exchange system for execution at the close of trading on such Reference Share Business Day for the Primary Exchange or such Related Exchange.

"Related Exchange" means each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to the Reference Share.

"Primary Exchange" means the primary exchange or market of trading of the Reference Share.

"Reference Share Business Day" means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

"Scheduled Closing Time" means, with respect to the Primary Exchange or the Related Exchange, on any Reference Share Business Day, the scheduled weekday closing time of the Primary Exchange or such Related Exchange on such Reference Share Business Day, without regard to after hours or any other trading outside of the regular trading session hours.

For purposes of the above definition:

(a) limitation on the hours in a trading day and/or number of days of trading will not constitute a Market Disruption Event if it results from an announced change in the regular business hours of the relevant exchange, and

(b) for purposes of clause (a) above, any limitations on trading during significant market fluctuations, under NYSE Rule 80B, NASD Rule 4120 or any analogous rule or regulation enacted or promulgated by the NYSE, NASD or any other self regulatory organization or the SEC of similar scope as determined by the Calculation Agent, will be considered "material."

Antidilution Adjustments

If one of the corporate events described below occurs, the Calculation Agent will determine whether such corporate event will have a material effect on the Reference Share or the Notes, or in the case of a Potential Adjustment Event, whether such Potential Adjustment Event has a diluting or concentrative effect on the theoretical value of one Reference Share. To the extent the Calculation Agent makes such a determination, the Calculation Agent will make the adjustments and computations described below. The Calculation Agent will also determine the effective date of that adjustment, and the replacement of the Reference Share, if applicable. Upon making any such adjustment, the Calculation Agent will give notice as soon as practicable to the Trustee, stating the adjustment made. The Calculation Agent will provide information about the adjustments it makes upon your written request.

If more than one corporate event requiring adjustment occurs, the Calculation Agent will make such an adjustment for each event in the order in which the events occur, and on a cumulative basis. Thus, having adjusted the Initial Share Price, the Final Share Price, the Cash Settlement Value or any other variable for the first corporate event, the Calculation Agent will adjust the appropriate variables for the second event, applying the required adjustment cumulatively.

To the extent the Calculation Agent makes an adjustment, it will make the adjustment with a view to offsetting, to the extent practical, any change in your economic position relative to the Notes that results solely from that corporate event. The Calculation Agent may modify the antidilution adjustments as necessary to ensure an equitable result.

The following corporate events are those that may require an adjustment:

Merger Events and Tender Offers

Merger Events. A "Merger Event" shall mean, in respect of the Reference Share, any (i) reclassification or change of such Reference Shares that results in a transfer of or an irrevocable commitment to transfer all of the outstanding Reference Share to another person or entity, (ii) consolidation, amalgamation, merger or binding share exchange of the Reference Issuer with or into another entity or person (other than a consolidation, amalgamation, merger or binding share exchange in which such Reference Issuer is the continuing entity and which does not result in a reclassification or change of all of such Reference Shares outstanding), (iii) takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person to purchase or otherwise obtain 100% of the outstanding Reference Shares (other than such Reference Shares owned or controlled by such other entity or person), or (iv) consolidation, amalgamation, merger or binding share exchange of the Reference Issuer or its subsidiaries with or into another entity in which the Reference Issuer is the continuing entity and which does not result in a reclassification or change of the Reference Shares of the Issuer outstanding but results in the outstanding Reference Shares of the Issuer (other than Reference Shares owned or controlled by such other entity) immediately following such event collectively representing less than 50% of the outstanding Reference Shares of the Issuer immediately prior to such event, in each case if the closing date of the Merger Event is on or before the Calculation Date.

Tender Offers. A "Tender Offer" shall mean, in respect of the voting shares of the Reference Issuer, any takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in such entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, not less than 10% of the outstanding voting shares of the Reference Issuer as determined by the Calculation Agent, based upon the making of filings with governmental or self-regulatory agencies or such other information as the Calculation Agent deems relevant.

If a Merger Event or a Tender Offer occurs and the consideration for the Reference Share consists solely of new shares that are publicly quoted, traded or listed on the New York Stock Exchange, American Stock Exchange, or NASDAQ (the "New Reference Share"), then the Reference Share will be adjusted to comprise the number of New Reference Shares to which a holder of one Reference Share immediately prior to the occurrence of the Merger Event or Tender Offer, as the case may be, would be entitled upon consummation of such Merger Event or Tender Offer, and the Calculation Agent shall adjust any or all of the Initial Share Price, the Final Share Price, the Cash Settlement Value or any other variable relevant to the terms of the Notes to account for the economic effect of such Merger Event or Tender Offer. The Calculation Agent will determine the effective date of any such adjustment (as described in this paragraph), and the replacement of the Reference Share, if applicable.

If the Approval Date (as defined herein) for a Merger Event or a Tender Offer occurs, on or prior to the Calculation Date, and the distributions of property made in respect of the Reference Share includes property other than New Reference Shares (other than cash paid in lieu of fractional shares), in whole or in part, then a holder of the Notes will receive a cash amount on the Maturity Date equal to the Consideration Value (as defined herein).

"Consideration Value" per Reference Share means, with respect to an event (other than one in which consideration consists solely of New Reference Shares), the sum of (i) in the case of cash received in such event, the amount of cash so received, and (ii) for any property other than cash received in such event, the market value of such property so received as of the Calculation Date. Any market value determined pursuant to (ii) above shall be determined on the basis of market quotations from four leading dealers in the relevant market. If that property cannot be determined on the basis of market quotations by four leading dealers in the relevant market, then the Calculation Agent will determine the market value of such property.

The "Approval Date" is the closing date of a Merger Event, or, in the case of a Tender Offer, the date on which the person or entity making the Tender Offer acquires or otherwise obtains the relevant percentage of the voting shares of the Reference Issuer.

In the event of a Merger Event or Tender Offer in which a holder of Reference Shares may elect the form of consideration it receives in respect of such Merger Event or Tender Offer, the consideration shall be deemed to consist of the types and amounts of each type of consideration distributed to a holder that makes no election, as determined by the Calculation Agent.

Nationalization, Delisting and Insolvency

Nationalization. "Nationalization" shall mean all the assets or substantially all the assets of the Reference Issuer are nationalized, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

Insolvency. "Insolvency" shall mean that, by reason of the voluntary or involuntary liquidation, bankruptcy or insolvency of, or any analogous proceeding involving, the Reference Issuer, (i) any of the Reference Shares of the Reference Issuer are required to be transferred to a trustee, liquidator or other similar official or (ii) holders of any of the Reference Share become legally prohibited from transferring the Reference Share.

Delisting Event. A "Delisting Event" shall occur, with respect to the Reference Share, if the Primary Exchange announces that pursuant to the rules of the Primary Exchange, the Reference Share cease (or will cease) to be listed, traded or publicly quoted on the Primary Exchange for any reason (other than a Merger Event or Tender Offer) and is not immediately re-listed, re-traded or re-quoted on an exchange or quotation system located in the same country as the Primary Exchange.

If the Announcement Date (as defined herein) for a Nationalization, Insolvency or Delisting Event occurs, on or prior to the Calculation Date, then a holder of the Notes will receive a cash amount on the Maturity Date equal to the Consideration Value (as defined above), which may be zero.

The "Announcement Date" means (i) in the case of a Nationalization, the day of the first public announcement by the relevant government authority that all or substantially all of the assets of the Reference Issuer are to be nationalized, expropriated or otherwise transferred to any governmental agency, authority or entity, (ii) in the case of a Delisting Event, the day of the first public announcement by the Primary Exchange that the Reference Share will cease to trade or be publicly quoted on such exchange, or (iii) in the case of an Insolvency, the day of the first public announcement of the institution of a proceeding or presentation of a petition or passing of a resolution (or other analogous procedure in any jurisdiction) that leads to an Insolvency with respect to the Reference Issuer. In the case of an acceleration of the maturity of the Notes, interest will be paid on the Notes through and excluding the related date of accelerated payment.

Potential Adjustment Events

Potential Adjustment Events. A "Potential Adjustment Event" shall mean, with respect to the Reference Share, any of the following (i) a subdivision, consolidation or reclassification of the Reference Share (other than a Merger Event or Tender Offer), or a free distribution or distribution of Reference Share to existing holders by way of bonus, capitalization or similar issue; (ii) a distribution to existing holders of the Reference Share of (A) Reference Shares, (B) other capital or securities granting the right to payment of distributions and/or proceeds of liquidation of the Reference Issuer equal, proportionate or senior to such payments to holders of such Reference Share or (C) any other type of securities, rights or warrants or other assets, in any case for payments (cash or other) at less than the prevailing market price, as determined by the Calculation Agent; (iii) an extraordinary distribution paid by the Reference Issuer; (iv) a call by the Reference Issuer in respect of Reference Share that are not fully paid; (v) a repurchase of Reference Shares or securities convertible into or exchangeable for Reference Shares, by the Reference Issuer whether out of profits or capital and whether the consideration for such repurchase is cash, securities or otherwise; or (vi) any other similar event that may have a diluting or concentrative effect on the theoretical value of the Reference Share other than Insolvency, Merger Event or Tender Offer, in each case if the Potential Adjustment Event occurs before the Calculation Date.

If a Potential Adjustment Event shall occur, then the Calculation Agent will determine whether such Potential Adjustment Event has a diluting or concentrative effect on the theoretical value of one Reference Share and, if so, will (i) make the corresponding adjustment(s), if any, to the Initial Share Price, the Final Share Price, the Cash Settlement

Value and any other variable (or any combination thereof) as the Calculation Agent determines appropriate to account for that diluting or concentrative effect, and (ii) determine the effective date(s) of the adjustment(s).

Redemption; Defeasance

The Notes are not subject to redemption before maturity, and are not subject to the defeasance provisions described in the section “Description of Debt Securities - Defeasance” in the accompanying prospectus.

Events of Default and Acceleration

If an Event of Default (as defined in the accompanying prospectus) with respect to any Notes has occurred and is continuing, then the amount payable to you, as a holder of a Note, upon any acceleration permitted by the Notes will be equal to the Cash Settlement Value as though the date of early repayment were the Maturity Date of the Notes, adjusted by an amount equal to any losses, expenses and costs to us of unwinding any underlying or related hedging or funding arrangements, all as determined by the Calculation Agent. If a bankruptcy proceeding is commenced in respect of us, the claims of the holder of a Note may be limited under Title 11 of the United States Code.

Same-Day Settlement and Payment

Settlement for the Notes will be made by Bear Stearns in immediately available funds. Payments of the Cash Settlement Value will be made by us in immediately available funds, so long as the Notes are maintained in book-entry form.

Calculation Agent

The Calculation Agent for the Notes will be Bear Stearns. All determinations made by the Calculation Agent will be at the sole discretion of the Calculation Agent and will be conclusive for all purposes and binding on us and the holders of the Notes, absent manifest error and provided the Calculation Agent shall be required to act in good faith in making any determination. Manifest error by the Calculation Agent, or any failure by it to act in good faith, in making a determination adversely affecting the payment of principal, interest or premium on principal to holders would entitle the holders, or the Trustee acting on behalf of the holders, to exercise rights and remedies available under the Indenture. If the Calculation Agent uses its discretion to make any determination, the Calculation Agent will notify us and the Trustee, who will provide notice to the registered holders of the Notes.

DESCRIPTION OF THE REFERENCE SHARE

Neither the Issuer nor any of its affiliates assumes any responsibility for the adequacy or accuracy of the information about the Reference Issuer contained in this Pricing Supplement or in any publicly available filings made by the Reference Issuer. You should make your own investigation into the Reference Issuer.

NYSE Group, Inc. (NYSE: NYX)

According to publicly available information, NYSE Group, Inc. ("NYX") operates multiple securities market centers in the United States. NYX operates New York Stock Exchange (NYSE) and NYSE Arca securities market centers. NYX, through these market centers, engages in securities listings; providing market-information products and services; and offering various investment vehicles and order execution services. NYSE is a liquid equities market, where customers could choose between the floor-based auction markets and subsecond electronic trading. NYSE provides a marketplace, where investors meet directly to buy and sell listed companies' common stock and other securities. NYX trades in approximately 480 closed-end funds that offer investors professional management, portfolio diversification, and liquidity and trading; offers approximately 980 corporate, agency, and government bonds; and trades in exchange-traded fund products. NYSE also provides order execution services that primarily include NYSE Direct+, Anonymous SuperDOT, and SuperDot, which help market professionals to execute and manage orders; trades in approximately 600 structured products; and offers information products. The common stock of NYX started trading on NYSE on March 7, 2006; therefore, the historical prices of NYX commenced on and from March 7, 2006.

The Reference Shares are registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Companies with securities registered under the Exchange Act are required to file periodically certain financial and other information specified by the Commission. Information provided to or filed with the Commission can be inspected and copied at the public reference facilities maintained by the Commission at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549 or at its Regional Offices located at Suite 1400, Citicorp Center, 500 West Madison Street, Chicago, Illinois 60661 and at the Woolworth Building, 233 Broadway, New York, New York 10279, and copies of such material can be obtained from the Public Reference Section of the Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. In addition, information provided to or filed with the Commission electronically can be accessed through a website maintained by the Commission. The address of the Commission's website is http://www.sec.gov. In addition, information regarding the Company may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of such reports.

This Pricing Supplement relates only to the Notes offered hereby and does not relate to the Reference Share or other securities of the Reference Issuer. The Issuer has derived all disclosures contained in this Pricing Supplement regarding the Reference Issuer from the publicly available documents described in the preceding paragraph. The Issuer has not participated in the preparation of such documents or made any due diligence inquiry with respect to the Reference Issuer in connection with the offering of the Notes. The Issuer makes no representation that such publicly available documents or any other any other publicly available information regarding the Reference Issuer are accurate or complete. Furthermore, the Issuer cannot give any assurance that all events occurring prior to the date hereof (including events that would affect the accuracy or completeness of the publicly available documents described in the preceding paragraph) that would affect the trading price of Reference Share (and therefore the Initial Share Price and the Cash Settlement Value) have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning the Reference Issuer could affect the value received on any date with respect to the Notes and, therefore, the trading value of the Notes. The Issuer does not have any obligation to disclose any information about the Reference Issuer or the Reference Share after the date of this Pricing Supplement.

Historical Performance of the Reference Share

The following table sets forth the month ending closing prices of the Reference Share for each calendar month in the period from March 1, 2006 to February 28, 2007. The Reference Share closing prices listed below were obtained from the Bloomberg Financial Service, without independent verification by the Issuer. The historical prices of the Reference Share should not be taken as an indication of future performance, and no assurance can be given that the price of the Reference Share will not decrease to or below the Initial Share Price during the term of the Notes. In addition, no assurance can be given that the price of the Reference Share will perform sufficiently from year to year to cause the holders of the Notes to receive 100% of the principal amount of the Notes.

Month-End Closing price of the Reference Share

	2006	**2007**
January	N/A	99.98
February	N/A	84.90
March	79.25	—
April	66.40	—
May	59.80	—
June	68.48	—
July	62.19	—
August	59.30	—
September	74.75	—
October	74.05	—
November	100.10	—
December	97.20	—

* All historical prices are denominated in USD and rounded to the nearest penny.

** All historical prices were calculated as of the last Reference Share Business Day of the relevant month.

*** The common stock of NYX started trading on NYSE on March 7, 2006; therefore, the historical prices of NYX commenced on and from March 7, 2006.

The following graph illustrates the historical performance of the Reference Share based on the closing price on the last Reference Share Business Day of each month from March 2006 to February 2007.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes certain of the material U.S. federal income tax consequences of the purchase, beneficial ownership, and disposition of the Notes. For purposes of this summary, a "U.S. holder" is a beneficial owner of a Note that is:

- an individual who is a citizen or a resident of the United States, for federal income tax purposes;
- a corporation (or other entity that is treated as a corporation for federal tax purposes) that is created or organized in or under the laws of the United States or any State thereof (including the District of Columbia);
- an estate whose income is subject to federal income taxation regardless of its source; or
- a trust if a court within the United States is able to exercise primary supervision over its administration, and one or more United States persons (as defined for federal income tax purposes) have the authority to control all of its substantial decisions.

For purposes of this summary, a "non-U.S. holder" is a beneficial owner of a Note that is:

- a nonresident alien individual for federal income tax purposes;
- a foreign corporation for federal income tax purposes;
- an estate whose income is not subject to federal income tax on a net income basis; or
- a trust if no court within the United States is able to exercise primary jurisdiction over its administration or if United States persons (as defined for federal income tax purposes) do not have the authority to control all of its substantial decisions.

An individual may, subject to certain exceptions, be deemed to be a resident of the United States for federal income tax purposes by reason of being present in the United States for at least 31 days in the calendar year and for an aggregate of at least 183 days during a three year period ending in the current calendar year (counting for those purposes all of the days present in the current year, one third of the days present in the immediately preceding year, and one sixth of the days present in the second preceding year).

This summary is based on interpretations of the Code, regulations issued thereunder, and rulings and decisions currently in effect (or in some cases proposed), all of which are subject to change. Any of those changes may be applied retroactively and may adversely affect the federal income tax consequences described herein. This summary addresses only holders that purchase Notes at initial issuance, and own Notes as capital assets and not as part of a "straddle," "hedge," "synthetic security," or "conversion transaction" for federal income tax purposes or as part of some other integrated investment. This summary does not discuss all of the tax consequences that may be relevant to particular investors or to investors subject to special treatment under the federal income tax laws (such as banks, thrifts or other financial institutions; insurance companies; securities dealers or brokers, or traders in securities electing mark-to-market treatment; regulated investment companies or real estate investment trusts; small business investment companies; S corporations; investors that hold their Notes through a partnership or other entity treated as a partnership for federal tax purposes; investors whose functional currency is not the U.S. dollar; certain former citizens or residents of the United States; persons subject to the alternative minimum tax; retirement plans or other tax-exempt entities, or persons holding the Notes in tax-deferred or tax-advantaged accounts; or "controlled foreign corporations" or "passive foreign investment companies" for federal income tax purposes). This summary also does not address the tax consequences to shareholders, or other equity holders in, or beneficiaries of, a holder, or any state, local or foreign tax consequences of the purchase, ownership or disposition of the Notes.

PROSPECTIVE PURCHASERS OF NOTES SHOULD CONSULT THEIR TAX ADVISORS AS TO THE FEDERAL, STATE, LOCAL, AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF NOTES.

In General

There are no statutory provisions, regulations, published rulings or judicial decisions addressing the characterization for federal income tax purposes of securities with terms that are substantially the same as those of the Notes. Accordingly, the proper U.S. federal income tax treatment of the Notes is uncertain. Under one approach, the Notes would be treated as pre-paid cash-settled forward contracts with respect to the Reference Share. The Issuer intends to treat the Notes consistent with this approach, and pursuant to the terms of the Notes, you agree to treat the Notes consistent with this approach. Except as otherwise provided in "—Alternative Characterizations and Treatments," the balance of this summary assumes that the Notes are so treated.

Federal Income Tax Treatment of U.S. Holders

Upon the receipt of cash at the maturity of the Note or upon the sale, exchange or other disposition of a Note in a taxable transaction, a U.S. holder generally will recognize gain or loss equal to the difference between the amount realized at maturity or upon the sale, exchange or other disposition and the U.S. holder's tax basis in the Note. A U.S. holder's tax basis in a Note will generally be equal to the U.S. holder's cost for the Note. Any such gain or loss generally will constitute capital gain or loss, and if the U.S. holder held the Notes for more than a year at the time of maturity, sale, exchange or other disposition, generally should be long-term capital gain or loss. Long-term capital gains of non-corporate taxpayers are generally eligible for reduced rates of taxation. The ability of U.S. holders to use capital losses to offset ordinary income is limited.

Alternative Characterizations and Treatments

Although the Issuer intends to treat each Note as a pre-paid cash-settled forward contract as described above, there are no statutory provisions, regulations, published rulings or judicial decisions addressing the characterization of securities with terms that are substantially the same as those of the Notes, and therefore the Notes could be subject to some other characterization or treatment for federal income tax purposes. For example, each Note could be treated as a "contingent payment debt instrument" for federal income tax purposes. In this event, a U.S. holder would be required to accrue original issue discount income, subject to adjustments, at the "comparable yield" of the Notes and any gain recognized with respect to the Note generally would be treated as ordinary income. Alternatively, it is possible that each Note could be treated as consisting of a cash-settled forward contract with respect to the Reference Shares and a deposit with us of cash in an amount equal to the principal amount of a Note to secure the holder's obligation to settle the forward contract, in which case a U.S. Holder would be required to accrue interest income or original issue discount on a current basis in respect of the deposit. Prospective investors should consult their tax advisors as to the federal income tax consequences to them if the Notes are treated as debt instruments for federal income tax purposes.

In addition, certain proposed Treasury regulations require the accrual of income on a current basis for contingent payments made under certain "notional principal contracts." The preamble to the proposed regulations states that the "wait and see" method of accounting does not properly reflect the economic accrual of income on those contracts and requires current accrual of income for some contracts already in existence. While the proposed regulations do not apply to pre-paid cash-settled forward contracts, the preamble to the proposed regulations indicates that similar timing issues exist in the case of pre-paid cash-settled forward contracts. If the IRS or the U.S. Treasury Department publishes future guidance requiring current economic accrual for contingent payments on pre-paid cash-settled forward contracts, it is possible that a U.S. holder could be required to accrue income over the term of the Notes.

Other alternative federal income tax characterizations or treatments of the Notes are possible and, if applied, could also affect the timing and the character of the income, gain, or loss with respect to the Notes.

Prospective investors in the Notes should consult their tax advisors as to the tax consequences to them of purchasing Notes, including any alternative characterizations and treatments.

Federal Income Tax Treatment of Non-U.S. Holders

A non-U.S. holder that is not subject to U.S. federal income tax as a result of any direct or indirect connection to the United States other than its ownership of a Note should not be subject to U.S. federal income or withholding tax in respect of the Notes so long as (1) the non-U.S. holder provides an appropriate statement, signed under penalties of perjury, identifying the non-U.S. holder and stating, among other things, that the non-U.S. holder is not a United States person (as defined for federal income tax purposes), (2) the non-U.S. holder is not a bank that has purchased the Notes in the ordinary course of its trade or business of making loans, as described in section 881(c)(3)(A) of the Code, (3) the non-U.S. holder is not a "10-percent shareholder" within the meaning of section 871(h)(3)(B) of the Code or a "related controlled foreign corporation" within the meaning of section 881(c)(3)(C) of the Code with respect to the Issuer, and (4) the Reference Shares are actively traded within the meaning of section 871(h)(4)(C)(v) of the Code. Unless the applicable pricing supplement indicates otherwise, we expect that the Reference Shares will be treated as actively traded within the meaning of section 871(h)(4)(C)(v) of the Code.

If any of these conditions are not met, a 30% withholding tax may apply to payments on the Notes, unless an income tax treaty reduces or eliminates such tax or the income is effectively connected with the conduct of a trade or business within the United States by such non-U.S. holder. In the latter case, such non-U.S. holder should be subject to U.S. federal income tax with respect to all income from the Notes at regular rates applicable to U.S. taxpayers, and, for a foreign corporation, possibly branch profits tax, unless an applicable treaty reduces or eliminates such tax.

In general, the gain realized on the maturity, sale, exchange or other disposition of the Notes by a non-U.S. holder should not be subject to U.S. federal income tax unless the gain is effectively connected with a trade or business conducted by the non-U.S. holder in the United States, in which case the non-U.S. holder will generally be subject to U.S. federal income tax on any income or gain in respect of the Note at the regular rates applicable to U.S. taxpayers, and, for a foreign corporation, possibly branch profits tax, unless an applicable treaty reduces or eliminates such tax, or the non-U.S. holder is an individual that is present in the United States for 183 days or more in the taxable year of the maturity, sale, exchange or other disposition and certain other conditions are satisfied, in which case the non-U.S. holder will generally be subject to tax at a rate of 30% on the amount by which the non-U.S. holder's capital gains derived from the maturity, sale, exchange, retirement or other disposition of the Notes and other assets that are from U.S. sources exceed capital losses allocable to U.S. sources.

Information Reporting and Backup Withholding

Distributions made on the Notes and proceeds from the sale of Notes to or through certain brokers may be subject to a "backup" withholding tax on "reportable payments" unless, in general, the holder of Notes complies with certain procedures or is an exempt recipient. Any amounts so withheld from distributions on the Notes generally would be refunded by the IRS or allowed as a credit against the holder of Notes federal income tax, provided the holder of Notes makes a timely filing of an appropriate tax return or refund claim.

Reports will be made to the IRS and to holder of Notes that are not exempt from the reporting requirements.

CERTAIN ERISA CONSIDERATIONS

Section 4975 of the Code prohibits the borrowing of money, the sale of property and certain other transactions involving the assets of plans that are qualified under the Code (“Qualified Plans”) or individual retirement accounts (“IRAs”) and persons who have certain specified relationships to them. Section 406 of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), prohibits similar transactions involving employee benefit plans that are subject to ERISA (“ERISA Plans”). Qualified Plans, IRAs and ERISA Plans are referred to as “Plans.”

Persons who have such specified relationships are referred to as “parties in interest” under ERISA and as “disqualified persons” under the Code. “Parties in interest” and “disqualified persons” encompass a wide range of persons, including any fiduciary (for example, investment manager, trustee or custodian) of a Plan, any person providing services (for example, a broker) to a Plan, the Plan sponsor, an employee organization any of whose members are covered by the Plan, and certain persons related to or affiliated with any of the foregoing.

The purchase and/or holding of Notes by a Plan with respect to which we, Bear Stearns and/or certain of our affiliates is a fiduciary and/or a service provider (or otherwise is a “party in interest” or “disqualified person”) would constitute or result in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code, unless such Notes are acquired or held pursuant to and in accordance with an applicable statutory or administrative exemption. Each of us and Bear Stearns are considered a “disqualified person” under the Code or a “party in interest” under ERISA with respect to many Plans, although neither we nor Bear Stearns can be a “party in interest” to any IRA other than certain employer-sponsored IRAs, as only employer-sponsored IRAs are covered by ERISA.

Applicable administrative exemptions may include certain prohibited transaction class exemptions (for example, Prohibited Transaction Class Exemption (“PTCE”) 84−14 relating to qualified professional asset managers, PTCE 96−23 relating to certain in-house asset managers, PTCE 91−38 relating to bank collective investment funds, PTCE 90−1 relating to insurance company separate accounts and PTCE 95−60 relating to insurance company general accounts).

It should also be noted that the Pension Protection Act of 2006 contains a statutory exemption from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code for transactions involving certain parties in interest or disqualified persons who are such merely because they are a service provider to a Plan, or because they are related to a service provider. Generally, the exemption would be applicable if the party to the transaction with the Plan is a party in interest or a disqualified person to the Plan but is not (i) an employer, (ii) a fiduciary who has or exercises any discretionary authority or control with respect to the investment of the Plan assets involved in the transaction, (iii) a fiduciary who renders investment advice (within the meaning of ERISA and Section 4975 of the Code) with respect to those assets, or (iv) an affiliate of (i), (ii) or (iii). Any Plan fiduciary relying on this new statutory exemption (Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code) and purchasing Notes on behalf of a Plan will be deemed to represent that (x) the fiduciary has made a good faith determination that the Plan is paying no more than, and is receiving no less than, adequate consideration in connection with the transaction and (y) neither we, Bear Stearns, nor any of our affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice (as defined above) with respect to the assets of the Plan which such fiduciary is using to purchase the Notes, both of which are necessary preconditions to utilizing this exemption. Any purchaser that is a Plan is encouraged to consult with counsel regarding the application of this exemption.

A fiduciary who causes a Plan to engage, directly or indirectly, in a non-exempt prohibited transaction may be subject to a penalty under ERISA, and may be liable for any losses to the Plan resulting from such transaction. Code Section 4975 generally imposes an excise tax on disqualified persons who engage, directly or indirectly, in non-exempt transactions with the assets of Plans subject to such Section. If an IRA engages in a prohibited transaction, the assets of the IRA are deemed to have been distributed to the IRA beneficiaries.

In accordance with ERISA's general fiduciary requirements, a fiduciary with respect to any ERISA Plan who is considering the purchase of Notes on behalf of such plan should consider the foregoing information and the information set forth in the applicable prospectus supplement and any applicable pricing supplement, and should determine whether such purchase is permitted under the governing plan document and is prudent and appropriate for the ERISA Plan in view of its overall investment policy and the composition and diversification of its portfolio. Fiduciaries of Plans established with, or for which services are provided by, us, Bear Stearns, and/or certain of our affiliates should consult with counsel before making any acquisition. Each purchaser of any Notes, the assets of which constitute the assets of one or more Plans, and each fiduciary that directs such purchaser with respect to the purchase or holding of such Notes, will be deemed to represent that the purchase, holding and disposition of the Notes does not and will not constitute a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code for which an exemption is not available.

Certain employee benefit plans, such as governmental plans (as defined in Section 3(32) of ERISA) and, if no election has been made under Section 410(d) of the Code, church plans (as defined in Section 3(33) of ERISA), are not subject to Section 406 of ERISA or Section 4975 of the Code. However, such plans may be subject to the provisions of applicable federal, state or local law ("Similar Law") similar to the foregoing provisions of ERISA or the Code. Fiduciaries of such plans ("Similar Law Plans") should consider applicable Similar Law when investing in the Notes. Each fiduciary of a Similar Law Plan will be deemed to represent that the Similar Law Plan's acquisition and holding of the Notes will not result in a non-exempt violation of applicable Similar Law.

The sale of any Note to a Plan or a Similar Law Plan is in no respect a representation by us or any of our affiliates that such an investment meets all relevant legal requirements with respect to investments by Plans or Similar Law Plans generally or any particular Plan or Similar Law Plan, or that such an investment is appropriate for a Plan or a Similar Law Plan generally or any particular Plan or Similar Law Plan.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds from the sale of the Notes for general corporate purposes. We or one or more of our subsidiaries (including BSIL) may hedge our obligations under the Notes by the purchase and sale of the Reference Share, exchange-traded and over-the-counter options on, or other derivative or synthetic instruments related to, the Reference Share, individual futures contracts on the Reference Share, futures contracts on the Reference Share and/or options on these futures contracts. At various times after the initial offering and before the maturity of the Notes, depending on market conditions (including the price of the Reference Share), in connection with hedging with respect to the Notes, we expect that we and/or one or more of our subsidiaries will increase or decrease those initial hedging positions using dynamic hedging techniques and may take long or short positions in any of these instruments. We or one or more of our subsidiaries may also take positions in other types of appropriate financial instruments that may become available in the future. If we or one or more of our subsidiaries has a long hedge position in any of these instruments then we or one or more of our subsidiaries may liquidate a portion of these instruments at or about the time of the maturity of the Notes. Depending on, among other things, future market conditions, the total amount and the composition of such positions are likely to vary over time. We will not be able to ascertain our profits or losses from any hedging position until such position is closed out and any offsetting position or positions are taken into account. Although we have no reason to believe that such hedging activity will have a material effect on the price of any of these instruments or on the price of the Reference Share, we cannot guarantee that we and one or more of our subsidiaries will not affect such prices as a result of its hedging activities. You should also refer to "Use of Proceeds" in the accompanying prospectus.

SUPPLEMENTAL PLAN OF DISTRIBUTION

Subject to the terms and conditions set forth in the Distribution Agreement dated as of June 19, 2003, as amended, we have agreed to sell to Bear Stearns, as principal, and Bear Stearns has agreed to purchase from us, the aggregate principal amount of Notes set forth opposite its name below.

Agent	**Principal Amount of Notes**
Bear, Stearns & Co. Inc.	$[n]
Total	$[n]

The Agent intends to initially offer $[n] of the Notes to the public at the offering price set forth on the cover page of this pricing supplement, and to subsequently resell the remaining face amount of the Notes at prices related to the prevailing market prices at the time of resale. Potential investors should understand that, as described on the cover, investors who purchase an aggregate amount of at least $1,000,000 of Notes in this initial distribution will be entitled to purchase such Notes for 99.00% of the principal amount. In the future, the Agent may repurchase and resell the Notes in market-making transactions, with resales being made at prices related to prevailing market prices at the time of resale or at negotiated prices. We will offer the Notes to Bear Stearns at a discount of [n]% of the price at which the Notes are offered to the public. Bear Stearns may reallow a discount to other agents not in excess of [n]% of the public offering price.

In order to facilitate the offering of the Notes, we may grant the Agent a 30-day option from the date of the final pricing supplement, to purchase from us up to an additional $[n] at the public offering price, less the agent's discount, to cover any over-allotments. The Agent may over-allot or effect transactions which stabilize or maintain the market price of the Notes at a price higher than that which might otherwise prevail in the open market. Specifically, the Agent may over-allot or otherwise create a short position in the Notes for its own account by selling more Notes than have been sold to it by us. If this option is exercised, in whole or in part, subject to certain conditions, the Agent will become obligated to purchase from us and we will be obligated to sell to the Agent an amount of Notes equal to the amount of the over-allotment exercised. The Agent may elect to cover any such short position by purchasing Notes in the open market. No representation is made as to the magnitude or effect of any such stabilization or other transactions. Such stabilizing, if commenced, may be discontinued at any time and in any event shall be discontinued within a limited period. No other party may engage in stabilization.

Payment of the purchase price shall be made in funds that are immediately available in New York City.

The agents may be deemed to be "underwriters" within the meaning of the Securities Act of 1933, as amended (the "Securities Act"). We have agreed to indemnify the agents against or to make contributions relating to certain civil liabilities, including liabilities under the Securities Act. We have agreed to reimburse the agents for certain expenses.

The Notes are a new issue of securities with no established trading market. The Notes will not be listed on any securities exchange and we do not expect a trading market will develop. Bear Stearns has advised us that, following completion of the offering of the Notes, it intends under ordinary market conditions to indicate prices for the Notes on request, although it is under no obligation to do so and may discontinue any market-making activities at any time without notice. Accordingly, no guarantees can be given as to whether an active trading market for the Notes will develop or, if such a trading market develops, as to the liquidity of such trading market. We cannot guarantee that bids for outstanding Notes will be made in the future; nor can we predict the price at which any such bids will be made. The Notes will cease trading as of the close of business on the Maturity Date.

Because Bear Stearns is our wholly-owned subsidiary, each distribution of the Notes will conform to the requirements set forth in Rule 2720 of the NASD Conduct Rules.

LEGAL MATTERS

The validity of the Notes will be passed upon for us by Cadwalader, Wickersham & Taft LLP, New York, New York.

You should only rely on the information contained in this pricing supplement, the accompanying prospectus supplement and prospectus. We have not authorized anyone to provide you with information or to make any representation to you that is not contained in this pricing supplement, the accompanying prospectus supplement and prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. This pricing supplement, the accompanying prospectus supplement and prospectus are not an offer to sell these Notes, and these documents are not soliciting an offer to buy these Notes, in any jurisdiction where the offer or sale is not permitted. You should not under any circumstances assume that the information in this pricing supplement, the accompanying prospectus supplement and prospectus is correct on any date after their respective dates.

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Pricing Supplement

Prospectus Supplement

The Bear Stearns Companies Inc.

$[n]

Medium-Term Notes, Series B

Accelerated Market Participation Securities

Linked to the common stock of NYSE Group, Inc.
Due April [n], 2008

PRICING SUPPLEMENT

Prospectus

Bear, Stearns & Co. Inc.

March [n], 2007

unit as of the quarterly distribution paid on January 14, 2004. On April 14, 2004, we paid a quarterly distribution of $0.70 per unit, or $2.80 per unit annually, to the Unitholders of record at the close of business on April 2, 2004. On June 17, 2004, we announced that we raised the quarterly distribution to $0.75 per unit (an annualized rate of $3.00) an increase of $0.05 per unit (an annualized increase of $0.20 per unit) to the Unitholders of record as of July 2, 2004. On September 20, 2004, we announced another increase to our quarterly distribution, raising it to $0.825 per unit, or $3.30 per unit annually. This distribution represented an increase of $0.075 per unit (an annualized increase of $0.30 per unit) over the distribution paid for the third quarter of fiscal 2004. The distribution was payable on October 15, 2004 to Unitholders of record as of the close of business on October 7, 2004. The current distribution includes incentive distributions payable to the General Partner to the extent the quarterly distribution exceeds $0.55 per unit (an annualized rate of $2.20).

Description of Indebtedness

In connection with its initial public offering, on June 25, 1996, Heritage entered into a Note Purchase Agreement whereby Heritage issued $120 million principal amount of 8.55% Senior Secured Notes (the Notes) with institutional investors. Interest is payable semi-annually in arrears on each December 31 and June 30. The Notes have a final maturity of June 30, 2011, with ten equal mandatory repayments of principal, which began on June 30, 2002. At August 31, 2004, $84 million of principal debt was outstanding under the Senior Secured Notes.

On November 19, 1997, Heritage entered into a Note Purchase Agreement (Medium Term Note Program) that provided for the issuance of up to $100 million of senior secured promissory notes if certain conditions were met. An initial placement of $32 million (Series A and B), at an average interest rate of 7.23% with an average 10-year maturity, was completed at the closing of the Medium Term Note Program. Interest is payable semi-annually in arrears on each November 19 and May 19. An additional placement of $15 million (Series C, D and E), at an average interest rate of 6.59% with an average 12-year maturity, was completed in March 1998. Interest is payable on Series C and D semi-annually in arrears on each September 13 and March 13. The proceeds of the placements were used to refinance amounts outstanding under the Acquisition Facility. No future placements are permitted under the unused portion of the Medium Term Note Program. During the fiscal year ended August 31, 2003, Heritage used $3.9 million and $5.0 million of the proceeds from the issuance of 1,610,000 of Common Units

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to retire the balance of the Series D and Series E Senior Secured Notes, respectively. At August 31, 2004, $31.8 million of principal debt was outstanding under the Medium Term Note Program.

On August 10, 2000, Heritage entered into a Note Purchase Agreement (Senior Secured Promissory Notes) that provided for the issuance of up to $250 million of fixed rate senior secured promissory notes if certain conditions were met. An initial placement of $180 million (Series A through F) at an average rate of 8.66% with an average 13-year maturity, was completed in conjunction with the merger with U.S. Propane. Interest is payable quarterly. The proceeds were used to finance the transaction with U.S. Propane and retire a portion of existing debt. On May 24, 2001, Heritage issued an additional $70 million (Series G through I) of the Senior Secured Promissory Notes to a group of institutional lenders with 7-, 12- and 15-year maturities and an average coupon rate of 7.66%. Heritage used the net proceeds from the Senior Secured Promissory Notes to repay the balance outstanding under the Acquisition Facility and to reduce other debt. Interest is payable quarterly. During the fiscal year ended August 31, 2003, Heritage used $7.5 million and $19.5 million of the proceeds from the issuance of 1,610,000 of Common Units to retire a portion of the Series G and Series H Senior Secured Promissory Notes, respectively. At August 31, 2004, $208.2 million of principal debt was outstanding under the Senior Secured Promissory Notes.

The Note Agreements for each of the Senior Secured Notes, Medium Term Note Program and Senior Secured Promissory Notes, and the Operating Partnership s bank credit facilities contain customary restrictive covenants applicable to the Operating Partnerships, changes in ownership of the Operating Partnerships, including limitations on the level of additional indebtedness, creation of liens, and substantial disposition of assets. These covenants require the Operating Partnerships to maintain ratios of Consolidated Funded Indebtedness to Consolidated EBITDA (as these terms are similarly defined in the bank credit facilities and the Note Agreements) of not more than 4.75 to 1 for HOLP s bank credit facility and Note Agreements and 4.75 to 1.0 during the 365-day period following the funding of the purchase price of the ET Fuel System and to 4.00 to 1.00 during any period other than the 365-day period following the funding of the purchase price of the ET Fuel System for ETC OLP s bank credit facility and Consolidated EBITDA to Consolidated Interest Expense (as these terms are similarly defined in the bank credit facilities and the Note Agreements) of not less than 2.25 to 1 for HOLP s bank credit facility and Note Agreements and 2.75 to 1 for ETC OLP s bank credit facility. The Consolidated EBITDA used to determine these ratios is calculated in accordance with these debt agreements. For purposes of calculating the ratios under the bank credit facilities and the Note Agreements, Consolidated EBITDA is based upon the Operating Partnership s EBITDA, as adjusted, during the most recent four quarterly periods and modified to give pro forma effect for acquisitions and divestures made during the test period, and is compared to Consolidated Funded Indebtedness as of the test date and the Consolidated Interest Expense for the most recent twelve months. The debt agreements also provide that the Operating Partnerships may declare, make, or incur a liability to make, a restricted payment during each fiscal quarter, if: (a) the amount of such restricted payment, together with all other restricted payments during such quarter, do not exceed Available Cash with respect to the immediately preceding quarter; (b) no default or event of default exists before such restricted payment; and (c) each Operating Partnership s restricted payment is not greater than the product of each Operating Partnership s Percentage of Aggregate Partner Obligations (as these terms are similarly defined in the bank credit facilities and the Note Agreements). The debt agreements further provide that HOLP s Available Cash is required to reflect a reserve equal to 50% of the interest to be paid on the notes. In addition, in the third, second and first quarters preceding a quarter in which a scheduled principal payment is to be made on the notes, Available Cash is required to reflect a reserve equal to 25%, 50%, and 75%, respectively, of the principal amount to be repaid on such payment dates.

Failure to comply with the various restrictive and affirmative covenants of the Operating Partnership s bank credit facilities and the Note Agreements could negatively impact our ability to incur additional debt and our ability to pay distributions. We are required to measure these financial tests and covenants quarterly and was in compliance or had no continuing defaults with all financial requirements, tests, limitations, and covenants related to financial ratios under the Senior Secured Notes, Medium Term Note Program, Senior Secured Promissory Notes, and the bank credit facilities at August 31, 2004. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of HOLP and its subsidiaries secure the Senior Secured, Medium Term, and Senior Secured Promissory Notes. In addition to the stated interest rate for the Notes, we are required to pay an additional 1% per annum on the outstanding balance of the Notes at such time as the Notes are not rated investment grade status or higher. On April 18, 2004 the Notes were rated investment grade or better thereby alleviating the requirement that we pay the additional 1% interest. All of the ETC OLP assets secure the bank credit facilities of ETC OLP.

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The following table summarizes our long-term debt and other contractual obligations as of August 31, 2004:

In thousands	**Payments Due by Period**				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1 3 Years**	**3 5 Years**	**More Than 5 Years**
Long-term debt	$1,101,828	$30,957	$111,077	$813,665	$146,129
Interest on long-term debt (a)	257,463	60,377	110,060	46,946	40,080
Operating lease obligations	13,437	4,794	5,152	2,863	628
Totals	$1,372,728	$96,128	$226,289	$863,474	$186,837

(a) Interest expense includes fixed rate debt on the assumed outstanding principal and interest on variable rate debt at the current interest rates on the bank credit facilities. See Note 5 Working Capital Facility and Long-Term Debt to the Consolidated Financial Statements beginning on Page F-1 of this report for further discussion of the long-term debt classifications and the maturity dates and interest rates related to long-term debt.

New Accounting Standards

In January of 2003, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 46 *Consolidation of Variable Interest Entities An Interpretation of ARB No. 51* (FIN 46). In December 2003, the FASB issued FIN 46R, which clarified certain issues identified in FIN 46. FIN 46R requires an entity to consolidate a variable interest entity to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the entity does not have a majority of voting interest. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception of any entity created after January 31, 2003. For an entity created before February 1, 2003, the provisions of this interpretation must be applied at the beginning of the first interim or annual period beginning after March 15, 2004. The adoption did not have an impact on the Partnerships consolidated financial position or results of operations.

As of August 31, 2004, we own various unconsolidated entities in which our share of the unconsolidated entities range from 49% to 50%. We account for our investments under the equity method of accounting as prescribed by APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. We do not control these entities and each partner shares in all profits and losses equal to their respective share in the entities. There are no limits on the exposure to losses or on the ability to share in returns. Based on the analysis performed, we are not the primary beneficiary of the entities, and as a result, we will not consolidate the entities but will continue to account for our investment in these entities under the equity method.

In May 2003, the FASB issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS 150 as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We adopted the provisions of

SFAS 150 as of September 1, 2003. The adoption did not have a material impact on the Partnership s consolidated financial position or results of operations.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to establish accounting policies and make estimates and assumptions that affect reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The selection and application of accounting policies is an important process that has developed as our business activities have evolved and as the accounting rules have developed. Accounting rules generally do not involve a selection among alternatives, but involve an implementation and interpretation of existing rules, and the use of judgment applied to the specific set of circumstances existing in our business. We make every effort to properly comply with all applicable rules on or before their adoption, and we believe the proper implementation and consistent application of the accounting rules are critical. Our critical accounting policies are discussed below. For further details on our accounting policies and a discussion of new accounting pronouncements, see Note 3 Summary of Significant Accounting Policies and Balance Sheet Detail to the Consolidated Financial Statements beginning on page F-1 of this report. We believe the following are critical accounting policies:

Revenue Recognition. We recognize revenue for sales or services at the time the natural gas or NGLs are delivered or at the time the service is performed. Transportation capacity payments are recognized when earned in the period the capacity is made available. Sales of propane, propane appliances, parts, and fitting are recognized at the later of the time of delivery of the product to the customer or the time of sale or installation. Revenue from service labor is recognized upon completion of the service and tank rent is recognized ratably over the period it is earned. Shipping and handling revenues are included in the price of propane charged to customers, and thus are classified as revenues.

Marketable Securities. We have marketable securities that are classified as available-for-sale. Unrealized holding losses occur as a result of declines in the market value of our holdings. The fair market value of these holdings is determined based upon the market price of the securities, which are publicly traded securities. Based on the performance of the securities over the preceding nine-month period, we reviewed the fair market value to determine if an other-than temporary impairment should be recorded.

Impairment of Long-Lived Assets and Goodwill. Long-lived assets are required to be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Goodwill must be tested for impairment annually or more frequently if events or changes in circumstances indicate that the related asset might be impaired. An impairment loss should be recognized only if the carrying amount of the asset/goodwill is not recoverable and exceeds its fair value.

In order to test for recoverability, we must make estimates of projected cash flows related to the asset which include, but are not limited to, assumptions about the use or disposition of the asset, estimated remaining life of the asset, and future expenditures necessary to maintain the asset s existing service potential. In order to determine fair value, we make certain estimates and assumptions, including, among other things, changes in general economic conditions in regions in which our markets are located, the availability and prices of natural gas and propane supply, our ability to negotiate favorable sales agreements, the risks that natural gas exploration and production activities will not occur or be successful, our dependence on certain significant customers and producers of natural gas, and competition from other midstream companies, including major energy producers. Due to the subjectivity of the assumptions used to test for recoverability and to determine fair value, significant impairment charges could result in the future, thus affecting our future reported net income.

Stock Based Compensation Plans. We account for our stock compensation plans following the fair value recognition method. This method was adopted as we believe it is the preferable method of accounting for stock based compensation. Please see the caption Stock Based Compensation Plans in Note 3 Summary of Significant Accounting Policies and Balance Sheet Detail to the Consolidated Financial Statements beginning on page F-1 of this report for additional information about this adoption.

Property, Plant, and Equipment. Maintenance capital expenditures are capital expenditures made to replace partially or fully depreciated assets in order to maintain the existing operating capacity of our assets and to extend their useful lives. Maintenance capital expenditures also include capital expenditures made to connect additional wells to our systems in order to maintain or increase throughput on its existing assets. Growth or expansion capital expenditures are capital expenditures made to expand the existing operating capacity of our assets, whether through construction or acquisition. We treat repair and maintenance expenditures that do not extend the useful life of existing assets as operating expenses as we incur them. Upon disposition or retirement of pipeline components or gas plant components, any gain or loss is recorded to accumulated depreciation. When entire pipeline systems, gas plants or other property and equipment are retired or sold, any gain or loss is included in operations. Depreciation of property, plant and equipment is provided using the straight-line method based on their estimated useful life ranging from 5 to 65 years. Changes in the estimated useful lives of the assets could have a material effect on our results of operation. We do not anticipate future changes in the estimated useful live of our property, plant, and equipment.

Amortization of Intangible Assets. We calculate amortization using the straight-line method over periods ranging from 2 to 15 years. We use amortization methods and determine asset values based on management s best estimate using reasonable and supportable assumptions and projections. Changes in the amortization methods or asset values could have a material effect on our results of operations. We do not anticipate future changes in the estimated useful lives of our intangible assets.

Fair Value of Derivative Commodity Contracts. We utilize various exchange-traded and over-the-counter commodity financial instrument contracts to limit our exposure to margin fluctuations in natural gas, NGL and propane prices. These contracts consist primarily of commodity forward, future, swaps, options and certain basis contracts as cash flow hedging instruments. Many of these contracts, which, in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities , are not accounted for as hedges, but are marked to fair value on the income statement. In our retail propane business, we classify all gains and losses from these derivative contracts entered into for risk management purposes as liquids marketing revenue in the consolidated statement of operations. On our contracts that are designated as cash flow hedging instruments in accordance with SFAS No. 133, the effective portion of the hedged gain or loss is initially reported as a component of other comprehensive income and is subsequently reclassified into earnings when the instrument settles. The ineffective portion of the gain or loss is reported in earnings immediately. We utilize published settlement prices for exchange-traded contracts, quotes provided by brokers, and estimates of market prices based on daily contract activity to estimate the fair value of these contracts. The values have been adjusted to reflect the potential impact of liquidating a position in an orderly manner over a reasonable period of time under existing market conditions. Changes in the methods used to determine the fair value of these contracts could have a material effect on our results of operations. We do not anticipate future changes in the methods used to determine the fair value of these derivative contracts.

Natural Gas Imbalances. We record imbalance receivables and payables when a customer delivers more or less gas into our pipelines than they take out. We primarily estimate the value of our imbalances at prices representing the value of the commodity at the end of the accounting reporting period. Changes in natural gas prices may impact our valuation. Based on our net receivable position of $6.1 million as of August 31, 2004, a change in natural gas prices of 10 percent could positively or negatively affect our results of operations by $0.6 million.

Volume Measurement. We record amounts for natural gas gathering and transportation revenue, liquid transportation and handling revenue, natural gas sales and natural gas purchases, and the sale of production based on volumetric calculations. Variances resulting from such calculations are inherent in our business.

Asset retirement obligation. An entity is required to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. If a reasonable estimate cannot be made in the period the asset retirement obligation is incurred, the liability should be recognized when a reasonable estimate of fair value can be made.

In order to determine fair value, management must make certain estimates and assumptions including, among other things, projected cash flows, a credit-adjusted risk-free rate, and an assessment of market conditions that could significantly impact the estimated fair value of the asset retirement obligation. These estimates and assumptions are very subjective. We have determined that we are obligated by contractual or regulatory requirements to remove assets or perform other remediation upon retirement of certain assets. However, the fair value of the asset retirement obligation cannot currently be reasonably estimated because the settlement dates are indeterminate. We will record an asset retirement obligation in the periods in which it can reasonably determine the settlement dates.

ITEM 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk includes the risk of loss arising from adverse changes in market rates and prices. We face market risk from commodity variations, risks related to interest rate variations, and to a lesser extent, credit risks. From time to time, we may utilize derivative financial instruments as described below to manage our exposure to such risks.

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Commodity Price Risk

We are exposed to commodity price risk from the risk of price changes in the natural gas and NGLs that we buy and sell and in our midstream, processing and marketing activities. Derivative instruments are used to protect margins on natural gas purchases, sales, transportation, and natural gas liquid sales. Pursuant to our risk management policy, we do not engage in speculative trading in our midstream, processing and marketing activities. In our retail propane business, the market price of propane is often subject to volatile changes as a result of supply or other market conditions over which we have no control. In the past, price changes have generally been passed along to our propane customers to maintain gross margins, mitigating the commodity price risk. In order to help ensure adequate supply sources are available to us during periods of high demand, we will at times purchase significant volumes of propane during periods of low demand, which generally occur during the summer months, at the then current market price, for storage both at our customer service locations and in major storage facilities and for future resale.

We use a combination of financial instruments including, but not limited to, futures, price swaps and basis trades to manage our exposure to market fluctuations in the prices of natural gas, NGLs and propane. Swaps and futures allow us to protect our margins because corresponding losses or gains in the value of financial instruments are generally offset by gains or losses in the physical market.

The use of financial instruments may expose us to the risk of financial loss in certain circumstances, including instances when (1) sales volumes are less than expected requiring market purchases to meet commitments, or (2) our counterparties fail to purchase the contracted quantities of natural gas or otherwise fail to perform. To the extent that we engage in hedging activities we may be prevented from realizing the benefits of favorable price changes in the physical market. However, we are similarly protected against decreases in such prices.

We manage our price risk related to future physical purchase or sale commitments for our producer services activities by entering into either corresponding physical delivery contracts or financial instruments with an objective to balance our future commitments and significantly reduce our risk to the movement in prices. However, we are subject to counterparty risk for both the physical and financial contracts. We account for such physical contracts under the normal purchases and sales exception in accordance with SFAS No. 133.

In our midstream and transportation segments, we account for certain of our derivatives as cash flow hedges under SFAS 133. This accounting allows for the effective portion of gains and losses on derivatives of cash flow hedges to be reported as other comprehensive income. The ineffective portion of the hedge will be reported in net income as it occurs. When the derivative is settled, along with the hedged transaction, the amount in other comprehensive income that is related to the derivative will be reported in net income.

For each reporting period, we record the fair value of financial instruments based on the difference between the quoted market price and the contract price. Accordingly, the change in fair value is recorded as a liability or asset. In addition, realized gains or losses from settled contracts are recorded in gain or loss from derivates. The effective portion of changes in the fair value of cash flow hedges is recorded in accumulated other comprehensive income until the related anticipated future cash flow is recognized in earnings.

The following summarizes our open commodity derivative positions as of August 31, 2004. Our counterparties to financial contracts include ABN Amro, BP Corporation, Sempra Energy Trading Corp., and Entergy-Koch Trading, LP.

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	Commodity	Notional Volume MMBTU	Maturity	Fair Value
Basis Swaps IFERC/Nymex	Gas	54,472,500	2004-2005	$ 1,451
Basis Swaps IFERC/Nymex	Gas	62,767,500	2004-2005	592
				$ 2,043
Swing Swaps IFERC	Gas	119,495,000	2004-2005	$ 704
Swing Swaps IFERC	Gas	45,265,000	2004-2005	(399)
Swing Swaps IFERC	Gas	76,720,000	2006-2008	
				$ 305
Futures Nymex	Gas	10,057,500	2004-2005	$(1,311)
Futures Nymex	Gas	12,677,500	2004-2005	2,941
				$ 1,630
		Barrels		
NGL Swaps	Condensate, Propane & Ethane	250,000	2004-2005	$ (86)

We also enter into energy trading contracts, which are not derivatives, and therefore are not within the scope of SFAS 133. EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 98-10), applied to energy trading contracts not within the scope of SFAS 133 that were entered into prior to October 25, 2002. The types of contracts we utilize in our liquids marketing segment include energy commodity forward contracts, options, and swaps traded on the over-the-counter financial markets. In accordance with the provisions of SFAS 133, derivative financial instruments utilized in connection with our liquids marketing activity are accounted for using the mark-to-market method. Additionally, all energy-trading contracts entered into prior to October 25, 2002 were accounted for using the mark-to-market method in accordance with the provisions of EITF 98-10 by Heritage. Under the mark-to-market method of accounting, forwards, swaps, options, and storage contracts are reflected at fair value, and are shown in the consolidated balance sheet as assets and liabilities from liquids marketing activities. As of August 31, 2002, Heritage adopted the applicable provisions of EITF Issue No. 02-3, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 02-3), which requires that gains and losses on derivative instruments be shown net in the statement of operations if the derivative instruments are held for trading purposes. Net realized and unrealized gains and losses from the financial contracts and the impact of price movements are recognized in the statement of operations as liquids marketing revenue. Changes in the assets and liabilities from the liquids marketing activities result primarily from changes in the market prices, newly originated transactions, and the timing and settlement of contracts. EITF 02-3 also rescinds EITF 98-10 for all energy trading contracts entered into after October 25, 2002 and specifies certain disclosure requirements. Consequently, we do not and Heritage did not apply mark-to-market accounting for any contracts entered into after October 25, 2002 that are not within the scope of SFAS 133. We attempt to balance its contractual portfolio in terms of notional amounts and timing of performance and delivery obligations. However, net unbalanced positions can exist.

The notional amounts and terms of these financial instruments as of August 31, 2004 include fixed price payor for 345,000 barrels of propane and fixed price receiver of 345,000 barrels of propane. Notional amounts reflect the volume of the transactions, but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure Heritage s exposure to market or credit risks.

The fair value of the financial instruments related to liquids marketing activities, as of August 31, 2004 were assets of $1.5 million and liabilities of $1.2 million.

On all transactions where we are exposed to counterparty risk, we analyze the counterparty s financial condition prior to entering into an agreement, establish limits, and monitor the appropriateness of these limits on an ongoing basis.

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Sensitivity analysis

At August 31, 2004, the fair value of Nymex futures was $1.6 million on a net short position of 2,620,000 MMBtu. A hypothetical change of 10% in the underlying commodity value would change the fair value of the futures by $1.1 million.

At August 31, 2004 the fair value of basis trades was $2.0 million on a net short of position of 8,295,000 MMBtu. A hypothetical change of 10% in basis prices would change the fair value by $0.4 million.

We also hedged liquid sales in our midstream segment during the quarter ended August 31, 2004. The fair value of these hedges at August 31, 2004 was $0.1 million on a short position of 250,000 Bbls. A hypothetical price change of 10% on the liquid hedges would have an effect of $0.9 million on the fair value of derivatives.

Estimates related to our liquids marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. A theoretical change of 10% in the underlying commodity value of the liquids marketing contracts would not change the market value of the contracts as there was no unbalanced positions at August 31, 2004.

The following table summarizes the fair value of our liquids marketing contracts, aggregated by method of estimating fair value of the contracts as of August 31, 2004 where settlement had not yet occurred. These contracts all have a maturity of less than 1 year. The market prices used to value these transactions reflect management s best estimate considering various factors including closing average spot prices for the current and outer months plus a differential to consider time value and storage costs.

Source of Fair Value	August 31, 2004	Heritage August 31, 2003
Prices actively quoted	$ 609	$ 80
Prices based on other valuation methods	902	3
Assets from liquids marketing	$1,511	$ 83
Prices actively quoted	$ 569	$ 80
Prices based on other valuation methods	656	
Liabilities from liquids marketing	$1,225	$ 80
Unrealized gains	$ 286	$ 3

The following table summarizes the changes in the unrealized fair value of our liquids marketing contracts where settlement had not yet occurred for the fiscal year ended August 31, 2004 and for Heritage for the fiscal years ended 2003 and 2002.

		Heritage	
	August 31, 2004	**August 31, 2003**	**August 31, 2002**
Unrealized gains (losses) in fair value of contracts outstanding at the beginning of the period	$	$483	$ (665)
Unrealized gains (losses) recognized at inception of contracts			
Unrealized gains (losses) recognized as a result of changes in valuation techniques and assumptions			
Other unrealized gains (losses) recognized during the period	1,286	850	1,207

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		Heritage	
	August 31, 2004	August 31, 2003	August 31, 2002
Less: Realized gains (losses) recognized during the period	1,000	1,330	59
Unrealized gains (losses) in fair value of contracts outstanding at the end of the period	$ 286	$ 3	$483

Interest Rate Risk

We are exposed to changes in interest rates, primarily as a result of our long-term debt with floating interest rates. An interest rate swap agreement is used to manage a portion of the exposure related to ETC OLP s Term Loan Facility to changing interest rates by converting floating rate debt to fixed rate debt. As of August 31, 2004, this interest rate swap had a notional amount of $75 million that matures on October 9, 2005. The fair value of the interest rate swap is marked to market and the changes in the fair value are recorded in interest expense. The fair value of the interest rate swap was a liability of $0.5 million as of August 31, 2004. We also have long-term debt instruments, which are typically issued at fixed interest rates. When these debt obligations mature, we may refinance all or a portion of such debt at then-existing market interest rates which may be more or less than the interest rates on the maturing debt.

As of August 31, 2004, we had $772.6 million of variable rate debt of which $75.0 million is covered by the interest rate swap discussed above. A change of one percent in the LIBOR rates effective as of August 31, 2004 would have changed interest expense by $7.0 million. This amount has been determined by considering the impact of the hypothetical interest rates on our variable rate borrowings outstanding as of August 31, 2004.

Credit risk

We are diligent in attempting to ensure that we issue credit to only credit-worthy customers. However, our purchase and resale of gas exposes us to significant credit risk, as the margin on any sale is generally a small percentage of the total sales price. Therefore, a credit loss can be very large relative to our overall profitability.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The Financial statements set forth starting on page F-1 of this report are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

At the date of the Energy Transfer Transactions, Ernst & Young LLP was the independent auditor for ETC OLP, and Grant Thornton LLP was the independent auditor for Heritage. On February 3, 2004, our Audit Committee dismissed Ernst & Young LLP and appointed Grant Thornton LLP to serve as our independent auditors for the current fiscal year ending August 31, 2004. This matter was previously reported on Form 8-K dated February 4, 2004.

ETC OLP was formed on October 1, 2002, and Ernst & Young LLP rendered an audit opinion for the eleven month period since inception to August 31, 2003. Ernst & Young LLP s report on ETC OLP s combined financial statements for the eleven months ended August 31, 2003 did not contain an adverse opinion or disclaimer of opinion, nor was such report qualified or modified as to uncertainty, audit scope or accounting principles. Since ETC OLP s inception and through the date of their dismissal, there were: (i) no disagreements with Ernst & Young LLP on any matter of accounting principle or practice, financial statement disclosure or auditing scope or procedure which, if not resolved to Ernst & Young LLP s satisfaction, would have caused them to make reference to the subject matter in connection with their report on the combined financial statements for such period; and (ii) no reportable events as defined in Item 304(a)(1)(v) of Regulation S-K.

We have provided Ernst & Young LLP with a copy of the foregoing disclosure. Attached as Exhibit 16 to a

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previously filed Form 8-K is a copy of Ernst & Young LLP s letter, dated February 4, 2004, stating its agreement with such statements.

Both Ernst & Young LLP and Grant Thornton LLP were engaged in discussions with respect to the preparation of the pro forma financial statements that were required in connection with the series of transactions described above.

Other than the above described discussions, since ETC OLP s inception and through the date of Ernst & Young LLP s dismissal, ETC OLP did not consult with Grant Thornton LLP with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on ETC OLP s financial statements, or any other matters or reportable events as set forth in Items 304(a)(2)(i) and (ii) of Regulation S-K.

ITEM 9A. CONTROLS AND PROCEDURES

We maintain controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officers of our General Partner, of the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rule 13a 15(e) and 15d 15(e) of the Exchange Act). Based upon that evaluation, management, including the Chief Executive Officers of our General Partner, concluded that our disclosure controls and procedures were adequate and effective as of August 31, 2004.

During fiscal year 2004, we began the implementation of a new accounting software system for our propane operations. In response to requirements associated with the implementation of this system and the transition from the prior system, certain changes were made to our internal controls over financial reporting. These changes were primarily made during the quarter ended May 31, 2004. Management continues to monitor these changes and have also continued the ongoing process of routinely reviewing and evaluating our internal controls over financial reporting. Based on that review and evaluation, management believes our disclosure controls and procedures were effective in enabling us to record, process, summarize and report the information required to be included in this annual report within the required time period.

There have been no other changes in our internal controls over financial reporting (as defined in Rule 13(a) 15 or Rule 15d 15(f) of the Exchange Act) or in other factors during the fiscal year covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting, and there have been no corrective actions with respect to significant deficiencies and material weaknesses in our internal controls.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Partnership Management

In February 2002, our Common Unitholders approved the substitution of U.S. Propane, L.P. (the General Partner) as General Partner of the Partnership. The General Partner manages and directs all of the Partnership s activities. The activities of the General Partner are managed and directed by its general partner, U.S. Propane, L.L.C. (USP LLC). Our officers and directors are officers and directors of USP LLC. The owners of the General

Partner and USP LLC appointed thirteen members, individually, each a manager of USP LLC, to USP LLC s Board of Directors. Collectively, these thirteen persons are referred to as our Board of Directors. Since February 2002 through January 2004, the Board of Directors has been comprised of its Chairman, its President and Chief Executive Officer, two persons designated by each of the four member/owners of USP LLC, and three independent persons approved by a majority of the member/owners.

In connection with the Energy Transfer Transactions in January 2004, the former owners of the General Partner sold all of their ownership interests in the General Partner and USP LLC to La Grange Energy, L.P. (the General Partner Transaction). The eight members of the Board of Directors that had been previously designated by the four member/owners of USP LLC and the former Chairman resigned at the time of the General Partner Transaction. The three independent members and USP LLC s President remained on the Board of Directors, and additional members were elected to the Board of Directors by La Grange Energy, L.P. Currently, USP LLC s Board of Directors is comprised of its two Co-Chairmen, USP LLC s President, four persons who qualify as independent under the NYSE s standards for audit committee members, and five persons elected by the other members of the Board of Directors.

Independent Committee

The Board of Directors appoints members of the Board to serve on the Independent Committee with the authority to review specific matters to which the Board of Directors believes there may be a conflict of interest in order to determine if the resolution of such conflict proposed by the General Partner is fair and reasonable to the Partnership and its Common Unitholders. Any matters approved by the Independent Committee will be conclusively deemed to be fair and reasonable to the Partnership, approved by all partners of the Partnership and not a breach by the General Partner or its Board of Directors of any duties they may owe the Partnership or the Common Unitholders. Bill W. Byrne, Stephen L. Cropper, and J. Charles Sawyer served as the members of the Independent Committee of the Board of Directors from the time of their appointment in October 2002 until February 2004. In February 2004, Stephen L. Cropper and Paul E. Glaske were appointed as members of the Independent Committee.

Audit Committee

The Board of Directors has established an Audit Committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Board of Directors appoints persons who are independent under the NYSE s standards for audit committee members to serve on its Audit Committee. The Board has determined that based on relevant experience, Audit Committee member Stephen L. Cropper qualifies as an Audit Committee financial expert. A description of Mr. Cropper s qualifications may be found elsewhere in this Item 10 under Directors and Executive Officers of the General Partner. The Audit Committee meets on a regularly scheduled basis with our independent accountants at least four times each year and is available to meet at their request. The Audit Committee has the authority and responsibility to review our external financial reporting, review our procedures for internal auditing and the adequacy of our internal accounting controls, consider the qualifications and independence of our independent accountants, engage and direct our independent accountants, including the letter of engagement and statement of fees relating to the scope of the annual audit work and special audit work which may be recommended or required by the independent accountants, and to engage the services of any other advisors and accountants as the Audit Committee deems advisable. The Audit Committee reviews and discusses the audited financial statements with management, discusses with our independent auditors matters required to be discussed by SAS 61, *Communications with Audit Committees,* and makes recommendations to the Board of Directors relating to our audited financial statements. The Audit Committee periodically recommends to the Board of Directors any changes or modifications to its charter that may be required. The Board of Directors adopts the Charter for the Audit Committee. Bill W. Byrne, Stephen L. Cropper, and J. Charles Sawyer have served as members of the Audit Committee of the Board of Directors since their appointment in February 2002. In February 2004, Paul E. Glaske was appointed as the fourth member and Chairman of the Audit Committee. Messrs. Byrne, Cropper, Sawyer and Glaske were reappointed to serve as the

Audit Committee in October 2004.

Compensation Committee

Although we are not required under NYSE rules to appoint a Compensation and Nominating Committee because we are a limited partnership, the Board of Directors of USP LLC has established a Compensation Committee to establish standards and make recommendations concerning the compensation of our officers and

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directors. In addition, the Compensation Committee determines and establishes the standards for any awards to our employees and officers under the equity compensation plans adopted by our Common Unitholders, including the performance standards or other restrictions pertaining to the vesting of any such awards. A director serving as a member of the Compensation Committee may not be an officer of or employed by the General Partner, the Partnership or its subsidiaries. Stephen L. Cropper, Bill W. Byrne and K. Rick Turner were appointed to serve as the members of the Compensation Committee in February 2004. Mr. Turner is the Chairman of the Compensation Committee.

Code of Ethics

The Board of Directors has adopted a Code of Ethics applicable to our officers, directors and employees. Specific provisions are applicable to the principal executive officer, principal financial officer, principal accounting officer and controller, or those persons performing similar functions, of our General Partner. The Code of Ethics can be viewed on our website at www.energytransfer.com. Amendments to, or waivers from, the Code of Ethics will also be available on our website and reported as may be required under SEC rules, however, any technical, administrative or other non-substantive amendments to the Code of Ethics may not be posted. Please note that the preceding Internet address is for information purposes only and is not intended to be a hyperlink. Accordingly, no information found and/or provided at such Internet addresses or at the Partnership s website in general is intended or deemed to be incorporated by reference herein.

Directors and Executive Officers of the General Partner

The following table sets forth certain information with respect to the executive officers and members of the Board of Directors as of October 31, 2004. Executive officers and directors are elected for one-year terms.

Name	Age	Position with General Partner
Ray C. Davis	62	Co-Chief Executive Officer and Co-Chairman of the Board of Directors of the General Partner
Kelcy L. Warren	48	Co-Chief Executive Officer and Co-Chairman of the Board of Directors of the General Partner
H. Michael Krimbill	51	President, Chief Financial Officer and Director of the General Partner
R.C. Mills	67	Executive Vice President and Chief Operating Officer
Mackie McCrea	45	Senior Vice President Commercial Development
Bradley K. Atkinson	49	Vice President Corporate Development
Robert A. Burk	47	Vice President and General Counsel and Secretary
John W. Daigh (1)	49	Vice President and Treasurer
Karen Z. Hicks (2)	42	Vice President of Administration and Controller
Stephen L. Cropper	54	Director of the General Partner

Bill W. Byrne	74	Director of the General Partner
J. Charles Sawyer	68	Director of the General Partner
David R. Albin	45	Director of the General Partner
Kenneth A. Hersh	41	Director of the General Partner

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Name	Age	Position with General Partner
Paul E. Glaske	71	Director of the General Partner
K. Rick Turner	46	Director of the General Partner
Ted Collins, Jr.	66	Director of the General Partner
John W. McReynolds	53	Director of the General Partner

(1) Elected Vice President and Treasurer September 2004.

(2) Elected Vice President of Administration September 2004.

Set forth below is biographical information regarding the foregoing officers and directors of our General Partner:

Ray C. Davis. Mr. Davis is Co-Chief Executive Officer and Co-Chairman of the Board of Directors of our General Partner and has served in that capacity since the combination of the operations of Energy Transfer and Heritage Propane in January 2004. Mr. Davis also serves as Co-Chief Executive Officer of the general partner of ETC OLP, and as Co-Chief Executive Officer and Co-Chairman of the Board of the general partner of La Grange Energy, positions he has held since their formation in 2002. Prior to the combination of the operations of Energy Transfer and Heritage Propane, Mr. Davis served as Vice President of the general partner of ET Company I, Ltd., the entity that operated Energy Transfer s midstream assets before it acquired Aquila, Inc. s midstream assets, having served in that capacity since 1996. From 1996 to 2000, he served as a Director of Crosstex Energy, Inc. From 1993 to 1996, he served as Chairman of the board of directors and Chief Executive Officer of Cornerstone Natural Gas, Inc. Mr. Davis has more than 31 years of business experience in the energy industry.

Kelcy L. Warren. Mr. Warren is the Co-Chief Executive Officer and Co-Chairman of the Board of our General Partner and has served in that capacity since the combination of the operations of Energy Transfer and Heritage Propane in January 2004. Mr. Warren also serves as Co-Chief Executive Officer of the general partner of ETC OLP, and as Co-Chief Executive Officer and Co-Chairman of the Board of the general partner of La Grange Energy, positions he has held since their formation in 2002. Prior to the combination of the operations of Energy Transfer and Heritage Propane, Mr. Warren served as President of the general partner of ET Company I, Ltd., having served in that capacity since 1996. From 1996 to 2000, he served as a director of Crosstex Energy, Inc. From 1993 to 1996, he served as President, Chief Operating Officer and a director of Cornerstone Natural Gas, Inc. Mr. Warren has more than 20 years of business experience in the energy industry

H. Michael Krimbill. Mr. Krimbill is the President and Chief Financial Officer of our General Partner, and is also a director of our General Partner. Mr. Krimbill joined Heritage as Vice President and Chief Financial Officer in 1990. He served as President of Heritage from April 1999 to January 2004 and as President and Chief Executive Officer from March 2000 to January 2004. Mr. Krimbill has served as a director of our General Partner since his election in August 2000. Prior to joining Heritage, Mr. Krimbill was the Treasurer of a publicly traded, fully integrated oil company.

R.C. Mills. Mr. Mills is the Executive Vice President and Chief Operating Officer of our General Partner. Mr. Mills has over 40 years of experience in the propane industry. Mr. Mills joined Heritage in 1991 as Executive Vice President and Chief Operating Officer. Before coming to Heritage, Mr. Mills spent 25 years with Texgas Corporation and its successor, Suburban Propane, Inc. At the time he left Suburban in 1991, Mr. Mills was Vice President of Supply and Wholesale.

Mackie McCrea. Mr. McCrea is the Senior Vice President Commercial Development of our General Partner and has served in that capacity since the combination of the operations of Energy Transfer and Heritage Propane in January 2004. Prior to the combination of the operations of Energy Transfer and Heritage Propane, Mr. McCrea served as Senior Vice President Business Development and Producer Services of the general partner of ETC OLP and ET Company I, Ltd., having served in that capacity since 1997.

Bradley K. Atkinson. Mr. Atkinson is Vice President Corporate Development of our General Partner and has served in that capacity since August 2000. Mr. Atkinson joined Heritage on April 16, 1998 as Vice President of

Administration. Prior to joining Heritage, Mr. Atkinson spent 12 years with MAPCO/ Thermogas, eight of which were spent in the acquisitions and business development of Thermogas.

Robert A. Burk. Mr. Burk is Vice President General Counsel and Secretary of our General Partner and has served in that capacity since February 2004. Prior to joining Energy Transfer, Mr. Burk was a partner in the law firm of Doerner, Sanders, Daniel & Anderson, LLP, which served as outside counsel to Heritage Propane since going public in 1996.

John W. Daigh. Mr. Daigh is Vice President and Treasurer of our General Partner and has served in that capacity since September 2004. Mr. Daigh joined Energy Transfer in October 2002, serving as ETC OLP s Vice President and Controller until assuming his current role as Vice President and Treasurer. Mr. Daigh served as Vice President of Economics at Aquila, Inc. from 1999 until the time that Energy Transfer acquired its assets in 2002. Mr. Daigh also served in various controller and management roles at Koch Industries, Inc. prior to his joining Aquila, Inc. in 1999.

Karen Z. Hicks. Ms. Hicks is Vice President of Administration and Controller of our General Partner, serving in that capacity since September 2004 and has served as Controller of our General Partner since July 2002. Ms. Hicks has spent 16 years in the propane industry, all of which have been with Energy Transfer and Heritage. Ms. Hicks started her career with Heritage as Accounting Manager and was promoted to Manager of Financial Reporting when the Partnership went public in 1996. In December 2000, Ms. Hicks was promoted to Assistant Controller and was promoted to Partnership Controller July 2002. Prior to her career in the propane industry, Ms. Hicks was a bank examiner for the State of Montana for 3 years.

Stephen L. Cropper. Mr. Cropper spent 25 years with The Williams Companies before retiring in 1998, as President and Chief Executive Officer of Williams Energy Services. Mr. Cropper is a director of NRG Energy, Inc. where he serves as the Chairman of the Corporate Governance and Nominating Committee. Mr. Cropper also serves as a director, Chairman of the Audit Committee, and member of the Compensation Committee of Sun Logistics Partners L.P. Mr. Cropper is a director and serves as the Chairman and an Audit Committee financial expert of Berry Petroleum Company. Mr. Cropper is a director of Rental Car Finance Corporation, a subsidiary of Dollar Thrifty Automotive Group. Mr. Cropper is also a director and serves as the Chairman of the Compensation Committee and a member of the Audit Committee and Executive Committee of QuikTrip Corporation. Mr. Cropper has served as a director of our General Partner since April 2000 and is a member of the Independent Committee, the Litigation Committee, the Compensation Committee, and the Audit Committee.

Bill W. Byrne. Mr. Byrne is the principal of Byrne & Associates, LLC, a gas liquids consulting group based in Tulsa, Oklahoma, and has held that position since 1992. Prior to that time, he served as Vice President of Warren Petroleum Company, the gas liquids division of Chevron Corporation, from 1982 to 1992. Mr. Byrne has served as a director of our General Partner since 1992 and is a member of both the Audit Committee and the Compensation Committee. Mr. Byrne is a former president and director of the National Propane Gas Association (NPGA).

J. Charles Sawyer. Mr. Sawyer is the President and Chief Executive Officer of Sawyer Cellars. Mr. Sawyer is also the President and Chief Executive Officer of Computer Energy, Inc., a provider of computer software to the propane industry since 1981. Mr. Sawyer was Chief Executive Officer of Sawyer Gas Co., a regional propane distributor, until it was purchased by Heritage in 1991. Mr. Sawyer has served as a director of or General Partner since 1991 and is a member of both the Independent Committee and the Audit Committee. Mr. Sawyer is a former president and director of the NPGA.

David R. Albin. Mr. Albin is a managing partner of Natural Gas Partners, L.L.C. and has served in that capacity or similar capacities since 1988. Prior to his participation as a founding member of Natural Gas Partners, L.P. in 1988, he was a partner in the $600 million Bass Investment Limited Partnership. Prior to joining Bass Investment Limited

Partnership, he was a member of the oil and gas group in the investment banking division of Goldman, Sachs & Co. Mr. Albin has served as a director of our General Partner since February 2004.

Kenneth A. Hersh. Mr. Hersh is a managing partner of Natural Gas Partners, L.L.C. and has served in that capacity or similar capacities since 1989. Prior to joining Natural Gas Partners, L.P. in 1989, he was a member of the energy group in the investment banking division of Morgan Stanley & Co. Mr. Hersh has served as a director of our General Partner since February 2004.

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Paul E. Glaske. Mr. Glaske retired as Chairman and Chief Executive Officer of Blue Bird Corporation, the largest manufacturer of school buses with manufacturing plants in three countries. Prior to becoming president of Blue Bird in 1986, Mr. Glaske served as the president of the Marathon LeTourneau Company, a manufacturer of large off-road mining and material handling equipment and off-shore drilling rigs. He currently is a member of the board of directors of the Texas Association of Business; SunTrust Bank, Middle Georgia, N.A.; Borg Warner Automotive, Inc.; and the U.S. Chamber of Commerce. Mr. Glaske has served as a director of our General Partner since February 2004 and is chairman of the Audit Committee and a member of the Independent Committee. In addition, Mr. Glaske serves as the Vice-Chairman of the Natural Gas Vehicle Coalition.

K. Rick Turner. Mr. Turner has been a principal of Stephens, Inc., one of the largest off-Wall Street investment banking groups, since 1990. Prior to joining Stephens in 1983, Mr. Turner was employed with Peat, Marwick, Mitchell & Company. Mr. Turner s areas of focus include oil and gas exploration, natural gas gathering and processing industries, and power technology. He currently serves as a director of Atlantic Oil Corporation; SmartSignal Corporation; Neucoll, Inc.; Jebco Seismic, LLC; and North American Energy Partners. Mr. Turner has served as a director of our General Partner since February 2004 and is a member of the Compensation Committee.

Ted Collins, Jr. Mr. Collins is an independent oil and gas producer. Mr. Collins previously served as President of Collins & Ware Inc. from 1988 to 2000, when its assets were sold to Apache Corporation. From 1982 to 1988, Mr. Collins was President of Enron Oil and Gas Company, and its predecessors, HNG Oil Company and HNG Internorth Exploration Co. From 1969 to 1982, Mr. Collins served as Executive Vice President of American Quaser Petroleum Company. Mr. Collins is a director and serves on the Finance Committee of Hanover Compression Company, and is a director and the Chairman of the Governance Committee of Encore Acquisition Company. Mr. Collins has served as a director of our General Partner since August 2004.

John W. McReynolds. Mr. McReynolds is a Partner in the Dallas law office of Hunton & Williams. Mr. McReynolds has been a practicing attorney with Hunton & Williams, and its predecessors, since beginning his career in 1978. Mr. McReynolds practice focuses on the energy industry and energy-related entities. Mr. McReynolds has served a director of our General Partner since August 2004.

Compensation of the General Partner

The General Partner does not receive any management fee or other compensation in connection with its management of the Partnership and the Operating Partnerships. The General Partner and its affiliates performing services for the Partnership and the Operating Partnerships are reimbursed at cost for all expenses incurred on behalf of the Partnership, including the costs of employee compensation allocable to Heritage, and all other expenses necessary or appropriate to the conduct of the business of, and allocable to, the Partnership. Following the Energy Transfer Transactions in January 2004, the employees of the General Partner became employees of our Operating Partnerships, and thus, the General Partner has not incurred additional reimbursable costs since that time. Heritage incurred costs reimbursable to the General Partner of $108.9 million for the year ended August 31, 2003 and $95.7 million for the year ended August 31, 2002.

Compliance with Section 16(a) of the Securities and Exchange Act

Section 16(a) of the Securities and Exchange Act of 1934 requires the Partnership s officers and directors, and persons who own more than 10% of a registered class of the Partnership s equity securities, to file reports of beneficial ownership and changes in beneficial ownership with the Securities and Exchange Commission (SEC). Officers, directors and greater than 10% Unitholders are required by SEC regulations to furnish the General Partner with copies of all Section 16(a) forms.

Based solely on our review of the copies of such forms received by us, or written representations from certain reporting persons that no Form 5s were required for those persons, we believe that during fiscal year ending August 31, 2004, all filing requirements applicable to its officers, directors, and greater than 10% beneficial owners were met in a timely manner, other than one late Form 4 filing for each TAAP, LP and TAAP GP LLC, and a late Form 3 filing for Robert A. Burk.

ITEM 11. EXECUTIVE COMPENSATION.

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The following table sets forth the annual salary, bonus and all other compensation awards and payouts for each of the past three fiscal years earned by: (i) all persons serving as the Chief Executive Officer of our General Partner during fiscal year 2004; (ii) the four next highly compensated executive officers other than the Chief Executive Officer, who served as executive officers of our General Partner during fiscal year 2004 and (iii) any persons who would have been reported had they been an executive officer of our General Partner at the end of fiscal year 2004.

Name and Principal Position	Year	Salary	Bonus (3)	Other Annual Compensation (4)	All Other Compensation (5)
Ray C. Davis	2004	$120,000	$	$ 172	$
Co-Chief Executive	2003				
Officer (1)	2002				
Kelcy L. Warren	2004	$120,000	$	$ 172	$
Co-Chief Executive	2003				
Officer (1)	2002				
H. Michael Krimbill	2004	$350,000	$609,000	$ 372	$1,321,240
President and Chief	2003	350,000	60,000	325	356,878
Financial Officer (2)	2002	350,000	350,000	242	
R. C. Mills	2004	$335,000	$594,000	$ 2,052	$1,321,240
Executive Vice President	2003	335,000	60,000	2,052	356,878
and Chief Operating Officer	2002	335,000	350,000	1,700	
Mackie McCrea	2004	$183,042	$248,000	$ 186	$
Senior Vice President	2003				
Commercial Development	2002				
Bradley K. Atkinson	2004	$220,000	$479,000	$ 165	$1,321,240
Vice President	2003	220,000	60,000	165	356,878
Corporate Development	2002	220,000	410,944	158	
Robert A. Burk (6)	2004	$200,000	$	$ 145	$
Vice President General	2003				
Counsel and Secretary	2002				
Michael L. Greenwood (7)	2004	$240,000	$499,000	$ 184	$1,024,756
Vice President and	2003	240,000		184	118,950
Chief Financial Officer	2002	240,000			
A. Dean Fuller (8)	2004	$205,755	$	$ 233	$
Senior Vice President	2003				
Operations	2002				

(1) Messrs Davis and Warren were named Co-Chief Executive Officers of our General Partner in January of 2004.

(2) Mr. Krimbill served as President and Chief Executive Officer of our General Partner until January 2004. After the transactions with ETC OLP, Mr. Krimbill was elected President and Chief Financial Officer of our General Partner.

(3) Bonuses are earned based on the results of operations for each fiscal year. Bonuses for the 2004 fiscal year for Messrs. Krimbill, Mills, Atkinson, and Greenwood also include payments for the termination of their employment contracts in connection with the Energy Transfer Transaction.

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(4) Consists of life insurance premiums.

(5) Consists of the value of Common Units issued pursuant to awards under the Long-Term Incentive Compensation Plan, which terminated in conjunction with the Energy Transfer Transaction.

(6) Mr. Burk was named Vice President General Counsel of our General Partner in February of 2004. Mr. Burk s 2004 salary is annualized.

(7) Mr. Greenwood served as Vice President Finance of our General Partner following the Energy Transfer Transaction until his retirement in August of 2004. Mr. Greenwood s salary is annualized for the fiscal year 2002.

(8) Mr. Fuller served as Senior Vice-President Operations following the Energy Transfer Transaction until his retirement in August of 2004.

Restricted Unit Plan

We previously adopted the Amended and Restated Restricted Unit Plan dated August 10, 2000, and amended February 4, 2002 as the Second Amended and Restated Restricted Unit Plan. (the Restricted Unit Plan), copies of which have been previously filed as exhibits, for certain directors and key employees of the General Partner and its affiliates. The Restricted Unit Plan provided rights to acquire up to 146,000 Common Units. The Restricted Unit Plan provided for the award or grant to key employees of the right to acquire Common Units on such terms and conditions (including vesting conditions, forfeiture or lapse of rights) as the Compensation Committee of the General Partner shall determine. In addition, eligible directors automatically received a director s grant of to 500 Common Units on each September 1, and newly elected directors were also entitled to receive a grant of 2,000 Common Units upon election or appointment to the Board. Directors who were our employees or employees of our General Partner were not entitled to receive a director s grant of Common Units but could receive Common Units as employees.

Generally, awards granted under the Restricted Unit Plan vested upon the occurrence of specified performance objectives established by the Compensation Committee at the time designations of grants were made, or if later, the three-year anniversary of the grant date. In the event of a change of control (as defined in the Restricted Unit Plan), all rights to acquire Common Units pursuant to the Restricted Unit Plan immediately vested. In connection with La Grange Energy s acquisition of our General Partner in January of 2004, all of the previous awards under the Restricted Unit Plan, except for awards for which waivers were granted thereunder or in conjunction with the employment agreement of the former Chairman of our General Partner, vested.

The issuance of Common Units pursuant to the Restricted Unit Plan was intended to serve as a means of incentive compensation, therefore, no consideration was payable by the plan participants upon vesting and issuance of the Common Units. As of August 31, 2004, 8,296 Units have been awarded and have not yet vested. Following the June 23, 2004 approval of the 2004 Unit Plan at a Special Meeting of the Unitholders the Restricted Unit Plan was terminated (except for the obligation to issue Common Units at the time the 8,296 Units previously awarded vest), and no additional grants will be made under the Restricted Unit Plan.

Long-Term Incentive Compensation Plan

Effective September 1, 2000, we adopted a long-term incentive compensation plan whereby units were to be awarded to the executive officers of our General Partner upon achieving certain targeted levels of Distributed Cash (as defined in the Long Term Incentive Plan) per unit. Awards under the program were made starting in 2003 based upon the average of the prior three years Distributed Cash per unit. A minimum of 250,000 units and if targeted levels were achieved, a maximum of 500,000 units were available for award under the Long-Term Incentive Plan. Awards under the program were made starting in 2003 based upon the average of the prior three years Distributed Cash per unit.

During the fiscal year ended August 31, 2003, 66,118 units vested pursuant to the vesting rights of the Long-Term Incentive Plan and Common Units were issued. In connection with the acquisition by La Grange Energy of our General Partner in January 2004, 150,018 units vested and Common Units were issued, and the Long-Term Incentive Plan terminated. Heritage recognized compensation expense of $0.6 million, $0.9 million, and $1.5 million for fiscal years 2004, 2003, and 2002, respectively.

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2004 Unit Plan

On June 23, 2004 at a special meeting of the Common Unitholders, our Common Unitholders approved the terms of our 2004 Unit Plan (the Plan), which provides for awards of Common Units and other rights to our employees, officers, and directors and is filed as an exhibit to this Form 10-K. The maximum number of Common Units that may be granted under this Plan is 900,000 net units issued. Any awards that are forfeited or which expire for any reason, or any units which are not used in the settlement of an award will be available for grant under the Plan. Units to be delivered upon the vesting of awards granted under the Plan may be (i) units acquired by us in the open market, (ii) units already owned by us or our General Partner, (iii) units acquired by us or our General Partner directly from the Partnership, or any other person, (iv) units that are registered under a registration statement for this Plan, (v) Restricted Units, or (vi) any combination of the foregoing.

Employee Grants. The Compensation Committee, in its discretion, may from time to time grant awards to any employee, upon such terms and conditions as it may determine appropriate and in accordance with specific general guidelines as defined by the Plan. All outstanding awards shall fully vest into units upon any Change in Control as defined by the Plan or upon such terms as the Compensation Committee may require at the time the award is granted. As of August 31, 2004, no grants of awards had been made to any employee under the 2004 Unit Plan. Subsequent to August 31, 2004, 129,600 awards of units were made under the 2004 Unit Plan to employees, including executive officers. These awards will vest subject to vesting over a three-year period based upon the achievement of certain performance criteria. Vested awards will convert into Common Units upon the third anniversary of the measuring date for the grants, which is September 1 of each year. Vesting occurs based upon the total return to the Partnership s Unitholders as compared to a group of MLP peers.

Director Grants. Each director who is not also (i) a shareholder or a direct or indirect employee of any parent, or (ii) a direct or indirect employee of USP LLC, the Partnership, or a subsidiary (Director Participant), who is elected or appointed to the Board for the first time shall automatically receive, on the date of his or her election or appointment, an award of up to 2,000 units (the Initial Director s Grant). Commencing on September 1, 2004 and each September 1 thereafter that this Plan is in effect, each Director Participant who is in office on such September 1, shall automatically receive an award of units equal to $15,000 divided by the fair market value of a Common Units on such date (Annual Director s Grant). Each grant of an award to a Director Participant will vest at the rate of 20% per year, beginning on the first anniversary date of the Award; provided however, notwithstanding the foregoing, (i) all awards to a Director Participant shall become fully vested upon a change in control, as defined by the Plan, unless voluntarily waived by such Director Participant, and (ii) all awards which have not yet vested on the date a Director Participant ceases to be a director shall vest on such terms as may be determined by the Compensation Committee. As of August 31, 2004, Initial Director s Grants totaling 4,000 units have been made.

Long-Term Incentive Grants. The Compensation Committee may, from time to time, grant awards under the Plan to any executive officer or any employee it may designate as a participant in accordance with general guidelines under the Plan. These guidelines include (i) options to purchase a specified number of units at a specified exercise price, which are clearly designated in the award as either an incentive stock option within the meaning of Section 422 of the Internal Revenue Code, or a non-qualifying stock option that is not intended to qualify as an incentive stock option under Section 422; (ii) Unit Appreciation Rights that specify the terms of the fair market value of the award on the date the stock appreciation right is exercised and the strike price; (iii) units; or (iv) any combination hereof. As of August 31, 2004, there has been no Long-Term Incentive Grants made under the Plan.

This Plan will be administered by the Compensation Committee of the Board of Directors and may be amended from time to time by the Board; provided however, that no amendment will be made without the approval of a majority of the Unitholders (i) if so required under the rules and regulations of the New York Stock Exchange or the Securities and Exchange Commission; (ii) that would extend the maximum period during which an award may be granted under the Plan; (iii) materially increase the cost of the Plan to the Partnership; or (iv) result in this Plan no longer satisfying the requirements of Rule 16b-3 of Section 16 of the Securities and Exchange Act of 1934. This Plan shall terminate no later that the 10th anniversary of its original effective date.

Compensation of Directors

We currently pay no additional remuneration to our employees who also serve as directors of the General Partner. Prior to February 2004, our General Partner paid each of its non-employee and nonaffiliated director

$10,000 annually, plus $1,000 per board meeting attended and $500 per committee meeting attended. In addition, each of the members of the Independent Committee received a payment of $30,000 during fiscal year 2004, as payment for services and expenses rendered in conjunction with our evaluation of potential acquisition candidates. We will reimburse all expenses associated with the compensation of directors to our General Partner.

In February 2004, the disinterested members of our Board of Directors, approved the payment to eligible directors of an annual retainer of $20,000, plus $2,000 per board meeting attended, an additional annual payment of $5,000 to $7,500 for serving on designated committees, plus $1,000 per committee meeting attended, plus an Annual Director s Grant as defined by the 2004 Unit Plan.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information as of October 31, 2004, regarding the beneficial ownership of the Partnership s securities by certain beneficial owners, all directors and named executive officers of the general partner of our General Partner, each of the named executive officers and all directors and executive officers of the general partner of our General Partner as a group, of our Common Units, Class C Units and Class E Units. The General Partner knows of no other person not disclosed herein beneficially owning more than 5% of our Common Units.

Energy Transfer Partners, L.P. Units

Title of Class	Name and Address of Beneficial Owner (1)	Beneficially Owned (2)	Percent of Class
Common Units	Ray C. Davis (3)		*
	Kelcy L. Warren (3)		*
	H. Michael Krimbill (4)	362,559	*
	Bill W. Byrne	78,157	*
	J. Charles Sawyer	68,657	*
	Stephen L. Cropper	7,500	*
	David R. Albin (5)		*
	Kenneth A. Hersh (5)		*
	Paul E. Glaske	10,000	*
	K. Rick Turner (5)		*
	Ted Collins, Jr.		*
	John McReynolds		*
	R.C. Mills (4)	368,009	*
	Mackie McCrea		*
	Bradley K. Atkinson	53,600	*
	Robert A. Burk		*
	Michael L. Greenwood (6)	61,111	*
	Dean A. Fuller (3) (6)		*
	All Directors and Executive Officers as a group (7) (19 persons)	985,181	2.21%
	La Grange Energy, L.P. (8)	15,883,234	35.58%
Class C Units	FHS Investments, L.L.C.	1,000,000	100%
Class E Units	Heritage Holdings, Inc. (9)	4,426,916	100%

* Less than one percent (1%)

(1) The address for La Grange Energy and Messrs. Davis and Warren is 2838 Woodside Street, Dallas, Texas 75204. The address for Heritage Holdings and Messrs. Krimbill, Atkinson, and Burk is 8801 S. Yale Avenue, Suite 310, Tulsa, Oklahoma 74137. The address for Mr. McCrea is 800 E. Sonterra Blvd., San Antonio, Texas 78258. The address for Mr.

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Mills is 5000 Sawgrass Village, Suite 4, Ponte Vedra Beach, Florida 32082. The address for FHS Investments is 2215 B Renaissance Dr., Suite 5, Las Vegas, Nevada 89119.

(2) Beneficial ownership for the purposes of the foregoing table is defined by Rule 13-d-3 under the Securities Exchange Act of 1934. Under that rule, a person is generally considered to be the beneficial owner of a security if he has or shares the power to vote or direct the voting thereof (Voting Power) or to dispose or direct the disposition thereof (Investment Power) or has the right to acquire either of those powers within sixty (60) days.

(3) Due to the ownership of Messrs. Davis, Warren, McCrea, and Fuller in La Grange Energy, L.P., they may be deemed to beneficially own the limited partnership interests held by La Grange Energy, L.P. to the extent of their respective interests therein. Any such deemed ownership is not reflected in the table.

(4) Each of Messrs. Mills and Krimbill shares Voting and Investment Power on a portion of their respective units with his/her spouse.

(5) Each of Messrs. Albin, Hersh, and Turner are representatives of or owners in entities owning interests in La Grange Energy, L.P. and may be deemed to beneficially own the limited partnership interest held by La Grange Energy, L.P., though such ownership is not depicted in the table.

(6) Messrs. Greenwood and Fuller retired from their respective offices prior to August 31, 2004.

(7) Includes persons who were not officers of our general partner at August 31, 2004 but included in the named executive officers table under Item 11, and includes persons who were named officers between September 1, 2004 and October 31, 2004.

(8) La Grange Energy, L.P. owns 95% all of the member interests of U.S. Propane, L.L.C. and 95% of the limited partner interests of U.S. Propane, L.P. U.S. Propane, L.L.C. is the General Partner of U.S. Propane, L.P. with a .01% general partner interest.

(9) Energy Transfer Partners, L.P. owns 100% of the common stock of Heritage Holdings, Inc.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Our natural gas midstream operations secure compression services from third parties. Energy Transfer Technologies, Ltd. is one of the entities from which compression services are obtained. Energy Transfer Group, LLC is the general partner of Energy Transfer Technologies, Ltd. These entities are collectively referred to as the ETG Entities . The ETG Entities were not acquired by us in conjunction with the January 2004 Energy Transfer Transactions. Our Co-Chief Executive Officers, Ray C. Davis and Kelcy L. Warren have an indirect ownership and one of our directors Ted Collins, Jr., has an ownership interest in the ETG Entities. In addition, two of our directors, Ted Collins, Jr. and John W. McReynolds, serve on the Board of Directors of the ETG Entities. The terms of each arrangement to provide compression services are reviewed by the Audit Committee, and are no less favorable than those available from other providers of compression services. During fiscal year 2004, payments totaling $279,000 were made to the ETG Entities for compression services provided to and utilized in our natural gas midstream operations.

One of our natural gas midstream subsidiaries owns a 50% interest in South Texas Gas Gathering, a joint venture that owns an 80% interest in the Dorado System, a 61-mile gathering system located in South Texas. The other 50% equity interest in South Texas Gas Gathering is an entity in which one of our directors, Ted Collins, Jr. owns a 50% interest. We are the operator of the Dorado System. At August 31, 2004, there was a balance of $248,000 owing to us by this co-owner entity for services we provided as operator.

During the fiscal year ended August 31, 2004, payments of approximately $112,000 were made to the law firm of Hunton & Williams for legal services rendered. These services were provided to ETC OLP and the Partnership in connection with the Energy Transfer Transactions in January of 2004, and for the representation of ETC OLP in ongoing matters. John W. McReynolds, a director of our General Partner since August 2004, is a partner in the Dallas, Texas office of Hunton & Williams.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following set forth fees billed by Grant Thornton LLP for the audit of our annual financial statements and other services rendered for the fiscal years ended August 31, 2004 and 2003:

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	Year Ended August 31,	
	2004	**2003**
Audit fees (1)	$1,024,033	$371,175
Audit related fees (2)	$ 1,500	$ 2,100
Tax fees (3)	$	$
All other fees (4)	$	$
Total	$1,025,533	$373,275

(1) Includes fees for audits of annual financial statements of our companies, reviews of the related quarterly financial statements, and services that are normally provided by the independent accountants in connection with statutory and regulatory filings or engagements, including reviews of documents filed with the Securities and Exchange Commission.

(2) Includes fees related to consultations concerning financial accounting and reporting standards.

(3) Includes fees related to professional services for tax compliance, tax advice, and tax planning.

(4) Consists of fees for services other than services reported above.

Pursuant to the charter of the Audit Committee, they are responsible for the oversight of our accounting, reporting and financial practices. The Audit Committee has the responsibility to select, appoint, engage, oversee, retain, evaluate and terminate our external auditors; pre-approve all audit and non-audit services to be provided, consistent with all applicable laws, to us by our external auditors; and establish the fees and other compensation to be paid to our external auditors. The Audit Committee also oversees and directs our internal auditing program and reviews our internal controls.

The Audit Committee has adopted a policy for the pre-approval of audit and permitted non-audit services provided by our principal independent accountants. The policy requires that all services provided by Grant Thornton LLP including audit services, audit-related services, tax services and other services, must be pre-approved by the Committee.

The Audit Committee reviews the external auditors proposed scope and approach as well as the performance of the external auditors. It also has direct responsibility for and sole authority to resolve any disagreements between our management and our external auditors regarding financial reporting, regularly reviews with the external auditors any problems or difficulties the auditors encountered in the course of their audit work, and, at least annually, uses its reasonable efforts to obtain and review a report from the external auditors addressing the following (among other items):

the auditors internal quality-control procedures;

any material issues raised by the most recent internal quality-control review, or peer review, of the external auditors;

the independence of the external auditors;

the aggregate fees billed by our external auditors for each of the previous two fiscal years; and

the rotation of the lead partner.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) 1. Financial Statements.

See Index to Financial Statements set forth on page F-1.

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2. Financial Statement Schedules.

None.

3. Exhibits.

See Index to Exhibits set forth on page E-1.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ENERGY TRANSFER PARTNERS, L.P.

By U.S. Propane L.P, its General Partner.
By U.S. Propane, L.L.C., its General Partner

By: /s/ Ray C. Davis

Ray C. Davis
Co-Chief Executive Officer and officer duly authorized to sign on behalf of the registrant

By: /s/ Kelcy L. Warren

Kelcy L. Warren
Co-Chief Executive Officer and officer duly authorized to sign on behalf of the registrant

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Ray C. Davis Ray C. Davis	Co-Chief Executive Officer and Co-Chairman of the Board (Principal Executive Officer)	November 15, 2004
/s/ Kelcy L. Warren Kelcy L. Warren	Co-Chief Executive Officer and Co-Chairman of the Board (Principal Executive Officer)	November 15, 2004
/s/ H. Michael Krimbill H. Michael Krimbill	President, Chief Financial Officer and Director (Principal Financial and Accounting Officer)	November 15, 2004
/s/ Bill W. Byrne Bill W. Byrne	Director	November 15, 2004
/s/ J. Charles Sawyer	Director	November 15, 2004

J. Charles Sawyer		
/s/ Stephen L. Cropper	Director	November 15, 2004
Stephen L. Cropper		
/s/ David R. Albin	Director	November 15, 2004
David R. Albin		
/s/ Kenneth A. Hersh	Director	November 15, 2004
Kenneth A. Hersh		

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Signature	Title	Date
/s/ Paul E. Glaske Paul E. Glaske	Director	November 15, 2004
/s/ K. Rick Turner K. Rick Turner	Director	November 15, 2004
/s/ Ted Collins, Jr. Ted Collins, Jr.	Director	November 15, 2004
/s/ John W. McReynolds John W. McReynolds	Director	November 15, 2004

INDEX TO FINANCIAL STATEMENTS

Energy Transfer Partners, L.P. and Subsidiaries
(Formerly Energy Transfer Company and surviving legal entity in the Energy Transfer Transactions)

Aquila Gas Pipeline Corporation and Subsidiaries
(The predecessor entity of Energy Transfer Company prior to the formation of Energy Transfer Company in October 2002)

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Oasis Pipe Line Company and Subsidiaries
(An investment of Aquila Gas Pipeline Corporation and
Energy Transfer Company until becoming a wholly owned subsidiary in December 2002)

Heritage Propane Partners, L.P. and Subsidiaries (Heritage)
(The propane operations of Energy Transfer Partners, L.P.
prior to the Energy Transfer Transactions)

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PART I FINANCIAL INFORMATION

The financial statements of Energy Transfer Partners, L.P. presented herein for the year ended August 31, 2004 include the results of operations for Energy Transfer Company for the entire period from September 1, 2003 through August 31, 2004, the results of operations for Heritage Propane Partners, L.P. (referenced herein as Heritage) only for the period from January 20, 2004 to August 31, 2004. Thus, the results of operations do not represent the entire results of operations for Heritage for the year ended August 31, 2004, as they do not include the results of operations of Heritage for the period prior to the Energy Transfer Transactions on January 20, 2004. Please read notes 1 and 2 to the Energy Transfer Partners, L.P. Consolidated Financial Statements for further explanation regarding the Energy Transfer Transactions.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Partners
Energy Transfer Partners, L.P.

We have audited the accompanying consolidated balance sheet of Energy Transfer Partners, L.P. (a Delaware limited partnership) and subsidiaries, formerly Energy Transfer Company as of August 31, 2004 and the related consolidated statements of operations, comprehensive income, partners capital, and cash flows for the year then ended. These financial statements are the responsibility of the Partnership s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Energy Transfer Partners, L.P. and subsidiaries as of August 31, 2004 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Tulsa, Oklahoma
November 11, 2004

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Partners of
Energy Transfer Company

We have audited the accompanying combined balance sheet of Energy Transfer Company as of August 31, 2003, and the related combined statements of income, partners capital, and cash flows for the eleven-month period ended August 31, 2003. These financial statements are the responsibility of the Partnership s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Energy Transfer Company as of August 31, 2003, and the combined results of their operations and their cash flows for the eleven month period ended August 31, 2003 in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

San Antonio, Texas
December 5, 2003

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ITEM 1. FINANCIAL STATEMENTS

ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED BALANCE SHEETS
(in thousands, except unit data)

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 81,745	$ 53,122
Marketable securities	2,464	
Accounts receivable, net of allowance for doubtful accounts	275,424	105,987
Accounts receivable from related companies	34	
Inventories	54,067	3,947
Deposits paid to vendors	3,023	19,053
Exchanges receivable	8,852	1,373
Price risk management asset	4,615	928
Prepaid expenses and other	6,658	770
Total current assets	436,882	185,180
PROPERTY, PLANT AND EQUIPMENT, net	1,467,649	393,025
INVESTMENT IN AFFILIATES	8,010	6,844
GOODWILL	313,720	13,409
INTANGIBLES AND OTHER ASSETS, net	100,421	3,645
Total assets	$2,326,682	$ 602,103

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED BALANCE SHEETS
(in thousands, except unit data)

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
LIABILITIES AND PARTNERS CAPITAL		
CURRENT LIABILITIES:		
Working capital facility	$ 14,550	$
Accounts payable	274,122	114,198
Accounts payable to related companies	4,276	820
Exchanges payable	2,846	1,410
Customer deposits	11,378	11,600
Accrued and other current liabilities	55,817	8,055
Price risk management liabilities	1,262	823
Income taxes payable	2,252	2,567
Current maturities of long-term debt	30,957	30,000
Total current liabilities	397,460	169,473
LONG-TERM DEBT, less current maturities	1,070,871	196,000
DEFERRED TAXES	109,896	55,385
OTHER NONCURRENT LIABILITIES		157
MINORITY INTERESTS	1,475	
	1,579,702	421,015
COMMITMENTS AND CONTINGENCIES		
PARTNERS CAPITAL:		
Common Unitholders (44,559,031 and 6,621,737 units authorized, issued and outstanding at August 31, 2004 and 2003, respectively)	720,187	180,896
Class C Unitholders (1,000,000 and 0 units authorized, issued and outstanding at August 31, 2004 and 2003, respectively)		
Class D Unitholders (0 authorized, issued and outstanding at August 31, 2004 and 2003)		
Class E Unitholders (4,426,916 and 0 authorized, issued and outstanding at		

August 31, 2004 and August 31, 2003, respectively held by subsidiary and reported as treasury units)		
Special Units (0 authorized, issued and outstanding at August 31, 2004 and 2003)		
General Partner	26,761	192
Accumulated other comprehensive income	32	
Total partners capital	746,980	181,088
Total liabilities and partners capital	$2,326,682	$ 602,103

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per unit and unit data)

	For the Year Ended August 31, 2004	For the Eleven Months Ended August 31, 2003
	(see Note 2)	(Energy Transfer Company)
REVENUES:		
Midstream and transportation	$ 2,102,101	$ 1,023,468
Propane	342,522	
Other	37,631	
Total revenues	2,482,254	1,023,468
COSTS AND EXPENSES:		
Cost of products sold	2,126,150	901,543
Operating expenses	152,100	27,960
Depreciation and amortization	50,848	13,461
Selling, general and administrative	33,135	15,965
Realized and unrealized (gains) losses on derivatives not accounted for as hedges	(25,499)	2,950
Total costs and expenses	2,336,734	961,879
OPERATING INCOME	145,520	61,589
OTHER INCOME (EXPENSE):		
Interest expense	(41,458)	(12,456)
Equity in earnings of affiliates	363	1,423
Gain (loss) on disposal of assets	(1,006)	
Interest income and other	509	501
INCOME BEFORE MINORITY INTERESTS AND INCOME TAXES	103,928	51,057
Minority interests	(295)	

INCOME BEFORE INCOME TAXES	103,633	51,057
Income tax expense	4,481	4,432
NET INCOME	99,152	46,625
GENERAL PARTNER S INTEREST IN NET INCOME	8,938	932
LIMITED PARTNERS INTEREST IN NET INCOME	$ 90,214	$ 45,693
BASIC NET INCOME PER LIMITED PARTNER UNIT	$ 3.45	$ 6.90
BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	26,114,371	6,621,737
DILUTED NET INCOME PER LIMITED PARTNER UNIT	$ 3.45	$ 6.90
DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	26,141,605	6,621,737

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	For the Year Ended August 31, 2004	For the Eleven Months Ended August 31, 2003
	(see Note 2)	(Energy Transfer Company)
Net income	$ 99,152	$ 46,625
Other comprehensive income:		
Reclassification adjustment for gains on derivative instruments included in net income accounted for as hedges	(3,396)	
Change in value of derivative instruments accounted for as hedges	3,481	
Change in value of available-for-sale securities	(53)	
Comprehensive income	$ 99,184	$ 46,625
Reconciliation of Accumulated Other Comprehensive Income		
Balance, beginning of period	$	$
Current period reclassification to earnings	(3,396)	
Current period change	3,428	
Balance, end of period	$ 32	$

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED STATEMENTS OF PARTNERS CAPITAL

(in thousands, except unit data)

Number of Units											Accum Ot Compr
Common	**Class C**	**Class D**	**Class E**	**Special**	**Common**	**Class C**	**Class D**	**Class E**	**Special**	**General Partner**	**Inc**
					$	$	$	$	$	$	$
6,621,737					139,180					108	
					(4,815)					(10)	
					46,531					94	
6,621,737					180,896					192	
					(208,927)						
					(52,963)		(5,405)			(5,015)	
16,502,913	1,000,000	7,721,542		3,742,515	103,631		205,382		38,000	(896)	
(4,426,916)			4,426,916		(158,235)			158,235			
			(4,426,916)					(158,235)			
14,375,000					528,129						
					(1,027)		(284)			23,542	
22,240					734						

11,464,057		(7,721,542)		(3,742,515)	256,007		(218,007)		(38,000)		
					42 71,900		18,314			8,938	
44,559,031	1,000,000				$ 720,187	$	$	$	$	$26,761	$

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
	(see Note 2)	(Energy Transfer Company)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 99,152	$ 46,625
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	50,848	13,461
Amortization of deferred finance costs charged to interest	2,642	2,311
Provision for loss on accounts receivable	1,667	
(Gain) loss on disposal of assets	1,006	
Deferred compensation on restricted units and long-term incentive plan	42	
Undistributed earnings of affiliates	(363)	(1,423)
Deferred income taxes	(3,723)	(1,116)
Dividend from subsidiary		1,000
Minority interests	502	
Other noncash, net		(40)
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(101,976)	(83,964)
Accounts receivable from related companies	331	
Inventories	34,714	(138)
Deposits paid to vendors	16,030	(19,053)
Exchanges receivable	(7,479)	(1,373)
Prepaid expenses and other	3,192	
Intangibles and other assets	(1,076)	282
Accounts payable	58,278	93,761
Accounts payable to related companies	599	820
Exchanges payable	1,436	1,410
Deposits from customers	(222)	11,600
Accrued and other current liabilites	10,730	4,134
Other long-term liabilities	(157)	157
Income taxes payable	(315)	2,567
Price risk management liabilities, net	(3,163)	(105)
Net cash provided by operating activities	162,695	70,916

CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, net of cash acquired	(681,835)	(306,131)
Capital expenditures	(109,688)	(13,872)
Cash invested in affiliates	(322)	
Proceeds from the sale of assets	1,108	9,843
Net cash used in investing activities	(790,737)	(310,160)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	894,079	246,000
Principal payments on debt	(510,084)	(20,000)
Net proceeds from issuance of Common Units	528,129	
Capital contribution from General Partner	22,231	77,706
Distributions to parent	(206,071)	(4,825)
Debt issuance costs	(8,236)	(6,515)
Unit distributions	(63,383)	
Net cash provided by financing activities	656,665	292,366
INCREASE IN CASH AND CASH EQUIVALENTS	28,623	53,122
CASH AND CASH EQUIVALENTS, beginning of period	53,122	
CASH AND CASH EQUIVALENTS, end of period	$ 81,745	$ 53,122

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended August 31, 2004 (see Note 2)	Eleven Months Ended August 31, 2003 (Energy Transfer Company)
NONCASH FINANCING ACTIVITIES:		
Notes payable incurred on noncompete agreements	$ 215	$
Issuance of Common Units in connection with certain acquistions	$ 734	$
General Partner capital contribution	$ 1,311	$
Contributed assets	$ 1,743	$ 31,017
Distributions payable to parent	$ 2,856	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 37,944	$ 8,486
Cash paid during the period for income taxes	$ 7,227	$ 2,935

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

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ENERGY TRANSFER PARTNERS, L.P. AND SUBSIDIARIES
(FORMERLY ENERGY TRANSFER COMPANY)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in thousands, except unit and per unit data)

1. OPERATIONS AND ORGANIZATION:

Energy Transfer Transactions

On January 20, 2004, Heritage Propane Partners, L.P., (Heritage) and La Grange Energy, L.P. (La Grange Energy) completed the series of transactions whereby La Grange Energy contributed its subsidiary, La Grange Acquisition, L.P. and its subsidiaries who conduct business under the assumed name of Energy Transfer Company, (ETC OLP) to Heritage in exchange for cash of $300,000 less the amount of ETC OLP debt in excess of $151,500, less ETC OLP s accounts payable and other specified liabilities, plus agreed upon capital expenditures paid by La Grange Energy relating to the ETC OLP business prior to closing, $433,909 of Heritage Common and Class D Units, and the repayment of the ETC OLP debt of $151,500. These transactions and the other transactions described in the following paragraphs are referred to herein as the Energy Transfer Transactions. In conjunction with the Energy Transfer Transactions and prior to the contribution of ETC OLP to Heritage, ETC OLP distributed its cash and accounts receivables to La Grange Energy and an affiliate of La Grange Energy contributed an office building to ETC OLP. La Grange Energy also received 3,742,515 Special Units as consideration for the project it had in progress to construct the Bossier Pipeline. The Special Units converted to Common Units upon the Bossier Pipeline becoming commercially operational on June 21, 2004. The conversion of the Special Units to Common Units was approved by Energy Transfer Partners Unitholders at a special meeting held on June 23, 2004.

Simultaneously with the Energy Transfer Transactions, La Grange Energy obtained control of Heritage by acquiring all of the interest in U.S. Propane, L.P., (U.S. Propane) the General Partner of Heritage, and U.S. Propane, L.P. s general partner, U.S. Propane, L.L.C., from subsidiaries of AGL Resources, Atmos Energy Corporation, TECO Energy, Inc. and Piedmont Natural Gas Company, Inc. for $30,000 (the General Partner Transaction). In conjunction with the General Partner Transaction, U.S. Propane, L.P. contributed its 1.0101% General Partner interest in Heritage Operating, L.P. (HOLP) to Heritage in exchange for an additional 1% General Partner interest in Heritage. Simultaneously with these transactions, Heritage purchased the outstanding stock of Heritage Holdings, Inc. (Heritage Holdings) from U.S. Propane, L.P. for $100,000.

Concurrent with the Energy Transfer Transactions, ETC OLP borrowed $325,000 from financial institutions and Heritage raised $355,948 of gross proceeds through the sale of 9,200,000 Common Units at an offering price of $38.69 per unit. The net proceeds were used to finance the transaction and for general partnership purposes.

Accounting Treatment of the Energy Transfer Transactions

The Energy Transfer Transactions were accounted for as a reverse acquisition in accordance with Statement of Financial Accounting Standard 141, *Business Combinations* (SFAS 141). Although Heritage is the surviving parent entity for legal purposes, ETC OLP is the acquiror for accounting purposes. As a result, ETC OLP s historical financial statements are now the historical financial statements of the registrant. Consequently, the registrant s financial statements do not reflect 100% of the results of Heritage within the period, as Heritage s results for the period from September 1, 2003 through January 19, 2004 (the date of the Energy Transfer Transactions) are not included. See Note 2. The operations of Heritage prior to the Energy Transfer Transactions are referred to as Heritage. The assets and liabilities of Heritage were initially recorded at fair value to the extent acquired byLa Grange Energy through its acquisition of the General Partner and limited partner interests of Heritage of approximately 35.4%, determined in accordance with Emerging Issues Task Force (EITF) 90-13 *Accounting for Simultaneous Common Control Mergers* and SFAS 141. The assets and liabilities of ETC OLP have been recorded at historical cost. Although the partners capital accounts of ETC OLP became the capital accounts of the Partnership, Heritage s partnership structure and partnership units survive. Accordingly, the partners capital accounts of ETC OLP have been restated based on the general partner interests and units received by La Grange Energy in the Energy Transfer Transactions. The acquisition of Heritage Holdings by Heritage was accounted for as a capital transaction as the primary asset held by Heritage Holdings is 4,426,916 Common Units of Heritage. Following the acquisition of Heritage Holdings by Heritage, these Common Units were converted to Class E Units. The Class E Units are recorded as treasury units in the consolidated financial statements.

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Costs incurred to construct the Bossier Pipeline are recorded at historical cost. The issuance of the additional Common Units upon the conversion of the Special Units adjusted the percent of Heritage acquired by La Grange Energy in the Energy Transfer Transactions and resulted in an additional fair value step-up being recorded in accordance with EITF 90-13. Upon the conversion of the Special Units on June 23, 2004, La Grange Energy acquired approximately 41.5% of Heritage, and approximately $38,000 additional step-up in the fair value of the assets and liabilities of Heritage was recorded. This does not consider any effects of the TUFCO System transaction or the unit offering that occurred in June 2004.

The excess purchase price over Heritage s cost was determined as follows:

Net book value of Heritage at January 20, 2004	$ 239,102
Historical goodwill at January 20, 2004	(170,500)
Equity investment from public offering	355,948
Treasury Class E Unit purchase	(157,340)
	267,210
Percent of Heritage acquired by La Grange Energy	41.5%
Equity interest acquired	$ 110,892
Fair market value of Limited Partner Units	668,534
Purchase price of General Partner Interest	30,000
Equity investment from public offering	355,948
Treasury Class E Unit purchase	(157,340)
	897,142
Percent of Heritage acquired by La Grange Energy	41.5%
Fair value of equity acquired	372,314
Net book value of equity acquired	110,892
Excess purchase price over Heritage cost	$ 261,422

The excess purchase price over Heritage cost was allocated as follows:

Property, plant and equipment (25 year life)	$ 40,461
Customer lists (15 year life)	15,991
Trademarks	12,152

Goodwill	192,818
	$261,422

The purchase accounting allocations recorded as of August 31, 2004 are preliminary. However, management is in the process of obtaining an independent valuation and does not believe there will be material modifications to the purchase price allocations.

Change of Partnership Name

On February 12, 2004, the Board of Directors of Heritage s General Partner voted to change the name of Heritage to Energy Transfer Partners, L.P., and began trading on the New York Stock Exchange under the ticker symbol ETP . The name change and new ticker symbol were effective March 1, 2004.

Business Operations

In order to simplify the obligations of Energy Transfer Partners, L.P. (the Partnership) under the laws of several jurisdictions in which it conducts business, the Partnership s activities are conducted through two subsidiary operating partnerships, ETC OLP, a Texas limited partnership which is engaged in midstream and transportation natural gas operations, and HOLP a Delaware limited partnership which is engaged in retail and wholesale propane operations (collectively the Operating Partnerships). The Partnership, the Operating Partnerships, and the Partnership s and Operating Partnership s other subsidiaries are collectively referred to in this report as Energy Transfer.

As of August 31, 2004, ETC OLP owned and operated approximately 5,950 miles of natural gas gathering and transportation pipelines with an aggregate throughput capacity of 4.7 billion cubic feet of natural gas per day, with natural gas treating and processing plants located in Texas, Oklahoma, and Louisiana. Its major asset groups consist of the Southeast Texas System, Elk City System, Oasis Pipeline, East Texas Pipeline and TUFCO System. On November 1, 2004, the Partnership closed on the acquisition of certain midstream natural gas assets of Devon

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Energy Corporation (Devon). The assets, known as the Texas Chalk and Madison Systems, include approximately 1,800 miles of gathering and mainline pipeline systems, four natural gas treating plants, condensate stabilization facilities, fractionation facilities and the 80 MMcf/d Madison gas processing plant.

HOLP sells propane and propane-related products to more than 650,000 active residential, commercial, industrial, and agricultural customers in 32 states. HOLP is also a wholesale propane supplier in the United States and in Canada, the latter through its participation in MP Energy Partnership. MP Energy Partnership is a Canadian partnership, in which the Partnership owns a 60% interest, engaged in lower-margin wholesale distribution and in supplying HOLP s northern U.S. locations. HOLP buys and sells financial instruments for its own account through its wholly owned subsidiary, Heritage Energy Resources, L.L.C. (Resources).

2. PRESENTATION OF FINANCIAL INFORMATION:

The accompanying financial statements for the year ended August 31, 2004 include the results of operations for ETC OLP for the entire period, consolidated with the results of operations of HOLP and Heritage Holdings beginning January 20, 2004. On June 2, 2004, ETC OLP acquired the TUFCO System from TXU Fuel Company, a subsidiary of TXU Corp. The former TUFCO System is referred to as the ET Fuel System. The accompanying financial statements for the year ended August 31, 2004 include the results of operations of the ET Fuel System beginning June 2, 2004 and the Bossier Pipeline since June 21, 2004.

During the eleven months ended August 31, 2003, ETC OLP owned the Southeast Texas System, the Oasis Pipeline, and the Elk City System. From October 1, 2002 through December 27, 2002, ETC OLP also owned a 50% equity interest in Oasis Pipe Line Company, which owns the Oasis Pipeline. After December 27, 2002, ETC OLP owned a 100% interest in Oasis Pipe Line Company. In addition, on December 27, 2002, an affiliate of La Grange Energy s general partner contributed to ETC OLP its marketing business (ET Company I) and its interest in the Vantex System, the Rusk County Gathering System, the Whiskey Bay System and the Chalkley Transmission System.

As stated previously, the financial statements of ETC OLP are the financial statements of the registrant, as ETC OLP was deemed the accounting acquiror from the Energy Transfer Transactions. ETC OLP was formed on October 1, 2002, and has an August 31 year-end. ETC OLP s predecessor entities had a December 31 year-end. Accordingly, ETC OLP s eleven-month period ended August 31, 2003 was treated as a transition period under the rules of the Securities and Exchange Commission and therefore, only an eleven-month period is presented for the period ended August 31, 2003. The accompanying combined financial statements of ETC OLP as of August 31, 2003 present the combined financial statements of ETC OLP and subsidiaries after the elimination of significant intercompany balances and transactions.

The following unaudited pro forma consolidated results of operations are presented as if the ET Fuel System, Oasis Pipe Line Company and ET Company I were wholly owned at the beginning of the periods presented and the Energy Transfer Transactions had been made at the beginning of the periods presented.

	Year Ended August 31, 2004		Eleven Months, Ended August 31, 2003	Year Ended August 31, 2003
	(actual)	(pro forma) (unaudited)	(actual)	(pro forma) (unaudited)

REVENUES:				
Midstream and transportation	$2,102,101	$2,142,935	$ 1,023,468	$1,204,620
Propane Operations	342,522	584,577		510,757
Other	37,631	65,928		60,718
Total revenues	2,482,254	2,793,440	1,023,468	1,776,095
COSTS AND EXPENSES:				
Cost of products sold	2,126,150	2,274,480	901,543	1,310,409
Operating expenses	152,100	220,549	27,960	187,288
Depreciation and amortization	50,848	75,547	13,461	65,278
Selling, general and administrative	33,135	45,251	15,965	36,963
Realized and unrealized (gains) losses on derivatives	(25,499)	(25,499)	2,950	(912)
Total costs and expenses	2,336,734	2,590,328	961,879	1,599,026
OPERATING INCOME	145,520	203,112	61,589	177,069

	Year Ended August 31, 2004		Eleven Months, Ended August 31, 2003	Year Ended August 31, 2003
	(actual)	(pro forma) (unaudited)	(actual)	(pro forma) (unaudited)
OTHER INCOME (EXPENSE)				
Interest expense	(41,458)	(69,273)	(12,456)	(68,433)
Equity in earnings of affiliates	363	859	1,423	1,120
Gain loss on disposal of assets	(1,006)	(1,006)		
Other	509	305	501	(872)
INCOME BEFORE MINORITY INTERESTS AND INCOME TAXES	103,928	133,997	51,057	108,884
Minority interests	(295)	(636)		(558)
INCOME BEFORE INCOME TAXES	103,633	133,361	51,057	108,326
Income Taxes	4,481	6,058	4,432	15,401
NET INCOME	99,152	127,303	46,625	92,925
GENERAL PARTNER S INTEREST IN NET INCOME	8,938	10,199	932	4,578
LIMITED PARTNERS INTEREST IN NET INCOME	$ 90,214	$ 117,104	$ 45,693	$ 88,347
BASIC EARNINGS PER LIMITED PARTNER UNIT	$ 3.45	$ 3.16	$ 6.90	$ 2.62
BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	26,114,371	37,076,700	6,621,737	33,783,619
DILUTED EARNINGS PER LIMITED PARTNER UNIT	$ 3.45	$ 3.16	$ 6.90	$ 2.61

DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	26,141,605	37,103,194	6,621,737	33,808,119

	Year Ended August 31, 2004		Eleven Months, Ended August 31, 2003	Year Ended August 31, 2003
	(actual)	(pro forma)	(actual)	(pro forma)
VOLUMES				
Midstream				
Natural gas MMBtu/d	975,000	975,000	524,000	527,000
NGLs bbls/d	12,000	12,000	13,000	14,000
Transportation				
Natural gas MMBtu/d	1,091,000	2,297,000	921,000	2,141,000
Propane operations (in gallons)				
Retail propane	226,209	397,862		375,939
Domestic wholesale	7,071	12,452		15,343
Foreign wholesale	28,648	51,947		58,958

The pro forma consolidated results of operations include adjustments to give effect to depreciation on the step-up of property, plant and equipment, amortization of customer lists, interest expense on acquisition debt, and certain other adjustments. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at the beginning of the periods presented or the future results of the combined operations.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BALANCE SHEET DETAIL:

Principles of Consolidation

La Grange Acquisition is a Texas limited partnership formed on October 1, 2002 and was 99.9% owned by its limited partner, La Grange Energy, L.P., and 0.1% owned by its general partner, LA GP, LLC. La Grange Acquisition is the 99.9% limited partner of ETC Gas Company, Ltd., ETC Texas Pipeline, Ltd., ETC Processing, Ltd., ETC Oklahoma Pipeline, Ltd., ETC Katy Pipeline, Ltd., and ETC Marketing, Ltd. and a

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99% limited partner of ETC Oasis, L.P. and ET Company I, Ltd. (collectively, the Operating Companies). The general partners of La Grange Acquisition, La Grange Energy, and the Operating Companies were ultimately owned and controlled by members of La Grange Energy s management, a private equity investor fund, and a group of institutional investors prior to the Energy Transfer Transactions. La Grange Acquisition and the Operating Companies conducted business under the name Energy Transfer Company. The historical financial statements of Energy Transfer Company represent the accounts of La Grange Acquisition and the Operating Companies (collectively ETC OLP) on a combined basis as entities under common control. The accompanying combined financial statements of Energy Transfer Company as of August 31, 2003 and for the eleven months ended August 31, 2003, include the accounts of ETC OLP after the elimination of significant intercompany balances and transactions. Further, ETC OLP s limited partner investments in each of the Operating Companies were eliminated against the Operating Companies limited partner s capital. From October 2002 through December 2002, ETC OLP owned a 20% interest in the Nustar Joint Venture. Effective December 27, 2002, ETC OLP owned a 50% interest in Vantex Gas Pipeline Company, LLC, and a 49.5% interest in Vantex Energy Services, Ltd. These investments are accounted for under the equity method, and are recorded as an investment in affiliates on the Partnership s consolidated balance sheets. All significant intercompany transactions have been eliminated. Prior to December 27, 2002, when the remaining 50% of Oasis Pipe Line Company (Oasis) capital stock was redeemed, ETC OLP accounted for its 50% ownership in Oasis under the equity method. ETC OLP purchased the remaining 50% interest in Oasis on December 27, 2002 and Oasis became a wholly owned subsidiary of ETC OLP. ETC OLP was contributed by La Grange Energy to Heritage and, thus, after the January 2004 Energy Transfer Transactions, ETC OLP, became wholly owned subsidiaries of the Partnership.

After the Energy Transfer Transactions, the consolidated financial statements of the registrant include the accounts of the Partnership s subsidiaries, including the Operating Partnerships, Heritage Holdings, and MP Energy Partnership, in which HOLP owns a 60% interest. A minority interest liability and minority interest expense is recorded for all partially owned subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

For purposes of maintaining partner capital accounts, the Partnership Agreement of Energy Transfer Partners, L.P. (the Partnership Agreement) specifies that items of income and loss shall generally be allocated among the partners in accordance with their percentage interests (see Note 11). Normal allocations according to percentage interests are made, however, only after giving effect to any priority income allocations in an amount equal to the incentive distributions that are allocated 100% to the General Partner.

Cash and Cash Equivalents

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

Marketable Securities

Marketable securities owned by the Partnership are classified as available-for-sale securities and are reflected as a current asset on the consolidated balance sheet at their fair value. Unrealized holding losses were $53 for the period ended August 31, 2004, and $0 for the eleven months ended August 31, 2003.

Accounts Receivable

The Partnership s midstream and transportation operations deal with counterparties that are typically either investment grade or are otherwise secured with a letter of credit or other form of security (corporate guaranty or prepayment). Management reviews midstream and transportation accounts receivable balances each week. Credit limits are assigned and monitored for all counterparties of the midstream and transportation operations. Management believes that the occurrence of bad debt in the Partnership s midstream and transportation segments is not significant; therefore, an allowance for doubtful accounts for the midstream and transportation segments was not deemed necessary at August 31, 2004 and 2003, respectively. Bad debt expense related to these receivables is recognized at the time an account is deemed uncollectible. The bad debt expense recorded during the year ended August 31, 2004 and the eleven months ended August 31, 2003 in the midstream and transportation segments was $123, and $0, respectively.

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The Partnership enters into netting arrangements with counterparties of derivative contracts to mitigate credit risk. Transactions are confirmed with the counterparty and the net amount is settled when due.

The Partnership grants credit to its customers for the purchase of propane and propane-related products. Also included in accounts receivable are trade accounts receivable arising from the Partnership s retail and wholesale propane operations and receivables arising from liquids marketing activities. Accounts receivable for retail and wholesale propane and liquids marketing activities are recorded as amounts billed to customers less an allowance for doubtful accounts. The allowance for doubtful accounts for the retail and wholesale propane and liquids marketing segments is based on management s assessment of the realizability of customer accounts. Management s assessment is based on the overall creditworthiness of the Partnership s customers and any specific disputes. Accounts receivable consisted of the following:

	August 31, 2004	**August 31, 2003**
		(Energy Transfer Company)
Accounts receivable midstream and transportation	$230,101	$ 105,987
Accounts receivable propane	46,990	
Less allowance for doubtful accounts	(1,667)	
Total, net	$275,424	$ 105,987

The activity in the allowance for doubtful accounts for the retail and wholesale propane and liquids marketing segments consisted of the following:

	Year Ended August 31, 2004	**Eleven Months Ended August 31, 2003**
		(Energy Transfer Company)
Balance, beginning of the period	$	$
Provision for loss on accounts receivable	1,667	
Accounts receivable written off, net of recoveries		

Balance, end of period	$ 1,667	$ —

Inventories

Midstream and transportation inventories are valued at market prices. These amounts turn over monthly and management believes the costs approximate market value. Propane inventories are valued at the lower of cost or market. The cost of propane inventories is determined using weighted-average cost of propane delivered to the customer service locations, and includes storage fees and inbound freight costs, while the cost of appliances, parts, and fittings is determined by the first-in, first-out method. Inventories consisted of the following:

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
Natural gas, propane and other NGLs	$41,732	$ 1,876
Appliances, parts and fittings and other	12,335	2,071
Total inventories	$54,067	$ 3,947

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Deposits

Deposits are paid to vendors in the midstream and transportation business as prepayments for natural gas deliveries in the following month. The Partnership makes prepayments when the volume of business with a vendor exceeds the Partnership s credit limit and/or when it is economically beneficial to do so. Deposits with vendors for gas purchases were $3,000 and $16,962 as of August 31, 2004 and 2003, respectively. The Partnership also has deposits with derivative counterparties of $23 and $2,091 as of August 31, 2004 and 2003, respectively.

Deposits are received from midstream and transportation customers as prepayments for natural gas deliveries in the following month and deposits from propane customers as security for future propane use. Prepayments and security deposits may also be required when customers exceed their credit limits or do not qualify for open credit. Deposits received from customers were $11,378 and $11,600 as of August 31, 2004 and 2003, respectively.

Exchanges

Exchanges consist of natural gas and NGL delivery imbalances with others. These amounts, which are valued at market prices, turn over monthly and are recorded as exchanges receivable or exchanges payable on the Partnership s consolidated balance sheets.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs that do not add capacity or extend the useful life are expensed as incurred. Expenditures to refurbish assets that either extend the useful lives of the asset or prevent environmental contamination are capitalized and depreciated over the remaining useful life of the asset. Additionally, the Partnership capitalizes certain costs directly related to the installation of company-owned propane tanks and construction of assets including internal labor costs, interest and engineering costs. Upon disposition or retirement of pipeline components or natural gas plant components, any gain or loss is recorded to accumulated depreciation. When entire pipeline systems, gas plants or other property and equipment are retired or sold, any gain or loss is included in operations.

The Partnership reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such a review should indicate that the carrying amount of long-lived assets is not recoverable, the Partnership reduces the carrying amount of such assets to fair value. No impairment of long-lived assets was recorded during the periods presented.

Components and useful lives of property, plant and equipment were as follows:

	August 31,	
	2004	**2003**
		(Energy Transfer Company)
Land and improvements	$ 27,771	$ 992
Buildings and improvements (10 to 30 years)	34,574	992
Pipelines and equipment (10 to 65 years)	833,538	385,448

Natural gas storage (40 years)	24,277	
Bulk storage, equipment and facilities (3 to 30 years)	48,947	
Tanks and other equipment (5 to 30 years)	328,026	
Vehicles (5 to 10 years)	56,922	883
Right of way (20 to 65 years)	59,338	4,057
Furniture and fixtures (3 to 10 years)	7,336	273
Linepack	12,850	5,176
Pad Gas	42,136	
Other (5 to 10 years)	5,581	1,453
	1,481,296	399,274
Less Accumulated depreciation	(57,346)	(13,672)
	1,423,950	385,602
Plus Construction work-in-process	43,699	7,423
Property, plant and equipment, net	$1,467,649	$393,025

Capitalized interest is included for pipeline construction projects. Interest is capitalized based on the current borrowing rate. As of August 31, 2004, a total of $926 has been capitalized for pipeline construction projects. There was no interest capitalized for the eleven months ended August 31, 2003.

Asset Retirement Obligation

The Partnership accounts for its asset retirement obligations in accordance with Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations,* (SFAS 143). SFAS No. 143 requires the Partnership to record the fair value of an asset retirement obligation as a liability in the period a legal obligation for the retirement of tangible long-lived assets is incurred, typically at the time the assets are placed into service. A corresponding asset is also recorded and depreciated over the life of the asset. After the initial measurement, an entity would recognize changes in the amount of the liability resulting from the passage of time and revisions to either the timing or amount of estimated cash flows.

The Partnership s management has completed the assessment of SFAS 143, and has determined that the Partnership is obligated by contractual requirements to remove facilities or perform other remediation upon retirement of certain assets. Determination of the amounts to be recognized is based upon numerous estimates and assumptions, including expected settlement dates, future retirement costs, future inflation rates, and the credit-adjusted risk-free interest rates. However, management is not able to reasonably determine the fair value of the asset retirement obligations as of August 31, 2004 because the settlement dates are indeterminable. An asset retirement obligation will be recorded in the periods management can reasonably determine the settlement dates.

Investment in Affiliates

The Partnership owns a 50% interest in Vantex Gas Pipeline Company, LLC, and a 49.5% interest in Vantex Energy Services, Ltd. The Partnership accounts for these investments under the equity method of accounting. The Vantex system is located in East Texas and is composed of approximately 250 miles of pipeline. Vantex Energy Services provides energy related marketing services to small and medium sized producers and end users on the Vantex Gas Pipeline system.

In December 2003, the Partnership purchased a 49% interest in Ranger Pipeline, L.P. (Ranger), which owns a 50% interest in Mountain Creek Joint Venture (Mountain Creek) for $250. Mountain Creek is located in North Texas and is composed of approximately 15 miles of pipeline. Mountain Creek supplies gas to an electric generation plant and earns the majority of its yearly income between the months of June and October.

Prior to December 27, 2002, when the remaining 50% of Oasis Pipe Line capital stock was redeemed, the Partnership accounted for its initial 50% ownership in Oasis Pipe Line under the equity method. During the three month period ended December 2002, the Partnership recognized $1.6 million of equity method income from the investment in Oasis Pipe Line. Oasis Pipe Line results from operations are recognized on a consolidated basis effective January 1, 2003.

Effective January 1, 2003, the Partnership sold its interest in the Nustar Joint Venture for approximately $9.6 million. No gain or loss was recognized, as the proceeds equaled the value assigned to the joint venture in the October 2002 purchase allocation.

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Goodwill

Goodwill is associated with acquisitions made for the Partnership s midstream and retail propane segments. There is no goodwill associated with the transportation segment. Of the $313,720 balance in goodwill, $25,442 is expected to be tax deductible. The changes in the carrying amount of goodwill for the years ended August 31, 2004 and the eleven months ended August 31, 2003 were as follows:

	Midstream	Retail Propane	Total
Balance October 1, 2002 (inception)	$	$	$
Goodwill acquired during the year	13,409		13,409
Balance as of August 31, 2003	$13,409	$	$ 13,409
Goodwill acquired during the year		300,311	300,311
Impairment losses			
Balance as of August 31, 2004	$13,409	$300,311	$313,720

The Partnership assesses the impairment of its goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets,* (SFAS 142), by determining whether the carrying amount exceeds the fair value of the recognized goodwill asset. If impairment has occurred, the difference between the carrying amount and the fair value is recognized as a loss in the consolidated statements of operations in the period of the impairment. Based on the annual impairment tests performed, there was no impairment as of August 31, 2004 or 2003.

Intangibles and Other Assets

Intangibles and other assets are stated at cost net of amortization computed on the straight-line method. The Partnership eliminates from its balance sheet the gross carrying amount and the related accumulated amortization for any fully amortized intangibles in the year they are fully amortized. Components and useful lives of intangibles and other assets were as follows:

	August 31, 2004		August 31, 2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
			(Energy Transfer Company)	
Amortized intangible assets -	$ 27,952	$ (3,006)	$	$

Noncompete agreements (5 to 15 years)				
Customer lists (15 years)	43,756	(2,307)		
Financing costs (3 to 15 years)	18,125	(5,515)	5,724	(2,464)
Consulting agreements (2 to 7 years)	132	(29)		
Other (10 years)	477	(143)	477	(92)
Total	90,442	(11,000)	6,201	(2,556)
Unamortized intangible assets -				
Trademarks	19,719			
Other assets	1,260			
Total intangibles and other assets	$111,421	$(11,000)	$6,201	$(2,556)

Aggregate amortization expense of intangible assets was $8,444 and $2,556 for the year ended August 31, 2004, and the eleven months ended August 31, 2003, respectively. Aggregate amortization expense includes $2,642 and $2,311 from amortization of deferred financing fees that was charged to interest expense for the year ended August 31, 2004 and the eleven-month period ended August 31, 2003, respectively. The estimated aggregate amortization expense for the next five fiscal years is $11,140 for 2005; $10,560 for 2006; $10,170 for 2007; $7,630 for 2008, and $6,075 for 2009.

The Partnership reviews other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such a review should indicate that the carrying amount of other intangible assets is not recoverable, the Partnership reduces the carrying amount of such assets to fair value. No impairment of other intangible assets has been recorded as of August 31, 2004 or 2003.

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Accrued and Other Current Liabilities

Accrued and other current liabilities consisted of the following:

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
Interest payable	$ 6,633	$ 1,014
Wages, payroll taxes and employee benefits	16,012	2,702
Deferred tank rent	4,581	
Taxes other than income	7,185	2,460
Advanced budget payments and unearned revenue	14,632	
Liquids Marketing	1,225	
Other	5,549	1,879
Accrued and other current liabilities	$55,817	$ 8,055

Fair Value

The carrying amounts of accounts receivable and accounts payable approximate their fair value. Based on the estimated borrowing rates currently available to the Partnership for long-term loans with similar terms and average maturities, the aggregate fair value and carrying amount of long-term debt at August 31, 2004 was $1,127,971 and $1,101,828, respectively. At August 31, 2003, the carrying amount of long-term debt approximated its fair value.

Revenue Recognition

Revenues for sales of natural gas, natural gas liquids (NGLs) including propane, and propane appliances, parts, and fittings are recognized at the later of the time of delivery of the product to the customer or the time of sale or installation. Revenue from service labor, transportation, treating, compression, and gas processing, is recognized upon completion of the service. Transportation capacity payments are recognized when earned in the period the capacity is made available. Tank rent is recognized ratably over the period it is earned.

Results from the midstream segment are determined primarily by the volumes of natural gas gathered, compressed, treated, processed, purchased and sold through our pipeline and gathering systems and the level of natural gas and NGL prices. The Partnership generates our midstream revenues and our gross margins principally under fee-based arrangements or other arrangements. Under fee-based arrangements, we receive a fee for natural gas gathering, compressing, treating or processing services. The revenue earned from these arrangements is directly related to the volume of natural gas that flows through its systems and is not directly dependent on commodity prices.

The Partnership also utilizes other types of arrangements in its midstream segment, including (i) discount-to-index price arrangements, which involve purchases of natural gas at either (1) a percentage discount to a specified index price, (2) a specified index price less a fixed amount or (3) a percentage discount to a specified index price less an additional fixed amount, (ii) percentage-of-proceeds arrangements under which we gather and processes natural gas on behalf of producers, selling the resulting residue gas and NGL volumes at market prices and remitting to producers an agreed upon percentage of the proceeds based on an index price, and (iii) keep-whole arrangements where we gather natural gas from the producer, processes the natural gas and sells the resulting NGLs to third parties at market prices. In many cases, the Partnership provides services under contracts that contain a combination of more than one of the arrangements described above. The terms of our contracts vary based on gas quality conditions, the competitive environment at the time the contracts are signed and customer requirements. Its contract mix may change as a result of changes in producer preferences, expansion in regions where some types of contracts are more common and other market factors.

Primarily the amount of capacity customers reserve as well as the actual volume of natural gas that flows through the transportation pipelines determines transportation segment results. Under transportation contracts, our customers are charged (i) a demand fee, which is a fixed fee for the reservation of an agreed amount of capacity on the transportation pipeline for a specified period of time and which obligates the customer to pay us even if the customer does not transport natural gas on the respective pipeline, (ii) a transportation fee, which is based on the actual throughput of natural gas by the customer on the Oasis Pipeline, (iii) a fuel retention based on a percentage of gas transported on the pipeline, or a combination of the three, generally payable monthly.

Shipping and Handling Costs

In accordance with the Emerging Issues Task Force Issue 00-10, *Accounting for Shipping and Handling Fees and Costs,* the Partnership has classified $35,895 and $10,883 from producer payments for natural gas, compression and treating, which can be considered handling costs, as revenue for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively. Costs related to fuel sold are included in cost of sales, while the remaining costs of approximately $19,834 and $8,879 included in operating expenses reflect the cost of fuel consumed for compression and treating for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively. The Partnership does not separately charge shipping and handling costs of propane to customers.

Costs and Expenses

Costs of products sold include actual cost of fuel sold adjusted for the effects of qualifying cash flow hedges, storage fees and inbound freight on propane, and the cost of appliances, parts, and fittings. Operating expenses include all costs incurred to provide products to customers, including compensation for operations personnel, insurance costs, vehicle maintenance, advertising costs, shipping and handling costs related to propane, purchasing costs, and plant operations. Selling, general and administrative expenses include all corporate expenses and compensation for corporate personnel.

Income Taxes

Energy Transfer Partners, L.P. is a limited partnership. As a result, the Partnership s earnings or losses for federal and state income tax purposes are included in the tax returns of the individual partners. Net earnings for financial statement purposes may differ significantly from taxable income reportable to unitholders as a result of differences between the tax basis and financial reporting basis of assets and liabilities and the taxable income allocation requirements under the Partnership Agreement.

Oasis, Heritage Holdings, and certain other of the Partnership s subsidiaries are taxable corporations and follow the asset and liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109). Under SFAS 109, deferred income taxes are recorded based upon differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the underlying assets are received and liabilities settled.

Income Per Limited Partner Unit

Basic net income per limited partner unit is computed by dividing net income, after considering the General Partner s interest, by the weighted average number of Common outstanding. Diluted net income per limited partner unit is computed by dividing net income, after considering the General Partner s interest, by the weighted average number of Common outstanding and the weighted average number of restricted units (Phantom Units) granted under the Restricted Unit Plan. A reconciliation of net income and weighted average units used in computing basic and diluted net income per unit is as follows:

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
Basic Net Income per Limited Partner Unit:		
Limited Partners interest in net income	$ 90,214	$ 45,693
Weighted average limited partner units	26,114,371	6,621,737
Basic net income per limited partner unit	$ 3.45	$ 6.90
Diluted Net Income per Limited Partner Unit:		
Limited partners interest in net income	$ 90,214	$ 45,963
Weighted average limited partner units	26,114,371	6,621,737
Dilutive effect of phantom units	27,234	
Weighted average limited partner units, assuming dilutive effect of phantom units	26,141,605	6,621,737
Diluted net income per limited partner unit	$ 3.45	$ 6.90

Unit Based Compensation Plans

The Partnership follows the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 *Accounting for Stock-based Compensation* (SFAS 123). SFAS 123 requires that significant assumptions be used during the year to estimate the fair value, which includes the risk-free interest rate used, the expected life of the grants under each of the plans and the expected distributions on each of the units granted. The Partnership assumed a weighted average risk free interest rate of 2.35% for the year ended August 31, 2004, in estimating the present value of the future cash flows of the distributions during the vesting period on the measurement date of each grant. Annual average cash distributions at the grant date were estimated to be $2.22 for the year ended August 31, 2004. The expected life of each grant is assumed to be the minimum vesting period under certain performance criteria of each grant. There were no grants outstanding at August 31, 2003.

Restricted Unit Plan

The General Partner previously adopted the Amended and Restated Restricted Unit Plan dated August 10, 2000, amended February 4, 2002 as the Second Amended and Restated Restricted Unit Plan (the Restricted Unit Plan), for certain directors and key employees of the General Partner and its affiliates. The Restricted Unit Plan provided rights to acquire up to 146,000 Common Units. The Restricted Unit Plan provided for the award or grant to key employees of the right to acquire Common Units on such terms and conditions (including vesting conditions, forfeiture or lapse of rights) as the Compensation Committee of the General Partner shall determine. In addition, eligible directors automatically received a director s grant of 500 Common Units on each September 1, and newly elected directors were also entitled to receive a grant of 2,000 Common Units upon election or appointment to the Board. Directors who were our employees or employees of the General Partner were not entitled to receive a director s grant of Common Units but could receive Common Units as employees.

Generally, awards granted under the Restricted Unit Plan vested upon the occurrence of specified performance objectives established by the Compensation Committee at the time designations of grants were made, or if later, the three-year anniversary of the grant date. In the event of a change of control (as defined in the Restricted Unit Plan), all rights to acquire Common Units pursuant to the Restricted Unit Plan immediately vested. Pursuant to the January 2004 acquisition of the General Partner of the Partnership by La Grange Energy, the change of

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control provisions of the Restricted Unit Plan were triggered, resulting in the early vesting of 21,600 units by Heritage. Individuals holding 4,500 grants waived their rights to early vesting under the change of control provisions. Heritage recognized compensation expense on the units that vested.

The issuance of the Common Units pursuant to the Restricted Unit Plan was intended to serve as a means of incentive compensation for performance and not primarily as an opportunity to participate in the equity appreciation in respect of the Common Units. Therefore, no consideration was payable by the plan participants upon vesting and issuance of the Common Units. Following the June 23, 2004 approval of the 2004 Unit Plan at the special meeting of the Unitholders, the Restricted Unit Plan was terminated (except for the obligation to issue Common Units at the time the 8,296 units previously awarded vest), and no additional grants will be made under the Restricted Unit Plan.

Deferred compensation expense recognized under the Restricted Unit Plan for the year ended August 31, 2004 and the eleven months ended August 31, 2003 was $42 and $0, respectively.

Long-Term Incentive Plan

Effective September 1, 2000, the General Partner adopted a long-term incentive compensation plan whereby units were to be awarded to the Executive Officers of the General Partner upon achieving certain targeted levels of Distributed Cash (as defined in the Long Term Incentive Plan) per unit. Awards under the program were made starting in 2003 based upon the average of the prior three years Distributed Cash per unit. A minimum of 250,000 units and if targeted levels were achieved, a maximum of 500,000 units were available for award under the Long Term Incentive Plan. During the fiscal year ended August 31, 2003, 66,118 units vested pursuant to the vesting rights of the Long-Term Incentive Plan and Common Units were issued. In connection with the acquisition by La Grange Energy of the General Partner in January 2004, 150,018 units vested and Common Units were issued, and the Long-Term Incentive Plan terminated. No deferred compensation expense was recognized under the long-term incentive plan for the year ended August 31, 2004, or the eleven months ended August 31, 2003. Heritage recorded deferred compensation expense of $564 on the units that vested in connection with the acquisition by La Grange Energy of the General Partner in January 2004.

2004 Unit Plan

On June 23, 2004 at a special meeting of the Common Unitholders, the Common Unitholders approved the terms of the Partnership s 2004 Unit Plan (the Plan), which provides for awards of Common Units and other rights to the Partnership s employees, officers, and directors. The maximum number of Common Units that may be granted under this Plan is 900,000 total units issued. Any awards that are forfeited or which expire for any reason, or any units which are not used in the settlement of an award will be available for grant under the Plan. Units to be delivered upon the vesting of awards granted under the Plan may be (i) units acquired by the Partnership in the open market, (ii) units already owned by the Partnership or its General Partner, (iii) units acquired by the Partnership or its General Partner directly from the Partnership, or any other person, (iv) units that are registered under a registration statement for this Plan, (v) Restricted Units, or (vi) any combination of the foregoing.

Employee Grants. The Compensation Committee, in its discretion, may from time to time grant awards to any employee, upon such terms and conditions as it may determine appropriate and in accordance with specific general guidelines as defined by the Plan. All outstanding awards shall fully vest into units upon any Change in Control as defined by the Plan or upon such terms as the Compensation Committee may require at the time the award is granted. As of August 31, 2004, no grants of awards had been made to any employee under the 2004 Unit Plan. Subsequent to August 31, 2004, awards totaling 129,600 units were made under the 2004 Unit Plan to employees, including executive officers. These awards will vest subject to vesting over a three-year period based upon the achievement of certain performance criteria. Vested awards will convert into Common Units upon the third anniversary of the measuring date for the grants, which is September 1 of each year. Vesting occurs based upon the total return to the Partnership s Unitholders as compared to a group of Master Limited Partnership peer companies. The issuance of Common Units pursuant to the 2004 Unit Plan is intended to serve as a means of incentive compensation, therefore, no consideration will be payable by the plan participants upon vesting and issuance of the Common Units.

Director Grants. Each director who is not also (i) a shareholder or a direct or indirect employee of any parent, or (ii) a direct or indirect employee of USP LLC, the Partnership, or a subsidiary (Director Participant), who is elected or appointed to the Board for the first time shall automatically receive, on the date of his or her election or appointment, an award of up to 2,000 Units (the Initial Director s Grant). Commencing on September 1, 2004 and each September 1 thereafter that this Plan is in effect, each Director Participant who is in office on

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such September 1, shall automatically receive an award of Units equal to $15,000 divided by the fair market value of a Common Units on such date (Annual Director s Grant). Each grant of an award to a Director Participant will vest at the rate of 20% per year, beginning on the first anniversary date of the Award; provided however, notwithstanding the foregoing, (i) all awards to a Director Participant shall become fully vested upon a change in control, as defined by the Plan, unless voluntarily waived by such Director Participant, and (ii) all awards which have not yet vested on the date a Director Participant ceases to be a director shall vest on such terms as may be determined by the Compensation Committee. As of August 31, 2004, initial Director s Grants totaling 4,000 Units have been made.

Long-Term Incentive Grants. The Compensation Committee may, from time to time, grant awards under the Plan to any executive officer or any employee it may designate as a participant in accordance with general guidelines under the Plan. These guidelines include (i) options to purchase a specified number of units at a specified exercise price, which are clearly designated in the award as either an incentive stock option within the meaning of Section 422 of the Internal Revenue Code, or a non-qualifying stock option that is not intended to qualify as an incentive stock option under Section 422; (ii) Unit Appreciation Rights that specify the terms of the fair market value of the award on the date the unit appreciation right is exercised and the strike price; (iii) units; or (iv) any combination hereof. As of August 31, 2004, there has been no Long-Term Incentive Grants made under the Plan.

This Plan will be administered by the Compensation Committee of the Board of Directors and may be amended from time to time by the Board; provided however, that no amendment will be made without the approval of a majority of the Unitholders (i) if so required under the rules and regulations of the New York Stock Exchange or the Securities and Exchange Commission; (ii) that would extend the maximum period during which an award may be granted under the Plan; (iii) materially increase the cost of the Plan to the Partnership; or (iv) result in this Plan no longer satisfying the requirements of Rule 16b-3 of Section 16 of the Securities and Exchange Act of 1934. This Plan shall terminate no later that the 10th anniversary of its original effective date.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Some of the other more significant estimates made by management include, but are not limited to, allowances for doubtful accounts, the fair value of derivative instruments, useful lives for depreciation and amortization, purchase accounting allocations and subsequent realizability of intangible assets, deferred taxes, and general business and medical self-insurance reserves. Actual results could differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified to conform with the 2004 presentation. These reclassifications have no impact on net income or total partners capital.

Accounting for Derivative Instruments and Hedging Activities

The Partnership applies Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) as amended. This statement requires that all derivatives be recognized in the balance sheet as either an asset or liability measured at fair value. Special accounting for qualifying hedges allows a derivative s gains and losses to offset related results on the hedged item in the statement of operations and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting treatment.

The Partnership has established a formal risk management policy in which derivative financial instruments are employed in connection with an underlying asset, liability and/or anticipated transaction. The midstream and transportation segments do not use derivative financial instruments for speculative purposes. At inception, the Partnership formally documents the relationship between the hedging instrument and the hedged item, the risk management objectives, and the methods used for assessing and testing effectiveness. The Partnership also assesses, both at the inception of the hedge and on an on-going basis, whether the derivatives that are used in its hedging transactions are highly effective in offsetting changes in cash flows. Furthermore, management meets on a weekly basis to assess the creditworthiness of the derivative counterparties to manage against the risk of default. If the

Partnership determines that a derivative is no longer highly effective as a hedge, it discontinues hedge accounting prospectively by including changes in the fair value of the derivative in current earnings.

The Partnership utilizes various exchange-traded and over-the-counter commodity financial instrument contracts to limit its exposure to margin fluctuations in natural gas and NGL prices. These contracts consist primarily of futures and swaps. Generally, management has previously elected not to apply hedge accounting to these contracts, therefore, the net gain or loss arising from marking to market these derivative instruments was previously recognized in earnings as unrealized gains and losses on the statement of operations. However, during the year ended August 31, 2004, the Partnership designated various new futures and certain associated basis contracts as cash flow hedging instruments in accordance with SFAS 133. The effective portion of the hedge gain or loss is initially reported as a component of other comprehensive income and is subsequently reclassified into earnings when the transaction being hedged occurs. The ineffective portion of the gain or loss is reported in earnings immediately. As of August 31, 2004, these hedging instruments had a net fair value of $85, which was recorded as price risk management assets and liabilities on the balance sheet through other comprehensive income. The Partnership reclassified into earnings gains of $3,396 for the year ended August 31, 2004 related to the commodity financial instruments, that were previously reported in accumulated other comprehensive income (loss). The amount of hedge ineffectiveness recognized in income was a gain of $895 for the year ended August 31, 2004. There were no financial instruments designated as hedges for the eleven months ended August 31, 2003.

The Partnership also entered into an interest rate swap agreement for the purpose of mitigating the interest rate risk associated with the ETC OLP Acquisition Term Note. The interest rate swap agreement is used to manage a portion of the exposure to changing interest rates by converting floating rate debt to fixed rate debt. The fair value of the swap was a liability of $539 and $807 as of August 31, 2004 and August 31, 2003, respectively, which is recorded as price risk management liabilities on the balance sheet. The Partnership recorded losses related to the changes in the fair value of the interest rate swap of $1,239 and $312 for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively.

In the course of normal operations, the Partnership routinely enters into contracts such as forward physical contracts for the purchase and sale of natural gas, propane, and other NGLs that qualify for and are designated as a normal purchase and sales contracts. Such contracts are exempted from the fair value accounting requirements of SFAS 133 and are accounted for using traditional accrual accounting.

The market prices used to value the financial derivative transactions reflect management s estimates considering various factors including closing exchange and over-the-counter quotations, and the time value of the underlying commitments. The values are adjusted to reflect the potential impact of liquidating a position in an orderly manner over a reasonable period of time under present market conditions.

Recently Issued Accounting Standards

In January of 2003, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 46 *Consolidation of Variable Interest Entities An Interpretation of ARB No. 51* (FIN 46). In December 2003, the FASB issued FIN 46R, which clarified certain issues identified in FIN 46. FIN 46R requires an entity to consolidate a variable interest entity if the entity is designated as the primary beneficiary of that variable interest entity even if the entity does not have a majority of voting interest. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception of any entity created after January 31, 2003. For an entity created before February 1, 2003, the provisions of this interpretation must be applied at the beginning of the first interim or annual period beginning after March 15, 2004. The implementation of FIN 46 did not have an impact on the Partnership s financial position or results of operations.

As of August 31, 2004, the Partnership owned various unconsolidated entities in which its share of the unconsolidated entities ranges from 49% to 50%. The Partnership accounts for its investments under the equity method of accounting as prescribed by APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. The Partnership does not control these entities, and each partner shares in all profits and losses equal to their respective share in the entities. There are no limits on the exposure to losses or on the ability to share in returns. Based on the analysis performed, the Partnership is not the primary beneficiary of the entities, and as a result, will not consolidate the entities but will continue to account for the investment in these entities under the equity method.

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In May 2003, the FASB issued Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS 150 as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Partnership adopted the provisions of SFAS 150 as of September 1, 2003. The adoption did not have a material impact on the Partnership s consolidated financial position or results of operations.

4. ACQUISITIONS:

Fiscal year 2004 acquisitions

On June 2, 2004, ETC OLP acquired the transportation assets of TXU Fuel Company (formerly the TUFCO System now referred to as the ET Fuel System) for $498,571 in cash. The assets include approximately 2,000 miles of intrastate pipeline and related storage facilities located in Texas, with a total system capacity of 1.3 billion cubic feet or natural gas per day. The purchase price was funded with borrowings under ETC OLP s amended debt agreement.

These assets allow ETC OLP to provide multiple services to producers in four major producing areas of Texas, as well as providing access to major natural gas markets. In addition, these assets are expected to provide significant growth opportunities for the Partnership going forward. The acquisition was accounted for using the purchase method. The purchase price has been initially allocated based on the estimated fair values of the individual assets acquired and the liabilities assumed at the date of the acquisition. The final allocation of the purchase price is pending completion of an independent appraisal. The results of operations for the ET Fuel System are included in the consolidated income statements beginning on June 2, 2004.

The unaudited pro forma results of operations as if the ET Fuel System had been acquired at the beginning of the periods presented are presented in Note 2 to the consolidated financial statements.

During the period from January 20, 2004 to August 31, 2004, HOLP acquired substantially all of the assets of three propane companies, which included Edwards Propane of Marshville, North Carolina, Custer Gas Service of Custer, South Dakota, and one other small company. The aggregate purchase price for these acquisitions totaled $16,967, which included liabilities assumed of $268. In the aggregate, these acquisitions are not material for pro forma disclosure purposes. These acquisitions were financed primarily with the HOLP Senior Revolving Acquisition facility and were accounted for by the purchase method under SFAS 141.

Fiscal year 2003 acquisitions

In October 2002, ETC OLP purchased certain operating assets from Aquila Gas Pipeline, primarily natural gas gathering, treating and processing assets in Texas and Oklahoma, for $263,676 in cash. At the closing of the acquisition of Aquila Gas Pipeline s assets, $5,000 was put into escrow until such time that proper consents and conveyance could be achieved related to a sales contract. It was later determined that it was unlikely that a proper conveyance could be achieved which resulted in the escrowed amount of $5,000 being returned to ETC OLP during the eight months ended August 31, 2003. The return of the $5,000 purchase price reduced ETC OLP s basis in property, plant and equipment.

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Assets acquired and purchase price allocation

The assets acquired and purchase price allocation of material acquisitions for the year ended August 31, 2004 and the eleven months ended August 31, 2003 were as follows:

	ET Fuel System June 2, 2004	Aquila Gas Pipeline October 2003
Materials and supplies	$	$ 1,626
Other assets	57	194
Property, plant and equipment	499,789	213,374
Investment in Oasis		41,670
Investment in Nustar Joint Venture		9,600
Deposits from vendor	(750)	
Accrued expenses	(525)	(2,788)
Total	$ 498,571	$ 263,676

On December 27, 2002, Oasis Pipe Line Company redeemed the remaining 50% of its capital stock owned by Dow Hydrocarbons Resources, Inc. for $87,000 and cancelled the stock which resulted in ETC OLP owning 100% of the capital stock of Oasis Pipe Line Company effective December 27, 2002.

Also, on December 27, 2002, ETC OLP Holdings, LP, a limited partner of La Grange Energy, contributed ET Company I to the Partnership. The investment in the Vantex system was included in the assets contributed.

5. WORKING CAPITAL FACILITY AND LONG-TERM DEBT:

Long-term debt consists of the following:

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
1996 8.55% Senior Secured Notes	$ 84,000	$
1997 Medium Term Note Program:		
7.17% Series A Senior Secured Notes	12,000	
7.26% Series B Senior Secured Notes	18,000	
6.50% Series C Senior Secured Notes	1,786	
2000 and 2001 Senior Secured Promissory Notes:		

8.47% Series A Senior Secured Notes	9,600	
8.55% Series B Senior Secured Notes	27,429	
8.59% Series C Senior Secured Notes	27,000	
8.67% Series D Senior Secured Notes	58,000	
8.75% Series E Senior Secured Notes	7,000	
8.87% Series F Senior Secured Notes	40,000	
7.21% Series G Senior Secured Notes	15,200	
7.89% Series H Senior Secured Notes	8,000	
7.99% Series I Senior Secured Notes	16,000	
Term Loan Facility	725,000	226,000
Senior Revolving Acquisition Facility	23,000	

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	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
Long term portion of the Senior Revolving Working Capital Facility	10,000	
Notes Payable on noncompete agreements with interest imputed at rates averaging 7.38%, due in installments through 2010	18,218	
Other	1,595	
Current maturities of long-term debt	(30,957)	(30,000)
	$ 1,070,871	$ 196,000

Maturities of the Senior Secured Notes, the Medium Term Note Program and the Senior Secured Promissory Notes (the Notes) are as follows:

1996 8.55% Senior Secured Notes:

mature at the rate of $12,000 on June 30 in each of the years 2002 to and including 2011. Interest is paid semi-annually.

1997 Medium Term Note Program:

Series A Notes: mature at the rate of $2,400 on November 19 in each of the years 2005 to and including 2009. Interest is paid semi-annually.

Series B Notes: mature at the rate of $2,000 on November 19 in each of the years 2003 to and including 2012. Interest is paid semi-annually.

Series C Notes: mature at the rate of $714 on March 13 in each of the years 2000 to and including 2003, $357 on March 13, 2004, $1,073 on March 13, 2005, and $357 in each of the years 2006 and 2007. Interest is paid semi-annually.

2000 and 2001 Senior Secured Promissory Notes:

Series A Notes: mature at the rate of $3,200 on August 15 in each of the years 2003 to and including 2007. Interest is paid quarterly.

Series B Notes: mature at the rate of $4,571 on August 15 in each of the years 2004 to and including 2010. Interest is paid quarterly.

Series C Notes: mature at the rate of $5,750 on August 15 in each of the years 2006 to and including 2007, $4,000 on August 15, 2008 and $5,750 on August 15, 2009 to and including

	2010. Interest is paid quarterly.
Series D Notes:	mature at the rate of $12,450 on August 15 in each of the years 2008 and 2009, $7,700 on August 15, 2010, $12,450 on August 15, 2011 and $12,950 on August 15, 2012. Interest is paid quarterly.
Series E Notes:	mature at the rate of $1,000 on August 15 in each of the years 2009 to and including 2015. Interest is paid quarterly.
Series F Notes:	mature at the rate of $3,636 on August 15 in each of the years 2010 to and including 2020. Interest is paid quarterly.
Series G Notes:	mature at the rate of $3,800 on May 15 in each of the years 2004 to and including 2008. Interest is paid quarterly. $7.5 million of these notes were retired during the fiscal year ended August 31, 2003.
Series H Notes:	mature at the rate of $727 on May 15 in each of the years 2006 to and including 2016. Interest is paid quarterly. $19.5 million of these notes were retired during the fiscal year ended August 31, 2003.
Series I Notes:	mature in one payment of $16,000 on May 15, 2013. Interest is paid quarterly.

All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of HOLP and its subsidiaries secure the Senior Secured, Medium Term, and Senior Secured Promissory Notes.

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In addition to the stated interest rate for the Notes, the Partnership is required to pay an additional 1% per annum on the outstanding balance of the Notes at such time as the Notes are not rated investment grade status or higher. As of August 31, 2004 the Notes were rated investment grade or better thereby alleviating the requirement that HOLP pay the additional 1% interest.

Effective August 31, 2004, ETC OLP entered into the Third Amendment to the Second Amended and Restated Credit Agreement. The terms of the Agreement are as follows:

A $725,000 Term Loan Facility that matures on January 18, 2008. Amounts borrowed under the ETC OLP Credit Facility bear interest at a rate based on either a Eurodollar rate, or a prime rate. The weighted average interest rate was 4.45% as of August 31, 2004. The Term Loan Facility is secured by substantially all of the ETC OLP s assets. As of August 31, 2004 and 2003, the Term Loan Facility had a balance of $725,000, and $226,000, respectively.

A $225,000 Revolving Credit Facility is available through January 18, 2008. Amounts borrowed under the ETC OLP Credit Facility bear interest at a rate based on either a Eurodollar rate, or a prime rate. The maximum commitment fee payable on the unused portion of the facility is 0.50%. The facility is fully secured by substantially all of ETC OLP s assets. As of August 31, 2004, there were no amounts outstanding under the Revolving Credit Facility, and $4,650 in letters of credit outstanding which reduce the amount available for borrowing under the Revolving Credit Facility. Letters of Credit under the Revolving Credit Facility may not exceed $40,000.

Effective March 31, 2004, HOLP entered into the Third Amended and Restated Credit Agreement. The terms of the Agreement are as follows:

A $75,000 Senior Revolving Working Capital Facility is available through December 31, 2006. Amounts borrowed under the Working Capital Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. The weighted average interest rate was 3.2038% for the amount outstanding at August 31, 2004. The maximum commitment fee payable on the unused portion of the facility is 0.50%. HOLP must reduce the principal amount of working capital borrowings to $10,000 for a period of not less than 30 consecutive days at least one time during each fiscal year. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of HOLP s subsidiaries secure the Senior Revolving Working Capital Facility. As of August 31, 2004, the Senior Revolving Working Capital Facility had a balance outstanding of $24,550, of which $10,000 was long-term and $14,550 was short-term. A $5,000 /Letter of Credit issuance is available to HOLP for up to 30 days prior to the maturity date of the Working Capital Facility. Letter of Credit Exposure plus the Working Capital Loan cannot exceed the $75,000 maximum Working Capital Facility. HOLP had outstanding Letters of Credit of $1,002 at August 31, 2004.

A $75,000 Senior Revolving Acquisition Facility is available through December 31, 2006. Amounts borrowed under the Acquisition Credit Facility bear interest at a rate based on either a Eurodollar rate or a prime rate. The weighted average interest rate was 3.2038% for the amount outstanding at August 31, 2004. The maximum commitment fee payable on the unused portion of the facility is 0.50%. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of HOLP s subsidiaries secure the Senior Revolving Acquisition Facility. As of August 31, 2004, the Senior Revolving Acquisition Facility had a balance outstanding of $23,000.

The agreements for each of the Senior Secured Notes, Medium Term Note Program, Senior Secured Promissory Notes, and the Operating Partnerships bank credit facilities contain customary restrictive covenants applicable to the Operating Partnerships, including limitations on substantial disposition of assets, changes in ownership of the Operating Partnerships, the level of additional indebtedness and creation of liens. These covenants require the Operating Partnerships to maintain ratios of Consolidated Funded Indebtedness to Consolidated EBITDA (as these terms are similarly defined in the bank credit facilities and the Note Agreements) of not more than, 4.75 to 1 for HOLP and 4.75 to 1.0 during the 365-day period following the funding of the purchase price of the ET Fuel System and to 4.00 to 1.00 during any period other than the 365-day period following the funding of the purchase price of the ET Fuel System for ETC OLP and Consolidated EBITDA to Consolidated Interest Expense (as these terms are similarly defined in the bank credit facilities and the Note Agreements) of not less than 2.25 to 1 for HOLP and 2.75 to 1 for ETC OLP. The Consolidated EBITDA used to determine these ratios is calculated in accordance with these debt agreements. For purposes of calculating the ratios under the bank credit facilities and the Note Agreements, Consolidated EBITDA is based upon the Operating Partnerships EBITDA, as adjusted for the most recent four quarterly periods, and modified to give pro forma effect for acquisitions and divestures made during the test period and is compared to Consolidated Funded Indebtedness as of the test date and the Consolidated Interest Expense for the most recent twelve months. These debt agreements also provide that the Operating Partnerships may declare, make, or incur a liability to make, restricted payments during each fiscal quarter, if: (a) the amount of such restricted payment, together with all other restricted payments during such quarter, do not exceed Available Cash with respect to the immediately preceding quarter; (b) no default or event of default exists before such restricted payments; and (c) each Operating Partnership s restricted payment is not greater than the product of each Operating Partnership s Percentage of Aggregate Available Cash multiplied by the Aggregate Partner Obligations (as these terms are similarly defined in the bank credit facilities and the Note Agreements). The debt agreements further provide that HOLP s Available Cash is required to reflect a reserve equal to 50% of the interest to be paid on the notes and in addition, in the third, second and first quarters preceding a quarter in which a scheduled principal payment is to be made on the notes, and a reserve equal to 25%, 50%, and 75%, respectively, of the principal amount to be repaid on such payment dates.

Failure to comply with the various restrictive and affirmative covenants of the Operating Partnerships bank credit facilities and the Note Agreements could negatively impact the Operating Partnerships ability to incur additional debt and/or the Partnership s ability to pay distributions. The Operating Partnerships are required to measure these financial tests and covenants quarterly and were in compliance with all requirements, tests, limitations, and covenants related to the Senior Secured Notes, Medium Term Note Program and Senior Secured Promissory Notes, and the bank credit facilities as of August 31, 2004.

Future maturities of long-term debt for each of the next five fiscal years and thereafter are $30,957 in 2005; $39,068, in 2006; $72,009 in 2007; $770,756 in 2008; $42,909 in 2009, and $146,129 thereafter.

6. INCOME TAXES:

The components of the federal and state income tax provision (benefit) of the Partnership s taxable subsidiaries is summarized as follows at August 31, 2004 and 2003:

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
Current Provision		
Federal	$ 6,505	$ 5,548
State	830	
Total	$ 7,335	$ 5,548
Deferred Provision		
Federal	(2,677)	(1,116)
State	(177)	

Total	$ (2,854)	$ (1,116)
Total tax provision	$ 4,481	$ 4,432
Effective tax rate	4.32%	8.68%

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The effective tax rate is different than the statutory rate due primarily from income attributable to the Partnership earnings not subject to federal and state income taxes. The difference between the statutory rate and the effective rate is summarized as follows:

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
Federal income tax rate	35.00%	35.00%
State income tax rate net of federal benefit	3.96%	
Increase (decrease) as a result of:		
Partnership earnings not subject to tax	(31.08%)	(26.32%)
Corporate subsidiary earnings not subject to state tax	(3.56%)	
Effective tax rate	4.32%	8.68%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the deferred tax liability were as follows:

	August 31, 2004	August 31, 2003
		(Energy Transfer Company)
Property, plant and equipment	$108,661	$ 55,736
Other	1,235	(351)
	$109,896	$ 55,385

7. MAJOR CUSTOMERS AND SUPPLIERS

The Partnership had gross sales as a percentage of total revenues to nonaffiliated major customers as follows:

Year Ended August 31, 2004	Eleven Months Ended August 31, 2003

Midstream Segment:		
BP Energy Company	11.6%	1.5%
Houston Pipeline Company	11.2%	11.1%
Dow Hydrocarbon and Resources, Inc.	10.7%	18.6%

The Partnership s major customers are in the midstream segment. The Partnership s natural gas operations have a concentration of customers in natural gas transmission, distribution and marketing, as well as industrial end-users while its NGL operations have a concentration of customers in the refining and petrochemical industries for the year ended August 31, 2004. These concentrations of customers may impact the Partnership s overall exposure to credit risk, either positively or negatively. As of August 31, 2004, the Partnership had a receivable from BP Energy Company that was 13.9% of the Partnership s total net accounts receivable. Management attempts to mitigate its credit risk by establishing strict credit policies for significant accounts receivable.

The Partnership had gross purchases as a percentage of total purchases from major suppliers as follows:

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
Midstream Segment:		
Unaffiliated		
BP Energy Company	11.0%	2.1%
Burlington Resources	6.1%	10.1%
Propane Segments (a)		
Unaffiliated		
Enterprise	22.5%	
Dynegy	21.8%	
Affiliated		
M.P. Oils, Ltd.	21.0%	

(a) Purchases from major suppliers in the propane segment represent amounts purchased from January 20, 2004 through August 31, 2004. If the Energy Transfer Transactions had occurred at the beginning of the periods presented, the percentages purchased from Enterprise, Dynegy and MP Oils Ltd. would have been 24.9%, 18.8%, and 19%, respectively for the year ended August 31, 2004 and 28.6%, 13,5% and 19% for the period ended August 31, 2003, respectively.

These concentrations of suppliers may impact the Partnership s overall exposure to credit risk, either positively or negatively. However, managements believes that the diversification of suppliers is sufficient to enable the Partnership to purchase all of its supply needs at market prices without a material disruption of operations if supplies are interrupted from any of our existing sources. Although no assurances can be given that supplies of propane will be readily available in the future, we expect a sufficient supply to continue to be available.

8. COMMITMENTS AND CONTINGENCIES:

Commitments

Certain property and equipment is leased under noncancelable leases, which require fixed monthly rental payments and expire at various dates through 2020. Rental expense under these leases totaled approximately $4,283 and $881 for the year ended August 31, 2004, and the eleven months ended August 31, 2003 respectively, and has been included in operating expenses in the accompanying statements of operations. Fiscal year future minimum lease commitments for such leases are $4,794 in 2005; $3,048 in 2006; $2,104 in 2007; $1,647 in 2008; $1,216 in 2009 and $628 thereafter.

The Partnership has forward commodity contracts, which will be settled by physical delivery. Short-term contracts, which expire in less than one year, require delivery up to 20 million British thermal units per day (MMBtu/d). Long-term contracts total require delivery of up to 156 MMBtu/d. The long-term contracts run through July 2013.

The Partnership has signed long-term agreements with several parties committing firm transportation volumes into a new pipeline system, which the Partnership was required to construct, and which is referred to as the Bossier Pipeline. Those commitments include an agreement with XTO Energy Inc. (XTO) to deliver approximately 200 MMBtu/d of natural gas into the pipeline. The term of the XTO Energy Inc. agreement runs nine years beginning when the Bossier

Pipeline becomes operational. The Bossier Pipeline became operational in June 2004.

ETC OLP in the normal course of business, purchases, processes and sells natural gas pursuant to long-term contracts. Such contracts contain terms that are customary in the industry. The Partnership believes that such terms are commercially reasonable and will not have a material adverse effect on the Partnership s financial position or results of operations.

The Partnership has entered into several propane purchase and supply commitments with varying terms as to quantities and prices, which expire at various dates through March 2005.

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Litigation

Although the midstream operating partnership, ETC OLP, may, from time to time, be involved in litigation and claims arising out of its operations in the normal course of business, ETC OLP is not currently a party to any material legal proceedings. In addition, management is not aware of any material legal or governmental proceedings against ETC OLP, or contemplated to be brought against ETC OLP, under the various environmental protection statutes to which it is subject.

Propane is a flammable, combustible gas. Serious personal injury and significant property damage can arise in connection with its storage, transportation or use. In the ordinary course of business, HOLP is sometimes threatened with or are named as a defendant in various lawsuits seeking actual and punitive damages for product liability, personal injury and property damage. The Partnership maintains liability insurance with insurers in amounts and with coverages and deductibles management believes are reasonable and prudent, and which are generally accepted in the industry. However, there can be no assurance that the levels of insurance protection currently in effect will continue to be available at reasonable prices or that such levels will remain adequate to protect us from material expenses related to product liability, personal injury or property damage in the future. Although any litigation is inherently uncertain, based on past experience, the information currently available and the availability of insurance coverage, we do not believe that pending or threatened litigation matters will have a material adverse effect on our financial condition or results of operations.

Of the pending or threatened matters in which the Partnership is a party, none have arisen outside the ordinary course of business except for an action filed by Heritage on November 30, 1999 against SCANA Corporation, Cornerstone Ventures, L.P. and Suburban Propane, L.P. (the SCANA litigation). Prior to trial, a settlement was reached with Defendant Cornerstone Ventures, L.P., and they were dismissed from the litigation. The trial began on October 4, 2004 against the remaining defendants and testimony was concluded on October 20, 2004. On October 21, 2004, the jury returned a verdict in favor of Heritage against SCANA and in favor of defendant Suburban. The jury found in favor of Heritage on all four claims against SCANA, awarding a total of $48 million in actual and punitive damages. It is expected that the court will render a final judgment by the end of November 2004. SCANA has publicly stated that it plans to appeal any adverse judgment by the court. The Partnership cannot predict whether the final judgment will affirm the jury verdict without any modification or whether any appeal of the final judgment by SCANA will be successful. As a result, management cannot yet predict whether the Partnership will receive any of the damages award covered by this verdict. Please read Note 11 for additional discussion of rights relating to the SCANA litigation.

The Partnership is a party to various legal proceedings and/or regulatory proceedings incidental to its business. Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against the Partnership. In the opinion of management, all such matters are either covered by insurance, are without merit or involve amounts, which, if resolved unfavorably, would not have a significant effect on the financial position or results of operations of the Partnership. Once management determines that information pertaining to a legal proceeding indicates that it is probable that a liability has been incurred, an accrual is established equal to management s estimate of the likely exposure. For matters that are covered by insurance, the Partnership accrues the related deductible. As of August 31, 2004 and 2003, an accrual of $930 and $112, respectively, was recorded as accrued and other current liabilities on the Partnership s consolidated balance sheets.

Environmental

The Partnership s operations are subject to extensive federal, state and local environmental laws and regulations that require expenditures for remediation at operating facilities and waste disposal sites. Although the Partnership believes its operations are in substantial compliance with applicable environmental laws and regulations, risks of additional costs and liabilities are inherent in the natural gas pipeline and processing business, and there can be no assurance that significant costs and liabilities will not be incurred. Moreover, it is possible that other developments, such as increasingly stringent environmental laws, regulations and enforcement policies thereunder, and claims for damages to property or persons resulting from the operations, could result in substantial costs and liabilities. Accordingly, the Partnership has adopted policies, practices, and procedures in the areas of pollution control, product safety, occupational health, and the handling, storage, use, and disposal of hazardous materials to prevent material environmental or other damage, and to limit the financial liability, which could result from such events. However, some risk of environmental or other damage is inherent in the natural gas pipeline and processing business, as it is with other entities engaged in similar businesses.

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In conjunction with the October 1, 2002 acquisition of the Texas and Oklahoma natural gas gathering and gas processing assets from Aquila Gas Pipeline, Aquila, Inc. agreed to indemnify ETC OLP for any environmental liabilities that arose from the operation of the assets for the period prior to October 1, 2002. Aquila also agreed to indemnify ETC OLP for 50% of any environmental liabilities that arose from the operations of Oasis Pipe Line Company prior to October 1, 2002.

Petroleum-based contamination or environmental wastes are known to be located on or adjacent to six sites, on which the Partnership presently has, or formerly had, retail propane operations. These sites were evaluated at the time of their acquisition. In all cases, remediation operations have been or will be undertaken by others, and in all six cases, Heritage obtained indemnification for expenses associated with any remediation from the former owners or related entities. The Partnership has not been named as a potentially responsible party at any of these sites, nor has the Partnership s operations contributed to the environmental issues at these sites. Accordingly, no amounts have been recorded in the Partnership s August 31, 2004 balance sheet. Based on information currently available to the Partnership, such projects are not expected to have a material adverse effect on the Partnership s financial condition or results of operations.

In July 2001, Heritage acquired a company that had previously received a request for information from the U.S. Environmental Protection Agency (the EPA) regarding potential contribution to a widespread groundwater contamination problem in San Bernardino, California, known as the Newmark Groundwater Contamination. Although the EPA has indicated that the groundwater contamination may be attributable to releases of solvents from a former military base located within the subject area that occurred long before the facility acquired by Heritage was constructed, it is possible that the EPA may seek to recover all or a portion of groundwater remediation costs from private parties under the Comprehensive Environmental Response, Compensation, and Liability Act (commonly called Superfund). Based upon information currently available to the Partnership, it is believed that the Partnership s liability if such action were to be taken by the EPA would not have a material adverse effect on the Partnership s financial condition or results of operations.

Environmental exposures and liabilities are difficult to assess and estimate due to unknown factors such as the magnitude of possible contamination, the timing and extent of remediation, the determination of the Partnership s liability in proportion to other parties, improvements in cleanup technologies and the extent to which environmental laws and regulations may change in the future. Although environmental costs may have a significant impact on the results of operations for any single period, the Partnership believes that such costs will not have a material adverse effect on its financial position. As of August 31, 2004 and August 31, 2003, an accrual of $473 and $633 was recorded in the Partnership s balance sheets to cover any material environmental liabilities that were not covered by the environmental indemnifications.

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9. PRICE RISK MANAGEMENT ASSETS AND LIABILITIES:

Commodity Price Risk

The Partnership is exposed to market risks related to the volatility of natural gas and NGL prices. To reduce the impact of this price volatility, the Partnership primarily uses derivative commodity instruments (futures and swaps) to manage its exposures to fluctuations in margins. The fair value of all price risk management assets and liabilities that are designated and documented as cash flow hedges and determined to be effective are recorded through other comprehensive income until the settlement month. The amount on the balance sheet relating to price risk management assets liabilities in accumulated other comprehensive income will be reclassified into earnings over the next twelve months. When the physical transaction settles, any gain or loss previously recorded in other comprehensive income (loss) on the derivative is recognized in the statement of operations. Unrealized gains or losses on price risk management assets and liabilities that do not meet the requirements for hedge accounting are recognized in the statement of operations. The Partnership s price risk management assets and liabilities were as follows as of August 31, 2004 and 2003:

August 31, 2004:	**Commodity**	**Notional Volume MMBTU**	**Maturity**	**Fair Value**
Basis Swaps IFERC/Nymex	Gas	54,472,500	2004-2005	$ 1,451
Basis Swaps IFERC/Nymex	Gas	62,767,500	2004-2005	592
				$ 2,043
Swing Swaps IFERC	Gas	119,495,000	2004-2005	$ 704
Swing Swaps IFERC	Gas	45,265,000	2004-2005	(399)
Swing Swaps IFERC	Gas	76,720,000	2006-2008	
				$ 305
Futures Nymex	Gas	10,057,500	2004-2005	$(1,311)
Futures Nymex	Gas	12,677,500	2004-2005	2,941
				1,630
		Barrels		
NGL Swaps	Condensate, Propane, Ethane	250,000	2004-2005	$ (86)
August 31, 2003		MMBTU		
Basis Swaps IFERC/Nymex	Gas	24,330,000	2003-2004	$ 612
Basis Swaps IFERC/Nymex	Gas	10,165,000	2003-2004	(184)

				$ 428
Futures Nymex	Gas	3,115,000	2003-2004	$ (56)
Futures Nymex	Gas	5,970,000	2003-2004	540
				$ 484

Estimates related to the Partnership s gas marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. The Partnership believes it is protected from the volatility in the energy commodities markets because it does not have unbalanced positions. Long-term physical contracts are tied to index prices. System gas, which is also tied to index prices, will provide the gas required by our long-term physical contracts. When third-party gas is required to supply long-term contracts, a hedge is put in place to protect the margin on the contract. Financial contracts, which are not tied to physical delivery, will be offset with financial contracts to balance the Partnership s positions.

Interest Rate Risk

The Partnership is exposed to market risk for changes in interest rates related to the bank credit facilities of ETC OLP. An interest rate swap agreement is used to manage a portion of the exposure related to LaGrange Acquisition s Term Loan Facility to changing interest rates by converting floating rate debt to fixed-rate debt. On October 9, 2002, ETC OLP entered into an interest rate swap agreement to manage its exposure to changes in interest rates. The interest rate swap has a notional value of $75,000 and matures on October 9, 2005. Under the terms of the interest rate swap agreement, the Partnership will pay a fixed rate of 2.76% and will receive three-

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month LIBOR with quarterly settlement commencing on January 9, 2003. The value of the interest rate swap is marked to market and recorded in interest expense. The value of the interest rate swap at August 31, 2004 and August 31, 2003 was a liability of $539 and $807, respectively, and was recorded as a component of price risk management liabilities on the Partnership s consolidated balance sheets.

The following represents gain (loss) on derivative activity:

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
		(Energy Transfer Company)
Unrealized gain recognized in earnings related to Partnership s derivative activity	$ 2,919	$ 889
Realized gain (loss) included in revenue	$22,314	$ (2,411)
Unrealized gain on interest rate swap	$ 267	
Realized loss on interest rate swap included in interest expense	$ (1,239)	$ (312)

10. LIQUIDS MARKETING:

HOLP buys and sells derivative financial instruments, which are within the scope of SFAS 133 and that are not designated as accounting hedges. HOLP also enters into energy trading contracts, which are not derivatives, and therefore, are not within the scope of SFAS 133. The types of contracts HOLP utilizes in its liquids marketing segment include energy commodity forward contracts, options, and swaps traded on the over-the-counter financial markets. In accordance with the provisions of SFAS 133, derivative financial instruments utilized in connection with Heritages Operating s liquids marketing activity are accounted for using the mark-to-market method. Under the mark-to-market method of accounting, forwards, swaps, options, and storage contracts are reflected at fair value, and are shown in the consolidated balance sheet as prepaid expenses and other and accrued and other current liabilities. The Partnership applies the applicable provisions of EITF Issue No. 02-3, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 02-3), which requires that gains and losses on derivative instruments be shown net in the statement of operations if the derivative instruments are held for trading purposes. Net realized and unrealized gains and losses from the financial contracts and the impact of price movements are recognized in the statement of operations as other revenue. Changes in the assets and liabilities from the liquids marketing activities result primarily from changes in the market prices, newly originated transactions, and the timing and settlement of contracts. Consequently, the Partnership does not apply mark-to-market accounting for any contracts that are not within the scope of SFAS 133. The Partnership attempts to balance its contractual portfolio in terms of notional amounts and timing of performance and delivery obligations. However, net unbalanced positions can exist or are established based on management s assessment of anticipated market movements.

The notional amounts and terms of these financial instruments as of August 31, 2004 include fixed price payor for 345 barrels of propane, and fixed price receiver of 345 barrels of propane. Notional amounts reflect the volume of the transactions, but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure the Partnership s exposure to market or credit risks.

Estimates related to the Partnership s liquids marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. A theoretical change of 10% in the underlying commodity value of the liquids marketing contracts would not change the market value of the contracts as there were no unbalanced positions at August 31, 2004.

Inherent in the resulting contractual portfolio are certain business risks, including market risk and credit risk. Market risk is the risk that the value of the portfolio will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by suppliers, customers, or financial counterparties to a contract. The Partnership takes an active role in managing and controlling market and credit risk over liquids marketing activities, and has established control procedures, which are reviewed on an

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ongoing basis. The Partnership monitors market risk of liquids marketing activities through a variety of techniques, including routine reporting to senior management. The Partnership attempts to minimize credit risk exposure through credit policies and periodic monitoring procedures.

The following table summarizes the fair value of liquids marketing contracts, aggregated by method of estimating fair value of the contracts as of August 31, 2004 where settlement had not yet occurred. There were no liquids marketing contracts outstanding at August 31, 2003. Liquids marketing contracts all have a maturity of less than 1 year. The market prices used to value these transactions reflect management s best estimate considering various factors including closing average spot prices for the current and outer months plus a differential to consider time value and storage costs.

Source of Fair Value	**August 31, 2004**
Prices actively quoted	$ 609
Prices based on other valuation methods	902
Assets from liquids marketing	$1,511
Prices actively quoted	$ 569
Prices based on other valuation methods	656
Liabilities from liquids marketing	$1,225
Unrealized gains	$ 286

The following table summarizes the changes in the unrealized fair value of liquids marketing contracts where settlement had not yet occurred for the year ended August 31, 2004. There were no liquids marketing contracts outstanding at August 31, 2003.

	August 31, 2004
Unrealized gains (losses) in fair value of contracts outstanding at the beginning of the period	$
Unrealized gains (losses) recognized at inception of contracts	
Unrealized gains (losses) recognized as a result of changes in valuation techniques and assumptions	

Other unrealized gains (losses) recognized during the period	1,286
Less: Realized gains (losses) recognized during the period	1,000
Unrealized gains (losses) in fair value of contracts outstanding at the end of the period	$ 286

The gross transaction volumes in barrels for liquids marketing contracts that were physically settled for the years ended August 31, 2004 was 1,042. There were no outstanding liquids marketing contracts for the eleven months ended August 31, 2003.

11. PARTNERS CAPITAL:

Units

Common Units, Class D Units, Special Units, Class E Units and Class C Units represent limited partner interests in the Partnership that entitle the holders thereof to the rights and privileges specified in the Partnership Agreement, as amended. As of August 31, 2004, there were issued and outstanding 44,559,031 Common Units representing an aggregate 98% limited partner interest in the Partnership. There are also 4,426,916 Class E Units outstanding that

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are entitled to receive distributions in accordance with their terms, and 1,000,000 Class C Units outstanding that are entitled only to participate in distributions that are attributable to the net amount received by the Partnership in connection with the SCANA litigation (defined in Note 7).

In connection with the Energy Transfer Transactions in January 2004, the Partnership issued 7,721,542 Class D Units and 3,742,515 Special Units to La Grange Energy, L.P. (the terms of the Class D Units and Special Units are described in more detail below). On June 23, 2004, the Partnership held a special meeting for the Common Unitholders of record on May 17, 2004 for the purpose of approving a proposal to change the terms of the Class D Units and the Special Units issued in connection with the Energy Transfer Transactions and to approve the Partnership s 2004 Unit Plan. At the meeting, the Common Unitholders approved (1) the change in terms and conversion of all 7,721,542 outstanding Class D Units into 7,721,542 Common Units, (2) the change in terms and conversion of all 3,742,515 outstanding Special Units into 3,742,515 Common Units upon the Bossier pipeline becoming commercially operational, which occurred on June 21, 2004, and (3) the 2004 Unit Plan, which provides for awards of Common Units and other rights to the Partnership s employees, officers and directors.

No person is entitled to preemptive rights in respect of issuances of securities by the Partnership, except that U.S. Propane has the right to purchase sufficient partnership securities to maintain its general partner equity interest in the Partnership.

Common Units. The Partnership s Common Units are registered under the Securities Act of 1934 and are listed for trading on the New York Stock Exchange. Each holder of a Common Unit is entitled to one vote per unit on all matters presented to the Limited Partners for a vote. In addition, if at any time any person or group (other than the Partnership s General Partner and its affiliates) owns beneficially 20% or more of all Common Units, any Common Units owned by that person or group may not be voted on any matter and are not considered to be outstanding when sending notices of a meeting of Unitholders (unless otherwise required by law), calculating required votes, determining the presence of a quorum or for other similar purposes under the Partnership Agreement. The Common Units are entitled to distributions of Available Cash as described below under Quarterly Distributions of Available Cash.

On January 20, 2004, the Partnership completed the sale of 8,000,000 Common Units at a public offering price of $38.69. On January 27, the Underwriters for the January 20 equity offering exercised an over-allotment option and an additional 1,200,000 units were sold. Net proceeds from the Common Unit offering and the over-allotment option were $334,330 and were used to pay a portion of the consideration for the Energy Transfer Transactions, and for general partnership purposes, including, but not limited to, repayment of additional debt, working capital, and capital expenditures On June 30, 2004, the Partnership completed the sale of 4,500,000 Common Units at a public offering price of $39.20 per unit. On July 2, 2004 the Partnership issued 675,000 Common Units to the Underwriters upon their exercise of their over-allotment option at the offering price of $39.20 per unit. Net proceeds from the Common Units offering and the exercise of the over-allotment option were $193,799 and were used to repay a portion of the outstanding indebtedness incurred to fund the ET Fuel System acquisition and for general partnership purposes.

On March 18, 2004, the Partnership issued 22,240 Common Units, with a total value of $734 as final settlement of the purchase price for Heritage s acquisition of 50% of Bi State Propane that was not previously owned by Heritage.

Class C Units. The 1,000,000 Class C Units were issued to Heritage Holdings in August 2000 in conjunction with the transaction with U.S. Propane and the change of control of the Partnership s General Partner in conversion of that portion of Heritage Holding s Incentive Distribution Rights that entitled it to receive any distribution attributable to the net amount received by the Partnership in connection with the settlement, judgment, award or other final nonappealable resolution of specified litigation filed by the Partnership prior to the transaction with U.S. Propane, which is referred to as the SCANA litigation. The Class C Units have zero initial capital account balance and were distributed by Heritage Holdings to its former stockholders in connection with the transaction with U.S. Propane.

On October 21, 2004, the Partnership announced that it received a favorable jury verdict with respect to the SCANA litigation. The jury found in favor of the Partnership on all four claims against SCANA, awarding a total of $48 million in actual and punitive damages. It is expected that the court would render a final judgment by the end of November 2004. SCANA has publicly stated that it plans to appeal any adverse judgment by the court. The Partnership cannot predict whether the final judgment will affirm the jury verdict without any modification or whether any appeal of the final judgment by SCANA will be successful. As a result, management cannot yet predict whether the Partnership will receive any of the damages award covered by this verdict. All decisions of the

Partnership s General Partner relating to the SCANA litigation are determined by a special litigation committee consisting of one or more independent directors of the Partnership s General Partner. As soon as practicable after the time that the Partnership or its affiliates receive any final cash or other payment as a result of the resolution of the SCANA litigation, the special litigation committee will determine the aggregate net amount of these proceeds distributable by the Partnership after deducting from the amounts received all costs and expenses incurred by the Partnership and its affiliates in connection with the SCANA litigation and any cash reserves necessary or appropriate to provide for operating expenditures.

Following this determination, the distributable proceeds will be deemed to be Available Cash under the Partnership Agreement and will be distributed as described below under Quarterly Distributions of Available Cash. The amount of distributable proceeds that would normally be distributed to holders of Incentive Distribution Rights will instead be distributed to the holders of the Class C Units, pro rata. The Partnership cannot predict whether it will receive any cash payments as a result of the SCANA litigation and, if so, when these distributions might be made to the Class C Unitholders.

The Class C Units do not have any rights to share in any of the Partnership s assets or distributions upon dissolution and liquidation of the Partnership, except to the extent that any such distributions consist of proceeds from the SCANA litigation to which the class C Unitholders would have otherwise been entitled. The Class C Units do not have the privilege of conversion into any other unit and do not have any voting rights except to the extent provided by law, in which case each Class C Unit will be entitled to one vote.

The amount of cash distributions to which the Incentive Distribution Rights are entitled was not increased by the creation of the Class C Units; rather, the Class C Units are a mechanism for dividing the Incentive Distribution Rights that Heritage Holdings and its former stockholders would have been entitled to.

Class D Units. The Class D Units were issued to La Grange Energy, L.P. in connection with the Energy Transfer Transactions in January 2004 and generally had voting rights identical to the voting rights of the Common Units, and the Class D Units voted with the Common Units as a single class on each matter with respect to which the Common Units were entitled to vote. Each Class D Unit initially was entitled to receive 100% of the quarterly amount distributed on each Common Unit, for each quarter, provided that the Class D Units were subordinated to the Common Units with respect to the payment of the minimum quarterly distribution for such quarter (and any arrearage in the payment of the minimum quarterly distribution for all prior quarters). The Partnership was required, as promptly as practicable following the issuance of the Class D Units, to submit to a vote of the Unitholders a change in the terms of the Class D Units to provide that each Class D Unit would convert into one Common Unit immediately upon such approval. Holders of the Class D Units were entitled to vote upon the proposal to change the terms of the Class D Units and the Special Units in the same proportion as the votes cast by the holders of the Common Units (other than the Common Units issued to La Grange Energy in connection with the Energy Transfer Transactions) with respect to this proposal. The Unitholders approved this change in the terms of the Class D Units on June 23, 2004 at a special meeting of the Common Unitholders. Pursuant to the request of the holders of the Class D Units, these Class D Units were converted to an equal number of Common Units on June 24, 2004.

Class E Units. In conjunction with the Partnership s purchase of the capital stock of Heritage Holdings, the 4,426,916 Common Units held by Heritage Holdings were converted into 4,426,916 Class E Units. The Class E Units generally do not have any voting rights but were entitled to vote on the proposals to make the Class D Units and Special Units convertible into Common Units. These Class E Units are entitled to aggregate cash distributions equal to 11.1% of the total amount of cash distributed to all Unitholders, including the Class E Unitholders, up to $2.82 per unit per year. Management plans to leave the Class E Units in the form described here indefinitely. In the event of the Partnership s termination and liquidation, the Class E Units will be allocated 1% of any gain upon liquidation and will be allocated any loss upon liquidation to the same extent as Common Units. After the allocation of such amounts, the Class E

Units will be entitled to the balance in their capital accounts, as adjusted for such termination and liquidation. The terms of the Class E Units were determined in order to provide the Partnership with the opportunity to minimize the impact of its ownership of Heritage Holdings, including the $57,449 in deferred tax liabilities of Heritage Holdings that were included in the purchase of Heritage Holdings. The Class E Units are treated as treasury stock for accounting purposes because they are owned by the Partnership s wholly owned subsidiary, Heritage Holdings. Due to the ownership of the Class E Units by this corporate subsidiary, the payment of distributions on the Class E Units will result in annual tax payments by Heritage Holdings at corporate federal income tax rates, which tax payments will reduce the amount of cash that would otherwise be available for distribution to the Partnership as the owner of Heritage Holdings. Because distributions on the Class E Units will be available to the Partnership as the owner of Heritage Holdings, those funds will be available, after payment of taxes, for General Partnership purposes, including to satisfy working capital requirements, for the repayment of outstanding debt and to make distributions to the Unitholders. Because the Class E Units are not entitled to receive any allocation of Partnership income, gain, loss, deduction or credit that is attributable to our ownership of Heritage Holdings, such amounts will instead be allocated to the General Partner in accordance with its respective interest and the remainder to all Unitholders other than the holders of Class E Units pro rata. In the event that Partnership distributions exceed $2.82 per unit annually, all such amounts in excess thereof will be available for distribution to Unitholders other than the holders of Class E Units in proportion to their respective interests.

Special Units. The Special Units were issued to La Grange Energy, L.P. on January 20, 2004 as consideration for the Bossier Pipeline in connection with the Energy Transfer Transaction. The Special Units generally did not have any voting rights but were entitled to vote on the proposal to change the terms of the Special Units in the same proportion as the votes cast by the holders of the Common Units (other than the Common Units issued to La Grange Energy in connection with the Energy Transfer Transaction) with respect to this proposal, and were not be entitled to share in partnership distributions. The Partnership was required, as promptly as practicable following the issuance of the Special Units, to submit to a vote of the Unitholders the approval of the conversion of the Special Units into Common Units in accordance with the terms of the Special Units. Following Unitholder approval at a special meeting of the Unitholders on June 23, 2004 and upon the Bossier Pipeline becoming commercially operational June 21, 2004, each Special Unit converted into one Common Unit on June 24, 2004 upon the request of the holder.

Incentive Distribution Rights. Incentive Distribution Rights represent the contractual right to receive an increasing percentage of quarterly distributions of Available Cash from operating surplus after the minimum quarterly distribution has been paid. Please read Quarterly Distributions of Available Cash below. The General Partner owns all of the Incentive Distribution Rights, except that in conjunction with the August 2000 transaction with U.S. Propane, the Partnership issued 1,000,000 Class C Units to Heritage Holdings, its general partner at that time, in conversion of that portion of Heritage Holdings s Incentive Distribution Rights that entitled it to receive any distribution made by the Partnership of funds attributable to the net amount received in connection with the settlement, judgment, award or other final nonappealable resolution of the SCANA litigation. The Class C Units were distributed by Heritage Holdings to its former shareholders. Any amount payable on the Class C Units in the future will reduce the amount otherwise distributable to holders of Incentive Distribution Rights at the time the distribution of such litigation proceeds is made and will not reduce the amount distributable to holders of Common Units. No payments to date have been made on the Class C Units.

Quarterly Distributions of Available Cash

The Partnership Agreement requires that the Partnership will distribute all of its Available Cash to its Unitholders and its General Partner within 45 days following the end of each fiscal quarter, subject to the payment of incentive distributions to the holders of Incentive Distribution Rights to the extent that certain target levels of cash distributions are achieved. The term Available Cash generally means, with respect to any fiscal quarter of the Partnership, all cash on hand at the end of such quarter, plus working capital borrowings after the end of the quarter, less reserves established by the General Partner in its sole discretion to provide for the proper conduct of the Partnership s business, to comply with applicable laws or any debt instrument or other agreement, or to provide funds for future distributions to partners with respect to any one or more of the next four quarters. Available Cash is more fully defined in the Partnership Agreement.

Distributions by the Partnership in an amount equal to 100% of Available Cash will generally be made 98% to the Common, Class D, and Class E Unitholders and 2% to the General Partner, subject to the payment of incentive distributions to the General Partner to the extent that certain target levels of cash distributions are achieved.

On April 14, 2004, the Partnership paid a quarterly distribution of $0.70 per unit, or $2.80 per unit annually, to the Unitholders of record at the close of business on April 2, 2004. On July 15, 2004, the Partnership paid a quarterly distribution of $0.75 per unit, or $3.00 per unit annually, to Unitholders of record at the close of business on July 2, 2004. On September 20, 2004, the Partnership declared a cash distribution for the fourth quarter ended August 31, 2004 of $0.825 per unit, or $3.30 per unit annually, payable on October 15, 2004 to Unitholders of record at the close of business on October 7, 2004. In addition to these quarterly distributions, the General Partner received quarterly distributions for its general partner interest in the Partnership, and incentive distributions to the extent the quarterly distribution exceeded $0.55 per unit. The total amount of distributions paid or declared relating to the quarters in the period from January 20, 2004 through August 31, 2004 on Common Units, the Class D Units, the Class E, the General Partner interests and the Incentive Distribution Rights totaled $89.8 million, $5.4 million,

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$9.3 million, $2.3 million and $6.9 million, respectively. All such distributions were made from Available Cash from Operating Surplus.

The Partnership makes distributions of available cash from operating surplus for any quarter in the following manner:

First, 98% to all Common and Class E Unitholders, in accordance with their percentage interests, and 2% to the General Partner, until each Common Unit has received $0.50 per unit for such quarter (the minimum quarterly distribution);

Second, 98% to all Common and Class E Unitholders, in accordance with their percentage interests, and 2% to the General Partner, until each Common Unit has received $0.55 per unit for such quarter (the first target distribution);

Third, 85% to all Common and Class E Unitholders, in accordance with their percentage interests, 13% to the holders of Incentive Distribution Rights, pro rata, and 2% to the General Partner, until each Common Unit has received at least $0.635 per unit for such quarter (the second target distribution);

Fourth, 75% to all Common and Class E Unitholders, in accordance with their percentage interests, 23% to the holders of Incentive Distribution Rights, pro rata, and 2% to the General Partner, until each Common Unit has received at least $0.825 per unit for such quarter; (the third target distribution); and

Fifth, thereafter, 50% to all Common and Class E Unitholders, in accordance with their percentage interests, 48% to the holders of Incentive Distribution Rights, pro rata, and 2% to the General Partner.

Notwithstanding the foregoing, any arrearage in the payment of the minimum quarterly distribution for all prior quarters and the distributions on each Class E unit may not exceed $2.82 per year. Please read Note 10 Partners Capital for a discussion of the Class C Units and the percentage interests in distributions of the different classes of units.

12. RETIREMENT BENEFITS:

The Partnership also sponsors a defined contribution profit sharing and 401(k) savings plan, which covers virtually all employees subject to service period requirements. Profit sharing contributions are made to the plan at the discretion of the Board of Directors and are allocated to eligible employees as of the last day of the plan year. Employer matching contributions are calculated using a discretionary formula based on employee contributions. The Partnership made matching contributions of $1,539 and $0 to the 401(k) savings plan for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively.

13. RELATED PARTY TRANSACTIONS:

Accounts payable to related companies as of August 31, 2004 includes $2,856 due to La Grange Energy. This amount represents the balance of funds due to La Grange Energy subject to final settlement of the Energy Transfer Transactions that have not yet been distributed.

Included in midstream and transportation revenues is income from affiliates of $17 and $709 for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively. Accounts payable to related companies as of August 31. 2004 includes approximately $1,400 payable to unconsolidated affiliates for purchases of natural gas.

The Partnership s natural gas midstream operations secure compression services from third parties. Energy Transfer Technologies, Ltd. is one of the entities from which compression services are obtained. Energy Transfer Group, LLC is the general partner of Energy Transfer Technologies, Ltd. These entities are collectively referred to as the ETG Entities . The ETG Entities were not acquired by the Partnership in conjunction with the January 2004 Energy Transfer Transactions. The Partnership s Co-Chief Executive Officers, have an indirect ownership in the ETG Entities. In addition, two of the General Partner s directors, serve on the Board of Directors of the ETG Entities. The terms of each arrangement to provide compression services are, in the opinion of management, no less favorable than those available from other providers of compression services. During fiscal year 2004, payments totaling $279 were made to the ETG Entities for compression services provided to and utilized in the Partnership s natural gas midstream operations.

One of the Partnership s natural gas midstream subsidiaries owns a 50% interest in South Texas Gas Gathering, a joint venture that owns an 80% interest in the Dorado System, a 61-mile gathering system located in South Texas. The other 50% equity interest in South Texas Gas Gathering is owned by one of the General Partner s directors. The Partnership is the operator of the Dorado System. At August 31, 2004, there was a balance of $248 owing to the Partnership by a director of the General Partner for services the Partnership provided as operator.

Beginning in 2003 and prior to the contribution by an affiliate of La Grange Energy of ET Company I to ETC, ETC had been charged rent by an affiliate for office space in Dallas, which is shared with La Grange Energy and ETC Holdings, L.P., an affiliate of La Grange Energy. For the 11 months ended August 31, 2003 and for the period from October 1, 2003 through January 20, 2004, the rent charged to ETC was $90 and $36, respectively. This office building was contributed to ETC in connection with the Energy Transfer Transaction. Since the Energy Transfer Transaction through August 31, 2004, ETC recognized rental income of $51 for office space occupied by La Grange Energy and its affiliates.

Prior to the Oasis Pipeline stock redemption and the contribution of ET Company I to ETC, ETC had purchases and sales of natural gas with Oasis Pipeline and ET Company I in the normal course of business. The following table summarizes these transactions:

	October 1, 2002 (Inception) Through December 21, 2002
Sales of natural gas to affiliated companies	$ 4,488
Purchases of natural gas from affiliated companies	$ 3,989
Transportation expenses	$ 922

Prior to the Energy Transfer Transactions, ET GP, LLC, the general partner of ETC Holdings, L.P., had a general and administrative services contract to act as an advisor and provide certain general and administrative services to La Grange Energy and its affiliates, including ETC. The general and administrative services that ET GP, LLC provides La Grange Energy and its subsidiaries under this contract included:

General oversight and direction of engineering, accounting, legal and other professional and operational services required for the support, maintenance and operation of the assets used in the Midstream operations, and

The administration, maintenance and compliance with contractual and regulatory requirements.

In exchange for these services, La Grange Energy and its affiliates were required to pay ET GP, LLC a $500 annual fee payable quarterly and pro-rated for any portion of a calendar year. Pursuant to this contract, La Grange Energy and its affiliates were also required to reimburse ET GP, LLC for expenses associated with formation of La Grange Energy and its affiliates and are required to indemnify ET GP, LLC, its affiliates, officers and employees for liabilities associated with the actions of ET GP, LLC, its affiliates, officers, and employees. As a result of the reimbursement provision, La Grange Energy charged ETC $449 for expenses associated with its formation. For the eleven months ended August 31, 2003, ETC was charged $375 under this contract. This general and administrative services contract was terminated upon the closing of the Energy Transfer Transaction. As of August 31, 2004, ETC owed La Grange Energy $250 for expenses under the contract from October 1, 2003 through January 20, 2004. This amount was paid subsequent to August 31, 2004.

14. REPORTABLE SEGMENTS:

The Partnership s financial statements reflect six reportable segments: ETC OLP s midstream and transportation operations, HOLP s retail and domestic wholesale propane operations, the foreign wholesale propane operations of MP Energy Partnership, and the liquids marketing activities of Resources. The operations which focus on the

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gathering, compression, treating, processing, transportation and marketing of natural gas, primarily at the Southeast Texas System and Elk City Systems, generate revenue primarily by the volumes of natural gas gathered, compressed, treated, processed, transported, purchased and sold through the Partnership s pipeline (excluding the transportation pipelines) and gathering systems and the level of natural gas and NGL prices. The transportation operations focus on transporting natural gas through the Partnership s Oasis Pipe Line ET Fuel System and Bossier Pipeline. Revenue is generated from fees charged to customers to reserve firm capacity on or move gas on the pipeline on an interruptible basis. The fee structure on the Oasis Pipe Line is derived from the gas price differential between the Waha and Katy hubs. A monetary fee, and/or fuel retention are components of the fee structure. Excess fuel retained after consumption is valued at the first of the month Katy tailgate price and strategically sold when market prices are high.

The Partnership s retail and wholesale propane segments sell products and services to retail and wholesale customers. Intersegment sales by the foreign wholesale segment to the domestic segment are priced in accordance with the partnership agreement of MP Energy Partnership. The Partnership manages these propane segments separately as each segment involves different distribution, sale, and marketing strategies. Selling, general and administrative expenses are allocated to the midstream and transportation operating segments, however, the Partnership evaluates the performance of its other operating segments based on operating income exclusive of selling, general, and administrative expenses of $11,711 and $0 for the year ended August 31, 2004 and the eleven months ended August 31, 2003, respectively. Investment in affiliates and equity in earnings (losses) of affiliates relates primarily to The Partnership s investment in Vantex Gas Pipeline Company and Vantex Energy Services, Ltd, and is part of the midstream segment. In addition, the Partnership s two largest customers revenues are included in the midstream segment s revenues. The following table presents the unaudited financial information by segment for the following periods:

	Year Ended August 31, 2004	**Eleven Months Ended August 31, 2003**
		(Energy Transfer Company)
Volumes		
Midstream		
Natural gas MMBtu/d	975,000	524,000
NGLs bbls/d	12,000	13,000
Transportation Natural gas MMBtu/d	1,091,000	921,000
Propane gallons (in thousands)		
Retail	226,209	
Domestic wholesale	7,071	
Foreign wholesale		
Affiliated	48,712	
Unaffiliated	28,648	
Elimination	(48,712)	

Total gallons	261,928	

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	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003
		(Energy Transfer Company)
Revenues:		
Midstream		
Unaffiliated	$2,015,944	$ 990,818
Affiliated	17	709
Eliminations	(27,798)	(9,559)
Transportation	113,938	41,500
Retail propane	315,177	
Domestic wholesale propane	5,358	
Foreign wholesale propane		
Affiliated	21,868	
Unaffiliated	21,987	
Eliminations	(21,868)	
Liquids marketing, net	863	
Other propane related	36,768	
Total	$2,482,254	$1,023,468
Cost of sales:		
Midstream	$1,932,575	$ 908,979
Eliminations	(27,798)	(9,559)
Transportation	11,270	2,123
Retail propane	174,769	
Domestic wholesale propane	4,742	
Foreign wholesale propane	20,129	
Other	10,463	
Total Cost of Sales	$2,126,150	$ 901,543
Operating Income		
Midstream	$ 66,680	$ 43,900
Transportation	56,299	17,689
Retail propane and other	33,726	
Domestic wholesale propane	(1,737)	
Foreign wholesale propane		
Affiliated	408	

Unaffiliated	1,843	
Elimination	(408)	
Liquids marketing	420	
Selling general and administrative expenses not allocated to segments	(11,711)	
Total	$ 145,520	$ 61,589
Gain (loss) on Disposal of Assets:		
Midstream	$ (6)	$
Transportation	(1)	
Retail propane	(999)	
Corporate	0	
Domestic wholesale propane	0	
Total	$ (1,006)	$
Minority Interest Expense:		
Corporate	$	$
Foreign wholesale propane	295	
Total	$ 295	$

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	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003 (Energy Transfer Company)
Depreciation and amortization:		
Midstream	$11,886	$ 10,647
Transportation	7,426	2,814
Retail propane	31,104	
Domestic wholesale propane	417	
Foreign wholesale propane	15	
Total	$50,848	$ 13,461
Interest Expense		
Midstream	$17,632	$ 11,924
Transportation	6,685	5,097
Eliminations	(5,999)	(4,565)
Retail propane	23,140	
Total	$41,458	$ 12,456
Earnings from equity investments		
Midstream	$ 499	$ (149)
Transportation		1,572
Foreign wholesale	(136)	
Total	$ 363	$ 1,423
Income tax expense		
Transportation	$ 1,716	$ 4,432
Corporate	2,765	
Total	$ 4,481	$ 4,432

	August 31, 2004	August 31, 2003 (Energy Transfer Company)
Total Assets:		
Midstream	$ 615,339	$ 413,096
Transportation	785,754	189,007
Retail propane	870,200	
Domestic wholesale propane	12,567	
Foreign wholesale propane	10,034	
Liquids marketing	8,952	
Corporate	23,836	
Total	$ 2,326,682	$ 602,103

	Year Ended August 31, 2004	Eleven Months Ended August 31, 2003 (Energy Transfer Company)
Additions to property, plant and equipment including acquisitions:		
Midstream	$ 26,339	$ 277,767
Transportation	570,169	42,236
Retail propane	515,284	
Domestic wholesale propane	4,492	
Foreign wholesale propane	528	
Corporate	3,229	
Total	$ 1,120,041	$ 320,003

Corporate assets include vehicles, office equipment and computer software for the use of administrative personnel. These assets are not allocated to segments.

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15. QUARTERLY FINANCIAL DATA (UNAUDITED):

Summarized unaudited quarterly financial data is presented below. The sum of net income per limited partner unit by quarter may not equal the net income per limited partner unit for the year due to variations in the weighted average units outstanding used in computing such amounts and because of the reverse merger accounting that occurred with the Energy Transfer Transactions. Heritage s business is seasonal due to weather conditions in its service areas. Propane sales to residential and commercial customers are affected by winter heating season requirements, which generally results in higher operating revenues and net income during the period from October through March of each year and lower operating revenues and either net losses or lower net income during the period from April through September of each year. Sales to industrial and agricultural customers are much less weather sensitive.

	Quarter Ended			
Fiscal 2004:	**(Energy Transfer Company) November 30**	**February 29**	**May 31**	**August 31**
Revenues	$414,986	$629,287	$642,175	$795,806
Gross Profit	34,382	97,435	112,045	112,242
Operating income	21,004	58,619	36,187	29,710
Net income	15,694	49,239	21,330	12,889
Basic and diluted net income per limited partner unit	$ 2.32	$ 2.38	$ 0.52	$ 0.22

	Quarter Ended			
	(Energy Transfer Company)			
Fiscal 2003	**Period from inception (October 1, 2002) through November 30**	**February 28**	**May 31**	**August 31**
Revenues	$78,319	$204,040	$372,586	$368,523
Gross Profit	10,998	29,536	42,936	38,455
Operating income	3,733	12,226	24,848	20,782
Net income	3,728	7,839	18,827	16,231
Basic and diluted net income per limited partner unit	$ 0.55	$ 1.16	$ 2.79	$ 2.40

Certain amounts from previously reported quarters have been reclassified to conform with current presentation. These reclassifications have no impact on net income or total partners capital.

16. SUBSEQUENT EVENTS:

On November 1, 2004 the Partnership announced the closing of the acquisition of certain midstream natural gas assets of Devon Energy Corporation (Devon) for approximately $64.6 million in cash after adjustments. The assets, known as the Texas Chalk and Madison Systems, include approximately 1,800 miles of gathering and mainline pipeline systems, four natural gas treating plants, condensate stabilization facilities, fractionation facilities and the 80 MMcf/d Madison gas processing plant.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Partners of
La Grange Acquisition, LP and Affiliates

We have audited the accompanying consolidated balance sheets of Aquila Gas Pipeline Corporation and Subsidiaries as of September 30, 2002, and the related consolidated statements of income, stockholder s equity and cash flows for the period ended September 30, 2002 and the year ended December 31, 2001. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aquila Gas Pipeline Corporation and Subsidiaries as of September 30, 2002, and the results of their operations and their cash flows for the period ended September 30, 2002 and the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

As discussed in the Note 1 to the consolidated financial statements, effective January 1, 2002, Aquila Gas Pipeline Corporation and Subsidiaries adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

/s/ ERNST & YOUNG LLP

San Antonio, Texas
July 17, 2003

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
(in thousands)

	September 30, 2002
ASSETS	
Current assets:	
Cash and cash equivalents	$
Accounts receivable	72,154
Inventories and exchanges, net	
Materials and supplies	2,622
Price risk management assets	18,100
Other current assets	66
Receivable due from affiliated companies	23,889
Total current assets	116,831
Pipeline, property, plant and equipment, at cost:	
Natural gas pipelines	465,441
Plants and processing equipment	93,872
Other	12,425
	571,738
Less accumulated depreciation	(210,399)
	361,339
Intangible assets, net	5,218
Investment in Oasis Pipe Line	100,748
Other, net	475
Price risk management assets	16,917
Total assets	$ 601,528
LIABILITIES AND STOCKHOLDER S EQUITY	
Current liabilities:	
Accounts payable	$ 71,981
Accrued expenses	3,938
Current maturities of long-term debt	
Accrued interest	975
Exchanges payable	784

Price risk management liabilities	19,334
Payable to affiliated companies	47,064
Total current liabilities	144,076
Long-term debt	66,250
Deferred income taxes	121,718
Price risk management liabilities	15,225
Commitments and contingencies	
Stockholder s equity:	
Common stock, $1.00 par value, 1,000 shares authorized and 10 shares issued	
Additional paid-in capital	90,591
Retained earnings	163,668
Total stockholder s equity	254,259
Total liabilities and stockholder s equity	$ 601,528

See accompanying notes.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Nine Months Ended September 30, 2002	Year Ended December 31, 2001
	(In thousands)	
Operating revenues	$933,099	$ 1,813,850
Costs and expenses:		
Cost of sales	880,064	1,715,261
Operating	12,717	18,126
General and administrative	9,575	19,949
Depreciation and amortization	22,915	30,779
Asset impairment		
Unrealized loss (gain) on derivatives	4,966	(13,255)
Total costs and expenses	930,237	1,770,860
Income from operations	2,862	42,990
Other income (expense)	(84)	1,901
Equity in net income of Oasis Pipe Line	5,425	3,128
Interest and debt expenses, net	(3,931)	(6,858)
Income before income taxes	4,272	41,161
Income tax (benefit) expense	(467)	15,403
Net income	$ 4,739	$ 25,758

See accompanying notes.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDER S EQUITY
Nine months ended September 30, 2002, and

Year ended December 31, 2001

	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholder s Equity
				(In thousands)	
Balance, December 31, 2000		$	$90,591	$133,171	$223,762
Net income	—			25,758	25,758
Balance, December 31, 2001			90,591	158,929	249,520
Net income	—			4,739	4,739
Balance, September 30, 2002		$	$90,591	$163,668	$254,259

See accompanying notes.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2002	Year Ended December 31, 2001
	(In thousands)	
Operating Activities		
Net income	$ 4,739	$ 25,758
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization, including interest	22,935	30,827
Equity in (income) loss of Oasis Pipe Line	(5,425)	(3,128)
Dividend from Oasis	4,000	1,500
Deferred income taxes	(956)	9,843
Gain or loss on sale of assets	61	(3,838)
Asset impairment		
Changes in operating assets and liabilities:		
Accounts receivable	48,939	102,688
Inventories and exchanges, net	1,973	925
Net change in price risk management assets and liabilities	7,168	(7,056)
Receivable due from affiliated companies	(13,499)	(10,390)
Other assets	455	(171)
Accounts payable	(59,137)	(98,802)
Accrued expenses	(4,531)	(1,739)
Accrued interest	706	(812)
Payable to affiliated companies	5,559	19,593
Net cash provided by operating activities	12,987	65,198
Investing Activities		
Additions to pipeline, property, plant and equipment	(5,486)	(26,866)
Proceeds from asset dispositions	4,999	6,139
Net cash used in investing activities	(487)	(20,727)
Financing Activities		
(Payments) borrowings under revolving credit agreement, net		(31,971)
Principal payments of debt	(12,500)	(12,500)
Net cash used in investing activities	(12,500)	(44,471)

Net (decrease) increase in cash and cash equivalents		
Cash and cash equivalents, beginning of year		
Cash and cash equivalents, end of year	$	$

See accompanying notes.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Nine Months Ended September 30, 2002, and

Year Ended December 31, 2001

(In thousands)

1. Summary of Business, Basis of Presentation and Significant Accounting Policies

Business

Aquila Gas Pipeline Corporation (Aquila Gas Pipeline or the Company) and subsidiaries owned and operated natural gas gathering and pipeline systems and gas processing plants and was engaged in the business of purchasing, gathering, transporting, processing and marketing natural gas and natural gas liquids (NGLs) in the States of Texas and Oklahoma.

Effective October 1, 2002, substantially all of the operating assets of Aquila Gas Pipeline were sold for $264 million to La Grange Acquisition, LP (La Grange Acquisition). La Grange Acquisition did not assume Pipeline s derivative positions or its liabilities, except for certain payables.

Principles of Consolidation and Basis of Presentation

Aquila Gas Pipeline was a wholly owned subsidiary of Aquila Merchant Services. Aquila Merchant Services was wholly owned by Aquila, Inc. (Aquila), formerly UtiliCorp United Inc.

The accompanying consolidated financial statements include the accounts of Aquila Gas Pipeline after the elimination of significant intercompany balances and transactions with subsidiaries. Unless otherwise indicated, all amounts included in the notes to the consolidated financial statements are expressed in thousands.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The more significant areas requiring the use of estimates relate to the fair value of financial instruments and useful lives for depreciation. Actual results may differ from those estimates.

The Company was subject to a number of risks inherent in the industry in which it operated, primarily fluctuating prices and gas supply. The Company s financial condition and results of operations depended significantly upon the prices received for natural gas and NGLs. These prices were subject to wide fluctuations due to a variety of factors that were beyond the control of the Company. In addition, the Company had to continually connect new wells to its gathering systems in order to maintain or increase throughput levels to offset natural declines in dedicated volumes. The number of new wells drilled depended on a variety of factors that were beyond the control of the Company.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash Paid for Interest

The following provides information related to cash paid for interest. No cash was paid for income taxes as taxes were settled through intercompany accounts with Aquila:

	September 30, 2002	December31 2001
	(In thousands)	
Interest, net of amount capitalized	$3,308	$6,219

Revenue Recognition

Operating revenues were recognized upon the delivery of natural gas or NGLs to the buyer of the related product or services.

Inventories and Exchanges

Inventories and exchanges consisted of NGLs on hand or natural gas and NGLs delivery imbalances with others and were presented net by customer/supplier on the consolidated balance sheet. These amounts turned over monthly, and management believed that cost approximated market value. Accordingly, these volumes were valued at market prices on the consolidated balance sheet.

Materials and Supplies

Materials and supplies were stated at the lower of cost (determined on a first-in, first-out basis) or market.

Shipping and Handling Costs

In accordance with the Emerging Issues Task Force Issue 00-10, Accounting for Shipping and Handling Fees and Costs , the Company classified all deductions from producer payments for fuel, compression and treating that can be considered handling costs as revenue. The associated fuel costs were included in cost of sales, while the remaining costs were included in operating costs.

Commodity Risk Management

In 1999, Aquila Gas Pipeline transferred all of its energy trading operations and management thereof to Aquila Energy Marketing (AEM), a wholly owned subsidiary of Aquila. AEM entered into forward physical contracts with third parties for the benefit of Aquila Gas Pipeline and where deemed necessary entered into intercompany financial derivative positions (e.g., swaps, futures and options) with Aquila Gas Pipeline and other affiliates to assist them in managing their exposures. Thus, Aquila Gas Pipeline had forward physical contracts with third parties and financial

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

derivative positions with AEM and affiliates. The Company received all gross margins associated with these transactions, and AEM charged Aquila Gas Pipeline for its share of AEM s costs to manage Aquila Gas Pipeline s positions.

The Company accounted for its derivative positions, both speculative forward positions and financial derivatives, under Emerging Issues Task Force Issue 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 98-10). Under EITF 98-10, the Company valued the derivative positions at market value with all changes being recognized in earnings. Realized gains and losses were included in revenues, while unrealized gains and losses were classified as such on the consolidated statements of income. Aquila Gas Pipeline s derivative positions were classified as current or long-term price risk management assets and liabilities based on their maturity.

The market prices used to value these transactions reflected management s estimates considering various factors, including closing exchange and over-the-counter quotations, time value and volatility factors of the underlying commitments. The values were adjusted to reflect the potential impact of liquidating a position in an orderly manner over a reasonable period of time under market conditions.

Although La Grange Acquisition is also involved in energy marketing and uses derivatives to manage its exposures, La Grange Acquisition did not purchase Aquila Gas Pipeline s derivative positions when it purchased its assets. Emerging Issues Task Force Issue 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities was issued in the fourth quarter of 2002 and rescinded the provisions of EITF 98-10. As such all energy trading derivative transactions are now governed by Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (Statement No. 133). Under Statement No. 133, La Grange Acquisition will continue to account for its financial derivative positions as mark to market instruments. However, as permitted under Statement No. 133, La Grange Acquisition has adopted a policy of treating all forward physical contracts that require physical delivery as normal purchases and sales contracts. As such, these contracts will not be marked to market and will be accounted for when delivery occurs. Had Aquila Gas Pipeline adopted this policy, it would have reversed unrealized mark to market gains of $1,938 at September 30, 2002.

Pipeline, Property, Plant and Equipment

Pipeline, property, plant and equipment were stated at cost. Additions and improvements that added to the productive capacity or extended the useful life of the asset were capitalized. Expenditures for maintenance and repairs that did not add capacity or extended the useful life were charged to expense as incurred. Upon disposition or retirement of pipeline components or gas plant components, any gain or loss was recorded to accumulated depreciation. When entire pipeline systems, gas plants or other property and equipment were retired or sold, any gain or loss was included in operations.

Depreciation of the pipeline systems, gas plants and processing equipment was calculated using the straight-line method based on an estimated useful life of primarily 25 years. Interest cost on funds used to finance major pipeline projects during their construction period was also capitalized. Capitalized interest cost was $35 and $86 for the periods ending September 30, 2002 and December 31, 2001, respectively.

The Company reviewed its long-lived assets, including finite lived intangibles, for impairment whenever facts and circumstances indicated impairment was potentially present. When impairment indicators were present, Aquila Gas Pipeline evaluated whether the assets in question were able to generate sufficient cash flows to recover their carrying value on an undiscounted basis. If not, the Company impaired the assets to their fair value, which was determined based on discounted cash flows or estimated salvage value.

AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Construction work in progress at September 30, 2002 was $669.

Stock Compensation

Some of Aquila Gas Pipeline s employees received stock options in Aquila. As permitted under generally accepted accounting principles, Aquila elected to account for the options under Accounting Principles Board Opinion No. 25, and because the options strike price was equal to or greater than the fair value at the date of grant, no compensation expense was recognized. See Note 6, for a summary of the options granted. As these were Aquila options, Aquila Gas Pipeline does not have full access to the information necessary to disclose what compensation expense would have been, had Aquila accounted for the options under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation , which requires compensation expense be recognized for the fair value of the options at the date of grant. La Grange Acquisition does not have a stock option plan in place for its employees.

Income Taxes

Aquila Gas Pipeline was included in the consolidated federal income tax returns filed by Aquila. Accordingly, all tax balances were ultimately settled through Aquila. Aquila Gas Pipeline had generally accounted for its taxes on a stand-alone or separate return basis (see Note 4). Periodically, taxes payable were settled through the intercompany accounts with Aquila and were not funded in cash.

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (Statement No. 109). Statement No. 109 requires that deferred tax assets and liabilities be established for the basis differences between the reported amounts of assets and liabilities for financial reporting purposes and income tax purposes.

Equity Method Investments

Aquila Gas Pipeline had a 50% investment in Oasis Pipe Line Company. Aquila Gas Pipeline accounted for this investment using the equity method.

Adoption of New Accounting Standard

On January 1, 2002, Aquila Gas Pipeline adopted Statement of Financial Accounting Standards No. 141, Business Combinations (Statement No. 141). Statement No. 141 addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, Business Combinations , and FASB Statement 38, Accounting for Preacquisition Contingencies of Purchased Enterprises. Statement No. 141 was effective for all business combinations initiated after June 30, 2001. Statement No. 141 eliminated the pooling-of-interest method of accounting for business combinations. Statement No. 141 also changed the criteria to recognize intangible assets apart from goodwill. As the Company has historically used the purchase method to account for all business combinations, adoption of this statement did not have a material impact on the Aquila Gas Pipeline s financial position or results of operations.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards

AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

No. 142, Goodwill and Other Intangible Assets (Statement No. 142). Statement No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and superseded APB Opinion No. 17, Intangible Assets. Statement No. 142 was effective for fiscal years beginning after December 15, 2001. This statement established new accounting for goodwill and other intangible assets recorded in business combinations. Under the new rules, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are be subjected to annual impairment tests in accordance with the statement. Other intangible assets continue to be amortized over their useful lives. Aquila Gas Pipeline adopted this standard on January 1, 2002. As amortization of goodwill was a significant non-cash expense, Statement No. 142 had a material impact on the Company s financial statements. The table below summarizes the financial results as if adoption had occurred on January 1, 2001.

	2001
	(In thousands)
Reported net income	$25,758
Add back: Goodwill amortization	900
Add back: Oasis excess basis amortization	1,650
Taxes	(365)
Adjusted net income	$27,943

2. Related-Party Transactions

Aquila Gas Pipeline entered into various types of transactions with Aquila and its affiliates. Aquila Gas Pipeline sold natural gas to Aquila and its affiliates and purchased natural gas and NGLs from Aquila. Additionally, Pipeline reimbursed Aquila for the direct and indirect costs of certain Aquila employees who provided services to the Company and for other costs (primarily general and administrative expenses) related to the Company s operations. Aquila also provided Aquila Gas Pipeline with a revolving credit agreement, as described in Note 3.

The following table summarizes transactions for the indicated periods:

	September 30, 2002	**December 31, 2001**
	(In thousands)	
Natural gas sales to affiliated companies	$166,372	$325,295
NGLs sales to affiliated companies	373	1,267
Purchases of natural gas from affiliated companies	101,398	170,105
Purchases of NGLs from affiliated companies	1,841	

Transportation expense with Oasis	3,900	6,727
Recognized (loss) gain from marketing transactions with AEM	2,678	(10,605)
Interest expense with Aquila	3,295	5,140
Reimbursement of direct costs to Aquila	(1,739)	15,283
Service agreement expenses charged by Aquila	2,628	3,504

The affiliated receivable due from Aquila was $23,889 for the period ending September 30, 2002. This receivable was created by overpayments on Aquila Gas Pipeline s revolving credit agreement (see Note 3) with Aquila. The affiliated payable due to Aquila was $47,064 as of September 30, 2002.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Debt

The following table summarizes Aquila Gas Pipeline s long-term debt:

	September 30, 2002
	(In thousands)
Loan agreement bearing interest at 6.83%, due 2006	$ 16,250
Loan agreement bearing interest at 6.47%, due 2005	50,000
8.29% senior notes, due 2002	
Total debt	66,250
Less Current maturities of long-term debt	
Total long-term debt	$ 66,250

Revolving Credit Agreement

Aquila Gas Pipeline had a credit agreement, as amended, with Aquila that provided a revolving credit facility (Revolver) for borrowings of up to $115,000. As of September 30, 2002, there was $115,000 available for use under the Revolver. Aquila swept all available cash daily to reduce the revolver. This resulted in a receivable due to Aquila Gas Pipeline of $23,889 as of September 30, 2002. The Revolver bore interest at Aquila Gas Pipeline s election of either (i) a base rate (the higher of the bank prime rate or 1/2 of 1 percent above the Federal Funds rate), (ii) an adjusted certificate of deposit rate or (iii) a Eurodollar rate. The maturity date of the Revolver automatically renewed in one-year periods from each commitment period (October of any given year), unless Aquila gave at least a one-year notice not to renew. As of September 30, 2002, the maturity date was October 2003. The Revolver was unsecured and was subordinate to the 8.29% senior notes described below. The Company paid an annual commitment fee to Aquila of 1/4 of 1% on the unutilized portion of the revolving credit facility. The Revolver required the Company to comply with certain restrictive covenants. At September 30, 2002, Aquila Gas Pipeline was in compliance with such covenants.

Loan Agreements

In 1995, Aquila Gas Pipeline entered into a loan agreement with Aquila Energy, a subsidiary of Aquila for $50,000. The loan was unsecured and bore interest at 6.47% due semi-annually. The principal amount of the loan was to be repaid to Aquila Energy by June 1, 2005. In 1997, Aquila Gas Pipeline entered into a second loan agreement with Aquila Energy for $16,250. This loan was unsecured and bore interest at 6.83% due semi-annually. The principal amount of the second loan was to be repaid to Aquila Energy by October 15, 2006.

Senior Notes

The 8.29% Senior Notes (Senior Notes) were unsecured and interest payments were due semi-annually. Principal payments of $12,500 were required each year and the balance was paid in full in September 2002. Upon issuance of the Senior Notes, Aquila Gas Pipeline deferred approximately $1,886 of initial fees and expenses that were amortized over the life of the notes.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Income Taxes

Components of income tax provision/(benefit) attributable to income before taxes are as follows:

	September 30, 2002	December 31, 2001
	(In thousands)	
Current	$ 489	$ 5,560
Deferred	(956)	9,843
Total	$ (467)	$ 15,403

Tax expense was different than the amount computed by applying the statutory federal income tax rate to income before taxes. A reconciliation of Aquila Gas Pipeline s income taxes with the United States Federal statutory rate is as follows:

	September 30, 2002	December 31, 2001
	(In thousands)	
Book income at U.S. federal statutory rate	35.0%	35.0%
Equity method earnings	(51.4)	(3.3)
State taxes	3.5	3.5
Other	2.0	2.0
Tax provision effective rate	(10.9)%	(37.2)%

Deferred taxes resulted from the effect of transactions that were recognized in different periods for financial and tax reporting purposes. Significant components of the Company s deferred tax assets and liabilities were as follows:

	September 30, 2002

	(In thousands)
Deferred tax assets:	
Basis difference in intangible assets	$ 6,649
Other	388
Total deferred tax assets	7,037
Deferred tax liabilities:	
Basis difference in fixed assets	(128,755)
Net deferred tax liabilities	$(121,718)

5. Major Customers

The Company s gross sales as a percentage of total revenues to nonaffiliated major customers were as follows:

	September 30, 2002	December 31, 2001
Customer A	17.5%	15.4%
Customer B	9.6%	11.0%

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s natural gas operations had a concentration of customers in natural gas transmission, distribution and marketing as well as industrial end-users, while its NGLs operations had a concentration of customers in the refining and petrochemical industries.

These concentrations of customers impacted the Company s overall exposure to credit risk, whether positively or negatively, in that the customers were similarly affected by changes in economic or other conditions. However, management believed that Aquila Gas Pipeline s portfolio of accounts receivable was sufficiently diversified to minimize any potential credit risk. Historically, Aquila Gas Pipeline has not incurred significant problems in collecting its accounts receivable and, as such, no allowance for doubtful accounts was provided in the accompanying consolidated financial statements. The Company s accounts receivable were generally not collateralized.

6. Retirement and Benefit Plans

Aquila had a defined contribution plan for virtually all employees. Pursuant to the plan, employees of the Company could defer a portion of their compensation and contribute it to a deferred account. The Company s matching contributions to the plan were $408 and $444 for the periods ended September 30, 2002 and December 31, 2001, respectively.

Aquila had a stock contribution plan under which eligible Aquila Gas Pipeline employees received a company contribution of 3 percent of their base income in Aquila common stock. The Company s expense associated with this plan was $27 and $231 for periods ending September 30, 2002 and December 31, 2001, respectively. The reduction for 2002 was due to the reduction in the number of employees eligible in 2002 and declines in the market value of the stock.

Aquila had a stock option plan under which eligible Aquila Gas Pipeline employees were granted options to purchase shares of Aquila s common stock. The plan provided that the options would not be granted at a price below the market price at the date of grant. Accordingly, no compensation cost was recognized for the options. The options vested one year from the date of grant and expired 10 years from the date of grant.

The following table summarizes the options granted to Aquila Gas Pipeline employees:

	September 30, 2002		Period Ended December 31, 2001	
	Options	**Average Price**	**Options**	**Average Price**
	(In thousands)			
Outstanding, beginning of period	170,298	$26.8387	115,876	$21.9475
Granted			85,810	34.8028
Exercised	(825)	18.2083	(25,688)	23.4483
Forfeited	(4,637)	22.7246	(5,700)	21.6565

Outstanding, end of period	164,836	$26.6896	170,298	$26.8387

AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Commitments and Contingencies

Lease Obligations

The Company had various non-cancelable operating leases. Total lease expense amounted to approximately $598 for the period ending September 30, 2002, and $1,059 for the period ending December 31, 2001. All leases were transferred to La Grange Acquisition effective October 1, 2002.

The following summarizes the future annual lease payments for the transferred leases for each of the next five years as of September 30, 2002:

	(In thousands)
2003	$775
2004	775
2005	773
2006	64
2007 and thereafter	

Taxes

The IRS has examined and proposed adjustments to Aquila s consolidated federal income tax returns for 1988 through 1993. The proposed adjustment affecting the Company was to lengthen the depreciable life of certain pipeline assets owned by Aquila Gas Pipeline. Aquila has filed a petition in U.S. Tax Court contesting the IRS proposed adjustments for the years 1990 through 1991. The IRS has also proposed an adjustment on the same issue for 1992 through 1998. Aquila has tentatively agreed with the IRS to hold this issue in abeyance pending the outcome of the earlier petition.

Aquila intends to vigorously contest the proposed adjustment and believes it is reasonably possible that they will prevail. If resolved unfavorably, it is expected that additional assessments for the years 1999 through September 30, 2002 would be made on the same issue.

Any additional taxes would result in an adjustment to the deferred tax liability with no effect on net income, while any payment of interest or penalties would affect net income. Aquila Gas Pipeline expects that the ultimate resolution of this matter will not have a material adverse effect on its financial position. Under the Asset Purchase Agreement between Aquila and La Grange Acquisition, La Grange Acquisition would not be impacted by resolution of this matter.

Contingencies

In 1996, Aquila Gas Pipeline and Exxon entered into a contract, which required Aquila Gas Pipeline to pay Exxon $5.1 million in 2006 if Aquila Gas Pipeline failed to deliver natural gas containing at least 2 gallons per mcf to the Exxon Katy Plant. In 2000, the determination was made that it was unlikely that the Company would be in a position to supply natural gas that would meet the contract specifications. Included in operating expenses in 2000 was an accrual of $3.6 million representing the present value of the future settlement. In 2001, the Company reached an agreement with Exxon to cancel the contract for a cash settlement of $3.7 million and the exchange of property for right-of-way.

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company was also a party to additional claims and was involved in various other litigation and administrative proceedings arising in the normal course of business. Aquila Gas Pipeline believed it was unlikely that the final outcome of any of the claims, litigation or proceedings to which it was a party would have a material adverse effect on its financial position or results of operations. However, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have an adverse effect on the Company s results of operations for the fiscal period in which such resolution occurred. Per the Asset Purchase Agreement between Aquila and La Grange Acquisition, Aquila has agreed to indemnify La Grange Acquisition for any litigation arising from operations before October 1, 2002.

In the normal course of business of its natural gas pipeline operations, the Company purchased, processed and sold natural gas pursuant to long-term contracts. Such contracts contained terms, which were customary in the industry. The Company believes that such terms were commercially reasonable and will not have a material adverse effect on its financial position or results of operations.

8. Commodity Risk Management

The following table details information on the Company s positions held or issued for trading purposes as of:

September 30, 2002

	Commodity	Notional Volume Bcf	Maturity	Aquila Pays	Aquila Receives	Fair Value
Basis Swaps						
EPNG Permian	Gas	0.4	2002	Nymex	IFERC	$ (142)
EPNG Permian	Gas	0.4	2002	IFERC	Nymex	143
Waha	Gas	3.3	2005	Nymex	IFERC	(711)
Waha	Gas	4.1	2005	IFERC	Nymex	826
Houston Ship	Gas	0.6	2005	Nymex	IFERC	(40)
Houston Ship	Gas	0.6	2005	IFERC	Nymex	44
EPNG Permian	Gas	1.5	2003	Nymex	IFERC	(723)
EPNG Permian	Gas	1.5	2003	IFERC	Nymex	731
EPNG San Juan	Gas		2002	Nymex	IFERC	(456)
EPNG San Juan	Gas		2002	IFERC	Nymex	714
Houston Ship	Gas	101.3	2005	Nymex	IFERC	(1,038)
Houston Ship	Gas	96.7	2005	IFERC	Nymex	1,076
Katy	Gas		2002	Nymex	IFERC	(89)
Katy	Gas		2002	IFERC	Nymex	94
TGP TX	Gas		2002	Nymex	IFERC	(36)
TGP TX	Gas		2002	IFERC	Nymex	16
SOCAL	Gas	1.5	2003	Nymex	IFERC	(428)
SOCAL	Gas	1.5	2003	IFERC	Nymex	174
TETC OLPO STX	Gas	13.6	2005	Nymex	IFERC	274

TETC OLPO STX	Gas	11.7	2005	IFERC	Nymex	(130)
Waha	Gas	97.1	2003	Nymex	IFERC	(8,617)
Waha	Gas	97.1	2003	IFERC	Nymex	8,531

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Buyer/ Seller	Commodity	Notional Volume Bcf	Maturity	Average Strike Price	Fair Value
Futures						
	Buyer	Gas	0.3	2002	3.203	$ (121)
	Seller	Gas	1.1	2002	2.685	(1,086)
	Buyer	Gas	115.9	2005	3.733	29,518
	Seller	Gas	114.3	2005	3.730	(29,729)
	Buyer	Gas	2.5	2002	3.150	679
	Seller	Gas	3.4	2002	2.995	(810)
Forwards						
	Buyer	Gas	181.0	2020	2.919	(3,683)
	Seller	Gas	339.7	2020	3.686	6,570
	Buyer	Transport	15.3	2004	0.029	(12)

	Buyer/ Seller	Commodity	Barrels in Thousands	Maturity	Average Strike Price	Fair Value
NGLs Futures						
	Seller	Ethane	150	2002	0.215	$ 194
	Buyer	Ethane	150	2002	0.265	121
	Seller	Propane	75	2002	0.373	265
	Buyer	Propane	135	2002	0.406	(287)
	Seller	Crude	(254)	2002	29.552	(1,374)

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AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The net gain from derivative activities for the periods ended September 30, 2002 and December 31, 2001 was $6,273 and $9,016, respectively.

9. Financial Instruments

The Company s carrying amounts for cash and cash equivalents, accounts receivable, other current assets, accounts payable and other current liabilities approximated fair value. The fair values of its derivative positions are disclosed in Note 8. The following summarizes the Company s carrying value and estimated fair value of its long-term debt obligations:

	September 30, 2002	
	Carrying Value	Fair Value
	(In thousands)	
6.83% Loan	$16,250	$19,123
6.47% Loan	50,000	55,751
Total	$66,250	$74,874

AQUILA GAS PIPELINE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Intangible Assets

The following table details the items included in intangible assets:

	Period Ended September 30, 2002
	(In thousands)
Goodwill	$ 9,491
Less: amortization	(7,837)
	1,654
Oasis transportation rights	18,620

Less: amortization	(15,905)
	2,715
Gathering producer relationship	14,930
Less: amortization	(14,081)
	849
Senior note deferred financing costs	
Less: amortization	
Intangibles, net	$ 5,218

Effective January 1, 2002, in accordance with Statements of Financial Accounting Standards No. 141 and No. 142, the Company ceased amortizing its goodwill. Further, the Company concluded that the carrying value of the goodwill was not impaired. Goodwill amortization was $900 in 2001. Amortization expense, excluding goodwill amortization, was $3,644 and $5,031 in September 30, 2002 and December 31, 2001, respectively.

At September 30, 2002, the estimated five-year amortization of the Oasis Pipe Line transportation rights and gathering producer relationships was as follows:

	(In thousands)
Remainder of 2002	$ 840
2003	1,990
2004	91
2005	91
2006	91
2007	91
Thereafter	370
	$3,564

The Oasis Pipe Line transportation rights was an agreement between Aquila Gas Pipeline and Oasis Pipe Line whereby Aquila Gas Pipeline could elect to reserve a portion of Oasis Pipe Line s line capacity in advance. The agreement has been amended numerous times, and under the most recent amendment it was cancelable by either party upon ninety days notice and it was scheduled to expire in July 2003. The gathering producer relationships related to certain fixed price gathering contracts that were being amortized over ten years.

11. Investment in Subsidiaries

Oasis Pipe Line

Prior to December 2000, Aquila Gas Pipeline had a 35% interest in Oasis Pipe Line. Thereafter, Aquila Gas Pipeline held 50% of the stock of Oasis Pipe Line. The following table presents financial information related to Oasis Pipe Line for the periods presented:

	Period Ended	
	September 30, 2002	December 31, 2001
	(In thousands)	
Revenues	$24,733	$26,153
Total operating expenses	7,772	11,266
Income before income tax expense	16,700	14,707
Net income	10,850	9,556
Pipeline s share of net income	5,425	4,778
Pipeline s share of distributions	4,000	1,500
Current assets	10,680	7,061
Total assets	53,929	50,453
Current liabilities	3,893	1,911
Long-term debt		
Shareholder s equity	41,912	39,062

At September 30, 2002, Aquila Gas Pipeline s investment exceeded its pro-rata share of Oasis Pipe Line s equity by $79,792. Prior to 2002, the excess purchase price was being amortized $1,650 per year. In accordance with Aquila Gas Pipeline s adoption of Statement of Financial Accounting Standards No. 141 and 142, this amortization was ceased effective January 1, 2002.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Oasis Pipe Line Company

We have audited the accompanying consolidated balance sheet of Oasis Pipe Line Company and Subsidiaries as of December 27, 2002, and the related consolidated statement of income, shareholders equity and cash flow for the period then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oasis Pipe Line Company and Subsidiaries as of December 27, 2002, and the consolidated results of its operations and its cash flows for the period then ended in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

San Antonio, Texas
July 15, 2003

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 27, 2002	December 31, 2001
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,962	$ 2,352
Accounts receivable trade (net of allowance for doubtful accounts of $153 in 2002 and $60 in 2001)	2,290	1,997
Accounts receivable affiliates	364	552
Inventories	1,215	1,351
Refundable income taxes		540
Prepaid insurance	325	269
Total current assets	12,156	7,061
Property, plant, and equipment:		
Pipeline facilities	169,308	168,745
Construction-in-progress		119
Less accumulated depreciation and amortization	(127,231)	(125,472)
Property, plant, and equipment, net	42,077	43,392
Other	413	
Total assets	$ 54,646	$ 50,453
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable trade	$ 264	$ 230
Accounts payable affiliates		13
Accrued liabilities	376	385
Accrued taxes	820	
Accrued taxes, other than income taxes		783
Accrued compensation	586	500
Total current liabilities	2,046	1,911
Deferred income taxes	9,461	9,480
Commitments and contingencies		

Shareholders equity:		
Common stock, $1 par value; 50,000 shares authorized and 6,667 shares outstanding	7	7
Additional paid-in capital	25,432	25,432
Retained earnings	35,537	31,460
	60,976	56,899
Less treasury stock, 2,000 shares	17,837	17,837
Total shareholders equity	43,139	39,062
Total liabilities and shareholders equity	$ 54,646	$ 50,453

See accompanying notes.

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands)

	Period Ended December 27, 2002	Year Ended December 31, 2001
Operating revenues:		
Gas transportation third party	$23,490	$15,749
Gas transportation affiliates	5,975	8,364
Proceeds from pipeline construction		
Gas sales third party	2,352	883
Fuel and unaccounted for gas		763
Other	914	394
Total operating revenues	32,731	26,153
Operating expenses:		
Fuel and unaccounted for gas	133	
Operations and maintenance	4,469	4,325
Cost of pipeline construction		
Depreciation and amortization	2,106	2,458
Taxes, other than income	1,207	1,171
Administrative and general	2,555	3,312
Total operating expenses	10,470	11,266
Operating income	22,261	14,887
Other income (expenses):		
Interest income	64	193
Interest expense shareholder		(433)
Other, net	(660)	60
Income before income taxes	21,665	14,707
Income tax expense	7,588	5,151
Net income	$14,077	$ 9,556

See accompanying notes

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
Period Ended December 27, 2002 and Year Ended December 31, 2001
(unaudited as to December 31, 2001 data)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Total
	Shares	Amount	Shares	Amount			
	(In thousands, except share data)						
Balance at December 31, 2000	6,667	7	2,000	(17,837)	25,432	24,904	32,506
Net income						9,556	9,556
Dividends paid ($.45 per share)						(3,000)	(3,000)
Balance at December 31, 2001	6,667	7	2,000	(17,837)	25,432	31,460	39,062
Net income						14,077	14,077
Dividends paid ($1.50 per share)						(10,000)	(10,000)
Balance at December 27, 2002	6,667	$ 7	2,000	$(17,837)	$25,432	$ 35,537	$ 43,139

See accompanying notes

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Period Ended December 27, 2002	Year Ended December 31, 2001
		(unaudited)
Operating Activities		
Net income	$ 14,077	$ 9,556
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	2,106	2,458
Deferred income taxes	(19)	213
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(105)	(1,744)
Inventories	136	120
Refundable income taxes	540	488
Accounts payable	21	(340)
Accrued liabilities	114	96
Other, net	(469)	3
Net cash provided by operating activities	16,401	10,850
Investing Activities		
Additions to property, plant, and equipment, net	(791)	(511)
Sale of property, plant, and equipment		5
Net cash used in investing activities	(791)	(506)
Financing Activities		
Repayment of notes payable related parties		(11,832)
Dividends paid	(10,000)	(3,000)
Note issued to purchase treasury stock		
Purchase of treasury stock		
Net cash used in financing activities	(10,000)	(14,832)
Increase (decrease) in cash and cash equivalents	5,610	(4,488)
Cash and cash equivalents, beginning of year	2,352	6,840

Cash and cash equivalents, end of year	$ 7,962	$ 2,352
Supplemental cash flow information:		
Cash paid for income taxes	$ 7,080	$ 4,450
Cash paid for interest		433

See accompanying notes

OASIS PIPE LINE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Period Ended December 27, 2002 and Year Ended December 31, 2001
(unaudited as to December 31, 2001 data)

1. Control and Ownership of the Company and Related-Party Transactions

Oasis Pipe Line Company (the Company), a Delaware corporation, is engaged in the operation of an intrastate natural gas transmission system in the state of Texas. Immediately prior to December 27, 2002, the Company was owned 50% by a subsidiary of Aquila Gas Pipeline Corporation (Aquila Gas Pipeline), and 50% by Dow Hydrocarbons & Resources, Inc. (DHRI). Prior to October 4, 2002, Aquila Gas Pipeline was the wholly owned subsidiary of Aquila, Inc. In October 2002, La Grange Acquisition, L.P. (La Grange Acquisition) acquired substantially all the assets of Aquila Gas Pipeline. On December 27, 2002 the Company redeemed all of DHRI s stock using funds advanced from La Grange Acquisition making the Company a wholly owned subsidiary of La Grange Acquisition.

Before December 28, 2000, ownership was 35% by a subsidiary of Aquila Gas Pipeline, 35% by El Paso Field Services (EPFS), and 30% by DHRI. On that date, EPFS sold 5% of its interest to DHRI and the remaining 30% interest was acquired by the Company as treasury stock.

During 2002, and 2001, the Company derived revenues from its shareholders and their affiliates for the transmission and sale of natural gas. The amount of such net revenues totaled approximately $5,975,000, and $8,364,000, for the years ended December 27, 2002, and December 31, 2001, respectively. Accounts receivable due from affiliates were approximately $364,000 and $552,000 for 2002 and 2001, respectively.

During 2000, the Company reacquired 2,000 previously issued shares of capital stock for $17.8 million. The acquisition was funded with working capital and the borrowing of $11.8 million from shareholders (Aquila Gas Pipeline and DHRI). The borrowings were represented by notes payable bearing interest at 9%. Interest expense associated with the notes payable was $433,000 during 2001. The notes were paid during 2001.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements present the financial position and results of operations of the Company prior to its becoming a subsidiary of La Grange Acquisition and therefore exclude the purchase adjustments relating to the redemption and intercompany promissory note on December 27, 2002 (see Note 7).

Inventories

The Company requires its customers to provide additional gas, based on predetermined quantities of gas to be delivered, for fuel. If the gas is in excess of the Company s needs, the Company can retain the excess gas or sell it to third parties. If additional fuel is required, the Company will purchase additional volumes in the market. Inventories represent the gas that is retained. The Company values inventories at the lower of cost or market as of the balance sheet dates.

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property, Plant, and Equipment

Normal maintenance that does not add capacity or extend the useful life of the equipment and repairs of property, plant, and equipment are charged to expense as incurred. Improvements that materially extend the useful lives of the assets are capitalized, and the assets replaced, if any, are retired. When capital assets are retired or replaced, the balance of the assets and the accumulated depreciation are removed and any gain or loss upon disposition is included in income. Fixed assets of approximately $346,000 and $134,000 were retired during 2002 and 2001, respectively.

Depreciation is computed using the straight-line method of accounting over the estimated useful lives of the related assets. Annual depreciable lives range from 5 to 85 years.

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

Environmental Expenditures

Environmental related restoration and remediation costs are recorded as liabilities and expensed when site restoration and environmental remediation and cleanup obligations are either known or considered probable and the related costs can be reasonably estimated.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial accounting bases and the tax bases of assets and liabilities. The deferred tax effects of these temporary differences are calculated using the tax rates currently in effect.

Revenue Recognition

Transportation revenue is recognized as transportation is provided. Capacity payments are recognized when earned in the period capacity was made available.

Financial Instruments and Credit Risk

The Company s financial instruments consist of cash and cash equivalents, accounts receivable, and accounts payable. The carrying value of the Company s financial instruments approximates fair value due to their short-term nature. The Company considers all investments with maturities of three months or less at acquisition to be cash equivalents. The Company s receivables are generally from entities involved in the energy industry or significant industrial customers. The Company specifically reviews all its receivables in determining its allowance for doubtful accounts and the receivables are generally unsecured.

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 the reported amount of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to the 2001 and 2000 amounts to conform to the 2002 presentation.

3. Income Taxes

Components of income tax provision/(benefit) attributable to income before taxes are as follows:

	December 27, 2002	December 31, 2001
Current	$ 7,607	$ 4,938
Deferred	(19)	213
Total income tax expense	$ 7,588	$ 5,151

The tax provision effective rate for December 27, 2002 and December 31, 2001 was 35%.

Deferred income taxes consist of the following:

	December 27, 2002	December 31, 2001
Property, plant and equipment	$ (9,178)	$ (9,131)
Other	(283)	(349)
Net deferred tax liabilities	$ (9,461)	$ (9,480)

4. Employee Benefit Plan

An employee savings plan is available to all permanent employees, effective the first day of their employment. For every $1 each employee contributes, the Company matches $1, not to exceed 5% of each employee s salary subject to the maximum contribution allowed by law. Each employee is fully vested on his or her first day of employment. The Company expensed contributions of approximately $144,000 and $140,000 for 2002 and 2001, respectively.

5. Contingencies

The Company is subject to federal, state and local environmental laws and regulations, which generally require expenditures for remediation at operating facilities and waste disposal sites. At December 27, 2002 and December 31, 2001, the Company had reserved approximately $252,000 and $292,000 respectively, for the expected costs of complying with such laws and regulations. These expected costs are primarily related to properties previously owned and are recorded on the consolidated balance sheets as accrued liabilities based upon management s estimates of the timing of the expenditure. The purchase and sale agreement between La Grange

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OASIS PIPE LINE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Acquisition and Aquila Gas Pipeline requires Aquila, Inc. to reimburse Oasis for 50% of any remediation expenditures related to operations prior to October 1, 2002.

On June 16, 2003, Guadalupe Power Partners, L.P. (GPP) sought and obtained a Temporary Restraining Order against Oasis Pipe Line. In their pleadings, GPP alleged unspecified monetary damages for the period from February 25, 2003 to June 16, 2003 and sought to prevent Oasis Pipe Line from implementing flow control measures to reduce the flow of gas to their power plant at varying hourly rates. Oasis Pipe Line filed a counterclaim against GPP asking for damages and a declaration that the contract was terminated as a result of the breach by GPP. Oasis Pipe Line and GPP agreed to a stand still order and referred this dispute to binding arbitration. Oasis Pipe Line has retained trial counsel to defend this matter and a date for the commencement of the arbitration proceedings has not yet been set.

The Company is also party to legal actions that have arisen in the ordinary course of its business. Due to the inherent uncertainty of litigation, the range of any possible loss cannot be estimated with a reasonable degree of precision.

6. Stock Redemption

On December 27, 2002, the Company purchased 50% of its capital stock owned by DHRI for $87 million. The Company funded the acquisition by borrowing $87 million from La Grange Acquisition evidenced by a promissory note (the Note). Effective with the redemption, the Company became a wholly owned subsidiary of La Grange Acquisition and is included in the financial statements of La Grange Acquisition effective December 27, 2002. The Note bears interest at an annual rate of 8.5% with payments of $1.6 million due monthly until final maturity on February 1, 2006 at which time the remaining balance will be due. The consolidated financial statements present the financial position and results of operations of the Company prior to its becoming a subsidiary of LaGrange Acquisition and therefore exclude the purchase adjustments relating to the redemption and intercompany promissory

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Partners
Energy Transfer Partners, L.P.

We have audited the accompanying consolidated balance sheet of Heritage Propane Partners, L.P. (a Delaware limited partnership) and subsidiaries as of August 31, 2003 and the related consolidated statements of operations, comprehensive income, partners capital, and cash flows for the period ended January 19, 2004 and for the years ended August 31, 2003 and 2002. These financial statements are the responsibility of the Partnership s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Propane Partners, L.P. and subsidiaries as of August 31, 2003 and the results of their operations and their cash flows for the period ended January 19, 2004 and for the years ended August 31, 2003 and 2002, in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2 to the consolidated financial statements, effective September 1, 2002, the Partnership changed its method of accounting for stock-based compensation plans and adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation following the modified prospective method of adoption described in Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure.

/s/ Grant Thornton LLP

Tulsa, Oklahoma
November 11, 2004

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES
(HERITAGE)

CONSOLIDATED BALANCE SHEET
(in thousands, except unit data)

	August 31, 2003
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 7,117
Marketable securities	3,044
Accounts receivable, net of allowance for doubtful accounts	35,879
Inventories	45,274
Assets from liquids marketing	83
Prepaid expenses and other	2,741
Total current assets	94,138
PROPERTY, PLANT AND EQUIPMENT, net	426,588
INVESTMENT IN AFFILIATES	8,694
GOODWILL	156,595
INTANGIBLES AND OTHER ASSETS, net	52,824
Total assets	$738,839
LIABILITIES AND PARTNERS CAPITAL	
CURRENT LIABILITIES:	
Working capital facility	$ 26,700
Accounts payable	43,690
Accounts payable to related companies	6,255
Accrued and other current liabilities	35,993
Liabilities from liquids marketing	80
Current maturities of long-term debt	38,309
Total current liabilities	151,027
LONG-TERM DEBT, less current maturities	360,762
MINORITY INTERESTS	4,002
	515,791

COMMITMENTS AND CONTINGENCIES	
PARTNERS CAPITAL:	
Common Unitholders (18,013,229 units issued and outstanding)	221,207
Class C Unitholders (1,000,000 units issued and outstanding)	
General Partner	2,190
Accumulated other comprehensive loss	(349)
Total partners capital	223,048
Total liabilities and partners capital	$738,839

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

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES
(HERITAGE)

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per unit and unit data)

	For the Period Ended January 19, 2004	For the Years Ended August 31, 2003	For the Years Ended August 31, 2002
REVENUES:			
Retail fuel	$ 221,459	$ 463,392	$ 365,334
Wholesale fuel	20,596	47,366	41,204
Liquids marketing, net	369	1,333	542
Other	27,928	59,385	55,245
Total revenues	270,352	571,476	462,325
COSTS AND EXPENSES:			
Cost of products sold	148,329	297,156	238,185
Operating expenses	60,735	152,131	133,203
Depreciation and amortization	15,389	37,959	36,998
Selling, general and administrative	10,100	14,037	12,978
Total costs and expenses	234,553	501,283	421,364
OPERATING INCOME	35,799	70,193	40,961
OTHER INCOME (EXPENSE):			
Interest expense	(12,754)	(35,740)	(37,341)
Equity in earnings of affiliates	496	1,371	1,338
Gain (loss) on disposal of assets	(240)	430	812
Other	(66)	(3,213)	(294)
INCOME BEFORE MINORITY INTERESTS AND INCOME TAXES	23,235	33,041	5,476
Minority interests	(572)	(876)	(574)
NET INCOME BEFORE INCOME TAXES	22,663	32,165	4,902
Income taxes	20	1,023	

NET INCOME	22,643	31,142	4,902
GENERAL PARTNER S INTEREST IN NET INCOME	551	1,319	918
LIMITED PARTNERS INTEREST IN NET INCOME	$ 22,092	$ 29,823	$ 3,984
BASIC NET INCOME PER LIMITED PARTNER UNIT	$ 1.21	$ 1.79	$ 0.25
BASIC AVERAGE NUMBER OF UNITS OUTSTANDING	18,286,352	16,635,966	15,738,621
DILUTED NET INCOME PER LIMITED PARTNER UNIT	$ 1.21	$ 1.79	$ 0.25
DILUTED AVERAGE NUMBER OF UNITS OUTSTANDING	18,333,036	16,694,343	15,777,307

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

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES
(HERITAGE)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	For the Period Ended January 19, 2004	For the Years Ended August 31, 2003	2002
Net income	$ 22,643	$31,142	$ 4,902
Other comprehensive income (loss)			
Reclassification adjustment for losses or gains on derivative instruments included in net income		(553)	
Reclassification adjustment for losses on available-for-sale securities included in net income		2,823	
Change in value of derivative instruments		553	4,464
Change in value of available-for-sale securities	(533)	480	(1,575)
Comprehensive income	$ 22,110	$34,445	$ 7,791
Reconciliation of Accumulated Other Comprehensive Loss			
Balance, beginning of period	$ (349)	$ (3,652)	$(6,541)
Current period reclassification to earnings		2,270	7,016
Current period change	(533)	1,033	(4,127)
Balance, end of period	$ (882)	$ (349)	$(3,652)

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

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES (HERITAGE)

CONSOLIDATED STATEMENTS OF PARTNERS CAPITAL
(in thousands, except unit data)

	Number of Units			
	Common	Class B Subordinated	Class C	Common
Balance, August 31, 2001	14,260,316	1,382,514	1,000,000	$190,548
Unit distribution				(38,159)
Conversion of Phantom Units	11,750			
Conversion of Subordinated Units	1,382,514	(1,382,514)		15,137
Issuance of units upon conversion of minority interest	162,913			1,729
General Partner capital contribution	(1,646)			(32)
Net change in accumulated other comprehensive loss per accompanying statements				
Other				1,821
Net income				2,633
Balance, August 31, 2002	15,815,847		1,000,000	173,677
Unit distribution				(42,042)
Issuance of Common Units	1,610,000			44,547
Conversion of Phantom Units	2,500			
Issuance of Common Units in connection with the Long-term incentive plan	66,118			
Issuance of Common Units in connection with certain acquisitions	551,456			15,000
General Partner capital contribution	(32,692)			(957)
Net change in accumulated other comprehensive loss per accompanying statements				
Other				1,159
Net income				29,823
Balance, August 31, 2003	18,013,229		1,000,000	221,207
Unit distribution				(23,696)
Conversion of Phantom Units	14,800			
Issuance of Common Units in connection with certain acquisitions	505,826			17,116
General Partner capital contribution				

Net change in accumulated other comprehensive loss per accompanying statements				
Other				1,232
Net income				22,092
Balance, January 19, 2004	18,533,855		1,000,000	$237,951

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Class B Subordinated	Class C	General Partner	Accumulated Other Comprehensive Income (Loss)	Total
Balance, August 31, 2001	$ 15,532	$	$ 1,875	$ (6,541)	$201,414
Unit distribution	(1,746)		(1,240)		(41,145)
Conversion of Phantom Units					
Conversion of Subordinated Units	(15,137)				
Issuance of units upon conversion of minority interest					1,729
General Partner capital contribution			32		
Net change in accumulated other comprehensive loss per accompanying statements				2,889	2,889
Other					1,821
Net income	1,351	—	918		4,902
Balance, August 31, 2002			1,585	(3,652)	171,610
Unit distribution			(1,342)		(43,384)
Issuance of Common Units					44,547
Conversion of Phantom Units					
Issuance of Common Units in connection with the Long-term incentive plan					
Issuance of Common Units in connection with certain acquisitions					15,000
General Partner capital contribution			628		(329)
Net change in accumulated other comprehensive loss per accompanying statements				3,303	3,303

Other					1,159
Net income			1,319		31,142
Balance, August 31, 2003			2,190	(349)	223,048
Unit distribution			(887)		(24,583)
Conversion of Phantom Units					
Issuance of Common Units in connection with certain acquisitions					17,116
General Partner capital contribution			180		180
Net change in accumulated other comprehensive loss per accompanying statements				(533)	(533)
Other					1,232
Net income			551		22,643
Balance, January 19, 2004	$	$	$ 2,034	$ (882)	$239,103

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

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES
(HERITAGE)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Period Ended January 19, 2004	For the Years Ended August 31, 2003	For the Years Ended August 31, 2002
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 22,643	$ 31,142	$ 4,902
Reconciliation of net income to net cash provided by operating activities-			
Depreciation and amortization	15,389	37,959	36,998
Provision for loss on accounts receivable	449	2,578	887
Loss on write down of marketable securities		2,823	
(Gain) loss on disposal of assets	240	(430)	(812)
Deferred compensation on restricted units and long- term incentive plan	1,232	1,159	1,878
Undistributed earnings of affiliates	(35)	(836)	(938)
Minority interests	491	(48)	(111)
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(29,745)	(4,066)	9,180
Inventories	(37,850)	4,855	17,827
Assets from liquids marketing	82	2,218	4,164
Prepaid and other expenses	(6,262)	4,177	8,086
Intangibles and other assets	(2,019)	238	1,197
Accounts payable	56,296	3,115	(4,094)
Accounts payable to related companies	(6,620)	1,253	(2,935)
Accrued and other current liabilites	555	10,800	(5,464)
Liabilities from liquids marketing	(80)	(1,738)	(5,312)
Net cash provided by operating activities	14,766	95,199	65,453
CASH FLOWS FROM INVESTING ACTIVITIES:			
Cash paid for acquisitions, net of cash acquired	(22,490)	(24,956)	(19,742)
Capital expenditures	(19,760)	(27,294)	(27,072)
Proceeds from the sale of assets	772	3,861	13,336
Investment in marketable securities			(29)
Other			95
Net cash used in investing activities	(41,478)	(48,389)	(33,412)

CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	239,359	173,678	164,715
Principal payments on debt	(170,539)	(219,282)	(156,584)
Net proceeds from issuance of Common Units		44,547	
Unit distributions	(24,583)	(43,384)	(41,145)
Other	180	152	(57)
Net cash provided by (used in) financing activities	44,417	(44,289)	(33,071)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	17,705	2,521	(1,030)
CASH AND CASH EQUIVALENTS, beginning of period	7,117	4,596	5,626
CASH AND CASH EQUIVALENTS, end of period	$ 24,822	$ 7,117	$ 4,596

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES
(HERITAGE)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Period Ended January 19, 2004	For the Years Ended August 31,	
		2003	2002
NONCASH FINANCING ACTIVITIES:			
Notes payable incurred on noncompete agreements	$ 6,914	$ 948	$ 2,737
Issuance of Common Units in connection with certain acquisitions	$ 17,116	$ 15,000	$
Issuance of Common Units upon conversion of minority interest	$	$	$ 1,729
General Partner capital contribution	$	$ 329	$
Conversion of equity investment in Bi State Partnership to wholly owned subsidiary upon purchase of remaining 50% that was not previously owned by Heritage	$ 8,249	$	$
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the period for interest	$ 12,261	$ 35,315	$ 37,610
Cash paid during the period for income taxes	$ 46	$ 523	$

The accompanying notes are an integral part of these financial statements

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HERITAGE PROPANE PARTNERS, L.P. AND SUBSIDIARIES (HERITAGE)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in thousands, except unit and per unit data)

1. OPERATIONS AND ORGANIZATION:

Energy Transfer Transactions

On January 20, 2004, Heritage Propane Partners, L.P., (Heritage) and La Grange Energy, L.P. (La Grange Energy) completed the series of transactions whereby La Grange Energy contributed its subsidiary, La Grange Acquisition, L.P. and its subsidiaries who conduct business under the assumed name of Energy Transfer Company, (ETC OLP) to Heritage in exchange for cash of $300,000 less the amount of Energy Transfer Company debt in excess of $151,500, less ETC OLP s accounts payable and other specified liabilities, plus agreed upon capital expenditures paid by La Grange Energy relating to the ETC OLP business prior to closing, $433,909 of Heritage Common and Class D Units, and the repayment of the ETC OLP debt of $151,500. These transactions and the other transactions described in the following paragraphs are referred to herein as the Energy Transfer Transactions. In conjunction with the Energy Transfer Transactions and prior to the contribution of ETC OLP to Heritage, ETC OLP distributed its cash and accounts receivables to La Grange Energy and an affiliate of La Grange Energy contributed an office building to ETC OLP. La Grange Energy also received 3,742,515 Special Units as consideration for the project it had in progress to construct the Bossier Pipeline.

Simultaneously with the Energy Transfer Transactions, La Grange Energy obtained control of Heritage by acquiring all of the interest in U.S. Propane, L.P., (U.S. Propane) the General Partner of Heritage, and U.S. Propane, L.P. s general partner, U.S. Propane, L.L.C., from subsidiaries of AGL Resources, Atmos Energy Corporation, TECO Energy, Inc. and Piedmont Natural Gas Company, Inc. for $30,000 (the General Partner Transaction). In conjunction with the General Partner Transaction, U.S. Propane L.P. contributed its 1.0101% General Partner interest in Heritage Operating, L.P. (HOLP) to Heritage in exchange for an additional 1% General Partner interest in Heritage. Simultaneously with these transactions, Heritage purchased the outstanding stock of Heritage Holdings, Inc. (Heritage Holdings) for $100,000.

Concurrent with the Energy Transfer Transactions, La Grange Acquisition borrowed $325,000 from financial institutions and Heritage raised $355,948 of gross proceeds net of underwriter s discount through the sale of 9,200,000 Common Units at an offering price of $38.69 per unit. The net proceeds were used to finance the transaction and for general partnership purposes.

Accounting treatment of the Energy Transfer Transactions

The Energy Transfer Transactions were accounted for as a reverse acquisition in accordance with SFAS 141. Although Heritage Propane Partners, L.P. is the surviving parent entity for legal purposes, ETC OLP is the acquirer for accounting purposes. As a result, ETC OLP s historical financial statements are now the historical financial statements of the registrant. The operations of Heritage Propane Partners, L.P. prior to the ETC OLP Transaction are referred to as Heritage. On February 12, 2004, the Board of Directors of Heritage Propane Partners, L.P. s General Partner voted to change the name of Heritage Propane Partners, L.P. to Energy Transfer Partners, L.P. The assets and liabilities and results of operations of Heritage as of January 19, 2004 are included in the financial statements of the surviving parent entity, Energy Transfer Partners, L.P.

Business Operations

In order to simplify the Heritage s obligations under the laws of several jurisdictions in which it conducts business, the Partnership s activities are conducted through a subsidiary operating partnership, Heritage Operating, L.P. (the Operating Partnership). The Partnership and the Operating Partnership are collectively referred to in this report as Heritage. Heritage sells propane and propane-related products to more than 650,000 active residential, commercial, industrial, and agricultural customers from over 310 customer service locations in 32 states. Heritage is also a wholesale propane supplier in the United States and in Canada, the latter through participation in MP Energy Partnership. MP Energy Partnership is a Canadian partnership, in which Heritage owns a 60% interest, engaged in lower-margin wholesale distribution and in supplying Heritage s northern U.S. locations. Heritage buys and sells financial instruments for its own account through its wholly owned subsidiary, Heritage Energy Resources, L.L.C. (Resources).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BALANCE SHEET DETAIL:

Principles of Consolidation

The consolidated financial statements of Heritage include the accounts of its subsidiaries, including Heritage Operating and its subsidiaries. At August 31, 2003, Heritage accounted for its 50% partnership interest in Bi-State Propane, (Bi-State) a propane retailer in the states of Nevada and California, under the equity method. On December 24, 2003, Heritage acquired the remaining 50% of Bi-State that it did not previously own, thereby making Bi-State a wholly owned subsidiary of Heritage.

For purposes of maintaining partner capital accounts, the Partnership Agreement of Heritage (the Partnership Agreement) specifies that items of income and loss shall be allocated among the partners in accordance with their percentage interests. Normal allocations according to percentage interests are made, however, only after giving effect to any priority income allocations in an amount equal to the incentive distributions that are allocated 100% to the General Partner. The 1.0101% general partner interest in the Operating Partnership held by the General Partner, U.S. Propane, L.P. (U.S. Propane), is accounted for in the consolidated financial statements of Heritage as a minority interest.

Revenue Recognition

Sales of propane, propane appliances, parts, and fittings are recognized at the later of the time of delivery of the product to the customer or the time of sale or installation. Revenue from service labor is recognized upon completion of the service and tank rent is recognized ratably over the period it is earned. Shipping and handling revenues are included in the price of propane charged to customers, and thus are classified as revenues.

Costs and Expenses

Costs of products sold include actual cost of fuel sold adjusted for the effects of qualifying cash flow hedges, storage fees and inbound freight, and the cost of appliances, parts, and fittings. Operating expenses include all costs incurred to provide products to customers, including compensation for operations personnel, insurance costs, vehicle maintenance, advertising costs, shipping and handling costs, purchasing costs, and plant operations. Selling, general and administrative expenses include all corporate expenses and compensation for corporate personnel.

Cash and Cash Equivalents

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

Marketable Securities

Heritage s marketable securities are classified as available-for-sale securities and are reflected as a current asset on the consolidated balance sheet at their fair value. During the year ended August 31, 2003, Heritage determined there was a non-temporary decline in the market value of its available-for-sale securities, and reclassified into earnings a loss of $2,823, which is net of minority interest and is recorded in other expense. Unrealized holding gains (losses) of $480 and $(1,575) for the years ended August 31, 2003 and 2002, respectively, were recorded through accumulated other comprehensive income (loss) based on the market value of the securities.

Accounts Receivable

Heritage grants credit to its customers for the purchase of propane and propane-related products. Accounts receivable are recorded at amounts billed to customers less an allowance for doubtful accounts. The allowance for doubtful accounts is based on management s assessment of the realizability of customer accounts. Management s assessment is based on the overall creditworthiness of Heritage s customers and any specific disputes. Heritage recorded bad debt expense net of recoveries of $449, $2,578 and $887, for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively. Accounts receivable consisted of the following:

	August 31, 2003
Accounts receivable	$39,383
Less allowance for doubtful accounts	3,504
Total, net	$35,879

The activity in the allowance for doubtful accounts consisted of the following:

	Period Ended January 19, 2004	Years Ended August 31, 2003	2002
Balance, beginning of the period	$ 3,504	$ 2,504	$ 3,576
Provision for loss on accounts receivable	449	2,578	887
Accounts receivable written off, net of recoveries	(449)	(1,578)	(1,959)
Balance, end of period	$ 3,504	$ 3,504	$ 2,504

Inventories

Inventories are valued at the lower of cost or market. The cost of fuel inventories is determined using weighted-average cost of fuel delivered to the retail districts and includes storage fees and inbound freight costs, while the cost of appliances, parts, and fittings is determined by the first-in, first-out method. Inventories consisted of the following:

	August 31, 2003
Fuel	$34,544
Appliances, parts and fittings	10,730
Total inventories	$45,274

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Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are expensed as incurred. Expenditures to refurbish tanks that either extend the useful lives of the tanks or prevent environmental contamination are capitalized and depreciated over the remaining useful life of the tanks. Additionally, Heritage capitalizes certain costs directly related to the installation of company-owned tanks, including internal labor costs. Components and useful lives of property, plant and equipment were as follows:

	August 31, 2003
Land and improvements	$ 21,937
Buildings and improvements (10 to 30 years)	30,843
Bulk storage, equipment and facilities (3 to 30 years)	43,340
Tanks and other equipment (5 to 30 years)	327,193
Vehicles (5 to 10 years)	76,239
Furniture and fixtures (3 to 10 years)	11,164
Other (5 to 10 years)	3,578
	514,294
Less Accumulated depreciation	(99,563)
	414,731
Plus Construction work-in-process	11,857
Property, plant and equipment, net	$426,588

Intangibles and Other Assets

Intangibles and other assets are stated at cost net of amortization computed on the straight-line method. Heritage eliminates from its balance sheet any fully amortized intangibles and the related accumulated amortization. Components and useful lives of intangibles and other assets were as follows:

	August 31, 2003	
	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets		

Noncompete agreements (5 to 15 years)	$42,742	$(15,893)
Customer lists (15 years)	28,378	(6,356)
Financing costs (3 to 15 years)	4,225	(1,995)
Consulting agreements (2 to 7 years)	517	(367)
Total	75,862	(24,611)
Unamortized intangible assets		
Trademarks	1,309	
Other assets	264	
Total intangibles and other assets	$77,435	$(24,611)

Aggregate amortization expense of intangible assets was $2,927, $7,811, and $8,152 for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively.

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Goodwill

Goodwill is associated with acquisitions made for Heritage s domestic retail segment; therefore, all goodwill is recorded in this segment. Of the $156,595 balance in goodwill, $23,923 is expected to be tax deductible. Goodwill is tested for impairment at the end of each fiscal year end in accordance with SFAS 142. The changes in the carrying amount of goodwill for the year ended August 31, 2003 were as follows:

Balance as of August 31, 2002	155,735
Goodwill acquired during the year	860
Impairment losses	
Balance as of August 31, 2003	156,595

Long-Lived Assets

Heritage reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such a review should indicate that the carrying amount of long-lived assets is not recoverable, Heritage reduces the carrying amount of such assets to fair value. No impairment of long-lived assets was recorded during the period ended January 19, 2004, or the years ended August 31, 2003 and 2002.

Accrued and Other Current Liabilities

Accrued and other current liabilities consisted of the following:

	August 31, 2003
Interest payable	$ 4,485
Wages and payroll taxes	4,932
Deferred tank rent	4,080
Advanced budget payments and unearned revenue	15,417
Customer deposits	2,137
Taxes other than income	2,405
Income taxes	500
Other	2,037
Accrued and other current liabilities	$35,993

Income Taxes

Heritage is a master limited partnership. As a result, Heritage s earnings or losses for federal and state income tax purposes are included in the tax returns of the individual partners. Accordingly, no recognition has been given to income taxes in the accompanying financial statements of Heritage except those incurred by corporate subsidiaries of Heritage that are subject to income taxes. On May 31, 2003 Guilford Gas Service, Inc., one of the Heritage s taxable subsidiaries was merged with the Operating Partnership. Taxes recorded in connection with this liquidation were approximately $250. Net earnings for financial statement purposes may differ significantly from taxable income reportable to unitholders as a result of differences between the tax basis and financial reporting basis of assets and liabilities and the taxable income allocation requirements under the Partnership Agreement. As of August 31, 2003 there was a liability of $500 recorded for income taxes incurred by Heritage s corporate subsidiaries.

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Income Per Limited Partner Unit

Basic net income per limited partner unit is computed by dividing net income, after considering the General Partner s interest, by the weighted average number of Common Units outstanding. Diluted net income per limited partner unit is computed by dividing net income, after considering the General Partner s interest, by the weighted average number of Common Units outstanding and, if dilutive, the weighted average number of restricted units (Phantom Units) outstanding under the Restricted Unit Plan. A reconciliation of net income and weighted average units used in computing basic and diluted net income per unit is as follows:

	Period Ended January 19, 2004	Years Ended August 31, 2003	Years Ended August 31, 2002
Basic Net Income per Limited Partner Unit:			
Limited Partners interest in net income	$ 22,092	$ 29,823	$ 3,984
Weighted average limited partner units	18,286,352	16,635,966	15,738,621
Basic net income per limited partner unit	$ 1.21	$ 1.79	$ 0.25
Diluted Net Income per Limited Partner Unit:			
Limited partners interest in net income	$ 22,092	$ 29,823	$ 3,984
Weighted average limited partner units	18,286,352	16,635,966	15,738,621
Dilutive effect of phantom units	46,684	58,377	38,686
Weighted average limited partner units, assuming dilutive effect of phantom units	18,333,036	16,694,343	15,777,307
Diluted net income per limited partner unit	$ 1.21	$ 1.79	$ 0.25

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Some of the more significant estimates made by management include, but are not limited to, allowances for doubtful accounts, derivative hedging instruments, liquids marketing assets and liabilities, purchase accounting allocations and subsequent realizability of intangible assets, and general business and medical self-insurance reserves. Actual results could differ from those estimates.

Fair Value

The carrying amounts of accounts receivable and accounts payable approximate their fair value. Based on the estimated borrowing rates currently available to Heritage for long-term loans with similar terms and average maturities, the aggregate fair value and carrying amount of long-term debt at August 31, 2003 was $421,579 and $399,071, respectively.

Stock Based Compensation Plans

During the fourth quarter of 2003, Heritage adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 *Accounting for Stock-based Compensation* (SFAS 123) effective as of September 1, 2002. Heritage applied the fair value recognition provisions following the modified prospective method of adoption described in Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148).

SFAS 123 requires that significant assumptions be used during the year to estimate the fair value, which includes the risk-free interest rate used, the expected life of the grants under each of the plans and the expected distributions on each of the grants. Heritage assumed a weighted average risk free interest rate of 6.29% for the period ended January 19, 2004, 5.72% for the year ended August 31, 2003, and 6.18% for the year ended August 31, 2002 in estimating the present value of the future cash flows of the distributions during the vesting period on the measurement date of each grant. Annual average cash distributions at the grant date were estimated to be $2.70 for the period ended January 19, 2004, $2.39 for the year ended August 31, 2003, and $2.37 for the year ended August 31, 2002. The expected life of each grant is assumed to be the minimum vesting period under certain performance criteria of each grant.

Accounting for Derivative Instruments and Hedging Activities

Heritage applies Financial Accounting Standards Board (FASB) Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). SFAS 133 requires that all derivatives be recognized in the balance sheet as either an asset or liability measured at fair value. Special accounting for qualifying hedges allows a derivative s gains and losses to offset related results on the hedged item in the statement of operations. There were no such financial instruments outstanding as of August 31, 2003.

Heritage buys and sells derivative financial instruments, which are within the scope of SFAS 133 and that are not designated as accounting hedges. Heritage also enters into energy trading contracts, which are not derivatives, and therefore are not within the scope of SFAS 133. EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 98-10), applied to energy trading contracts not within the scope of SFAS 133 that were entered into prior to October 25, 2002. The types of contracts Heritage utilizes in its liquids marketing segment include energy commodity forward contracts, options, and swaps traded on the over-the-counter financial markets. In accordance with the provisions of SFAS 133, derivative financial instruments utilized in connection with Heritage s liquids marketing activity are accounted for using the mark-to-market method. Additionally, all energy trading contracts entered into prior to October 25, 2002 were accounted for using the mark-to-market method in accordance with the provisions of EITF 98-10. Under the mark-to-market method of accounting, forwards, swaps, options, and storage contracts are reflected at fair value, and are shown in the consolidated balance sheet as assets and liabilities from liquids marketing activities. As of August 31, 2002, Heritage adopted the applicable provisions of EITF Issue No. 02-3, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF 02-3), which requires that gains and losses on derivative instruments be shown net in the statement of operations if the derivative instruments are held for trading purposes. Net realized and unrealized gains and losses from the financial contracts and the impact of price movements are recognized in the statement of operations as liquids marketing revenue. Changes in the assets and liabilities from the liquids marketing activities result primarily from changes in the market prices, newly originated transactions, and the timing and settlement of contracts. EITF 02-3 also rescinds EITF 98-10 for all energy trading contracts entered into after October 25, 2002 and specifies certain disclosure requirements. Consequently, Heritage does not apply mark-to-market accounting for any contracts entered into after October 25, 2002, that are not within the scope of SFAS 133. Heritage attempts to balance its contractual portfolio in terms of notional amounts and timing of performance and delivery obligations. However, net unbalanced positions can exist or are established based on management s assessment of anticipated market movements.

The notional amounts and terms of these financial instruments as of August 31, 2003 include fixed price payor for 45 barrels of propane and fixed price receiver of 195 barrels of propane, respectively. Notional amounts reflect the volume of the transactions, but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure Heritage s exposure to market or credit risks.

Estimates related to Resource s liquids marketing activities are sensitive to uncertainty and volatility inherent in the energy commodities markets and actual results could differ from these estimates. A theoretical change of 10% in the underlying commodity value of the liquids marketing contracts would result in an approximate $345 change in the market value of the contracts as there were approximately 6.3 million gallons of net unbalanced positions at August 31, 2003.

Inherent in the resulting contractual portfolio are certain business risks, including market risk and credit risk. Market risk is the risk that the value of the portfolio will change, either favorably or unfavorably, in response to changing market conditions. Credit risk is the risk of loss from nonperformance by suppliers, customers, or financial counterparties to a contract. Heritage and Resources take active roles in managing and controlling market and credit risk and have established control procedures, which are reviewed on an ongoing basis. Heritage monitors

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market risk through a variety of techniques, including routine reporting to senior management. Heritage attempts to minimize credit risk exposure through credit policies and periodic monitoring procedures.

The following table summarizes the fair value of Resources contracts, aggregated by method of estimating fair value of the contracts as of August 31, 2003 where settlement had not yet occurred. Resources contracts all have a maturity of less than 1 year. The market prices used to value these transactions reflect management s best estimate considering various factors including closing average spot prices for the current and outer months plus a differential to consider time value and storage costs.

Source of Fair Value	August 31, 2003
Prices actively quoted	$ 80
Prices based on other valuation methods	3
Assets from liquids marketing	$ 83
Prices actively quoted	$ 80
Prices based on other valuation methods	
Liabilities from liquids marketing	$ 80
Unrealized gains (losses)	$ 3

The following table summarizes the changes in the unrealized fair value of Resources contracts where settlement had not yet occurred for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002.

	January 19, 2004	August 31, 2003	August 31, 2002
Unrealized gains (losses) in fair value of contracts outstanding at the beginning of the period	$ 3	$ 483	$ (665)
Unrealized gains (losses) recognized at inception of contracts			
Unrealized gains (losses) recognized as a result of changes in valuation techniques and assumptions			
Other unrealized gains (losses) recognized during the period	366	850	1,207

Less: Realized gains (losses) recognized during the period	369	1,330	59
Unrealized gains (losses) in fair value of contracts outstanding at the end of the period	$	$ 3	$ 483

The following table summarizes the gross transaction volumes in barrels for liquids marketing contracts that were physically settled for the period ended January 19, 2004 and the years ended August 31, 2003, and 2002:

	(in thousands)
Period ended January 19, 2004	29
Fiscal year ended August 31, 2003	181
Fiscal year ended August 31, 2002	350

3. ACQUISITIONS:

During the period ended January 19, 2004, Heritage acquired the assets of Big Sky Petroleum, Archibald Propane, Moore-L.P. Gas, Inc., Sunbeam L.P., Gas, Inc. Metro Lift Propane, and two other small companies. Heritage also acquired the 50% interest in Bi-State Propane that it did not previously own. The aggregate purchase price for these

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acquisitions was $47,989 which included $22,490 in cash, $17,116 in Common Units issued, and $8,383 liabilities assumed and non-compete agreements.

On January 2, 2003, Heritage purchased the propane assets of V-1 Oil Co. (V-1) of Idaho Falls, Idaho for total consideration of $35.4 million after post-closing adjustments. The acquisition price was payable $20.0 million in cash, with $17.3 million of that amount financed by the Acquisition Facility, and by the issuance of 551,456 Common Units of Heritage valued at $15.0 million, and assumed $0.4 million in liabilities. V-1 s propane distribution network included 35 customer service locations in Colorado, Idaho, Montana, Oregon, Utah, Washington, and Wyoming. Heritage was able to expand its market presence in the Northwest and achieve a greater geographical balance through the transaction with V-1. This acquisition enhanced Heritage s current operations and reduced costs through synergies with existing operations in locations in which Heritage was already conducting business. The results of operations of V-1 from January 2, 2003 to August 31, 2003 are included in the consolidated statement of operations of Heritage for the year ended August 31, 2003.

The following unaudited pro forma consolidated results of operations are presented as if the acquisition of V-1 had been made at the beginning of the period presented:

	Year ended August 31, 2003	**Year ended August 31, 2002**
Total revenues	$582,690	$494,805
Limited partners interest in net income	$ 31,430	$ 6,806
Basic net income per limited partner unit	$ 1.89	$ .42
Diluted net income per limited partner unit	$ 1.88	$ .42

The pro forma consolidated results of operations include adjustments to give effect to depreciation on the step-up of property, plant and equipment, amortization of customer lists, interest expense on acquisition debt, and certain other adjustments. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the transactions been made at the beginning of the periods presented or the future results of the combined operations. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed of V-1 as of the date of acquisition:

Current assets	$ 4,952
Property, plant, & equipment	29,324
Goodwill	20
Customer lists (15 years)	740
Trademarks	370
Total assets acquired	$35,406
Total liabilities assumed	(423)
Net assets acquired	$34,983

Of the total amount assigned to goodwill, $20 is expected to be deductible for tax purposes.

During the year ended August 31, 2003, Heritage also acquired substantially all of the assets of four other companies, which included V-1 Oil Company of Spokane, Washington, Stegall Petroleum located in North Carolina, 1st Propane of Boise Idaho, and Love Propane Gas located in South Carolina. Heritage also purchased the stock of Tri-Cities Gas Company, Inc. located in Alabama. The aggregate purchase price for these acquisitions totaled $6.4 million, which included liabilities assumed and non-compete agreements of $1.4 million for periods ranging from five to ten years. In the aggregate, these acquisitions are not material for proforma disclosure purposes. These acquisitions were financed primarily with the acquisition facility and were accounted for by the purchase method under SFAS 141. Heritage has historically accounted for business combinations using the purchase method; therefore, the guidelines of SFAS 141 did not have a significant impact on how Heritage accounted for these acquisitions.

During the year ended August 31, 2002, Heritage purchased the stock of Virginia Gas Propane Company, Inc., in Virginia, Mt. Pleasant Propane, Inc. in Tennessee and two other smaller companies. Heritage also acquired substantially all of the assets of six companies, which included Tri-County Propane, Inc., located in North Carolina, Franconia Gas Corporation located in New Hampshire and Quality Gas, Inc. also located in North Carolina. The aggregate purchase price for these acquisitions totaled $24,915, which included liabilities assumed and non-compete agreements of $5.2 million for periods ranging from five to ten years. In the aggregate, these acquisitions are not material for pro forma disclosure purposes. These acquisitions were financed primarily with the acquisition facility and were accounted for by the purchase method under SFAS 141.

Heritage recorded the following intangible assets in conjunction with these acquisitions as of August 31, 2003:

Customer lists (15 years)	$1,166
Non-compete agreements (5 to 10 years)	769
Total amortized intangible assets	1,935
Trademarks and trade names	381
Goodwill	860
Other assets	
Total intangible assets acquired	$3,176

Goodwill was warranted because these acquisitions enhance Heritage s current operations and certain acquisitions are expected to reduce costs through synergies with existing operations. Heritage assigned all of the goodwill acquired to the retail-operating segment of Heritage. The results of operations from these acquisitions are included on Heritage s statement of operations from the dates acquired.

4. WORKING CAPITAL FACILITY AND LONG-TERM DEBT:

Long-term debt consists of the following:

	August 31, 2003
1996 8.55% Senior Secured Notes	$96,000
1997 Medium Term Note Program:	
7.17% Series A Senior Secured Notes	12,000
7.26% Series B Senior Secured Notes	20,000
6.50% Series C Senior Secured Notes	2,143
2000 and 2001 Senior Secured Promissory Notes:	
8.47% Series A Senior Secured Notes	16,000
8.55% Series B Senior Secured Notes	32,000
8.59% Series C Senior Secured Notes	27,000
8.67% Series D Senior Secured Notes	58,000
8.75% Series E Senior Secured Notes	7,000

8.87% Series F Senior Secured Notes	40,000
7.21% Series G Senior Secured Notes	19,000
7.89% Series H Senior Secured Notes	8,000
7.99% Series I Senior Secured Notes	16,000
Senior Revolving Acquisition Facility	24,700
Notes Payable on noncompete agreements with interest imputed at rates averaging 7.38%, due in installments through 2010, collateralized by a first security lien on certain assets of Heritage	20,110

	August 31, 2003
Other	1,118
Current maturities of long-term debt	(38,309)
	$360,762

Maturities of the Senior Secured Notes, the Medium Term Note Program and the Senior Secured Promissory Notes are as follows:

1996 8.55% Senior Secured Notes:

mature at the rate of $12,000 on June 30 in each of the years 2002 to and including 2011. Interest is paid semi-annually.

1997 Medium Term Note Program:

Series A Notes: mature at the rate of $2,400 on November 19 in each of the years 2005 to and including 2009. Interest is paid semi-annually.

Series B Notes: mature at the rate of $2,000 on November 19 in each of the years 2003 to and including 2012. Interest is paid semi-annually.

Series C Notes: mature at the rate of $714 on March 13 in each of the years 2000 to and including 2003, $357 on March 13, 2004, $1,073 on March 13, 2005, and $357 in each of the years 2006 and 2007. Interest is paid semi-annually.

2000 and 2001 Senior Secured Promissory Notes:

Series A Notes: mature at the rate of $3,200 on August 15 in each of the years 2003 to and including 2007. Interest is paid quarterly.

Series B Notes: mature at the rate of $4,571 on August 15 in each of the years 2004 to and including 2010. Interest is paid quarterly.

Series C Notes: mature at the rate of $5,750 on August 15 in each of the years 2006 to and including 2007, $4,000 on August 15, 2008 and $5,750 on August 15, 2009 to and including 2010. Interest is paid quarterly.

Series D Notes: mature at the rate of $12,450 on August 15 in each of the years 2008 and 2009, $7,700 on August 15, 2010, $12,450 on August 15, 2011 and $12,950 on August 15, 2012. Interest is paid quarterly.

Series E Notes: mature at the rate of $1,000 on August 15 in each of the years 2009 to and including 2015. Interest is paid quarterly.

Series F Notes:	mature at the rate of $3,636 on August 15 in each of the years 2010 to and including 2020. Interest is paid quarterly.
Series G Notes:	mature at the rate of $3,800 on May 15 in each of the years 2004 to and including 2008. Interest is paid quarterly. $7.5 million of these notes were retired during the fiscal year ended August 31, 2003.
Series H Notes:	mature at the rate of $727 on May 15 in each of the years 2006 to and including 2016. Interest is paid quarterly. $19.5 million of these notes were retired during the fiscal year ended August 31, 2003.
Series I Notes:	mature in one payment of $16,000 on May 15, 2013. Interest is paid quarterly.

The Senior Secured Notes, the Medium Term Note Program, and the Senior Secured Promissory Notes contain restrictive covenants including limitations on substantial disposition of assets, changes in ownership of Heritage, additional indebtedness, and require the maintenance of certain financial ratios. At August 31, 2003, Heritage was in compliance with these covenants or had no continuing defaults. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of Heritage s subsidiaries secure the notes.

The Note Agreements for each of the Senior Secured Notes, Medium Term Note Program and Senior Secured Promissory Notes, and the Bank Credit Facility contain customary restrictive covenants applicable to the Operating Partnership, including limitations on the level of additional indebtedness, creation of liens, and sale of assets. These covenants require the Operating Partnership to maintain ratios of Consolidated Funded Indebtedness to Consolidated

EBITDA (as these terms are similarly defined in the Bank Credit Facility and the Note Agreements) of not more than 5.00 to 1 for the Bank Credit Facility and not more than 5.25 to 1 for the Note Agreements and Consolidated EBITDA to Consolidated Interest Expense (as these terms are similarly defined in the Bank Credit Facility and the Note Agreements) of not less than 2.25 to 1. The Consolidated EBITDA used to determine these ratios is calculated in accordance with these debt agreements. For purposes of calculating the ratios under the Bank Credit Facility and the Note Agreements, Consolidated EBITDA is based upon Heritage s EBITDA, as adjusted for the most recent four quarterly periods, and modified to give pro forma effect for acquisitions and divestures made during the test period and is compared to Consolidated Funded Indebtedness as of the test date and the Consolidated Interest Expense for the most recent twelve months. These debt agreements also provide that the Operating Partnership may declare, make, or incur a liability to make, a restricted payment during each fiscal quarter, if: (a) the amount of such restricted payment, together with all other restricted payments during such quarter, do not exceed Available Cash with respect to the immediately preceding quarter; and (b) no default or event of default exists before such restricted payment and after giving effect thereto. The debt agreements further provide that Available Cash is required to reflect a reserve equal to 50% of the interest to be paid on the notes. In addition, in the third, second and first quarters preceding a quarter in which a scheduled principal payment is to be made on the notes, Available Cash is required to reflect a reserve equal to 25%, 50%, and 75%, respectively, of the principal amount to be repaid on such payment dates.

Failure to comply with the various restrictive and affirmative covenants of the Operating Partnership s Bank Credit Facility and the Note Agreements could negatively impact the Operating Partnership s ability to incur additional debt and/or Heritage s ability to pay distributions. The Operating Partnership is required to measure these financial tests and covenants quarterly and was in compliance or had no continuing defaults with all requirements, tests, limitations, and covenants related to the Senior Secured Notes, Medium Term Note Program and Senior Secured Promissory Notes, and the Bank Credit Facility at August 31, 2003.

Effective July 16, 2001, Heritage entered into the Fifth Amendment to the First Amended and Restated Credit Agreement (Bank Credit Facility). The terms of the Bank Credit Facility as amended are as follows:

A $65,000 Senior Revolving Working Capital Facility, expiring June 30, 2004 with $26,700 outstanding at August 31, 2003. The interest rate and interest payment dates vary depending on the terms Heritage agrees to when the money is borrowed. Heritage must be free of all working capital borrowings for 30 consecutive days each fiscal year. The weighted average interest rate was 2.49125% for the amount outstanding at August 31, 2003. The maximum commitment fee payable on the unused portion of the facility is 0.50%. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of Heritage s subsidiaries secure the Senior

Revolving Working Capital Facility.

A $50,000 Senior Revolving Acquisition Facility is available through December 31, 2003, at which time the outstanding amount must be paid in ten equal quarterly installments beginning March 31, 2004, with $24,700 outstanding as of August 31, 2003. The interest rate and interest payment dates vary depending on the terms Heritage agrees to when the money is borrowed. The weighted average interest rate was 2.49125% for the amount outstanding at August 31, 2003. The maximum commitment fee payable on the unused portion of the facility is 0.50%. All receivables, contracts, equipment, inventory, general intangibles, cash concentration accounts, and the capital stock of Heritage s subsidiaries secure the Senior Revolving Acquisition Facility.

Heritage entered into an amendment and restatement of the above described Bank Credit Facility effective as of December 31, 2003, which increased the amount available to be borrowed under each of the Working Capital Facility and the Acquisition Facility to up to $75 million and extended the maturity of each Facility to December 31, 2006.

Future maturities of long-term debt for each of the next five fiscal years and thereafter are $38,309 in 2004; $40,288 in 2005; $48,474 in 2006; $38,514 in 2007; $45,223 in 2008, and $188,263 thereafter.

5. COMMITMENTS AND CONTINGENCIES:

Certain property and equipment is leased under noncancelable leases, which require fixed monthly rental payments and expire at various dates through 2020. Rental expense under these leases totaled approximately $1,269, $2,997, and $2,977 for the period ended January 19, 2004 and the years ended August 31, 2003, and 2002, respectively, and has been included in operating expenses in the accompanying statements of operations. Certain of these leases contain renewal options and also contain escalation clauses, which are accounted for on a straight-line basis over the minimum lease term. Fiscal year future minimum lease commitments for such leases are $1,647 in 2004; $1,906 in 2005; $1,325 in 2006; $929 in 2007; $934 in 2008 and $846 thereafter.

The General Partner of Heritage had employment agreements with seven employees. The employment agreements provided for total annual base salary of $1,545. The employment agreements provided for the Executives to participate in bonus and incentive plans.

The Employment Agreements provided that in the event of a change of control of the ownership of the General Partner or in the event an Executive (i) is involuntarily terminated (other than for misconduct or disability) or (ii) voluntarily terminates employment for good reason (as defined in the agreements), such Executive will be entitled to continue receiving his base salary and to participate in all group health insurance plans and programs that may be offered to executives of the General Partner for the remainder of the term of the Employment Agreement or, if earlier, the Executive s death, and the Executive will vest immediately in the Minimum Award of the number of Common Units to which the Executive is entitled under the Long Term Incentive Plan to the extent not previously awarded, and if the Executive is terminated as a result of the foregoing, all restrictions on the transferability of the units purchased by such executive under the Subscription Agreement dated as of June 15, 2000, shall automatically lapse in full on such date. Pursuant to the Energy Transfer Transactions, the change of control provisions of the Employment Agreements were triggered upon consummation of the acquisition by La Grange Energy of Heritage s General Partner, which resulted in the payment of approximately $1.6 million in salary and the issuance of 150,018 Common Units pursuant to their terms. In addition, pursuant to the terms of one of the Employment Agreements, an additional 20,000 Common Units were issued to a former officer following his retirement subsequent to January 19, 2004. Each Employment Agreement also provided that if any payment received by an Executive is subject to the 20% federal excise tax under Section 4999(a) of the Code of the Internal Revenue Service, the payment will be grossed up to permit the Executive to retain a net amount on an after-tax basis equal to what he would have received had the excise tax and all other federal and state taxes on such additional amount not been payable. In addition, each Employment Agreement contained non-competition and confidentiality provisions.

Heritage is a party to various legal proceedings incidental to its business. Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against Heritage. In the opinion of management, all such matters are either covered by insurance, are without merit or involve amounts, which, if resolved unfavorably, would not have a significant effect on the financial position or results of operations of Heritage. Once management determines that information pertaining to a legal proceeding indicates that it is probable that a liability has been incurred, an accrual is established equal to management s estimate of the likely exposure. For matters that are covered by insurance, Heritage accrues the related deductible. As of August 31, 2003, an accrual of $941 was recorded as accrued and other current liabilities on Heritage s consolidated balance sheet.

Petroleum-based contamination or environmental wastes are known to be located on or adjacent to six sites, on which Heritage presently has, or formerly had, operations. These sites were evaluated at the time of their acquisition. In all cases, remediation operations have been or will be undertaken by others, and in all six cases, Heritage obtained indemnification for expenses associated with any remediation from the former owners or related entities. Heritage has not been named as a potentially responsible party at any of these sites, nor has Heritage s operations contributed to the environmental issues at these sites. Accordingly, no amounts have been recorded in Heritage s August 31, 2003 consolidated balance sheet. Based on information currently available to Heritage, such projects are not expected to have a material adverse effect on Heritage s financial condition or results of operations.

In July 2001, Heritage acquired a company that had previously received a request for information from the U.S. Environmental Protection Agency (the EPA) regarding potential contribution to a widespread groundwater contamination problem in San Bernardino, California, known as the Newmark Groundwater Contamination. Although the EPA has indicated that the groundwater contamination may be attributable to releases of solvents from a former military base located within the subject area that occurred long before the facility acquired by Heritage was constructed, it is possible that the EPA may seek to recover all or a portion of groundwater remediation costs from private parties under the Comprehensive Environmental Response, Compensation, and Liability Act (commonly called Superfund). Based upon information currently available to Heritage, it is not believed that Heritage s liability if such action were to be taken by the EPA would have a material adverse effect on Heritage s financial condition or results of operations.

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6. PARTNERS CAPITAL:

The Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P. (Partnership Agreement) contains specific provisions for the allocation of net earnings and losses to each of the partners for purposes of maintaining the partner capital accounts.

On September 1, 2003 and October 25, 2003, an additional 1,500 and 13,300 Common Units, respectively, were issued by Heritage to holders of grants that had previously been awarded under the terms of the Partnership s Restricted Unit Plan.

On December 24, 2003 Heritage issued 413,180 Common Units, with a total value of $13,635 in exchange for certain assets acquired in connection with the acquisition of the remaining 50% of Bi State Propane that Heritage did not previously own, and on January 1, 2004 Heritage issued 92,646 Common Unit with a total value of $3,481 in exchange for certain assets acquired in connection with the acquisition of Metro Lift Propane.

On September 1, 2002 and April 14, 2003, an additional 500 and 2,000 Common Units, respectively, were issued by Heritage to holders of grants that had previously been awarded under the terms of the Partnership s Restricted Unit Plan. On August 10, 2003, Heritage issued 66,118 Common Units under the terms of Heritage s Long-Term Incentive Plan upon the attainment of the performance targets required for such awards.

On January 2, 2003, the Heritage issued 551,456 Common Units, with a total value of $15,000 in exchange for certain assets acquired in connection with the acquisition of the propane distribution assets of V-1 Oil Co.

On May 20, 2003, Heritage sold 1,610,000 Common Units in an underwritten public offering at a public offering price of $29.26 per unit. This sale included the exercise of the underwriters over-allotment option to purchase an additional 210,000 Common Units. Heritage used approximately $35.9 million of the $44.5 million net proceeds from the sale of the Common Units to repay a portion of the indebtedness outstanding under various tranches of its Senior Secured Notes. The remainder of the proceeds was used for general partnership purposes, including repayment of additional debt. To effect the transfer of the contribution required by the General Partner to maintain its 1% general partner interest in Heritage and its 1.0101% general partner interest in the Operating Partnership as a result of the offering, the General Partner contributed 32,692 previously issued Common Units back to Heritage and those units were cancelled.

Prior to February 4, 2002, Heritage had Class B Subordinated Units representing limited partner interests that were issued to certain former stockholders of Heritage Holdings, who are or were also members of management, in connection with the transaction with U.S. Propane. The Class B Subordinated Units had the same voting rights as the Subordinated Units outstanding before the end of the Subordination Period, and generally participated pro rata with the Common Units in Heritage s income, gains, losses, deductions, credits, and distributions. Each Class B Subordinated Unit was entitled to one vote on each matter with respect to which the Class B Subordinated Units were entitled to vote.

On February 4, 2002, at a special meeting of the Common Unitholders of the Registrant, the Common Unitholders approved the amendment of the Partnership Agreement that converted all of the 1,382,514 outstanding Class B Subordinated Units into 1,382,514 Common Units. The Common Units issued upon conversion of the Class B Subordinated Units share equally with other Common Units in distributions of Available Cash.

In conjunction with the Common Unitholder approval of the substitution of U.S. Propane as the General Partner of Heritage, Heritage issued 162,913 Common Units to the former General Partner Heritage Holdings in exchange for its 1.0101% general partner interest in the Operating Partnership. Heritage also issued 158,026 Common Units to Heritage Holdings in conversion of its 1% general partner interest in Heritage and cancelled 158,026 Common Units held by U.S. Propane upon their conversion into Incentive Distribution Rights and a 1% general partner interest in Heritage and 1,646 Common Units held by U.S. Propane to maintain its general partner interest in Heritage.

On September 1, 2001 and June 30, 2002, an additional 1,750 and 10,000 Common Units, respectively, were issued by Heritage to holders of grants that had previously been awarded under the terms of Heritage s Restricted Unit Plan.

In conjunction with the transaction with U.S. Propane and the change of control of the former General Partner, Heritage Holdings, Heritage issued 1,000,000 newly created Class C Units to Heritage Holdings in conversion of that portion of its Incentive Distribution Rights that entitled it to receive any distribution made by Heritage attributable to the net amount received in connection with the settlement, judgment, award or other final nonappealable resolution of the SCANA litigation filed by Heritage prior to the transaction with U.S. Propane. The Class C Units have zero initial capital account balance and were distributed by Heritage Holdings to its former stockholders in connection with the transaction with U.S. Propane. Thus, U.S. Propane will not receive any distributions made with respect to the SCANA litigation that would have gone to Heritage Holdings with respect to its General Partner interest and Incentive Distribution Rights had it remained the General Partner of Heritage. Upon receiving final cash payment as a result of the resolution of the SCANA litigation, the special litigation committee will determine the amount of litigation proceeds to be distributed, after deducting all costs and expenses of the litigation incurred by Heritage and its affiliates and such reserves as the special committee deems necessary or advisable. The resulting amount of distributable proceeds will be distributed in the same manner as Heritage s distribution of Available Cash pursuant to the Partnership Agreement, except that the amount that would normally be distributed to the holders of Incentive Distribution Rights will be distributed to the holders of Class C Units, pro rata. Each holder of Class C Units receiving a distribution of cash in any taxable year will be allocated items of gross income with respect to such taxable year in an amount equal to the cash distributed to the holder. Holders of Class C Units will not be allocated any other items of income, gain, loss deduction or credit and have no other rights except the right to share in any distributions upon dissolution and liquidation of the Partnership if such distributions consist of proceeds from the SCANA litigation and to which the Class C Units would have otherwise been entitled. The Class C Units may not be converted into any other unit. The Class C Units have no voting rights, except to the extent provided by Delaware law with respect to a vote as a class, in which case each Class C Unit will be entitled to one vote.

Quarterly Distributions of Available Cash

The Partnership Agreement requires that Heritage will distribute all of its Available Cash to its Unitholders and its General Partner within 45 days following the end of each fiscal quarter, subject to the payment of incentive distributions to the holders of Incentive Distribution Rights to the extent that certain target levels of cash distributions are achieved. The term Available Cash generally means, with respect to any fiscal quarter of Heritage, all cash on hand at the end of such quarter, plus working capital borrowings after the end of the quarter, less reserves established by the General Partner in its sole discretion to provide for the proper conduct of Heritage s business, to comply with applicable laws or any Heritage debt instrument or other agreement, or to provide funds for future distributions to partners with respect to any one or more of the next four quarters. Available Cash is more fully defined in the Partnership Agreement.

Prior to the Unitholder vote on February 4, 2002, distributions by Heritage in an amount equal to 100% of Available Cash were made 97% to the common and Class B Subordinated Unitholders, 1.0101% to U.S. Propane for its limited partner interest in the Operating Partnership and 1.9899% to the former General Partner, Heritage Holdings. After the Unitholder vote, distributions by Heritage in an amount equal to 100% of Available Cash will generally be made 98% to the Common Unitholders and 2% to U.S. Propane, subject to the payment of incentive distributions to the holders of Incentive Distribution Rights to the extent that certain target levels of cash distributions are achieved.

The Minimum Quarterly Distribution was made to the Common and Subordinated Unitholders for the quarters ended November 30, 1996 through August 31, 1998. For the quarter ended November 30, 1998, a quarterly distribution of $0.5125 was paid to the Common and Subordinated Unitholders. For each of the quarters ended February 28, 1999 through and including May 31, 2000, quarterly distributions of $0.5625 per unit were paid to the Common and Subordinated Unitholders. Heritage raised the quarterly distribution $0.0125 per unit for each of the six consecutive quarters beginning with the quarter ended August 31, 2000 through the quarter ended November 30, 2001. The distribution remained at $0.6375 per unit for each of the quarters ended February 28, 2002 through and including May 31, 2003. For each of the quarters ended August 31, 2003, through and including November 30, 2003, quarterly distributions of $0.65 per unit (or $2.60 annually) were paid to the Common Unitholders. The quarterly distributions for the quarters ended February 28, 1999 through November 30, 2003 included incentive distributions payable to the General Partner to the extent the quarterly distribution exceeded $0.55 per unit.

After the conversion of the Class B Subordinated Units was approved on February 4, 2002, each Class B Subordinated unit converted into one Common Unit and then participates pro rata with the other Common Units in distributions of Available Cash. Heritage currently distributes Available Cash, excluding any Available Cash to be distributed to the Class C Unitholders as follows:

First, 98% to all Unitholders, pro rata, and 2% to the General Partner, until all Unitholders have received $0.50 per unit for such quarter and any prior quarter;

Second, 98% to all Unitholders, pro rata, and 2% to the General Partner, until all Unitholders have received $0.55 per unit for such quarter;

Third, 85% to all Unitholders, pro rata, 13% to the holders of Incentive Distribution Right, pro rata, and 2% to the General Partner, until all Common Unitholders have received at least $0.635 per unit for such quarter;

Fourth, 75% to all Unitholders, pro rata, 23% to the holders of Incentive Distribution Right, pro rata and 2% to the General Partner, until all Common Unitholders have received at least $0.825 per unit for such quarter;

Fifth, thereafter 50% to all Unitholders, pro rata, 48% to the holders of Incentive Distribution Right, pro rata, and 2% to the General Partner.

The total amount of distributions paid during the period ended January 19, 2004 on Common Units, the general partner interests and the Incentive Distribution Rights totaled $12.0 million, $0.3 million and $0.3 million, respectively. All such distributions were made from Available Cash from Operating Surplus.

Restricted Unit Plan

The General Partner of Heritage has adopted the Amended and Restated Restricted Unit Plan dated August 10, 2000, amended February 4, 2002 as the Second Amended and Restated Restricted Unit Plan (the Restricted Unit Plan), for certain directors and key employees of the General Partner and its affiliates. The Restricted Unit Plan covers rights to acquire 146,000 Common Units. The right to acquire the Common Units under the Restricted Unit Plan, including any forfeiture or lapse of rights is available for grant to key employees on such terms and conditions (including vesting conditions) as the Compensation Committee of the General Partner shall determine. Each director shall automatically receive a Director s grant with respect to 500 Common Units on each September 1 that such person continues as a director. Newly elected directors are also entitled to receive a grant with respect to 2,000 Common Units upon election or appointment to the Board. Directors who are employees of U.S. Propane, TECO, Atmos Energy, Piedmont Natural Gas or AGL Resources or their affiliates are not entitled to receive a Director s grant of Common Units. Generally, the rights to acquire the Common Units will vest upon the later to occur of the three-year anniversary of the grant date, or on such terms as the Compensation Committee may establish, which may include the achievement of performance objectives. In the event of a change of control (as defined in the Restricted Unit Plan), all rights to acquire Common Units pursuant to the Restricted Unit Plan will immediately vest. Pursuant to the Energy Transfer Transactions, the change of control provisions of the Restricted Unit Plan were triggered, resulting in the early vesting of 21,600 units by Heritage. Individuals holding 4,500 grants waived their rights to early vesting under the change of control provisions.

The issuance of the Common Units pursuant to the Restricted Unit Plan is intended to serve as a means of incentive compensation for performance and not primarily as an opportunity to participate in the equity appreciation in respect of the Common Units. Therefore, no consideration will be payable by the plan participants upon vesting and issuance of the Common Units. As of January 19, 2004, 4,500 restricted units were outstanding and 14,300 were available for grants to non-employee directors and key employees. Deferred compensation expense of $668, $244 and $378 was recognized for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively.

Long-Term Incentive Plan

Effective September 1, 2000, Heritage adopted a long-term incentive plan whereby Common Units were to be awarded based on achieving certain targeted levels of Distributed Cash (as defined in the Long Term Incentive Plan) per unit. Awards under the program were made starting in 2003 based upon the average of the prior three years Distributed Cash per unit. A minimum of 250,000 Common Units and if certain targeted levels were achieved, a maximum of 500,000 Common Units could be awarded. In connection with the January 2004 acquisition of our general partner by La Grange Energy, L.P., the minimum award, reduced by the amount of previous awards and any amounts not awarded, vested, and a total of 150,018 Common Units were issued.

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Deferred compensation expense of $564, $915 and $1,500 was recognized for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively.

7. PROFIT SHARING AND 401(K) SAVINGS PLAN:

Heritage sponsors a defined contribution profit sharing and 401(k) savings plan (the Plan), which covers all employees subject to service period requirements. Contributions are made to the Plan at the discretion of the Board of Directors and are allocated to eligible employees as of the last day of the plan year based on their pro rata share of total contributions. Employer matching contributions are calculated using a discretionary formula based on employee contributions. Heritage did not recognize any expense under the profit sharing provision of the Plan for the period ended January 19, 2004 or during the years ended August 31, 2003 or 2002. Heritage made matching contributions of $956, $2,144, and $2,339 to the 401(k) savings plan for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively.

8. RELATED PARTY TRANSACTIONS:

Heritage has no employees and is managed by the General Partner. Pursuant to the Partnership Agreement, the General Partner is entitled to reimbursement for all direct and indirect expenses incurred or payments it makes on behalf of Heritage, and all other necessary or appropriate expenses allocable to Heritage or otherwise reasonably incurred by the General Partner in connection with operating Heritage s business. These costs, which totaled approximately $47,380 for the period ended January 19, 2004, $108,861 for the year ended August 31, 2003, and $95,749 for the year ended August 31, 2002, include compensation and benefits paid to officers and employees of the General Partner.

Accounts payable to related companies include non-interest bearing amounts payable from Heritage to the General Partner of $4,784 as of August 31, 2003 and interest bearing amounts payable of $1,471 to Bi-State Propane as of August 31, 2003. Bi-State Propane purchases all of Bi-State s propane that is delivered to and sold out of its plants from an affiliate of Bi-State under a supply agreement. The supply agreement requires the affiliate to sell propane to Bi-State at the affiliates established cost plus freight charges to the destination. Total purchases under the agreement by Bi-State were 5.9 million gallons, 17.0 million gallons and 12.8 million gallons for a total cost of $4,359, $11,975, and $7,480, for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively.

9. REPORTABLE SEGMENTS:

Heritage s financial statements reflect four reportable segments: the domestic retail operations of Heritage, the domestic wholesale operations of Heritage, the foreign wholesale operations of MP Energy Partnership, and the liquids marketing activities of Resources. Heritage s reportable domestic and wholesale fuel segments are strategic business units that sell products and services to retail and wholesale customers. Intersegment sales by the foreign wholesale segment to the domestic segment are priced in accordance with the partnership agreement of MP Energy Partnership. Heritage manages these segments separately as each segment involves different distribution, sale, and marketing strategies. Heritage evaluates the performance of its operating segments based on operating income, exclusive of selling, general, and administrative expenses of $10,100, $14,037 and $12,978 for the period ended January 19, 2004 and the years ended August 31, 2003 and 2002, respectively. Selling, general and administrative expenses, interest expense and other expenses are not allocated by segment. Investment in affiliates and equity in earnings (losses) of affiliates relates primarily to Heritage s investment in Bi-State Propane (see Note 10), and is part of the domestic retail fuel segment. The following table presents the unaudited financial information by segment for the following periods:

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	For the Period ended January 19, 2004	For the Years ended August 31,	
		2003	2002
Gallons:			
Domestic retail propane	171,653	375,939	329,574
Domestic wholesale propane	5,381	15,343	16,798
Foreign wholesale propane			
Affiliated	45,386	94,881	67,265
Unaffiliated	23,299	58,958	65,309
Elimination	(45,386)	(94,881)	(67,265)
Total	200,333	450,240	411,681

	For the Period ended January 19 2004	For the Years ended August 31,	
		2003	2002
Revenues:			
Domestic retail propane	$221,459	$463,392	$365,334
Domestic wholesale propane	4,036	10,719	9,956
Foreign wholesale propane			
Affiliated	45,209	59,126	33,561
Unaffiliated	16,560	36,647	31,248
Elimination	(45,209)	(59,126)	(33,561)
Liquids marketing, net	369	1,333	542
Other	27,928	59,385	55,245
Total	$270,352	$571,476	$462,325
Operating Income (Loss):			
Domestic retail propane	$ 44,972	$ 83,945	$ 55,901
Domestic wholesale propane	(726)	(2,903)	(3,940)
Foreign wholesale propane			
Affiliated	483	784	500
Unaffiliated	1,614	2,608	1,914
Elimination	(483)	(784)	(500)
Liquids marketing	39	580	64

Selling, general and administrative not allocated to segments	(10,100)	(14,037)	(12,978)
Total	$ 35,799	$ 70,193	$ 40,961

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	For the Period ended January 19	For the Years ended August 31,	
Gain (Loss) on Disposal of Assets:			
Domestic retail propane	$ (251)	$ 386	$ 544
Domestic wholesale propane	11	44	268
Total	$ (240)	$ 430	$ 812
Minority Interest Expense:			
Corporate	$ 231	$ 318	$ 213
Foreign wholesale propane	341	558	361
Total	$ 572	$ 876	$ 574
Depreciation and amortization:			
Domestic retail propane	$15,195	$37,442	$36,550
Domestic wholesale propane	184	494	426
Foreign wholesale propane	10	23	22
Total	$15,389	$37,959	$36,998

	As of August 31, 2003
Total Assets:	
Domestic retail propane	$691,900
Domestic wholesale propane	12,197
Foreign wholesale propane	13,912
Liquids Marketing	4,474
Corporate	16,356
Total	$738,839

Additions to property, plant and equipment including acquisitions:	
Domestic retail propane	$ 57,499
Domestic wholesale propane	280
Foreign wholesale propane	
Corporate	2,344
Total	$ 60,123

Corporate assets include vehicles, office equipment and computer software for the use of administrative personnel. These assets are not allocated to segments. Corporate minority interest expense relates to U.S. Propane s general partner interest in the Operating Partnership.

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10. SIGNIFICANT INVESTEE:

At August 31, 2003, Heritage held a 50% interest in Bi-State Propane. Heritage accounted for this 50% interest in Bi-State Propane under the equity method. Heritage s investment in Bi-State Propane totaled $8,242 at August 31, 2003. Heritage received distributions of $535 from Bi-State Propane for the year ended August 31, 2003. The Operating Partnership guaranteed $5 million of debt incurred by Bi-State Propane to a financial institution. At August 31, 2003, management considered the likelihood of Heritage incurring a liability resulting from the guarantee to be remote. Therefore Heritage did not record a liability on the balance sheets as of August 31, 2003 for this guarantee because the guarantee was in effect prior to the issuance of FIN 45, and there have been no amendments to the original guarantee. Bi-State Propane s financial position is summarized below:

	August 31, 2003
Current assets	$ 3,393
Noncurrent assets	23,187
	$26,580
Current liabilities	$ 3,701
Long-term debt	7,750
Partners capital:	
Heritage	8,242
Other partner	6,887
	$26,580

On December 24, 2003, Heritage purchased the 50% interest in Bi-State Propane that it did not previously own. Heritage now owns 100% of Bi-State Propane. Beginning December 24, 2003, Heritage consolidates the results of Bi-State, as Bi-State became a wholly owned subsidiary of the Partnership. Bi-State Propane s results of operations for the years ended August 31, 2003 and 2002, respectively are summarized below:

	For the Years Ended August 31,	
	2003	2002
Revenues	$22,536	$16,815
Gross profit	10,507	8,934
Net income:		
Heritage	1,292	1,274

Other Partner	1,275	1,329

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11. QUARTERLY FINANCIAL DATA (UNAUDITED):

Summarized unaudited quarterly financial data is presented below. The sum of net income (loss) per limited partner unit by quarter may not equal the net income (loss) per limited partner unit for the year due to variations in the weighted average units outstanding used in computing such amounts. Heritage s business is seasonal due to weather conditions in its service areas. Propane sales to residential and commercial customers are affected by winter heating season requirements, which generally results in higher operating revenues and net income during the period from October through March of each year and lower operating revenues and either net losses or lower net income during the period from April through September of each year. Sales to industrial and agricultural customers are much less weather sensitive.

	Quarter Ended	Period Ended
	November 30	January 19, 2004
Fiscal 2004:		
Revenues	$123,726	$146,626
Gross Profit	57,356	64,667
Operating income (loss)	6,709	29,090
Net income (loss)	(1,296)	23,939
Basic and diluted net income (loss) per limited partner unit	$ (0.09)	$ 1.30

	Quarter Ended			
	November 30	February 28	May 31	August 31
Fiscal 2003:				
Revenues	$113,460	$249,809	$125,739	$ 82,468
Gross Profit	56,440	121,389	58,958	37,533
Operating income (loss)	10,926	62,385	6,154	(9,271)
Net income (loss)	1,504	49,752	(2,166)	(17,948)
Basic and diluted net income (loss) per limited partner unit	$ 0.08	$ 3.03	$ (0.14)	$ (1.01)

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INDEX TO EXHIBITS

The exhibits listed on the following Exhibit Index are filed as part of this report. Exhibits required by Item 601 of Regulation S-K, but which are not listed below, are not applicable.

	Exhibit Number	Description
(1)	3.1	Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(8)	3.1.1	Amendment No. 1 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(14)	3.1.2	Amendment No. 2 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(17)	3.1.3	Amendment No. 3 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(17)	3.1.4	Amendment No. 4 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(23)	3.1.5	Amendment No. 5 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(23)	3.1.6	Amendment No. 6 to Amended and Restated Agreement of Limited Partnership of Heritage Propane Partners, L.P.
(1)	3.2	Agreement of Limited Partnership of Heritage Operating, L.P.
(10)	3.2.1	Amendment No. 1 to Amended and Restated Agreement of Limited Partnership of Heritage Operating, L.P.
(17)	3.2.2	Amendment No. 2 to Amended and Restated Agreement of Limited Partnership of Heritage Operating, L.P.
(23)	3.2.3	Amendment No. 3 to Amended and Restated Agreement of Limited Partnership of Heritage Operating, L.P.
(23)	3.3	Amended Certificate of Limited Partnership of Energy Transfer Partners, L.P.
(16)	3.4	Amended Certificate of Limited Partnership of Heritage Operating, L.P.
(18)	4.1	Registration Rights Agreement for Limited Partner Interests of Heritage Propane Partners, L.P.
(23)	4.2	Unitholder Rights Agreement dated January 20, 2004 among Heritage Propane Partners, L.P., Heritage Holdings, Inc., TAAP LP and La Grange Energy, L.P.

(1)	10.2	Form of Note Purchase Agreement (June 25, 1996).
(2)	10.2.1	Amendment of Note Purchase Agreement (June 25, 1996) dated as of July 25, 1996.
(3)	10.2.2	Amendment of Note Purchase Agreement (June 25, 1996) dated as of March 11, 1997.

	Exhibit Number	Description
(5)	10.2.3	Amendment of Note Purchase Agreement (June 25, 1996) dated as of October 15, 1998.
(6)	10.2.4	Second Amendment Agreement dated September 1, 1999 to June 25, 1996 Note Purchase Agreement.
(9)	10.2.5	Third Amendment Agreement dated May 31, 2000 to June 25, 1996 Note Purchase Agreement and November 19, 1997 Note Purchase Agreement.
(8)	10.2.6	Fourth Amendment Agreement dated August 10, 2000 to June 25, 1996 Note Purchase Agreement and November 19, 1997 Note Purchase Agreement.
(11)	10.2.7	Fifth Amendment Agreement dated as of December 28, 2000 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.
(23)	10.2.8	Sixth Amendment Agreement dated as of December 28, 2000 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.
(1)	10.3	Form of Contribution, Conveyance and Assumption Agreement among Heritage Holdings, Inc., Heritage Propane Partners, L.P. and Heritage Operating, L.P.
(1)**	10.6	Restricted Unit Plan.
(3)**	10.6.1	Amendment of Restricted Unit Plan dated as of October 17, 1996.
(10)**	10.6.2	Amended and Restated Restricted Unit Plan dated as of August 10, 2000.
(16)**	10.6.3	Second Amended and Restated Restricted Unit Plan dated as of February 4, 2002.
(26)	10.6.4	2004 Unit Plan
(4)	10.16	Note Purchase Agreement dated as of November 19, 1997.
(5)	10.16.1	Amendment dated October 15, 1998 to November 19, 1997 Note Purchase Agreement.
(6)	10.16.2	Second Amendment Agreement dated September 1, 1999 to November 19, 1997 Note Purchase Agreement and June 25, 1996 Note Purchase Agreement.
(7)	10.16.3	Third Amendment Agreement dated May 31, 2000 to November 19, 1997 Note Purchase Agreement and June 25, 1996 Note Purchase Agreement.
(8)	10.16.4	Fourth Amendment Agreement dated August 10, 2000 to November 19, 1997 Note Purchase Agreement and June 25, 1996 Note Purchase Agreement.

(11)	10.16.5	Fifth Amendment Agreement dated as of December 28, 2000 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.
(22)	10.16.6	Sixth Amendment Agreement dated as of November 18, 2003 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.

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	Exhibit Number	Description
(8)	10.17	Contribution Agreement dated June 15, 2000 among U.S. Propane, L.P., Heritage Operating, L.P. and Heritage Propane Partners, L.P.
(8)	10.17.1	Amendment dated August 10, 2000 to June 15, 2000 Contribution Agreement
(8)	10.18	Subscription Agreement dated June 15, 2000 between Heritage Propane Partners, L.P. and individual investors
(8)	10.18.1	Amendment dated August 10, 2000 to June 15, 2000 Subscription Agreement
(13)	10.18.2	Amendment Agreement dated January 3, 2001 to the June 15, 2000 Subscription Agreement.
(14)	10.18.3	Amendment Agreement dated October 5, 2001 to the June 15, 2000 Subscription Agreement.
(8)	10.19	Note Purchase Agreement dated as of August 10, 2000.
(11)	10.19.1	Fifth Amendment Agreement dated as of December 28, 2000 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.
(12)	10.19.2	First Supplemental Note Purchase Agreement dated as of May 24, 2001 to the August 10, 2000 Note Purchase Agreement.
(22)	10.19.3	Sixth Amendment Agreement dated as of December 28, 2000 to June 25, 1996 Note Purchase Agreement, November 19, 1997 Note Purchase Agreement and August 10, 2000 Note Purchase Agreement.
(13)	10.20	Stock Purchase Agreement dated as of July 5, 2001 among the shareholders of ProFlame, Inc. and Heritage Holdings, Inc.
(13)	10.21	Stock Purchase Agreement dated as of July 5, 2001 among the shareholders of Coast Liquid Gas, Inc. and Heritage Holdings, Inc.
(13)	10.22	Agreement and Plan of Merger dated as of July 5, 2001 among California Western Gas Company, the Majority Stockholders of California Western Gas Company signatories thereto, Heritage Holdings, Inc. and California Western Merger Corp.
(13)	10.23	Agreement and Plan of Merger dated as of July 5, 2001 among Growth Properties, the Majority Shareholders signatories thereto, Heritage Holdings, Inc. and Growth Properties Merger Corp.
(13)	10.24	Asset Purchase Agreement dated as of July 5, 2001 among L.P.G. Associates, the Shareholders of L.P.G. Associates and Heritage Operating, L.P.

(13)	10.25	Asset Purchase Agreement dated as of July 5, 2001 among WMJB, Inc., the Shareholders of WMJB, Inc. and Heritage Operating, L.P.
(13)	10.25.1	Amendment to Asset Purchase Agreement dated as of July 5, 2001 among WMJB, Inc., the Shareholders of WMJB, Inc. and Heritage Operating, L.P.

	Exhibit Number	Description
(16)	10.26	Assignment, Conveyance and Assumption Agreement between U.S. Propane, L.P. and Heritage Holdings, Inc., as the former General Partner of Heritage Propane Partners, L.P. dated as of February 4, 2002
(16)	10.27	Assignment, Conveyance and Assumption Agreement between U.S. Propane, L.P. and Heritage Holdings, Inc., as the former General Partner of Heritage Operating, L.P., dated as of February 4, 2002
(19)	10.28	Assignment for Contribution of Assets in Exchange for Partnership Interest dated December 9, 2002 among V-1 Oil Co., the shareholders of V-1 Oil Co., Heritage Propane Partners, L.P. and Heritage Operating, L.P.
(20)	10.30	Acquisition Agreement dated November 6, 2003 among the owners of U.S. Propane, L.P. and U.S. Propane, L.L.C., and La Grange Energy, L.P.
(20)	10.31	Contribution Agreement dated November 6, 2003 among La Grange Energy, L.P., and Heritage Propane Partners, L.P. and U.S. Propane, L.P.
(21)	10.31.1	Amendment No. 1 dated December 7, 2003 to Contribution Agreement dated November 6, 2003 among La Grange Energy, L.P. and Heritage Propane Partners, L.P. and U.S. Propane, L.P.
(20)	10.32	Stock Purchase Agreement dated November 6, 2003 among the owners of Heritage Holdings, Inc. and Heritage Propane Partners, L.P.
(23)	10.34	Second Amended and Restated Credit Agreement among La Grange Acquisition, L.P. and Banks dated January 20, 2004.
(24)	10.34.1	First Amendment effective June 1, 2004, to Second Amended and Restated Credit Agreement among La Grange Acquisition, L.P. and Banks dated January 20, 2004.
(24)	10.34.2	Second Amendment effective June 1, 2004, to Second Amended and Restated Credit Agreement among La Grange Acquisition, L.P. and Banks dated January 20, 2004.
(*)	10.34.3	Third Amendment effective August 31, 2004 to Second Amended and Restated Credit Agreement among La Grange Acquisition, L.P. and Banks dated January 20, 2004.
(24)	10.35	Purchase and Sale Agreement between TXU Fuel Company and Energy Transfer Partners, L.P. dated April 25, 2004.
(24)	10.35.1	First Amendment to Purchase and Sale Agreement and Closing Agreement between TXU Fuel Company and Energy Transfer Partners, L.P. dated June 1, 2004.
(25)	10.36	Third Amended and Restated Credit Agreement amount Heritage Operating L.P. and the Banks dated March 31, 2004.

(*)	21.1	List of Subsidiaries.
(*)	23.3	Consent of Grant Thornton LLP.
(*)	23.4	Consent of Ernst & Young LLP.

	Exhibit Number	Description
(*)	31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(*)	31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(*)	32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
(*)	32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
(*)	99.1	Financial Statements of U.S. Propane, L.P. as of August 31, 2004.
(*)	99.2	Financial Statements of U.S. Propane, L.L.C. as of August 31, 2004.

(1) Incorporated by reference to the same numbered Exhibit to Registrant s Registration Statement of Form S-1, File No. 333-04018, filed with the Commission on June 21, 1996.

(2) Incorporated by reference to the same numbered Exhibit to Registrant s Form 10-Q for the quarter ended November 30, 1996.

(3) Incorporated by reference to the same numbered Exhibit to Registrant s Form 10-Q for the quarter ended February 28, 1997.

(4) Incorporated by reference to the same numbered Exhibit to Registrant s Form 10-Q for the quarter ended May 31, 1998.

(5) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-K for the year ended August 31, 1998.

(6) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-K for the year ended August 31, 1999.

(7) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended May 31, 2000.

(8) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 8-K dated August 23, 2000.

(9) File as Exhibit 10.16.3.

(10) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-K for the year ended August 31, 2000.

(11)

Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended February 28, 2001.

(12) Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended May 31, 2001.

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(13)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 8-K dated August 15, 2001.
(14)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-K for the year ended August 31, 2001.
(15)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended November 30, 2001.
(16)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended February 28, 2002.
(17)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended May 31, 2002.
(18)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 8-K dated February 4, 2002.
(19)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 8-K dated January 6, 2003.
(20)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended May 31, 2003.
(21)	Incorporated by reference to the same numbered Exhibit to Registrant s Form 10-Q for the quarter ended November 30, 2003).
(22)	Incorporated by reference as the same numbered exhibit to the Registrant s Form 10-Q for the quarter ended February 29, 2004.
(23)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended February 29, 2004.
(24)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 8-K filed June 14, 2004.
(25)	Incorporated by reference to the same numbered Exhibit to the Registrant s Form 10-Q for the quarter ended May 31, 2004.
(26)	Incorporated by reference to Annex A of the Registrant s Schedule 14A Proxy Statement filed May 18, 2004.

(*) Filed herewith.

(**) Denotes a management contract or compensatory plan or arrangement.