

Kern River Gas Transmission Company
Notes to Statements L and M – Regulatory Basis
(Unaudited)

1. General

The financial statements included herein have been prepared by Kern River Gas Transmission Company (“Kern River”) without audit. In the opinion of management of Kern River, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly, in conformity with the Code of Federal Regulations, the financial position as of January 31, 2004, and the results of operations for the one-month period ended January 31, 2004. The financial statements have been prepared based upon the accounting regulations of the Federal Energy Regulatory Commission (“FERC”) pursuant to the Code of Federal Regulations, Title 18, Part 201, Uniform System of Accounts. Therefore, these financial statements contain certain differences from general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States, including account classification and the deferral of FERC prescribed depreciation expense pending future recovery. Certain information and notes normally included in financial statements have been condensed or omitted, although Kern River believes that the disclosures are adequate to prevent the information presented from being misleading. The results of operations for the one-month period ended January 31, 2004 are not necessarily indicative of the results to be expected for the full year.

The unaudited financial statements include the accounts of Kern River is parent company only. In accordance with FERC accounting regulations, Kern River’s 100% ownership of Kern River Funding Corporation (“Funding”) is accounted for by the equity method.

The unaudited financial statements should be read in conjunction with the financial statements included in Kern River’s audited financial statements and the notes thereto for the year ended December 31, 2003.

2. New Accounting Pronouncements

No new accounting pronouncements were adopted by Kern River during January 2004.

3. Other Credit Risks

As a general policy, collateral is not required for receivables from creditworthy customers. Customers’ financial condition and creditworthiness are regularly evaluated, and historical losses have been minimal. However, during 2003 the creditworthiness of certain customers declined to below investment grade. In order to protect Kern River, and as permitted by the terms of Kern River’s tariff, Kern River has required these customers to provide cash deposits, included in Customer Deposits on statement L or letters of credit, which are not reflected on the balance sheet, which will be held until these customers’ creditworthiness improves or their contracts end. The customer cash deposits which Kern River holds were \$63.5 million and \$64.3 million at January 31, 2004 and December 31, 2003, respectively. Kern River places the cash deposits received in an escrowed security funds account which is reported as an Other Property and Investments Special Funds on statement L. The customer escrowed security funds were \$63.5 million and \$64.3 million at January 31, 2004 and December 31, 2003, respectively.

4. Commitments and Contingencies

Litigation

No significant changes occurred, applicable to ongoing litigation, during January 2004.

Summary of Other Legal and Contingent Liabilities

Kern River is party to legal proceedings incidental to its operations. Kern River believes, based on advice of counsel, that the outcome of these proceedings, individually and in the aggregate, will not have a materially adverse effect on the financial position or results of operations of Kern River.