NISOURCE INC/DE
Form 10-K/A
January 27, 2006

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
(Amendment No. 1)
þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from___to ___
Commission file number 001-16189
NiSource Inc.
(Exact name of registrant as specified in its charter)

Delaware	35-2108964
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
801 East 86th Avenue Merrillville, Indiana	46410
(Address of principal executive offices)	(Zip Code)

(877) 647-5990
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock	New York, Chicago and Pacific
Preferred Share Purchase Rights	New York, Chicago and Pacific

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes þ No o

The aggregate market value of Common Stock (based upon the June 30, 2004, closing price of $20.62 on the New York Stock Exchange) held by non-affiliates was approximately $5,353,692,122.

There were 271,244,195 shares of Common Stock, $0.01 Par Value outstanding as of February 28, 2005.

Documents Incorporated by Reference

Part III of this report incorporates by reference specific portions of the Registrant s Notice of Annual Meeting and Proxy Statement relating to the Annual Meeting of Stockholders to be held on May 10, 2005.

Table of Contents

NiSource Inc.

Explanatory Note

This Form 10K/A is being filed to reflect the restatement of the Statements of Consolidated Cash Flows as discussed in Note 23 to the consolidated financial statements included in Item 8. This restatement does not impact operating, financing and investing cash flows related to continuing operations or the net change in cash and cash equivalents as originally presented in the Statements of Consolidated Cash Flows.

This Form 10-K/A hereby amends:

Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operation. Revisions have been made to various amounts discussed in Liquidity and Capital Resources related to the Statements of Consolidated Cash Flows as a result of restated amounts.

Part II, Item 8, Financial Statements and Supplementary Data. Corrections have been made to the Statements of Consolidated Cash Flows for 2003 and 2002, Note 23 has been added to Notes to Financial Statements and the Report of Independent Registered Public Accounting Firm has been updated.

Part IV, Item 15, Exhibits. Amended to file herewith, Exhibit 23.1, Consent of Independent Registered Public Accounting Firm, and Exhibits 31.1, 31.2, 32.1, 32.2, Certifications of the Chief Executive Officer and the Chief Financial Officer of NiSource Inc. pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

CONTENTS

		Page No.
Part II		
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	4
Item 8.	Financial Statements and Supplementary Data	39
Part IV		
Item 15	Exhibits, Financial Statement Schedules	100
Signature		101

Consent of Deloitte & Touche LLP
Certification of CEO
Certification of CFO
Certification of CEO
Certification of CFO

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NiSource Inc.

Index **Page**

Index	Page
Consolidated Review	4
Results of Operations	6
Liquidity and Capital Resources	8
Market Risk Disclosures	13
Off Balance Sheet Items	16
Other Information	16
Results and Discussion of Segment Operations	20
Gas Distribution Operations	21
Gas Transmission and Storage Operations	28
Electric Operations	32
Other Operations	37

Note regarding forward-looking statements

The Management s Discussion and Analysis, including statements regarding market risk sensitive instruments, contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Investors and prospective investors should understand that many factors govern whether any forward-looking statement contained herein will be or can be realized. Any one of those factors could cause actual results to differ materially from those projected. These forward-looking statements include, but are not limited to, statements concerning NiSource Inc. s (NiSource) plans, objectives, expected performance, expenditures and recovery of expenditures through rates, stated on either a consolidated or segment basis, and any and all underlying assumptions and other statements that are other than statements of historical fact. From time to time, NiSource may publish or otherwise make available forward-looking statements of this nature. All such subsequent forward-looking statements, whether written or oral and whether made by or on behalf of NiSource, are also expressly qualified by these cautionary statements. All forward-looking statements are based on assumptions that management believes to be reasonable; however, there can be no assurance that actual results will not differ materially.

Realization of NiSource s objectives and expected performance is subject to a wide range of risks and can be adversely affected by, among other things, weather, fluctuations in supply and demand for energy commodities, growth opportunities for NiSource s businesses, increased competition in deregulated energy markets, the success of regulatory and commercial initiatives, dealings with third parties over whom NiSource has no control, the scope, timing and impact of any outsourcing initiative, actual operating experience of NiSource assets, the regulatory process, regulatory and legislative changes, changes in general economic, capital and commodity market conditions, and counter-party credit risk, many of which risks are beyond the control of NiSource. In addition, the relative contributions to profitability by each segment, and the assumptions underlying the forward-looking statements relating thereto, may change over time.

CONSOLIDATED REVIEW

Executive Summary

NiSource generates virtually 100% of the company s operating income through the sale, distribution, transportation and storage of natural gas and the generation, transmission and distribution of electricity, which are rate regulated. A significant portion of NiSource s operations is subject to seasonal fluctuations in sales. During the heating season, which is primarily from November through March, net revenues from gas are more significant, and during the cooling season, which is primarily from June through September, net revenues from electric sales and transportation services are more significant than in other months.

4

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

As a regulated company, NiSource is exposed to regulatory risk and manages this risk by monitoring its operations and working with various regulatory bodies to maintain a business that continues to provide value for its customers and stockholders in this changing environment. In 2003 and 2004, NiSource implemented several innovative agreements by working collaboratively with regulators and other key stakeholders. Ohio regulators approved an Uncollectible Expense Rider in 2003 that began in April 2004, which allowed Columbia Gas of Ohio, Inc. (Columbia of Ohio) to recover previously uncollected bad debts from January 1, 2003 forward and also allowed payment-troubled customers to have the opportunity to participate in CHOICE® programs for the first time. In 2004, Ohio regulators modified parts of a regulatory stipulation designed to enhance the CHOICE® program and provide Columbia of Ohio customers rate certainty. NiSource s pipeline companies completed the renegotiation of most of their firm transportation and storage service contracts with their customers in 2004, as these contracts expired on October 31, 2004. In December 2004, Northern Indiana Public Service Company (Northern Indiana) was granted approval by the Indiana Utility Regulatory Commission (IURC) to initiate a one-year pilot program for low-income energy assistance entitled, NIPSCO Winter Warmth which will be funded by a surcharge to customers and a Northern Indiana contribution. In 2003, Northern Indiana received approval from the IURC to recover costs associated with environmental compliance programs for nitrogen oxide pollution reduction equipment at the company s generating stations for which Northern Indiana recorded revenues of $22.3 million in 2004 related to qualified capital and operating costs. Overall, NiSource s regulatory strategies that were initiated in 2003 and 2004 have begun to produce returns and benefit both its customers and the company. All regulatory matters are discussed in the segment sections of the Management Discussion and Analysis.

In addition to the regulatory initiatives, NiSource has closely controlled operation and maintenance costs and reduced debt and interest expense. With the focus on regulated operations and organizational structure, NiSource was able to deliver income from continuing operations of $1.63 per share for the year ended December 31, 2004.

During 2004, total long and short-term borrowings decreased $353.8 million. Additionally, interest expense was $60.8 million lower for the twelve months ended December 31, 2004 compared with 2003 due to lower long-term interest rates as a result of refinancing activity completed in 2003 and 2004. NiSource currently anticipates that its $900 million of notes, due in November 2005, will be replaced with a new debt issue. In the fourth quarter of 2004, NiSource entered into forward swap arrangements to reduce its risk of rising interest rates relating to its anticipated refinancing of these notes in November 2005.

Going forward, NiSource will continue to focus on the regulated, core businesses of strategically located gas and electric operations that generate virtually 100% of the company s operating income. NiSource will also continue to explore commercial and regulatory initiatives that benefit both customers and shareholders, invest in pipeline expansion and storage projects to bring additional gas supplies to key markets, improve the balance sheet and lower operating expenses. In addition to initiatives already underway, NiSource is exploring refinancing opportunities that could further reduce interest expense. Management is also evaluating initiatives to lower operation and maintenance costs. Outsourcing may be a part of a comprehensive approach to capture this opportunity.

Financial results for 2005 are expected to be negatively impacted by some of these operational and financial initiatives, along with impacts of regulatory proceedings and pipeline re-contracting that took place in 2004. Earnings per share from continuing operations could be $0.10 to $0.15 lower than 2004 results.

NiSource also intends to increase the level of capital expenditures and other investing activities during 2005. For 2005, the projected capital program is expected to be $623.6 million, which is $100.2 million higher than the 2004 level. This higher spending is mainly due to increased expenditures for pipeline integrity related work and growth initiatives in the Gas Transmission and Storage Operations segment and system upgrades in the Gas Distribution Operations segment to maintain service and reliability. The program is expected to be funded primarily with cash from operations.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Finally, NiSource has always been committed to providing accurate and complete financial reporting as well as requiring a strong commitment to ethical behavior by its employees. During 2004, NiSource documented and tested all significant controls across its financial processes and NiSource s management has concluded that the company s internal control over financial reporting was effective as of the end of the period covered by the annual report. Refer to Item 9A, Management s Report on Internal Controls Over Financial Reporting. NiSource s senior management takes an active role in the development of the Form 10-K and the monitoring of the company s internal control structure and performance. In addition, NiSource will continue the mandatory ethics training program in which employees at every level and in every function of the organization participate.

Results of Operations

The Consolidated Review information should be read taking into account the critical accounting policies applied by NiSource and discussed in Other Information of this Item 7.

Income from Continuing Operations and Net Income

For the twelve months ended December 31, 2004, NiSource reported income from continuing operations of $430.2 million, or $1.63 per share, compared to $425.7 million, or $1.64 per share, in 2003 and $398.1 million, or $1.89 per share in 2002.

Including results from discontinued operations and a change in accounting, NiSource reported 2004 net income of $436.3 million, or $1.65 per share, 2003 net income of $85.2 million, or $0.33 per share, and $372.5 million, or $1.77 per share for 2002. Earnings per share are not comparable because of 6.8 million shares issued upon the settlement of forward stock purchase contracts comprising a component of NiSource s Stock Appreciation Income Linked Securities[SM] (SAILS[SM]) in November 2004, 13.1 million shares issued upon the settlement of forward equity agreements in February 2003 and an equity offering of 41.4 million shares that was completed in November 2002.

Net Revenues

Total consolidated net revenues (gross revenues less cost of sales) for the twelve months ended December 31, 2004 were $3,055.7 million, a $4.6 million decrease compared with 2003. Gas Distribution Operations net revenues decreased $36.0 million, primarily as a result of reduced residential and commercial natural gas deliveries due to warmer weather of approximately $33 million compared to last year and lower revenues from contract cost reduction programs, reduced sales of retail products, releases of capacity and gas cost incentives that amounted to $33.1 million partially offset by increased revenues from regulatory strategies of approximately $25.8 million from the stipulation agreement granted for Columbia of Ohio and the recovery for conservation measures granted to Bay State Gas Company (Bay State). The reduction in Gas Distribution Operations net revenue was partially offset by a $31.6 million increase in electric net revenue for 2004 as compared to 2003. This was the result of higher net revenues from environmental trackers, increased customer usage and the effect of reserves recorded for regulatory refunds in the comparable 2003 period.

Total consolidated net revenues for the twelve months ended December 31, 2003 were $3,060.3 million, a $10.6 million decrease compared with 2002. Items that favorably impacted the year included colder weather during the heating season in the first quarter amounting to $60 million and modest increases in non-weather related volume of $15.4 million. These favorable items were offset by reduced electric revenue of $21.9 million due to cooler weather during the summer cooling season, lower interruptible service revenues and firm service revenues of $19.7 million in the Gas Transmission and Storage Operations segment due to measures undertaken during the first quarter period of sustained, colder-than-normal weather, a decrease in storage and transportation revenues of $13.5 million due mainly to reduced deliveries to power generating facilities, and credits totaling $24.5 million pertaining to the Indiana Utility Regulatory Commission (IURC) electric rate review settlement.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Expenses

Operating expenses were $1,983.7 million in 2004, a $39.7 million increase from 2003 due primarily to the comparable 2003 period being favorably impacted by insurance recoveries, recovery of previously uncollected accounts receivable under the Columbia of Ohio bad debt tracker, and the reversal of legal, environmental, and other accrued expenses of approximately $40.5 million and a $16.6 million gain on the sale of Columbia Service Partners, Inc. (Columbia Service Partners). Operating expenses for 2004 were favorably impacted by a reduction in estimated property taxes of $29.3 million partially offset by an increase in depreciation expense of approximately $13 million. Operating expenses of $1,944.0 million for 2003 increased $25.3 million over 2002. Operating expense increases experienced during 2003 included $28.5 million in pension and post-retirement benefit expenses, an increase in uncollectible accounts receivable expense amounting to $21.3 million, and increased property tax expense of $12.3 million. Expense reductions for 2003 include $27.5 million in reduced administrative and employee-related expenses, the approval of a bad debt tracker for Columbia of Ohio for the recovery of $25.2 million of previously uncollected accounts receivable, and insurance recoveries and the reversal of legal, environmental, and other accrued expenses of approximately $35.3 million. In addition, NiSource sold Columbia Service Partners for a gain of $16.6 million in the third quarter of 2003 and Midtex Gas Storage for a gain of $7.5 million in the fourth quarter of 2003. The 2002 period included $24.5 million of insurance recoveries for environmental expenses, a reduction in estimated sales taxes of $11.4 million related to sales of natural gas to customers of a subsidiary previously engaged in the retail and wholesale gas marketing business, a reduction in reserves for environmental expenditures and unaccounted-for gas amounting to $20 million, offset by $14.8 million of increased expenses related to NiSource s reorganization initiatives and other employee-related costs and $8.7 million related to the recognition of a reserve related to a long-term note receivable.

Other Income (Deductions)

Other Income (Deductions) in 2004 reduced income $400.9 million compared to a reduction of $456.4 million in 2003. Interest expense, net decreased $60.8 million from 2003 primarily due to lower long-term interest rates and a decrease in total debt of $354 million from December 31, 2003. Other, net decreased $7.9 million as a result of decreased interest income in 2004.

Other Income (Deductions) in 2003 reduced income $456.4 million compared to a reduction of $535.2 million in 2002. Interest expense, net decreased $51.7 million from 2002 primarily due to lower short-term and long-term interest rates and a decrease in total debt of $191 million from December 31, 2002. Minority interest, consisting of dividends paid on company-obligated mandatorily redeemable preferred securities associated with the Corporate Premium Income Equity Securities (Corporate PIES), was $2.5 million in 2003 compared to $20.4 million in 2002 as a result of the settlement and remarketing of the Corporate PIES in February 2003.

Income Taxes

Income taxes increased $6.7 million in 2004 as compared with 2003 and increased $15.3 million in 2003 over 2002 primarily as a result of higher pre-tax income in each succeeding period. The effective income tax rates were 35.9%, 35.5%, and 35.5 % in 2004, 2003 and 2002, respectively.

Discontinued Operations

Discontinued operations reflected income of $6.1 million, or $0.02 per share, in 2004 compared to a loss of $331.7 million, or $1.28 per share, in 2003 and a loss of $25.6 million, or $0.12 per share, in 2002. The current year s income from discontinued operations, after-tax, is mostly the result of a reduction in estimated income taxes associated with NiSource s former exploration and production subsidiary, Columbia Energy Resources, Inc. (CER). In 2003, an after-tax loss of $301.2 million was related to the sale of CER, while a loss of $29.1 million was recognized on the sale of six PEI Holdings, Inc. (PEI) subsidiaries and a loss of $1.3 million on the sale of Columbia Transmission Communications Corporation (Transcom). The 2002 results were unfavorably impacted by a charge of $51.3 million, after-tax, that was recognized as a result of the continuing depressed market for dark fiber and NiSource s decision to exit the telecommunications business.

Change in Accounting

The change in accounting in 2003 of $8.8 million, net-of-tax, resulted from the cumulative effect of adopting the Financial Accounting Standards Board statement on asset retirement obligations.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Liquidity and Capital Resources

The Liquidity and Capital Resources disclosures of the accompanying management s discussion and analysis gives effect to the restatement of our 2003 and 2002 Statements of Consolidated Cash Flows as discussed in Note 23, Restatement of Statement of Consolidated Cash Flows, in the Notes to Consolidated Financial Statements.

Generally, cash flow from operations has provided sufficient liquidity to meet operating requirements. A significant portion of NiSource s operations, most notably in the gas distribution, gas transportation and electric businesses, is subject to seasonal fluctuations in cash flow. During the heating season, which is primarily from November through March, cash receipts from gas sales and transportation services typically exceed cash requirements. During the summer months, cash on hand, together with the seasonal increase in cash flows from the electric business during the summer cooling season and external short-term and long-term financing, is used to purchase gas to place in storage for heating season deliveries, perform necessary maintenance of facilities, make capital improvements in plant and expand service into new areas.

Operating Activities. Net cash from operating activities for the twelve months ended December 31, 2004 was $1,056.3 million, an increase of $488.1 million from a year ago. This change was due primarily to a use of approximately $432 million from working capital changes during the comparable 2003 period versus only a $7 million use this year. The 2003 impact to working capital resulted from a decrease of exchange gas payables that were accrued at the end of 2002 and the replacement of a lower cost inventory level with a significantly higher cost inventory level. Additionally, $44.8 million of cash was used during 2003 by businesses that were disposed of during that year.

Investing Activities. On October 20, 2003, NiSource sold all of the steel-related, inside-the-fence assets of its subsidiary PEI, to Private Power, LLC (Private Power). The sale included six PEI operating subsidiaries and the name Primary Energy . Private Power paid approximately $325.4 million, comprised of $113.1 million in cash and the assumption of debt-related liabilities and other obligations. The assumption of such liabilities and the after tax cash proceeds from the sale reduced NiSource s debt by $206.3 million. NiSource has accounted for the assets sold as discontinued operations and has adjusted periods after 1999 accordingly. During 2003, NiSource recognized an after-tax loss of $29.1 million related to the sale.

On August 29, 2003, NiSource sold its exploration and production subsidiary, CER, to a subsidiary of Triana Energy Holdings for $330 million, plus the assumption of obligations to deliver approximately 94.0 billion cubic feet (Bcf) of natural gas pursuant to existing forward sales contracts. On January 28, 2003, NiSource s former subsidiary, Columbia Natural Resources, Inc., sold its interest in certain natural gas exploration and production assets in New York for approximately $95 million. NiSource has accounted for CER as discontinued operations and has adjusted periods after 1999 accordingly. During 2003, NiSource recognized an after-tax loss of $301.2 million related to the sales.

Financing Activities. On July 29, 2003, NiSource filed a shelf registration statement with the Securities and Exchange Commission to periodically sell up to $2.5 billion in debt securities, common and preferred stock, and other securities. The registration statement became effective on August 7, 2003, which when combined with NiSource s pre-existing shelf capacity, provided the Company with an aggregate $2.8 billion of total issuance capacity. After the $250 million of notes issued on November 4, 2003 and the $450 million of notes issued on November 23, 2004, both of which are discussed below, NiSource s shelf capacity remains at $1.85 billion.

On November 23, 2004, NiSource Finance Corp. (NiSource Finance) issued $450 million of 5-year floating rate unsecured notes that mature November 23, 2009. The notes are callable, at par, on or after November 23, 2006. Subsequently, on December 10, 2004, NiSource Finance used $250 million of the proceeds from the $450 million floating rate note offering to redeem $250 million of existing floating rate notes that were due May 2005. The remaining proceeds were used to repay a portion of NiSource Finance short-term borrowings.

On November 1, 2004, NiSource issued approximately 6.8 million shares of common stock upon the settlement of the forward stock purchase contracts comprising a component of NiSource s SAILS^{SM}. NiSource received approximately $144.4 million in satisfaction of the SAILS^{SM} holders obligation under the stock purchase contracts, which was used

to pay down short-term borrowings. Effective November 1, 2004, the interest rate on the $144.4

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

million of debentures that comprised the debt component of the SAILS[SM] was reset to 3.628% per annum. The debentures mature November 1, 2006.

During July 2004, Northern Indiana redeemed $32 million of its medium-term notes, with an average interest rate of 6.53%.

During April 2004, NiSource Capital Markets, Inc. (NiSource Capital Markets) redeemed $80 million of its medium-term notes, with an average interest rate of 7.39%.

During February 2004, Northern Indiana redeemed $111.1 million of its medium-term notes and Bay State redeemed $10 million of its medium-term notes, with an average interest rate of 7.49% and 7.63%, respectively. The associated redemption premium was $4.6 million, of which $4.2 million was charged to expense and $0.4 million was recorded as a regulatory asset.

On December 18, 2003, $55 million of new tax-exempt Pollution Control Revenue Refunding Bonds were issued by Jasper County, Indiana on behalf of Northern Indiana. The new tax-exempt bonds were issued on an auction rate basis and bear interest at a floating rate as determined in 35-day increments by the tax-exempt auction process. The proceeds of the bonds were loaned to Northern Indiana, pursuant to a financing agreement dated as of December 1, 2003, and were used to refund Northern Indiana s $55 million aggregate principal amount of Jasper County, Indiana Collateralized Pollution Control Refunding Revenue Bonds Series 1991. As a result of the refunding, the final series of First Mortgage Bonds outstanding under Northern Indiana s First Mortgage Indenture were discharged, cancelled and returned to Northern Indiana. There are no longer any First Mortgage Bonds outstanding under the First Mortgage Indenture. Northern Indiana intends to obtain and file in due course in the appropriate recording offices in Indiana the releases necessary to remove the First Mortgage Indenture from the title records with respect to the Northern Indiana property formerly subject to the lien of the First Mortgage Indenture.

On November 4, 2003, NiSource Finance issued $250 million of 18-month floating rate unsecured notes with a maturity date of May 4, 2005. The notes were subsequently called on December 10, 2004 at par value. Also on November 4, 2003, NiSource Finance issued $250 million of 3.20% three-year unsecured notes that mature November 1, 2006. The proceeds were used to repay a portion of NiSource Finance s $750 million notes, which matured on November 15, 2003.

On July 21, 2003, NiSource Finance issued $500 million of 5.40% eleven-year senior unsecured notes that mature July 15, 2014. The proceeds were used to reduce other maturing debt and for working capital needs. During the time period of March 2003 through July 2003, Northern Indiana redeemed $124 million of Northern Indiana medium term notes. On April 15, 2003, NiSource Finance repaid at maturity $300 million of its 5.75% two-year senior notes. On March 31, 2003, NiSource Capital Markets redeemed $75 million of its 7.75% Subordinated Debentures due March 1, 2026.

On July 8, 2003 NiSource announced that it would reduce its common stock dividend to $0.92 per share from $1.16 per share on an annual basis. This change took effect beginning with the dividend payable on November 20, 2003. The change in the dividend, the sale of non-core assets, the November 2002 equity offering and ongoing debt reduction efforts have stabilized NiSource s credit ratings, enhanced cash flows and provided funds to reinvest in NiSource s core businesses for the future. NiSource s decision was also influenced by the fact that its dividend yield and payout ratio prior to the dividend reduction were higher than industry averages.

In February 2003, NiSource issued approximately 13.1 million shares of common stock upon the settlement of forward equity agreements comprising a component of the Corporate PIES. Concurrently with the settlement of the forward agreements, NiSource remarketed most of the underlying debentures, due February 19, 2005, and reset the interest rate to 4.25%. NiSource received net proceeds of $344.1 million from the remarketing in satisfaction of the Corporate PIES holders obligations under the forward equity agreements. The sole purchaser of the remarketed debentures purchased newly-offered 6.15% notes of NiSource Finance due March 1, 2013, using the remarketed debentures as consideration.

In November 2002, NiSource issued 41.4 million shares of common stock at a per-share price of $18.30 ($17.75 on a net basis). The net proceeds of approximately $734.9 million were used to reduce debt.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Credit Facilities

NiSource is currently in the process of renewing its $500 million 364-day credit facility, and plans to incorporate this facility and its $750 million 3-year facility into a combined $1.25 billion 5-year credit facility. The new facility is expected to close in March 2005 and will include sub-limits for letters of credit of $500 million and swingline loans of $200 million. NiSource anticipates that a debt to capitalization financial covenant will be the only financial covenant required under this new facility.

As of March 1, 2005, there are no borrowings under the existing facility. NiSource had short term cash investments of $146.1 million as of that date.

During March 2004, NiSource obtained a new $500 million 364-day credit facility and a $750 million 3-year credit facility with a syndicate of banks led by Barclays Capital. The new facilities replaced an expiring $1.25 billion credit facility. NiSource had outstanding credit facility advances of $307.6 million at December 31, 2004, at a weighted average interest rate of 3.04%, and advances of $685.5 million at December 31, 2003, at a weighted average interest rate of 1.82%. As of December 31, 2004 and December 31, 2003, NiSource had $111.6 million and $126.4 million of standby letters of credit outstanding, respectively. At December 31, 2004, $89.4 million of the $111.6 million total outstanding letters of credit resided within a separate bi-lateral letter of credit arrangement with Barclays Bank that NiSource obtained during February 2004. Of the remaining $22.2 million of standby letters of credit outstanding at December 31, 2004, $18.2 million resided under NiSource s 3-year credit facility and $4.0 million resided under an uncommitted arrangement with another financial institution. As of December 31, 2004, $924.2 million of credit was available under the credit facilities.

Debt Covenants

NiSource is subject to two financial covenants under both its existing 364-day and 3-year revolving credit facilities. On a consolidated basis, NiSource must maintain an interest coverage ratio of not less than 1.75, as determined for each period of four consecutive fiscal quarters. Additionally, NiSource must maintain a debt to capitalization ratio that does not exceed 70 percent. As of December 31, 2004, NiSource was in compliance with these financial covenants.

NiSource is also subject to certain negative covenants under the revolving credit facilities. Such covenants include a limitation on the creation or existence of new liens on NiSource s assets, generally exempting liens on utility assets, purchase money security interests, preexisting security interests and an additional asset basket equal to 5% of NiSource s consolidated net tangible assets. An asset sale covenant generally restricts the sale, lease and/or transfer of NiSource s assets to no more than 10% of its consolidated total assets. The revolving credit facilities also include a cross-default provision, which triggers an event of default under the credit facility in the event of an uncured payment default relating to any indebtedness of NiSource or any of its subsidiaries in a principal amount of $50 million or more.

NiSource s bond indentures generally do not contain any financial maintenance covenants. However, NiSource s bond indentures are generally subject to cross default provisions ranging from uncured payment defaults of $5 million to $50 million, and limitations on the incurrence of liens on NiSource s assets, generally exempting liens on utility assets, purchase money security interests, preexisting security interests and an additional asset basket capped at either 5% or 10% of NiSource s consolidated net tangible assets.

Sale of Trade Accounts Receivables

On May 14, 2004, Columbia of Ohio entered into an agreement to sell, without recourse, substantially all of its trade receivables, as they originate, to Columbia of Ohio Receivables Corporation (CORC), a wholly-owned subsidiary of Columbia of Ohio. CORC, in turn, is party to an agreement, also dated May 14, 2004, in which it sells an undivided percentage ownership interest in the accounts receivable to a commercial paper conduit sponsored by Dresdner Kleinwort Wasserstein. The conduit can purchase up to $300 million of accounts receivable under the agreement. The agreement, which replaced a prior similar agreement, expires in May 2005, but can be renewed if mutually agreed to by both parties. As of December 31, 2004, $137.7 million of accounts receivable had been sold by CORC.

Under the agreement, Columbia of Ohio acts as administrative agent, by performing record keeping and cash collection functions for the accounts receivable sold by CORC. Columbia of Ohio receives a fee, which provides adequate compensation, for such services.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

On December 30, 2003, Northern Indiana entered into an agreement to sell, without recourse, all of its trade receivables, as they originate, to NIPSCO Receivables Corporation (NRC), a wholly-owned subsidiary of Northern Indiana. NRC, in turn, is party to an agreement in which it sells an undivided percentage ownership interest in the accounts receivable to a commercial paper conduit. The conduit can purchase up to $200 million of accounts receivable under the agreement. The agreement will expire on December 26, 2005, but can be renewed if mutually agreed to by both parties. As of December 31, 2004, NRC had sold $133.3 million of accounts receivable. Under the arrangement, Northern Indiana may not sell any new receivables if Northern Indiana s debt rating falls below BBB- or Baa3 at Standard and Poor s and Moody s, respectively.

Under the agreement, Northern Indiana acts as administrative agent, performing record keeping and cash collection functions for the accounts receivable sold. Northern Indiana receives a fee, which provides adequate compensation, for such services.

Credit Ratings

On July 8, 2003, Moody s Investors Service affirmed the senior unsecured ratings of NiSource at Baa3, and the existing ratings of all other subsidiaries, concluding a review for possible downgrade that began on May 13, 2003. Moody s ratings outlook for NiSource and its subsidiaries is now stable . On June 30, 2003, Fitch Ratings affirmed their BBB senior unsecured rating for NiSource and the BBB+ rating for Columbia Energy Group (Columbia). Fitch also lowered the rating of Northern Indiana by one notch to BBB+ due to Fitch s policy of restricting the ratings between a parent and its subsidiaries where short-term financing facilities are solely at the holding company level. This did not reflect weakening credit at Northern Indiana. Fitch s outlook for NiSource and all of its subsidiaries is stable. On June 16, 2003, Standard and Poor s affirmed its senior unsecured ratings of NiSource at BBB, and the existing ratings of all other subsidiaries. Standard and Poor s outlook for NiSource and all of its subsidiaries was revised from negative to stable.

Certain EnergyUSA-TPC Corp. (TPC) electric trading agreements contain ratings triggers that require increased collateral if the credit ratings of NiSource or certain of its subsidiaries are rated below BBB- by Standard and Poor s or Baa3 by Moody s. The collateral requirement from a downgrade below the ratings trigger levels would amount to approximately $3 million to $5 million. In addition to agreements with ratings triggers, there are other electric or gas trading agreements that contain adequate assurance or material adverse change provisions. The collateral requirement for those agreements would amount to approximately $50 million to $55 million.

Columbia is the principal for surety bonds issued to guarantee performance under forward gas sales agreements. The surety bonds related to forward gas sales under agreements with Mahonia II Limited have indemnity values amounting to approximately $71.1 million as of December 31, 2004, which decline over time and have ratings triggers if the credit rating of Columbia falls below BBB at Standard and Poor s or Baa2 at Moody s. Columbia s long-term debt ratings are currently BBB and Baa2 at Standard and Poor s and Moody s, respectively. The collateral requirement from a downgrade below the ratings trigger levels would require the posting of a letter of credit of approximately $71.1 million declining over time. In another, but unrelated transaction, the surety, in accordance with the terms of its indemnity agreement, required NiSource to post a letter of credit in the face amount of approximately $131 million, declining over time, to support the bonds. At December 31, 2004, the total amount of letters of credit required with respect to this transaction was $89.4 million.

Contractual Obligations and Commercial Commitments

NiSource has certain contractual obligations that extend beyond 2005. The obligations include long-term debt, mandatorily redeemable preferred stock, lease obligations, and purchase obligations for pipeline capacity, transportation and storage services by NiSource s Gas Distribution Operations subsidiaries. The total contractual obligations in existence at December 31, 2004 and their maturities were:

(in millions)	Total	2005	2006	2007	2008	2009	After

Long-term debt	$ 6,207.2	$ 1,298.7	$ 438.3	$ 370.7	$ 33.5	$ 465.9	$ 3,600.1
Mandatorily redeemable preferred stock	1.5	0.9	0.6				
Capital leases	2.6	0.4	0.5	0.4	0.4		0.9
Operating leases	273.7	46.5	44.5	39.1	33.9	26.8	82.9
Purchase obligations	1,121.3	212.5	162.4	142.5	112.4	87.9	403.6
Total contractual obligations	$ 7,606.3	$ 1,559.0	$ 646.3	$ 552.7	$ 180.2	$ 580.6	$ 4,087.5

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

NiSource has obligations associated with interest and tax payments. For 2005, NiSource projects that it will be required to make interest and tax payments of approximately $990 million. Also, NiSource expects to make contributions of $3.6 million to its pension plans and $52.7 million to its postretirement medical and life plans in 2005.

In addition, Northern Indiana has a service agreement with Pure Air, a general partnership between Air Products and Chemicals, Inc. and First Air Partners LP, under which Pure Air provides scrubber services to reduce sulfur dioxide emissions for Units 7 and 8 at the Bailly Generating Station. Services under this contract commenced on June 15, 1992, and have current annual charges approximating $17.2 million. The agreement provides that, assuming various performance standards are met by Pure Air, a termination payment would be due if Northern Indiana terminated the agreement prior to the end of the twenty-year contract period.

NiSource has made certain commercial commitments that extend beyond 2005. The commitments include lines of credit, letters of credit and guarantees, which support commercial activities. The total commercial commitments in existence at December 31, 2004, including commercial commitments for discontinued operations, and the years in which they expire were:

(in millions)	Total	2005	2006	2007	2008	2009	After
Lines of credit	$ 307.6	$ 307.6	$	$	$	$	$
Letters of credit	111.6	19.2	1.9	1.1	89.4		
Guarantees	5,623.5	1,324.2	925.2	63.0	68.8	525.6	2,716.7
Total commercial commitments	$ 6,042.7	$ 1,651.0	$ 927.1	$ 64.1	$ 158.2	$ 525.6	$ 2,716.7

Of the commercial commitments outstanding shown above, NiSource had approximately $3.7 billion of debt and capital lease obligations recorded on its Consolidated Balance Sheets at December 31, 2004.

Pension Funding

Due to strong equity markets, the fair value of NiSource s pension fund assets as of September 30, 2004, have increased for the second year in a row. Additionally, $18.2 million in employer contributions were made during 2004 to certain of NiSource s qualified and non-qualified pension plans. NiSource expects market returns to revert to normal levels as demonstrated in historical periods and expects to contribute $3.6 million in 2005 to certain pension plans and may provide additional funding for the pension obligations if returns on plan assets fall short of the assumed 9.0% long-term earnings rate assumption. As a result of the increase in the fair value of the plan assets, NiSource expects pension expense for 2005 to decrease approximately $3.6 million from the amount recognized in 2004. See Note 10, Pension and Other Postretirement Benefits, in the Notes to Consolidated Financial Statements for more information.

Capital Expenditures and Other Investing Activities

The table below reflects actual capital expenditures and other investing activities by segment for 2004 and 2003 and an estimate for year 2005:

(in millions)	2005E	2004	2003
Gas Distribution Operations	$ 255.3	$ 225.2	$ 195.1
Transmission & Storage Operations	206.3	133.3	120.5
Electric Operations	128.1	154.0	225.1
Other Operations	33.9	10.9	31.8

Total	$ 623.6	$ 523.4	$ 572.5

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

For 2004, capital expenditures and other investing activities were $523.4 million, a decrease of $49.1 million from 2003. This reduction in capital expenditures was mainly due to a reduction in expenditures for nitrogen oxide (NOx) compliance. The Gas Distribution Operations segment s capital program in 2004 included initiatives to extend service to new areas and develop future markets through new services that may be added to the existing business and to create a potential new pool of customers, as well as expenditures to ensure safe, reliable and improved service to customers and modernize and upgrade facilities. The Gas Transmission and Storage Operations segment invested primarily in modernizing and upgrading facilities and meeting the needs of existing and new customers through the construction of significant new facilities, either wholly-owned by NiSource or in partnership with other qualified project participants. Electric Operations capital program included improvements related to the operational integrity of generation, transmission and distribution assets, expenditures related to environmental compliance regarding NOx reduction, and additions to electric distribution systems related to new customers. Capital expenditures in Other Operations mainly comprise partnership investments and enterprise-wide information technology infrastructure improvement. In 2004, Other Operations included a recovery of funds related to prior year investments.

For 2005, the projected capital program is expected to be $623.6 million, which is $100.2 million higher than the 2004 level. This higher spending is mainly due to increased expenditures for pipeline integrity related work and growth initiatives in the Gas Transmission and Storage Operations segment and system upgrades in the Gas Distribution Operations segment to maintain service and reliability. The program is expected to be funded primarily with cash from operations. Increases in 2005 capital expenditures will be partly offset by a continued reduction in estimated expenditures for NOx compliance.

Market Risk Disclosures

Risk is an inherent part of NiSource s energy businesses. The extent to which NiSource properly and effectively identifies, assesses, monitors and manages each of the various types of risk involved in its businesses is critical to its profitability. NiSource seeks to identify, assess, monitor and manage, in accordance with defined policies and procedures, the following principal trading and non-trading risks that are involved in NiSource s energy businesses: commodity market risk, interest rate risk and credit risk. Risk management at NiSource is a multi-faceted process with committee oversight that requires constant communication, judgment and knowledge of specialized products and markets. NiSource s senior management takes an active role in the risk management process and has developed policies and procedures that require specific administrative and business functions to assist in the identification, assessment and control of various risks. In recognition of the increasingly varied and complex nature of the energy business, NiSource s risk management policies and procedures continue to evolve and are subject to ongoing review and modification.

Various analytical techniques are employed to measure and monitor NiSource s market and credit risks, including value-at-risk and instrument sensitivity to market factors (VaR). VaR represents the potential loss or gain for an instrument or portfolio from changes in market factors, for a specified time period and at a specified confidence level.

Non-Trading Risks

Commodity price risk resulting from non-trading activities at NiSource s rate-regulated subsidiaries is limited, since regulations allow recovery of prudently incurred purchased power, fuel and gas costs through the rate-making process. If states should explore additional regulatory reform, these subsidiaries may begin providing services without the benefit of the traditional ratemaking process and may be more exposed to commodity price risk.

Effective July 1, 2002, TPC sold a significant portion of its net obligations under its gas forward transaction portfolio, physical storage inventory and associated agreements to a third party. Beginning with the effective date of the sale, the primary remaining operations associated with TPC include commercial and industrial gas sales (including arranging supply), power marketing and gas supply associated with Whiting Clean Energy, Inc. and power trading. With the exception of power trading and one remaining gas trading transaction, which expired in October 2002, since July 1, 2002 the gas-related activities at TPC were no longer considered trading activities for accounting purposes.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

As a result of the fixed-to-variable interest rate swap transactions referenced above, $1,160 million of NiSource Finance s existing long-term debt is now subject to fluctuations in interest rates.

NiSource is exposed to interest rate risk as a result of changes in interest rates on borrowings under revolving credit agreements, variable rate pollution control bonds and floating rate notes, which have interest rates that are indexed to short-term market interest rates. NiSource is also exposed to interest rate risk due to changes in interest rates on fixed-to-variable interest rate swaps that hedge the fair value of long-term debt. Based upon average borrowings and debt obligations subject to fluctuations in short-term market interest rates during 2004 and 2003, an increase in short-term interest rates of 100 basis points (1%) would have increased interest expense by $20.5 million and $16.2 million for the years 2004 and 2003, respectively.

Between October 27, 2004 and November 1, 2004, NiSource Finance entered into $900 million of forward starting interest rate swaps, hedging the future interest payments of long-term debt. The $900 million of forward starting swaps included $450 million notional value of 12-year forward starting swaps entered into with three counterparties and $450 million notional value of 15-year forward starting swaps entered into with three additional counterparties. Entering into these hedge transactions allows NiSource Finance to mitigate the risk from rising interest rates and uncertain interest expense cash flows in the future. Assuming prevailing credit spreads in effect at the time the forward starting swaps were put in place, the swaps would result in a net effective interest rate of approximately 5.55%-5.65% for the planned 12-year note issuance and approximately 5.70%-5.80% for the planned 15-year note issuance. These approximate interest rates assume the relationship between swap spreads embedded in the forward starting swaps and NiSource Finance s credit spread remain constant from execution date of the swaps through the planned notes issuance date anticipated in September 2005. Each of the forward starting swap transactions have both an effective date and a mandatory early termination date of September 7, 2005, which is the date NiSource Finance anticipates completing $900 million of new debt issuance, consisting of $450 million of 12-year notes and $450 million of 15-year notes.

On May 12, 2004, NiSource Finance entered into fixed-to-variable interest rate swap agreements in a notional amount of $660 million with six counterparties having a 6 1/2-year term. NiSource Finance will receive payments based upon a fixed 7.875% interest rate and pay a floating interest amount based on U.S. 6-month British Banker Association (BBA) London InterBank Offered Rate (LIBOR) plus an average of 3.08% per annum. There was no exchange of premium at the initial date of the swaps. In addition, each party has the right to cancel the swaps on May 15, 2009 at mid-market.

On May 12, 2004, Columbia terminated all remaining fixed-to-variable interest rate swap agreements.

On July 22, 2003, NiSource Finance entered into fixed-to-variable interest rate swap agreements in a notional amount of $500 million with four counterparties with an 11-year term. NiSource Finance will receive payments based upon a fixed 5.40% interest rate and pay a floating interest amount based on U.S. 6-month BBA LIBOR plus an average of 0.78% per annum. There was no exchange of premium at the initial date of the swaps. In addition, each party has the right to cancel the swaps on either July 15, 2008 or July 15, 2013 at mid-market.

On April 11, 2003, Columbia entered into fixed-to-variable interest rate swap agreements in a notional amount of $100 million with two counterparties. Columbia received payments based upon a fixed 7.42% interest rate and paid a floating interest amount based on U.S. 6-month BBA LIBOR plus an average of 2.39% per annum. There was no exchange of premium at the initial date of the swaps. These interest rate swap agreements were terminated on May 12, 2004.

On April 4, 2003, Columbia terminated a fixed-to-variable interest rate swap agreement in a notional amount of $100 million. Columbia received a settlement payment from the counterparty amounting to $8.2 million, which is being amortized as a reduction to interest expense over the remaining term of the underlying debt.

On September 3, 2002, Columbia entered into new fixed-to-variable interest rate swap agreements totaling $281.5 million with three counterparties effective as of September 5, 2002. According to the agreements, Columbia will receive payments based upon a fixed 7.32% interest rate and will pay a floating interest amount based on U.S.

6-month BBA LIBOR plus 2.66% per annum. There was no exchange of premium at inception of the swaps. These interest rate swap agreements were terminated on May 12, 2004.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Due to the nature of the industry, credit risk is a factor in many of NiSource s business activities. Credit risk arises because of the possibility that a customer, supplier or counterparty will not be able or willing to fulfill its obligations on a transaction on or before the settlement date. For derivative contracts such as interest rate swaps, credit risk arises when counterparties are obligated to pay NiSource the positive fair value or receivable resulting from the execution of contract terms. Exposure to credit risk is measured in terms of both current and potential exposure. Current credit exposure is generally measured by the notional or principal value of financial instruments and direct credit substitutes, such as commitments, standby letters of credit and guarantees. Because many of NiSource s exposures vary with changes in market prices, NiSource also estimates the potential credit exposure over the remaining term of transactions through statistical analyses of market prices. In determining exposure, NiSource considers collateral that it holds to reduce individual counterparty credit risk.

Trading Risks

Prior to the July 1, 2002 sale of the TPC gas marketing and trading contracts, NiSource s trading operations consisted of gas- and power-related activities. Beginning July 1, 2002, with the exception of one remaining gas trading transaction, which expired in October 2002, the trading activities of TPC have involved power only.

The transactions associated with NiSource s power trading operations give rise to various risks, including market risks resulting from the potential loss from adverse changes in the market prices of electricity. The power trading operations market and trade over-the-counter contracts for the purchase and sale of electricity. Those contracts within the power trading portfolio that require settlement by physical delivery are often net settled in accordance with industry standards.

Fair value represents the amount at which willing parties would transact an arms-length transaction. Fair value is determined by applying a current price to the associated contract volume for a commodity. The current price is derived from one of three sources including actively quoted markets such as the New York Mercantile Exchange (NYMEX), other external sources including electronic exchanges and over-the-counter broker-dealer markets, as well as financial models such as the Black-Scholes option pricing model.

The fair values of the contracts related to NiSource s trading operations, the activity affecting the changes in the fair values during 2004, the sources of the valuations of the contracts during 2004 and the years in which the remaining contracts (all power trading) mature are:

(in millions at December 31)	**2004**
Fair value of trading contracts outstanding at the beginning of the period	**$ (1.5)**
Contracts realized or otherwise settled during the period (including net option premiums received)	**(0.4)**
Fair value of new contracts entered into during the period	**(8.6)**
Other changes in fair values during the period	**7.5**
Fair value of contracts outstanding at the end of the period	**$ (3.0)**

(in millions)	2005	2006	2007	2008	After
Prices from other external sources	$ (0.7)	$	$	$	$
Prices based on models/other method	(2.3)				
Total fair values	$ (3.0)	$	$	$	$

The caption Prices from other external sources generally includes contracts traded on electronic exchanges and over-the-counter contracts whose value is based on published indices or other publicly available pricing information. Contracts shown within Prices based on models/other method are generally valued employing the widely used Black-Scholes option-pricing model.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Market Risk Measurement

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, volatilities, correlations or other market factors, such as liquidity, will result in losses for a specified position or portfolio. NiSource calculates a one-day VaR at a 95% confidence level for the power trading group and the gas marketing group that utilize a variance/covariance methodology. Based on the results of the VaR analysis, the daily market exposure for power trading on an average, high and low basis was $0.2 million, $0.4 million and effectively zero, during 2004, respectively. The daily market exposure for the gas marketing and trading portfolios on an average, high and low basis was $0.1 million, $0.4 million and $0.1 million during 2004, respectively. Prospectively, management has set the VaR limits at $2.5 million for power trading and $0.5 million for gas marketing. Exceeding the VaR limits would result in management actions to reduce portfolio risk.

Refer to this Item 7, Critical Accounting Policies, and Note 1-Q, Accounting for Risk Management and Energy Trading Activities, and Note 6, Risk Management and Energy Trading Activities, in the Notes to Consolidated Financial Statements for further discussion of NiSource s risk management.

Off Balance Sheet Arrangements

NiSource has issued guarantees that support up to approximately $1.2 billion of commodity-related payments for its current subsidiaries involved in energy marketing and power trading and to satisfy requirements under forward gas sales agreements of a former subsidiary. These guarantees were provided to counterparties in order to facilitate physical and financial transactions involving natural gas and electricity. To the extent liabilities exist under the commodity-related contracts subject to these guarantees, such liabilities are included in the Consolidated Balance Sheets. In addition, NiSource has other guarantees, purchase commitments, operating leases, lines of credit and letters of credit outstanding. Refer to Note 6, Risk Management and Energy Trading Activities, and Note 17, Other Commitments and Contingencies, in the Notes to Consolidated Financial Statements for additional information about NiSource s off balance sheet arrangements.

Northern Indiana has a service agreement with Pure Air, a general partnership between Air Products and Chemicals, Inc. and First Air Partners LP, under which Pure Air provides scrubber services to reduce sulfur dioxide emissions for Units 7 and 8 at the Bailly Generating Station. Services under this contract commenced on June 15, 1992, and have current annual charges approximating $17.2 million. The agreement provides that, assuming various performance standards are met by Pure Air, a termination payment would be due if Northern Indiana terminated the agreement prior to the end of the twenty-year contract period.

In addition, NiSource has sold certain accounts receivable. NiSource s accounts receivable programs qualify for sale accounting because they meet the conditions specified in Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. In the agreements, all transferred assets have been isolated from the transferor and put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. NiSource does not retain any interest in the receivables under these programs. Refer to Note 16, Fair Value of Financial Instruments, in the Notes to Consolidated Financial Statements for additional information on these agreements.

Other Information

Critical Accounting Policies

NiSource applies certain accounting policies based on the accounting requirements discussed below that have had, and may continue to have, significant impacts on NiSource s results of operations and Consolidated Balance Sheets.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Basis of Accounting for Rate-Regulated Subsidiaries. Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS No. 71), provides that rate-regulated subsidiaries account for and report assets and liabilities consistent with the economic effect of the way in which regulators establish rates, if the rates established are designed to recover the costs of providing the regulated service and if the competitive environment makes it probable that such rates can be charged and collected. NiSource s rate-regulated subsidiaries follow the accounting and reporting requirements of SFAS No. 71. Certain expenses and credits subject to utility regulation or rate determination normally reflected in income are deferred on the Consolidated Balance Sheets and are recognized in income as the related amounts are included in service rates and recovered from or refunded to customers. The total amounts of regulatory assets and liabilities reflected on the Consolidated Balance Sheets were $998.4 million and $1,214.3 million at December 31, 2004, and $893.2 million and $1,164.5 million at December 31, 2003, respectively. For additional information, refer to Note 1-D, Basis of Accounting for Rate-Regulated Subsidiaries, in the Notes to Consolidated Financial Statements.

In the event that regulation significantly changes the opportunity for NiSource to recover its costs in the future, all or a portion of NiSource s regulated operations may no longer meet the criteria for the application of SFAS No. 71. In such event, a write-down of all or a portion of NiSource s existing regulatory assets and liabilities could result. If transition cost recovery is approved by the appropriate regulatory bodies that would meet the requirements under generally accepted accounting principles for continued accounting as regulatory assets and liabilities during such recovery period, the regulatory assets and liabilities would be reported at the recoverable amounts. If unable to continue to apply the provisions of SFAS No. 71, NiSource would be required to apply the provisions of SFAS No. 101, Regulated Enterprises Accounting for the Discontinuation of Application of Financial Accounting Standards Board (FASB) Statement No. 71. In management s opinion, NiSource s regulated subsidiaries will be subject to SFAS No. 71 for the foreseeable future.

Certain of the regulatory assets reflected on NiSource s Consolidated Balance Sheets require specific regulatory action in order to be included in future service rates. Although recovery of these amounts is not guaranteed, NiSource believes that these costs meet the requirements for deferral as regulatory assets under SFAS No. 71. Regulatory assets requiring specific regulatory action amounted to $174.5 million at December 31, 2004. If NiSource determined that the amounts included as regulatory assets were not recoverable, a charge to income would immediately be required to the extent of the unrecoverable amounts.

Accounting for Risk Management Activities. Under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as subsequently amended by SFAS No. 137, SFAS No. 138, and SFAS No. 149 (collectively referred to as SFAS No. 133,) the accounting for changes in the fair value of a derivative depends on the intended use of the derivative and resulting designation. Unrealized and realized gains and losses are recognized each period as components of other comprehensive income, earnings, or regulatory assets and liabilities depending on the nature of such derivatives. For subsidiaries that utilize derivatives for cash flow hedges, the effective portions of the gains and losses are recorded to other comprehensive income and are recognized in earnings concurrent with the disposition of the hedged risks. For fair value hedges, the gains and losses are recorded in earnings each period along with the change in the fair value of the hedged item. As a result of the rate making process, the rate-regulated subsidiaries generally record gains and losses as regulatory liabilities or assets and recognize such gains or losses in earnings when both the contracts settle and the physical commodity flows. These gains and losses recognized in earnings are then subsequently recovered in revenues through rates.

In order for a derivative contract to be designated as a hedge, the relationship between the hedging instrument and the hedged item or transaction must be highly effective. The effectiveness test is performed at the inception of the hedge and each reporting period thereafter, throughout the period that the hedge is designated. Any amounts determined to be ineffective are recorded currently in earnings.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Although NiSource applies some judgment in the assessment of hedge effectiveness to designate certain derivatives as hedges, the nature of the contracts used to hedge the underlying risks is such that the correlation of the changes in fair values of the derivatives and underlying risks is high. NiSource generally uses NYMEX exchange-traded natural gas futures and options contracts and over-the-counter swaps based on published indices to hedge the risks underlying its natural-gas-related businesses. NiSource had $209.4 million and $188.7 million of price risk management assets and $52.4 million and $36.7 million of price risk management liabilities, all primarily related to hedges, at December 31, 2004 and 2003, respectively. The amount of unrealized gains recorded to other comprehensive income, net of tax, was $93.9 million and $91.7 million at December 31, 2004 and 2003, respectively.

Accounting for Energy Trading Activities. Energy trading activities refers to energy contracts entered into with the objective of generating profits on or from exposure to shifts or changes in market prices. NiSource evaluates the contracts of its trading operations in accordance with the criteria for derivative contracts under SFAS No. 133. Through 2002, contracts not meeting the criteria under SFAS No. 133 were recorded at fair value under Emerging Issues Task Force Issue No. 98-10, Accounting for Energy Trading and Risk Management Activities (EITF No. 98-10).

Pursuant to EITF No. 98-10, when certain trading criteria are met, energy contracts, including energy-related contracts such as tolling, transportation and storage contracts, should be accounted for at fair value (marked to market) along with any related derivative contracts, recognizing related gains and losses currently in earnings. In the October 2002 EITF meeting, EITF No. 98-10 was rescinded and only contracts meeting the definition in SFAS No. 133 can be marked to market. Refer to Note 6, Risk Management and Energy Trading Activities, in the Notes to Consolidated Financial Statement for further information.

While the assessment of fair values for NiSource s trading contracts have been mainly based on pricing information for exchange-traded contracts, transportation and storage agreements related to gas trading deals entered into prior to the cessation of gas trading activities were marked to fair value based on the results of internal models. No estimates of fair values on transportation and storage contracts related to gas trading activities remained as of December 31, 2002 due to the sale or expiration of all gas-trading related agreements during the year. In addition, power trading options were marked to fair value through earnings based on internal calculations of fair value employing the widely-used Black-Scholes option pricing model. The fair value of the mark-to-fair-value options outstanding was a loss of $3.0 million and a loss of $1.5 million at December 31, 2004 and 2003, respectively.

NiSource s Consolidated Balance Sheets contained price risk management assets of $8.8 million and $21.9 million and price risk management liabilities of $11.9 million and $23.4 million, at December 31, 2004 and 2003, respectively, related to unrealized gains and losses on trading activities.

Pensions and Postretirement Benefits. NiSource has defined benefit plans for both pensions and other postretirement benefits. The plans are accounted for under SFAS No. 87, Employers Accounting for Pensions , and SFAS No. 106, Employers Accounting for Postretirement Benefits Other than Pensions. The calculation of the net obligations and annual expense related to the plans requires a significant degree of judgment regarding the discount rates to be used in bringing the liabilities to present value, long-term returns on plan assets and employee longevity, among other assumptions. Due to the size of the plans and the long-term nature of the associated liabilities, changes in the assumptions used in the actuarial estimates could have material impacts on the measurement of the net obligations and annual expense recognition. For further discussion of NiSource s pensions and other postretirement benefits see Note 10, Pension and Other Postretirement Benefits, in the Notes to Consolidated Financial Statements.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

NiSource Inc.

Recently Issued Accounting Pronouncements

SFAS No. 123 (revised 2004) Share-Based Payment (SFAS No. 123R). In December 2004, the FASB issued SFAS No. 123R which requires that the cost resulting from all share-based payment transactions be recognized in the financial statements and establishes fair value as the measurement objective in accounting for these transactions. This statement is effective for public entities as of the beginning of the first interim or annual reporting period beginning after June 15, 2005, using a modified version of the prospective application.

NiSource has traditionally aw