

NISOURCE INC/DE
Form 10-K
March 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007
OR

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 No

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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
The aggregate market value of Common Stock (based upon the June 30, 2007, closing price of \$20.71 on the New York Stock Exchange) held by non-affiliates was approximately \$5,655,237,621.

There were 274,155,779 shares of Common Stock, \$0.01 Par Value outstanding as of January 31, 2008.

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 13, 2008.

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DEFINED TERMS

The following is a list of frequently used abbreviations or acronyms that are found in this report:

NiSource Subsidiaries and
Affiliates

Bay State	Bay State Gas Company
Capital Markets	NiSource Capital Markets, Inc.
CER	Columbia Energy Resources, Inc.
CNR	Columbia Natural Resources, Inc.
Columbia	Columbia Energy Group
Columbia Atlantic Trading	Columbia Atlantic Trading Corporation
Columbia Energy Services	Columbia Energy Services Corporation
Columbia Gulf	Columbia Gulf Transmission Company
Columbia of Kentucky	Columbia Gas of Kentucky, Inc.
Columbia of Maryland	Columbia Gas of Maryland, Inc.
Columbia of Ohio	Columbia Gas of Ohio, Inc.
Columbia of Pennsylvania	Columbia Gas of Pennsylvania, Inc.
Columbia of Virginia	Columbia Gas of Virginia, Inc.
Columbia Petroleum	Columbia Petroleum Corporation
Columbia Transmission	Columbia Gas Transmission Corporation
CORC	Columbia of Ohio Receivables Corporation
Crossroads Pipeline	Crossroads Pipeline Company
Granite State Gas	Granite State Gas Transmission, Inc.
Hardy Storage	Hardy Storage Company, L.L.C.
IWC	Indianapolis Water Company
Kokomo Gas	Kokomo Gas and Fuel Company
Lake Erie Land	Lake Erie Land Company
Millennium	Millennium Pipeline Company, L.P.
NDC Douglas Properties	NDC Douglas Properties, Inc.
NiSource	NiSource Inc.
NiSource Corporate Services	NiSource Corporate Services Company
NiSource Development Company	NiSource Development Company, Inc.
NiSource Finance	NiSource Finance Corp.
Northern Indiana	Northern Indiana Public Service Company
Northern Indiana Fuel and Light	Northern Indiana Fuel and Light Company
Northern Utilities	Northern Utilities, Inc.
NRC	NIPSCO Receivables Corporation
PEI	PEI Holdings, Inc.
Primary Energy	Primary Energy, Inc.
TPC	EnergyUSA-TPC Corp.
Transcom	Columbia Transmission Communications Corporation
Whiting Clean Energy	Whiting Clean Energy, Inc.

Abbreviations

AFUDC	Allowance for funds used during construction
AICPA	American Institute of Certified Public Accountants
Algonquin	Algonquin Gas Transmission Co.
AOC	Administrative Order by Consent Order
APB No. 25	

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ASM	Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees
BART	Ancillary Services Market
BBA	Best Alternative Retrofit Technology
Bcf	British Banker Association
Board	Billion cubic feet
BP	Board of Directors
CAIR	BP Amoco p.l.c.
CAMR	Clean Air Interstate Rule
CCGT	Clean Air Mercury Rule
	Combined Cycle Gas Turbine

DEFINED TERMS (continued)

CERCLA	Comprehensive Environmental Response Compensation and Liability Act (Also known as Superfund)
CPCN	Certificate of Public Convenience and Necessity
Day 2	Began April 1, 2005 and refers to the operational control of the energy markets by MISO, including the dispatching of wholesale electricity and generation, managing transmission constraints, and managing the day-ahead, real-time and financial transmission rights markets
DOT	United States Department of Transportation
Dth	Dekatherm
ECR	Environmental Cost Recovery
ECRM	Environmental Cost Recovery Mechanism
ECT	Environmental cost tracker
EER	Environmental Expense Recovery
EERM	Environmental Expense Recovery Mechanism
EITF No. 06-03	Emerging Issues Task Force Issue No. 06-03, How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)
Empire	Empire State Pipeline
EPA	United States Environmental Protection Agency
EPS	Earnings per share
ESA	Energy Sales Agreement
FAC	Fuel adjustment clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FIN 39	FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts an interpretation of APB Opinion No. 10 and FASB Statement No. 105
FIN 46R	FASB Interpretation No. 46, Consolidation of Variable Interest Entities (revised December 2003) an interpretation of ARB No. 51
FIN 47	FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations
FIN 48	FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes
FIP	Federal Implementation Plan
FSP FIN 39-1	FASB Staff Position FIN39-1: Amendment of FASB Interpretation No. 39
FTRs	Financial Transmission Rights
General Electric	General Electric International, Inc.
gwh	Gigawatt hours
hp	Horsepower
IBM	International Business Machines Corp.
IBM Agreement	The Agreement for Business Process & Support Services
IDEM	Indiana Department of Environmental Management
Iroquois	Iroquois Gas Transmission System LP
IRP	Integrated Resource Plan
IRS	Internal Revenue Service
IURC	Indiana Utility Regulatory Commission
LDCs	Local distribution companies
LIBOR	London InterBank Offered Rate

LIFO	Last-in, first-out
LNG	Liquefied Natural Gas
MGP	Manufactured gas plant
MISO	Midwest Independent Transmission System Operator
Mitchell Station	Dean H. Mitchell Coal Fired Generating Station
MLP	Master Limited Partnership
MMDth	Million dekatherms

DEFINED TERMS (continued)

mw	Megawatts
N/A	Not available
NAAQS	National Ambient Air Quality Standards
NASDAQ	National Association of Securities Dealers Automated Quotations
NOV	Notice of Violation
NO _x	Nitrogen oxide
NPDES	National Pollutant Discharge Elimination System
NYMEX	New York Mercantile Exchange
OUCC	Indiana Office of Utility Consumer Counselor
PCB	Polychlorinated biphenyls
Piedmont	Piedmont Natural Gas Company, Inc.
ppm	parts per million
PPS	Price Protection Service
PUCO	Public Utilities Commission of Ohio
QPAI	Qualified production activities income
RCRA	Resource Conservation and Recovery Act
RFP	Request for Proposal
SAB No. 92	Staff Accounting Bulletin No. 92, Accounting and Disclosures Relating to Loss Contingencies
SEC	Securities and Exchange Commission
SFAS No. 5	Statement of Financial Accounting Standards No. 5, Accounting for Contingencies
SFAS No. 71	Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation
SFAS No. 87	Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions
SFAS No. 88	Statement of Financial Accounting Standards No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits
SFAS No. 101	Statement of Financial Accounting Standards 101, Regulated Enterprises Accounting for the Discontinuation of Application of Financial Accounting Standards Board Statement No. 71
SFAS No. 106	Statement of Financial Accounting Standards No. 106, Employers Accounting for Postretirement Benefits Other than Pensions
SFAS No. 123	Statement of Financial Accounting Standards No. 123, Share-Based Payment
SFAS No. 123R	Statement of Financial Accounting Standards No. 123R, Share-Based Payment
SFAS No. 131	Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information
SFAS No. 133	Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended
SFAS No. 140	Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Asset and Extinguishments of Liabilities
SFAS No. 141R	Statement of Financial Accounting Standards No. 141R, Business Combinations

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SFAS No. 142	Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets
SFAS No. 143	Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations
SFAS No. 144	Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets

DEFINED TERMS (continued)

SFAS No. 157	Statement of Financial Accounting Standards No. 157, Fair Value Measurement
SFAS No. 158	Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans
SFAS No. 159	Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115
SFAS No. 160	Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51
SIP	State Implementation Plan
SNG	Synthetic Natural Gas
SO2	Sulfur dioxide
SOP 96-1	Statement of Position 96-1, Environmental Remediation Liabilities
SOP 98-1	Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use
VaR	Value-at-risk and instrument sensitivity to market factors

PART I

ITEM 1. BUSINESS

NiSource Inc.

NiSource is an energy holding company whose subsidiaries provide natural gas, electricity and other products and services to approximately 3.8 million customers located within a corridor that runs from the Gulf Coast through the Midwest to New England. NiSource is the successor to an Indiana corporation organized in 1987 under the name of NIPSCO Industries, Inc., which changed its name to NiSource Inc. on April 14, 1999. In connection with the acquisition of Columbia on November 1, 2000, NiSource became a Delaware corporation registered under the Public Utility Holding Company Act of 1935. Effective February 8, 2006, the Public Utility Holding Company Act of 1935 was repealed. NiSource is now a holding company under the Public Utility Holding Company Act of 2005.

NiSource is the largest natural gas distribution company operating east of the Rocky Mountains, as measured by number of customers. NiSource's principal subsidiaries include Columbia, a vertically-integrated natural gas distribution, transmission and storage holding company whose subsidiaries provide service to customers in the Midwest, the Mid-Atlantic and the Northeast; Northern Indiana, a vertically-integrated gas and electric company providing service to customers in northern Indiana; and Bay State, a natural gas distribution company serving customers in New England. NiSource derives substantially all of its revenues and earnings from the operating results of its 16 direct subsidiaries.

NiSource's business segments are: Gas Distribution Operations; Gas Transmission and Storage Operations; Electric Operations; and Other Operations. Following is a summary of the business for each reporting segment. Refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", for additional information for each segment.

Gas Distribution Operations

NiSource's natural gas distribution operations serve more than 3.3 million customers in nine states and operate approximately 58 thousand miles of pipeline. Through its wholly owned subsidiary, Columbia, NiSource owns five distribution subsidiaries that provide natural gas to approximately 2.2 million residential, commercial and industrial customers in Ohio, Pennsylvania, Virginia, Kentucky and Maryland. NiSource also distributes natural gas to approximately 795 thousand customers in northern Indiana through three subsidiaries: Northern Indiana, Kokomo Gas and Northern Indiana Fuel and Light. Additionally, NiSource's subsidiaries Bay State and Northern Utilities distribute natural gas to approximately 342 thousand customers in Massachusetts, Maine and New Hampshire.

Gas Transmission and Storage Operations

NiSource's Gas Transmission and Storage Operations subsidiaries own and operate approximately 16 thousand miles of interstate pipelines and operate one of the nation's largest underground natural gas storage systems capable of storing approximately 637 Bcf of natural gas. Through its subsidiaries, Columbia Transmission, Columbia Gulf, Crossroads Pipeline and Granite State Gas, NiSource owns and operates an interstate pipeline network extending from offshore in the Gulf of Mexico to Lake Erie, New York and the eastern seaboard. Together, these companies serve customers in 19 northeastern, mid-Atlantic, midwestern and southern states and the District of Columbia.

The Gas Transmission and Storage Operations subsidiaries are engaged in several projects that will expand their facilities and throughput. The largest such project is the Millennium Pipeline, which received FERC approval in December 2006. The reconfigured project will begin at an interconnect with Empire, an existing pipeline that originates at the Canadian border and extends easterly towards Syracuse, New York. Empire will construct a lateral pipeline southward to connect with Millennium near Corning, New York. Millennium will extend eastward to an interconnect with Algonquin at Ramapo, New York. Another project is Hardy Storage, a Columbia Transmission partnership to develop a storage field in West Virginia to provide additional natural gas storage for the eastern United States. Also, on January 14, 2008, the FERC awarded Columbia Transmission a certificate for its Eastern Market Expansion project, which has precedent agreements with four East Coast customers.

ITEM 1. BUSINESS (continued)

NiSource Inc.

Electric Operations

NiSource generates, transmits and distributes electricity through its subsidiary Northern Indiana to approximately 457 thousand customers in 20 counties in the northern part of Indiana and engages in wholesale and transmission transactions. Northern Indiana owns four and has the current ability to operate three coal-fired electric generating stations. The three operable facilities have a net capability of 2,574 mw. Northern Indiana also operates six gas-fired generating units with a net capability of 323 mw and two hydroelectric generating plants with a net capability of 10 mw. These facilities provide for a total system operating net capability of 2,907 mw. Northern Indiana's transmission system, with voltages from 69,000 to 345,000 volts, consists of 2,778 circuit miles. Northern Indiana is interconnected with five neighboring electric utilities.

During the year ended December 31, 2007, Northern Indiana generated 78.5% and purchased 21.5% of its electric requirements. Northern Indiana's Mitchell Station, indefinitely shut down in 2002, is not included in the net capacity of the three coal-fired generation stations. Northern Indiana does not anticipate restarting the Mitchell Station in the near term. Northern Indiana's IRP, filed with the IURC in November 2007, indicated a gap between customer demand projections and company owned generating capability of approximately 1,000 mw. Northern Indiana anticipates regulatory approval to acquire CCGT generating facilities in 2008. On January 25, 2008, Northern Indiana filed a CPCN to purchase the Sugar Creek CCGT facility. Northern Indiana is requesting the IURC and the FERC to approve the purchase by the second quarter of 2008.

Northern Indiana participates in the MISO transmission service and wholesale energy market. The MISO is a nonprofit organization created in compliance with FERC, to improve the flow of electricity in the regional marketplace and to enhance electric reliability. Additionally, MISO is responsible for managing the energy markets, managing transmission constraints, managing the day-ahead, real-time and financial transmission rights markets and managing the ancillary market. Northern Indiana transferred functional control of its electric transmission assets to MISO and transmission service for Northern Indiana occurs under the MISO Open Access Transmission Tariff.

Other Operations

The Other Operations segment participates in energy-related services including gas marketing, power and gas risk management and ventures focused on distributed power generation technologies, including a cogeneration facility, fuel cells and storage systems. PEI operates the Whiting Clean Energy project at BP's Whiting, Indiana refinery, which is a 525 mw cogeneration facility that uses natural gas to produce electricity for sale in the wholesale markets and also provides steam for industrial use. Additionally, the Other Operations segment is involved in real estate and other businesses.

Divestiture of Non-Core Assets

In recent years, NiSource sold certain businesses judged to be non-core to NiSource's strategy. Lake Erie Land, a wholly owned subsidiary of NiSource, has sold and is in the process of selling certain real estate, which included its Sand Creek Golf Club assets, which were sold in June 2006, to a private real estate developer. In addition, NDC Douglas Properties, a subsidiary of NiSource Development Company, is in the process of exiting its low income housing investments.

Business Strategy

NiSource focuses its business strategy on its core, rate-regulated asset-based businesses with virtually 100% of its operating income generated from the rate-regulated businesses. With the nation's fourth largest natural gas pipeline, the largest natural gas distribution network east of the Rocky Mountains and one of the nation's largest natural gas storage networks, NiSource operates throughout the energy-intensive corridor that extends from the supply areas in the Gulf Coast through the consumption centers in the Midwest, Mid-Atlantic, New England and Northeast. This corridor includes over 40% of the nation's population and close to 50% of its natural gas consumption. NiSource continues to position its assets to meet the corridor's growing energy needs.

Competition and Changes in the Regulatory Environment

The regulatory frameworks applicable to NiSource's operations, at both the state and federal levels, continue to evolve. These changes have had and will continue to have an impact on NiSource's operations, structure and profitability.

Management continually seeks new ways to be more competitive and profitable in this changing environment, including providing gas customers with increased choices for products and services.

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ITEM 1. BUSINESS (continued)

NiSource Inc.

Natural Gas Competition. Open access to natural gas supplies over interstate pipelines and the deregulation of the commodity price of gas has led to tremendous change in the energy markets. LDC customers and marketers began to purchase gas directly from producers and marketers and an open, competitive market for gas supplies has emerged. This separation or unbundling of the transportation and other services offered by pipelines and LDCs allows customers to purchase the commodity independent of services provided by the pipelines and LDCs. The LDCs continue to purchase gas and recover the associated costs from their customers. NiSource's Gas Distribution Operations subsidiaries are involved in programs that provide customers the opportunity to purchase their natural gas requirements from third parties and use the NiSource Gas Distribution Operations subsidiaries for transportation services.

Electric Competition. In December 1999, the FERC issued Order 2000, a final rule addressing the formation and operation of Regional Transmission Organizations. The rule was intended to eliminate pricing inequities in the provisioning of wholesale transmission service. In compliance with the rule, Northern Indiana transferred functional control of its electric transmission assets to MISO on October 1, 2003. Transmission service for Northern Indiana occurs under the MISO Open Access Transmission Tariff. On April 1, 2005, MISO implemented an electric energy market following approved FERC tariffs. Northern Indiana currently sells all power from its plants into this market. NiSource's Other Operations subsidiaries also experience competition for energy sales and related services from third party providers. NiSource meets these challenges through innovative programs aimed at providing energy products and services at competitive prices while also providing new services that are responsive to the evolving energy market and customer requirements.

Financing Subsidiary

NiSource Finance is a wholly-owned, consolidated finance subsidiary of NiSource that engages in financing activities to raise funds for the business operations of NiSource and its subsidiaries. NiSource Finance was incorporated in February 2000 under the laws of the state of Indiana. NiSource Finance's obligations are fully and unconditionally guaranteed by NiSource.

Other Relevant Business Information

NiSource's customer base is broadly diversified, with no single customer accounting for a significant portion of revenues.

As of December 31, 2007, NiSource had 7,607 employees of whom 3,384 were subject to collective bargaining agreements.

For a listing of certain subsidiaries of NiSource refer to Exhibit 21.

NiSource files various reports with the SEC. The reports include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. NiSource makes all SEC filings available without charge to the public on its web site at <http://www.nisource.com>.

ITEM 1A. RISK FACTORS

NiSource Inc.

There are many factors that could have a material adverse effect on NiSource's operating results, financial condition and cash flows. New risks may emerge at any time, and NiSource cannot predict those risks or estimate the extent to which they may affect financial performance. Each of the risks described below could adversely impact the value of NiSource's securities.

NiSource has substantial indebtedness, which could adversely affect its financial condition.

NiSource has a significant amount of indebtedness outstanding in part as a result of the acquisition of Columbia and Bay State. NiSource had total consolidated indebtedness of \$6,689.3 million outstanding as of December 31, 2007. The substantial indebtedness could have important consequences to investors. For example, it could:

limit the ability to borrow additional funds or increase the cost of borrowing additional funds;

reduce the availability of cash flow from operations to fund working capital, capital expenditures and other general corporate purposes;

limit the flexibility in planning for, or reacting to, changes in the business and the industries in which the company operates;

lead parties with whom NiSource does business to require additional credit support, such as letters of credit, in order for NiSource to transact such business;

place NiSource at a competitive disadvantage compared to competitors that are less leveraged; and

increase vulnerability to general adverse economic and industry conditions.

Some of NiSource's debt obligations contain financial covenants related to debt-to-capital ratios and cross-default provisions. NiSource's failure to comply with any of these covenants could result in an event of default, which if not cured or waived, could result in the acceleration of outstanding debt obligations. Additionally, a drop in NiSource's credit rating could adversely impact the cost for NiSource to issue new debt securities.

On December 18, 2007, Standard and Poor's lowered its senior unsecured ratings for NiSource and its subsidiaries to BBB-. Standard and Poor's outlook for NiSource and all of its subsidiaries is stable. On December 3, 2007, Moody's Investors Services affirmed the senior unsecured ratings for NiSource at Baa3, and the existing ratings of all other subsidiaries. Moody's changed its ratings outlook for NiSource and its subsidiaries to negative from stable. On July 10, 2007, Fitch Ratings affirmed their BBB senior unsecured rating for NiSource and the BBB+ ratings for Northern Indiana. Fitch's outlook for NiSource and all of its subsidiaries is stable. Although all ratings continue to be investment grade, an additional downgrade by Standard and Poor's or Moody's would result in a rating that is below investment grade.

Certain NiSource affiliates have agreements that 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 \$40 million. In addition to agreements with ratings triggers, there are other agreements that contain adequate assurance or material adverse change provisions that could result in additional credit support such as letters of credit and cash collateral to transact business.

NiSource's costs of compliance with environmental laws are significant. The costs of compliance with future environmental laws and the incurrence of environmental liabilities could impact cash flow and profitability.

NiSource's subsidiaries are subject to extensive federal, state and local environmental requirements that, among other things, regulate air emissions, water usage and discharges, remediation and the management of chemicals, hazardous waste and solid waste. Compliance with these legal requirements requires NiSource to commit significant expenditures for installation of pollution control equipment, remediation, environmental monitoring, emissions fees and permits at many of NiSource's facilities. These expenditures are significant, and NiSource expects that they will

continue to be significant in the future.

If NiSource's subsidiaries fail to comply with environmental laws and regulations or cause harm to the environment or persons, even if caused by factors beyond NiSource's control, that failure or harm may result in the assessment of civil or criminal penalties and damages against NiSource and its subsidiaries. In September 2004, the EPA issued

ITEM 1A. RISK FACTORS (continued)

NiSource Inc.

an NOV to Northern Indiana alleging violations of the new source review provisions of the Clean Air Act. An adverse outcome in this matter could require capital expenditures beyond the EPA requirements that cannot be determined at this time and could require payment of substantial penalties.

Existing environmental laws and regulations may be revised, and new laws and regulations seeking to protect the environment may be adopted or become applicable to NiSource's subsidiaries. Revised or additional laws and regulations could result in significant additional expense and operating restrictions on NiSource's facilities or increased compliance costs, which may not be fully recoverable from customers and would therefore reduce net income. The cost impact of any new or amended legislation would depend upon the specific requirements enacted and cannot be determined at this time.

A significant portion of the gas and electricity NiSource sells is used by residential and commercial customers for heating and air conditioning. Accordingly, the operating results fluctuate depending on the weather and, to a certain extent, usage of gas or electricity.

Energy sales are sensitive to variations in weather. Forecasts of energy sales are based on normal weather, which represents a long-term historical average. Significant variations from normal weather could have, and have had, a material impact on energy sales. Additionally, residential usage, and to some degree commercial usage, have shown to be sensitive to fluctuations in commodity costs for gas and electricity, whereby usage declines with increased costs, thus affecting NiSource's financial results.

NiSource's electric operations are subject to economic conditions in certain industries.

Electric operations in northern Indiana have been and may continue to be adversely affected by events in the steel and steel related industries. In particular, sales to large industrial customers within these steel and steel related industries may be impacted by economic downturns. The U.S. steel industry continues to adjust to changing market conditions including international competition, increased costs, and fluctuating demand for their products.

The majority of NiSource's net revenues are subject to economic regulation and are exposed to the impact of regulatory rate reviews and proceedings.

Virtually all of NiSource's net revenues are subject to economic regulation at either the federal or state level. As such, the net revenues generated by those regulated companies are subject to regulatory review by the applicable federal or state authority. These rate reviews determine the energy rates charged to customers and directly impact revenues. As part of a settlement reached in other regulatory proceedings, Northern Indiana has agreed to file an electric base rate case with the IURC on or before July 1, 2008. Columbia of Ohio filed a base rate case on March 3, 2008. Columbia of Pennsylvania filed a base rate case on January 28, 2008. Both companies expect final resolution of the cases to occur in 2008. The outcome for any rate case could have a material effect on NiSource's financial results.

NiSource recently restructured its outsourcing agreement with IBM, which included transitioning many of the functions which had been outsourced. Many associated changes in systems and personnel are being made, which may increase operational and control risks during transition and may have an impact on the business and its financial condition.

Under NiSource's restructured agreement with IBM, most functions, other than information technology, which had been outsourced to IBM will be transitioned back to NiSource or other third party providers. There will be costs incurred to undertake this transition and there could be a risk of operational delays, potential errors and control failures during the transition phase.

ITEM 1A. RISK FACTORS (continued)

NiSource Inc.

NiSource's Whiting Clean Energy project has generated losses and may be sold at a substantial discount to the value of the facility on NiSource's balance sheet.

NiSource owns and operates a merchant energy facility, Whiting Clean Energy, at BP's Whiting, Indiana refinery. This facility uses natural gas to generate electricity for sale in the wholesale markets and to generate steam for industrial use by BP's refinery. The profitability of this facility is dependant upon the market prices for electricity and natural gas and regional load dispatch patterns. On July 27, 2007, Whiting Clean Energy submitted a proposal in response to the Northern Indiana-issued RFP 2008 Combined Cycle Request for Proposals. Whiting Clean Energy was notified during October 2007 that its proposal to sell its facility was selected by Northern Indiana based on a purchase price of \$210 million. However, on December 22, 2007, BP indicated it would exercise a contractual right of first refusal to purchase the Whiting Clean Energy facility. NiSource is in discussions with BP regarding several aspects of the offer. The carrying amount of the Whiting Clean Energy facility is approximately \$270 million.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES**NiSource Inc.**

Discussed below are the principal properties held by NiSource and its subsidiaries as of December 31, 2007.

Gas Distribution Operations. NiSource's Gas Distribution Operations subsidiaries own and operate a total of 58,362 miles of pipelines and certain related facilities. This includes: (i) for the five distribution subsidiaries of its Columbia system, 35,266 miles of pipelines, 1,350 reservoir acres of underground storage, eight storage wells, liquid propane facilities with a capacity of 1.8 million gallons, an LNG facility with a total capacity of 0.5 million gallons and one compressor station with 800 hp of installed capacity, (ii) for its Northern Indiana system, 15,274 miles of pipelines, 27,129 reservoir acres of underground storage, 82 storage wells, two compressor stations with a total of 6,000 hp of installed capacity and an LNG facility with a storage capacity of 48.6 million gallons, (iii) for its Bay State system, 5,843 miles of pipelines, LNG facilities with a total capacity of 22.0 million gallons and liquid propane facilities with a capacity of 1.7 million gallons (iv) for its Northern Indiana Fuel and Light system, 943 miles of pipelines, and (v) for its Kokomo Gas system, 1,036 miles of pipelines and an LNG facility with a capacity of 4.9 million gallons. The physical properties of the NiSource gas utilities are located throughout Ohio, Indiana, Pennsylvania, Virginia, Kentucky, Maryland, Massachusetts, Maine and New Hampshire.

Gas Transmission and Storage Operations. Columbia Transmission has approximately 867,000 reservoir acres of underground storage, 3,524 storage wells, 12,105 miles of interstate pipelines and 86 compressor stations with 580,548 hp of installed capacity. These operations are located in Delaware, Kentucky, Maryland, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Virginia and West Virginia. Not including the offshore assets held for sale to Tennessee Gas Pipeline Company, Columbia Gulf has 3,430 miles of transmission pipelines and 11 compressor stations with 445,444 hp of installed capacity. Columbia Gulf's operations are located in Kentucky, Louisiana, Mississippi, Tennessee, Texas, Wyoming, and the offshore Gulf of Mexico. Granite State Gas has 86 miles of transmission pipeline with operations located in Maine, Massachusetts and New Hampshire. Crossroads Pipeline has 211 miles of transmission pipeline and one compressor station with 3,000 hp of installed capacity. Crossroads Pipeline's operations are located in Indiana and Ohio.

Electric Operations. Northern Indiana owns four and has the current ability to operate three coal-fired electric generating stations. The three operable facilities have a net capability of 2,574 mw. Northern Indiana also operates six gas-fired generating units with a net capability of 323 mw and two hydroelectric generating plants with a net capability of 10 mw. These facilities provide for a total system operating net capability of 2,907 mw. Northern Indiana's transmission system, with voltages from 69,000 to 345,000 volts, consists of 2,778 circuit miles. Northern Indiana is interconnected with five neighboring electric utilities.

During the year ended December 31, 2007, Northern Indiana generated 78.5% and purchased 21.5% of its electric requirements. Northern Indiana's Mitchell Station, indefinitely shut down in 2002, is not included in the net capacity of the three coal-fired generation stations. Northern Indiana does not anticipate restarting the Mitchell Station in the near term. Northern Indiana's IRP, filed with the IURC in November 2007, indicated a gap between customer demand projections and company owned generating capability of approximately 1,000 mw. Northern Indiana anticipates regulatory approval to acquire CCGT generating facilities in 2008. On January 25, 2008, Northern Indiana filed a CPCN to purchase the Sugar Creek CCGT facility. Northern Indiana is requesting the IURC and the FERC to approve the purchase by the second quarter of 2008.

Other Operations. PEI owns and operates the Whiting Clean Energy project at BP's Whiting, Indiana refinery, which is a 525 mw cogeneration facility that uses natural gas to produce electricity for sale in the wholesale markets and also provides steam for industrial use. As noted above, Whiting Clean Energy is in discussions with BP regarding BP's offer to purchase the Whiting Clean Energy facility. Through other subsidiaries, NiSource owns the Southlake Complex, its 325,000 square foot headquarters building located in Merrillville, Indiana and other residential and development property.

ITEM 2. PROPERTIES (continued)

NiSource Inc.

Character of Ownership. The principal offices and properties of NiSource and its subsidiaries are held in fee and are free from encumbrances, subject to minor exceptions, none of which are of such a nature as to impair substantially the usefulness of such properties. Many of the offices in various communities served are occupied by subsidiaries of NiSource under leases. All properties are subject to liens for taxes, assessments and undetermined charges (if any) incidental to construction. It is NiSource's practice regularly to pay such amounts, as and when due, unless contested in good faith. In general, the electric lines, gas pipelines and related facilities are located on land not owned in fee but are covered by necessary consents of various governmental authorities or by appropriate rights obtained from owners of private property. NiSource does not, however, generally have specific easements from the owners of the property adjacent to public highways over, upon or under which its electric lines and gas distribution pipelines are located. At the time each of the principal properties was purchased a title search was made. In general, no examination of titles as to rights-of-way for electric lines, gas pipelines or related facilities was made, other than examination, in certain cases, to verify the grantors' ownership and the lien status thereof.

ITEM 3. LEGAL PROCEEDINGS

NiSource Inc.

1. Stand Energy Corporation, et al. v. Columbia Gas Transmission Corporation, et al., Kanawha County Court, West Virginia

On July 14, 2004, Stand Energy Corporation filed a complaint in Kanawha County Court in West Virginia. The complaint contains allegations against various NiSource companies, including Columbia Transmission and Columbia Gulf, and asserts that those companies and certain select shippers engaged in an illegal gas scheme that constituted a breach of contract and violated state law. The illegal gas scheme complained of by the plaintiffs relates to the Columbia Transmission and Columbia Gulf gas imbalance transactions that were the subject of the FERC enforcement staff investigation and subsequent settlement approved in October 2000. Columbia Transmission and Columbia Gulf filed a Motion to Dismiss on September 10, 2004. In October 2004, however, the plaintiffs filed their Second Amended Complaint, which clarified the identity of some of the select shipper defendants and added a federal antitrust cause of action. To address the issues raised in the Second Amended Complaint, the Columbia companies revised their briefs in support of the previously filed motions to dismiss. In June 2005, the Court granted in part and denied in part the Columbia companies motion to dismiss the Second Amended Complaint. The Columbia companies have filed an answer to the Second Amended Complaint. On December 1, 2005, Plaintiffs filed a motion to certify this case as a class action. The Court has ordered that discovery will proceed on the issue of class certification as well as the merits.

2. United States of America ex rel. Jack J. Grynberg v. Columbia Gas Transmission Corporation, et al., U.S. District Court, E.D. Louisiana

The plaintiff filed a complaint in 1997, under the False Claims Act, on behalf of the United States of America, against approximately seventy pipelines, including Columbia Gulf and Columbia Transmission. The plaintiff claimed that the defendants had submitted false royalty reports to the government (or caused others to do so) by mismeasuring the volume and heating content of natural gas produced on Federal land and Indian lands. The Plaintiff's original complaint was dismissed without prejudice for misjoinder of parties and for failing to plead fraud with specificity. The plaintiff then filed over sixty-five new False Claims Act complaints against over 330 defendants in numerous Federal courts. One of those complaints was filed in the Federal District Court for the Eastern District of Louisiana against Columbia and thirteen affiliated entities (collectively, the Columbia defendants).

Plaintiff's second complaint, filed in 1997, repeated the mismeasurement claims previously made and added valuation claims alleging that the defendants undervalued natural gas for royalty purposes in various ways, including sales to affiliated entities at artificially low prices. Most of the Grynberg cases were transferred to Federal court in Wyoming in 1999.

On October 20, 2006, the Federal District Court issued an Order granting the Columbia defendants motion to dismiss for lack of subject matter jurisdiction. The Plaintiff has appealed the dismissal of the Columbia defendants.

3. Tawney, et al. v. Columbia Natural Resources, Inc., Roane County, WV Circuit Court

The Plaintiffs, who are West Virginia landowners, filed a lawsuit in early 2003 against CNR alleging that CNR underpaid royalties on gas produced on their land by improperly deducting post-production costs and not paying a fair value for the gas. In December 2004, the court granted plaintiffs motion to add NiSource and Columbia as defendants. Plaintiffs also claimed that the defendants fraudulently concealed the deduction of post-production charges. The court certified the case as a class action that includes any person who, after July 31, 1990, received or is due royalties from CNR (and its predecessors or successors) on lands lying within the boundary of the state of West Virginia. All claims by the government of the United States are excluded from the class. Although NiSource sold CNR in 2003, NiSource remains obligated to manage this litigation and for the majority of any damages ultimately awarded to the plaintiffs.

On January 27, 2007, the jury hearing the case returned a verdict against all defendants in the amount of \$404.3 million; this is comprised of \$134.3 million in compensatory damages and \$270 million in punitive damages. In January 2008, defendants filed their petition for appeal, and will be filing an amended petition in March, with the West Virginia Supreme Court

ITEM 3. LEGAL PROCEEDINGS (continued)

NiSource Inc.

of Appeals, which may or may not accept the appeal. NiSource has not established a reserve for the punitive damages portion of the verdict.

4. John Thacker, et al. v. Chesapeake Appalachia, L.L.C., U.S. District Court, E.D. Kentucky

On February 8, 2007, Plaintiff filed this purported class action, alleging that Chesapeake Appalachia, L.L.C. (Chesapeake) has failed to pay royalty owners the correct amounts pursuant to the provisions of their oil and gas leases covering real property located within the state of Kentucky. Columbia has assumed the defense of Chesapeake in this matter pursuant to the provisions of the Stock Purchase Agreement dated July 3, 2003, among Columbia, NiSource, and Triana Energy Holding, Inc., Chesapeake s predecessor in interest. Plaintiffs filed an amended complaint on March 19, 2007, which, among other things, added NiSource and Columbia as defendants. All of the Defendants Motions to Dismiss have been fully briefed and await a ruling by the court.

5. Environmental Protection Agency Notice of Violation

On September 29, 2004, the EPA issued an NOV to Northern Indiana for alleged violations of the Clean Air Act and the Indiana SIP. The NOV alleges that modifications were made to certain boiler units at three of Northern Indiana s generating stations between the years of 1985 and 1995 without obtaining appropriate air permits for the modifications. Northern Indiana is currently in discussions with the EPA regarding possible resolutions to this NOV.

6. Pennsylvania Department of Environmental Protection Proposed Consent Order and Agreement

On February 21, 2007, Pennsylvania Department of Environmental Protection provided representatives of Columbia Transmission with a proposed Consent Order and Agreement covering an unmanned equipment storage site located in rural southwest Pennsylvania. The site in question is also subject to the EPA s Administrative Order by Consent (Refer to Note 18-E, Environmental Matters, in the Notes to Consolidated Financial Statements for additional information regarding the Administrative Order by Consent). Pursuant to that order, Columbia Transmission has submitted a remediation plan to the EPA and the Pennsylvania Department of Environmental Protection. The EPA has approved the remediation plan and discussions are ongoing with the Pennsylvania Department of Environmental Protection regarding the proposed remediation. It is currently anticipated that remediation will begin in spring 2008.

Pennsylvania Department of Environmental Protection s proposed order alleges that Columbia Transmission has violated the state s Clean Streams Act and Solid Waste Management Act by discharging petroleum products onto the property and into the waters of the state. In addition to requiring remediation and monitoring activities at the site, the state has proposed penalties for these violations. Columbia Transmission plans to engage in further discussions with the agency regarding the proposed order, including the rationale for the proposed penalty.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

SUPPLEMENTAL ITEM. EXECUTIVE OFFICERS OF THE REGISTRANT

NiSource Inc.

The following is a list of the Executive Officers of the Registrant, including their names, ages, years with NiSource and offices held, as of February 1, 2008.

Name	Age	Years with NiSource	Office(s) Held in Past 5 Years
Robert C. Skaggs, Jr.	53	7	<p>Chief Executive Officer of NiSource since July 2005.</p> <p>President of NiSource since October 2004.</p> <p>Executive Vice President, Regulated Revenue of NiSource from October 2003 to October 2004.</p> <p>President of Columbia of Ohio from February 1997 to October 2003 and Columbia of Kentucky from January 1997 to October 2003.</p> <p>President of Bay State and Northern Utilities from November 2000 to October 2003.</p> <p>President of Columbia of Virginia, Columbia of Maryland, and Columbia of Pennsylvania from December 2001 to October 2003.</p>
Christopher A. Helms	53	2	<p>Executive Vice President and Group Chief Executive Officer of NiSource since January 4, 2008.</p> <p>Pipeline Group President of NiSource from April 2005 to December 2007.</p> <p>Principal of Helms & Company LP from December 2003 to March 2005.</p> <p>President of CMS Panhandle Companies from March 1999 to June 2003.</p> <p>Executive Vice President of CMS Gas Transmission Corp. from March 1999 to June 2003.</p>
Eileen O Neill Odum	53	-	<p>Executive Vice President and Group Chief Executive Officer of NiSource since December 2007.</p> <p>Executive Vice President and Chief Operating Officer of Commonwealth Telephone Enterprises from July 2004 to March 2007.</p> <p>President, Service Corporation of Verizon Communications from December 2003 to May 2004.</p>

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President, National Operations of Verizon Communications from July 2000 to December 2003.

Michael W. O Donnell 63

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Executive Vice President and Chief Financial Officer of NiSource since November 2000.

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SUPPLEMENTAL ITEM. EXECUTIVE OFFICERS OF THE REGISTRANT (continued)
NiSource Inc.

Name	Age	Years with NiSource	Office(s) Held in Past 5 Years
Carrie J. Hightman	50	-	Executive Vice President and Chief Legal Officer of NiSource since December 2007. President, AT&T Illinois from April 2001 through October 2006.
Robert D. Campbell	48	2	Senior Vice President, Human Resources, of NiSource since May 2006. Senior Vice President, Human Resources, NiSource Corporate Services since September 2005. Of Counsel with the law firm of Schiff Hardin, LLP from January 2004 to September 2005. Vice President, Human Resource Operations and Regulated Revenue, NiSource Corporate Services from October 2003 to January 2004. Vice President, Employee and Labor Relations, NiSource Corporate Services from June 2001 to October 2003.
Jeffrey W. Grossman	56	7	Vice President and Controller of NiSource since November 2000.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****NiSource Inc.**

NiSource's common stock is listed and traded on the New York Stock Exchange. The table below indicates the high and low sales prices of NiSource's common stock, on the composite tape, during the periods indicated.

	2007		2006	
	High	Low	High	Low
First Quarter	24.80	23.04	21.54	19.51
Second Quarter	25.43	19.90	22.08	19.99
Third Quarter	21.68	17.58	23.30	20.88
Fourth Quarter	20.82	17.49	24.80	21.48

As of December 31, 2007, NiSource had 38,091 common stockholders of record and 274,176,752 shares outstanding. Holders of shares of NiSource's common stock are entitled to receive dividends when, and if declared by NiSource's Board out of funds legally available. The policy of the Board has been to declare cash dividends on a quarterly basis payable on or about the 20th day of February, May, August and November. NiSource paid quarterly common dividends totaling \$0.92 per share for the years ended December 31, 2007, 2006 and 2005. By unanimous written consent dated January 4, 2008, the Board declared a quarterly common dividend of \$0.23 per share, payable on February 20, 2008 to holders of record on January 31, 2008.

Although the Board currently intends to continue the payment of regular quarterly cash dividends on common shares, the timing and amount of future dividends will depend on the earnings of NiSource's subsidiaries, their financial condition, cash requirements, regulatory restrictions, any restrictions in financing agreements and other factors deemed relevant by the Board.

ITEM 6. SELECTED FINANCIAL DATA**NiSource Inc.**

Year Ended December 31,

(\$ in millions except per share data)

	2007	2006	2005	2004	2003
Statement of Income Data:					
Gross Revenues					
Gas Distribution	\$ 4,446.5	\$ 4,189.3	\$ 4,600.4	\$ 3,801.8	\$ 3,554.5
Gas Transportation and Storage	1,090.1	1,033.2	1,000.0	1,013.4	1,033.5
Electric	1,358.0	1,299.2	1,248.6	1,121.0	1,115.9
Other	1,045.2	968.3	1,046.8	721.0	538.1
Total Gross Revenues	7,939.8	7,490.0	7,895.8	6,657.2	6,242.0
Net Revenues (Gross Revenues less Cost of Sales, excluding depreciation and amortization)	3,263.7	3,124.6	3,146.6	3,047.5	3,056.4
Operating Income	931.9	880.0	952.6	1,078.0	1,122.3
Income from Continuing Operations	312.0	313.5	284.1	433.0	426.9
Results from Discontinued Operations net of taxes	9.4	(31.7)	22.7	3.3	(332.9)
Cumulative Effect of Change in Accounting Principle net of taxes		0.4	(0.3)		(8.8)
Net Income	321.4	282.2	306.5	436.3	85.2
Balance Sheet Data:					
Total Assets	18,004.8	18,156.5	17,958.5	16,987.8	16,624.0
Capitalization					
Common stockholders' equity	5,076.6	5,013.6	4,933.0	4,787.1	4,415.9
Preferred stock			81.1	81.1	81.1
Long-term debt, excluding amounts due within one year	5,594.4	5,146.2	5,271.2	4,835.9	5,993.4
Total Capitalization	\$10,671.0	\$10,159.8	\$10,285.3	\$ 9,704.1	\$10,490.4
Per Share Data:					
Basic Earnings (Loss) Per Share (\$)					
Continuing operations	1.14	1.15	1.05	1.64	1.64
Discontinued operations	0.03	(0.11)	0.08	0.01	(1.28)
Change in accounting principles					(0.03)
Basic Earnings Per Share	1.17	1.04	1.13	1.65	0.33
Diluted Earnings (Loss) Per Share (\$)					
Continuing operations	1.14	1.14	1.04	1.63	1.63
Discontinued operations	0.03	(0.11)	0.08	0.01	(1.27)
Change in accounting principles					(0.03)
Diluted Earnings Per Share	1.17	1.03	1.12	1.64	0.33

Other Data:

Return on average common equity	6.4%	5.7%	6.3%	9.5%	2.0%
Times interest earned (pre-tax)	2.23	2.18	2.16	2.53	2.31
Dividends paid per share (\$)	0.92	0.92	0.92	0.92	1.10
Market values during the year (\$):					
High	25.43	24.80	25.50	22.82	21.97
Low	17.49	19.51	20.44	19.65	16.39
Close	18.89	24.10	20.86	22.78	21.94
Book value of common stock (\$)	18.52	18.32	18.09	17.69	16.81
Shares outstanding at the end of the year (in thousands)	274,177	273,654	272,623	270,626	262,630
Number of common shareholders	38,091	40,401	46,451	50,020	42,034
Capital expenditures (\$ in millions)	788.3	637.4	590.4	517.0	574.2
Number of employees	7,607	7,439	7,822	8,628	8,614

(a) During the fourth quarter of 2007, Whiting Clean Energy redeemed its outstanding long-term notes. The associated redemption premium of \$40.6 million was recorded as a loss on early extinguishment of long-term debt.

(b) Northern Indiana detected an error in its unbilled revenue calculation and revised its estimate for unbilled electric and gas revenues. As a result, this correction reduced net revenues by \$25.5 million in the fourth quarter of 2007.

- (c) In 2007, NiSource amended its ten-year agreement with IBM to provide business process and support services to NiSource. The original and amended IBM agreement reduced Operating Income by \$13.2 million, \$12.3 million and \$82.8 million due to restructuring and transition costs during 2007, 2006 and 2005, respectively.
- (d) In 2007, NiSource adopted the new measurement date provisions of SFAS No. 158 which decreased Total Assets by approximately \$80.2 million, decreased Total Liabilities by approximately \$76.8 million and decreased total common stock equity by approximately \$3.4 million, net of taxes.

- (e) In 2006, NiSource adopted SFAS No. 158 which increased Total Assets by approximately \$491.2 million, increased Total Liabilities by approximately \$347.6 million and increased total common stock equity by approximately \$143.6 million, net of taxes.

- (f) During the fourth quarter 2005, Columbia redeemed issues of its senior unsecured notes and recorded charges associated with the redemption of these securities totaling \$108.6 million, which were recognized as a loss on early extinguishment of long-term debt.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**NiSource Inc.**

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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's 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 success of NiSource's restructured outsourcing agreement, actual operating experience of NiSource's 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 is an energy holding company whose subsidiaries are engaged in the transmission, storage and distribution of natural gas in the high-demand energy corridor stretching from the Gulf Coast through the Midwest to New England and the generation, transmission and distribution of electricity in Indiana. NiSource generates virtually 100% of its operating income through these rate-regulated businesses. 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.

NiSource is a holding company under the Public Utility Holding Company Act of 2005.

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

NiSource Inc.

For the twelve months ended December 31, 2007, NiSource reported income from continuing operations before cumulative effect of change in accounting principle of \$312.0 million, or \$1.14 per basic share, compared to \$313.5 million, or \$1.15 per basic share in 2006.

Increases in net revenues and equity earnings were offset by higher operating expenses and other deductions. The increase in net revenues of \$139.1 million was impacted by the following key factors:

Favorable weather during 2007 as compared to 2006 increased Gas Distribution and Electric Operations net revenues by approximately \$90 million. While NiSource's gas markets experienced 3% warmer weather compared to normal, this was approximately 11% more favorable than the prior year. Northern Indiana's electric market experienced a 13% warmer summer cooling season compared to normal weather; This was approximately 29% warmer than 2006.

Higher net revenues from firm capacity reservation fees within Gas Transmission and Storage Operations. This increase more than offset lower revenues from shorter term transportation and storage services resulting from stabilization in the natural gas market. One of the drivers behind this improvement is that the Columbia Gulf mainline pipeline was fully subscribed throughout 2007.

Increased wholesale margins, residential volumes, and customer growth within Electric Operations net revenues.

Other Operations generated operating income for 2007 compared to an operating loss last year. This improvement is driven by Whiting Clean Energy. See the discussion below under the heading Whiting Clean Energy.

Electric Operations accrued \$33.5 million in the third quarter of 2007 for a settlement relating to power purchased by Northern Indiana during 2006 and 2007. See the discussion below under the heading, Rate Development and Other Regulatory Matters, for more information regarding the settlement.

Northern Indiana detected an error in its unbilled revenue calculation and revised its estimate for unbilled electric and gas revenues in the fourth quarter of 2007. Over a period of several years, Northern Indiana used incorrect customer usage data to calculate its unbilled revenue. As a result, this correction reduced electric net revenues by \$10.9 million and gas net revenues by \$14.6 million in the fourth quarter of 2007. The unbilled revenue estimates were never billed to customers.

Additionally, equity earnings in unconsolidated affiliates increased \$21.7 million due to Hardy Storage being placed in service in April 2007, higher AFUDC earnings from Millennium and the impact of Millennium recording a \$13 million reserve in 2006 related to vacated portions of the original project.

The revenue and equity earnings increases were offset by increases in operating expenses, interest expense and a loss on early extinguishment of debt. Following are the primary drivers for those increases.

Operation and maintenance expenses increased due primarily to \$68.7 million higher employee and administrative expenses that include payroll, benefits and corporate services. Within corporate services, the cost increases were primarily related to NiSource's business services arrangement with IBM which was impacted by the pricing structure under the original IBM Agreement. In December 2007, NiSource and IBM finalized a restructuring of their business services agreement. Going forward, NiSource will be in a position to more effectively manage its employee and administrative expenses, while ensuring delivery of services needed to meet the company's needs. See discussion of IBM Agreement.

Operation and maintenance expenses also increased due to electric generation and maintenance costs and impacts from severe storms.

On December 31, 2007, Whiting Clean Energy redeemed \$292.1 million of its notes due June 20, 2011, having an average interest rate of 8.30%. The associated redemption premium of \$40.6 million was charged to loss on early extinguishment of long-term debt.

Interest expense increased due to higher short-term interest rates and credit facility fees.

Increases in property taxes and higher depreciation cost over the prior year.

These factors and other impacts to the financial results are discussed in more detail within the following discussions of Results of Operations and Results and Discussion of Segment Operations.

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

NiSource Inc.

Four-Point Platform for Growth

NiSource has established four key initiatives to build a platform for long-term, sustainable growth: commercial and regulatory initiatives; commercial growth and expansion of the gas transmission and storage business; financial management of the balance sheet; and process and expense management.

Commercial and Regulatory Initiatives

Whiting Clean Energy. On December 18, 2006, Whiting Clean Energy and BP executed an amendment which materially changed the terms of the ESA under which Whiting Clean Energy provides steam to BP. The agreement specifies a planned termination of the ESA at the end of 2009, with options for BP to extend the term one additional year under renegotiated steam pricing. Whiting Clean Energy accrued \$17.0 million in December 2006, for costs associated with contract termination terms under the agreement. Additionally, BP would have the right of first refusal regarding any offers for the sale of the Whiting Clean Energy facility at BP.

On July 27, 2007, Whiting Clean Energy submitted a proposal in response to the Northern Indiana-issued RFP 2008 Combined Cycle Request for Proposals. Whiting Clean Energy was notified during October 2007 that its proposal to sell its facility was selected by Northern Indiana based on a purchase price of \$210 million. On December 22, 2007, BP indicated it would exercise a contractual right of first refusal to purchase the Whiting Clean Energy facility.

Whiting Clean Energy is in discussions with BP regarding several aspects of the offer. The carrying amount of the Whiting Clean Energy facility is approximately \$270 million.

On December 31, 2007, Whiting Clean Energy redeemed \$292.1 million of its notes due June 20, 2011, having an average interest rate of 8.30%. The associated redemption premium of \$40.6 million was charged to loss on early extinguishment of long-term debt. The redemption was financed with NiSource borrowings.

Rate Development and Other Regulatory Matters. NiSource is moving forward on regulatory initiatives across several distribution company markets. Whether through full rate case filings or other approaches, NiSource's goal is to develop strategies that benefit all stakeholders as it addresses changing customer conservation patterns, develops more contemporary pricing structures, and embarks on long-term investment programs to enhance its infrastructure. Rate case planning activities are underway at Northern Indiana with a filing anticipated during 2008.

Columbia of Pennsylvania, on January 28, 2008, filed a base rate case with the Pennsylvania Public Utilities Commission seeking to increase the company's base rates by approximately \$60 million annually, effective October 28, 2008. The rate case filing follows Columbia of Pennsylvania's 2007 launch of a 20-year, \$1.4 billion natural gas infrastructure enhancement program that is designed to replace in excess of 100 miles of underground natural gas distribution lines and related facilities annually. Columbia of Pennsylvania is also actively supporting legislation in Pennsylvania that would provide for a regulatory mechanism to recover the costs associated with natural gas infrastructure improvement programs on a timely basis.

On February 1, 2008, Columbia of Ohio filed its Notice of Intent to File An Application For Increase in Rates. The Columbia of Ohio Application was filed on March 3, 2008, requesting an increase in base rates in excess of \$80 million.

On December 21, 2007, Columbia of Virginia received approval from the Virginia State Corporation Commission to implement an off-system sales and capacity release incentive mechanism, effective January 1, 2008. The incentive mechanism provides Columbia of Virginia the opportunity to reduce overall gas costs for its customers and to generate incremental revenue by allowing the company to retain up to 25% of off-system sales and capacity release revenues, with the remainder to be returned to customers.

At Bay State, the Massachusetts Department of Public Utilities approved a \$5.9 million annual increase in the company's base rates, effective November 1, 2007, under the company's performance-based rate mechanism. On October 17, 2007, Bay State petitioned the Massachusetts Department of Public Utilities to allow the company to collect an additional \$7.5 million in annual revenue related to usage reductions occurring since its last rate case. Bay State also requested approval of a steel infrastructure tracker that would allow for recovery of ongoing

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

NiSource Inc.

infrastructure replacement program investments. The Massachusetts Department of Public Utilities is scheduled to hold hearings on this matter in the first quarter of 2008.

Columbia of Kentucky received approval during 2007 of a base rate case settlement with regulatory stakeholders that increases total annual revenues by \$7.25 million, or 4.5 percent.

During 2007, Northern Indiana achieved a number of important regulatory and operational accomplishments. In May 2007, the company received IURC approval for its Rate Simplification program, which provides benefits for both Northern Indiana and its customers, including the creation of a new energy conservation program.

On January 30, 2008, the IURC approved a settlement agreement which was reached in October 2007 with the OUCC, LaPorte County and a group of Northern Indiana industrial customers to resolve questions relating to the costs paid by customers for power purchased by Northern Indiana versus the amount of these costs absorbed by Northern Indiana.

The terms of the settlement call for Northern Indiana to make a one-time payment to resolve this question as it relates to power purchased from January 1, 2006 through September 30, 2007. The amount of the refund is set at \$33.5 million. A reserve for the entire amount was recorded in the third quarter of 2007. Northern Indiana

implemented a new benchmarking standard that will govern the allocation of costs for purchased power between customers and Northern Indiana. The benchmark defines the price below which customers will pay for power purchases and above which Northern Indiana must absorb a portion of the costs. The benchmark is based upon the costs of power generated by a hypothetical natural gas fired CCGT's using gas purchased and delivered to Northern Indiana. This will most likely result in Northern Indiana absorbing some purchased power costs that will reduce net revenues during future periods. The agreement also contemplates Northern Indiana adding generating capacity to its existing portfolio. The benchmark will be adjusted as new capacity is added. The added generating capacity will substantially reduce the amount of purchased power and mitigate the impact of the adjusted benchmark. Further, the settling parties agreed to support Northern Indiana's deferral and future recovery of carrying costs and depreciation associated with the acquisition of new generating facilities. In the approving order, the IURC dictated that, while the parties agreed to support the deferral of costs mentioned above, the IURC would rule on such deferral in CPCN proceedings.

On November 1, 2007, Northern Indiana filed its bi-annual IRP with the IURC. The plan showed the need to add approximately 1,000 mw of new capacity. Additionally, during November 2007, Northern Indiana filed a CPCN as well as contracts to purchase power generated with renewable energy, specifically with wind. The CPCN requested approval to purchase two CCGT power plants—the Whiting Clean Energy facility owned by PEI, a wholly owned subsidiary of NiSource, and the Sugar Creek facility located in west central Indiana and owned by LS Power Group.

On December 22, 2007, BP indicated it would exercise a contractual right of first refusal to purchase the Whiting Clean Energy facility. Whiting Clean Energy is in discussions with BP regarding several aspects of the offer. As a result, on January 25, 2008, Northern Indiana filed an amended CPCN to address just the Sugar Creek CCGT facility. The estimated cost of the facility is \$329 million. Northern Indiana is requesting the IURC and the FERC to approve the purchase by the second quarter of 2008.

Columbia of Ohio and other stakeholders reached an agreement in the fourth quarter of 2007 that establishes the framework for operations under Columbia of Ohio's CHOICE® program for the next several years and provides for a wholesale gas supply auction by early 2010. On January 23, 2008, the PUCO approved the agreement. During 2007, Columbia of Ohio also filed with the PUCO a Joint Stipulation that clarifies the company's operational responsibilities for customer-owned service lines and faulty risers. The stipulation establishes a recovery mechanism to collect certain costs associated with repair or replacement of customer-owned service lines and replacement of risers and resolves outstanding issues related to this important customer safety program.

Refer to the Results and Discussion of Segment Operations for a complete discussion of regulatory matters.

Pending Sale of Northern Utilities and Granite State Gas. On February 15, 2008, NiSource reached a definitive agreement under which Unitil Corporation will acquire NiSource subsidiaries Northern Utilities and Granite State Gas for \$160 million plus net working capital at the time of closing. Historically, net working capital has averaged

approximately \$25 million. Under the terms of the transaction, Until Corporation will acquire Northern Utilities, a local gas distribution company serving 52 thousand customers in 44 communities in Maine and New Hampshire and Granite State Gas, an 86-mile FERC regulated gas transmission pipeline primarily located in Maine and New

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

NiSource Inc.

Hampshire. The transaction, expected to be complete by the end of 2008, is subject to federal and state regulatory approvals. During the quarter ended March 31, 2008, NiSource expects to recognize an after tax loss of approximately \$65 million related to the pending sale and to account for Northern Utilities and Granite State Gas as discontinued operations.

NiSource acquired Northern Utilities and Granite State Gas in 1999 as part of the company's larger acquisition of Bay State. NiSource is retaining its ownership of Bay State as a core component of the company's long-term, investment-driven growth strategy.

Commercial Growth and Expansion of the Gas Transmission and Storage Business

Master Limited Partnership. On December 21, 2007, NiSource Energy Partners, L.P., an MLP and subsidiary of NiSource, filed an S-1 registration statement with the SEC in which it proposed making an initial public offering of common units in the MLP and NiSource proposed contributing its interest in Columbia Gulf to the MLP. NiSource management believes the formation of an MLP is a natural complement to NiSource's gas transmission and storage growth strategy, and should provide NiSource access to competitively priced capital to support future growth investment.

Millennium Pipeline Project. In June 2007, construction began on the Millennium Pipeline, a 182-mile-long, 30-inch-diameter pipeline across New York's Southern Tier and lower Hudson Valley. The project is expected to be completed in November 2008 and will transport up to 525,400 Dth per day of natural gas to markets along its route, as well as to the New York City markets through its pipeline interconnections. Millennium is jointly owned by affiliates of NiSource, KeySpan Corporation, and DTE Energy.

Hardy Storage Project. Hardy Storage completed its third full quarter of operations, receiving customer injections into its new underground natural gas storage facility in West Virginia. Injections this year will allow the field to deliver up to 150,000 Dth of natural gas per day during the 2008-2009 winter heating season. Customers withdrew over 900,000 Dth from the storage field during the last two months of 2007. When fully operational in 2009, the field will have a working storage capacity of 12 billion cubic feet, delivering more than 176,000 Dth of natural gas per day. Hardy Storage is a joint venture of subsidiaries of Columbia Transmission and Piedmont.

Columbia Transmission, the operator of Hardy Storage, is expanding its natural gas transmission system by 176,000 Dth per day to provide the capacity needed to deliver Hardy Storage supplies to customer markets. Construction of these transmission facilities is substantially complete and partially in service. The remainder will be placed in-service in the first half of 2008.

Eastern Market Expansion Project. On May 3, 2007, Columbia Transmission filed a certificate application before the FERC for approval to expand its facilities to provide additional storage and transportation services and to replace certain existing facilities. This Eastern Market Expansion project is projected to add 97,000 Dth per day of storage and transportation capacity and is fully subscribed on a 15-year contracted firm basis. On January 14, 2008, the FERC issued a favorable order which granted a certificate to construct the project and the project is expected to be in service by spring 2009.

Ohio Storage Project. Columbia Transmission concluded successful open seasons to gauge customer interest in an expansion of its storage in Ohio. The final scope of the project will be determined based on the outcome of the ongoing customer discussions. This project was previously referred to as the Crawford Storage Field project.

Other Growth Projects. Columbia Gulf recently expanded interconnection points to provide incremental delivery capacity of 30,000 Dth per day to Henry Hub and 85,000 Dth per day to Southern Natural Gas near Lafayette, Louisiana. Columbia Gulf entered into firm contracts for this capacity and the facilities were placed into service during the third quarter of 2007. A successful open season was held in the first quarter of 2007 to sell capacity of 380,000 Dth per day to two interconnection points with Transcontinental Gas Pipeline. This capacity provides increased access to downstream pipelines and their customers that access mid-Atlantic and Northeast markets. These interconnection points were placed into service in the fourth quarter of 2007.

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

An open season to solicit interest and contracts for expanded capacity on Columbia Gulf's system for delivery to Florida Gas Transmission was held in October and November 2007. This project is currently in development based on customer interest expressed during the open season.

Financial Management of the Balance Sheet

Refinancing of Debt. On August 31, 2007, NiSource Finance issued \$800 million of 6.40%, 10.5-year senior unsecured notes that mature March 15, 2018. The proceeds were used to repay short-term bank borrowings, to fund the redemption of \$24 million of Northern Indiana variable rate pollution control bonds due November 2007 and for capital expenditures and general corporate purposes. The short-term bank borrowings were previously used to fund the redemption of Northern Indiana's preferred stock in 2006, having a total redemption value of \$81.6 million, and for the repayment of an aggregate \$503.5 million of long-term debt in 2006 and the first nine months of 2007.

Shelf Registration. On December 21, 2007, NiSource filed a shelf registration statement with the SEC for an unspecified principal amount of debt securities, common and preferred stock, and other securities. NiSource is classified as a well-known seasoned issuer and the registration statement will be effective for three years.

Credit Ratings. On December 18, 2007, Standard and Poor's lowered its senior unsecured ratings for NiSource and its subsidiaries to BBB-. Standard and Poor's outlook for NiSource and all of its subsidiaries is stable. On December 3, 2007, Moody's Investors Services affirmed the senior unsecured ratings for NiSource at Baa3, and the existing ratings of all other subsidiaries. Moody's changed its ratings outlook for NiSource and its subsidiaries to negative from stable. On July 10, 2007, Fitch Ratings affirmed their BBB senior unsecured rating for NiSource and the BBB+ ratings for Northern Indiana. Fitch's outlook for NiSource and all of its subsidiaries is stable. Although all ratings continue to be investment grade, an additional downgrade by Standard and Poor's or Moody's would result in a rating that is below investment grade.

Process and Expense Management

IBM Agreement. During the second quarter of 2005, NiSource Corporate Services reached a definitive agreement with IBM under which IBM was to provide a broad range of business transformation and outsourcing services to NiSource and was anticipated to provide a cost savings over the 10-year agreement. As a part of the transformation initiatives, many new information technology systems and process changes had an accelerated time-line for completion, which increased costs in 2006 and 2007 and created the risk of operational delays, potential errors and control failures which could impact NiSource and its financial condition. In August 2006, further implementation of certain information technology systems was delayed due to difficulties encountered with the first wave of new system implementations.

In early 2007, a high-level team of NiSource and IBM resources began an overall reassessment of the outsourcing initiative primarily to focus on operational and transformational improvements and remediation and to develop an integrated plan that enables NiSource to achieve its business objectives going forward. In the first quarter of 2007, NiSource decided to bring certain finance and accounting functions back within the company. These functions included general accounting, fixed asset accounting, and budgeting. In December 2007, NiSource and IBM finalized a restructuring of their business services agreement. Under the restructured agreement, IBM will primarily provide information technology services, with a number of other business service functions to be transitioned back to the NiSource organization. Going forward, NiSource will be in a position to more effectively manage its employee and administrative expenses, while ensuring delivery of services needed to meet the company's needs.

2008-2010 Outlook

Earnings from continuing operations for the 2008-2010 periods are expected to fall within a range of \$1.23 to \$1.35 per share. These expected results assume normal weather and no impact from business dispositions, impairments, costs to retire debt and other significant items similar to those that impacted 2007 results. These items are discussed within the Results of Operation of this Item 7. Some of the actions taken during 2007 to establish a foundation for future growth will place pressure on NiSource's earnings in 2008. For example, the planned acquisition of a new generating facility and the purchase power settlement will impact earnings prior to the effectiveness of the electric rate

case in the Northern Indiana business, but have been factored in to these projected earnings.

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

NiSource Inc.

From a financing and credit rating standpoint, NiSource expects to issue additional long term debt in excess of \$500 million during 2008 and is committed to maintaining an investment grade rating.

NiSource's four-part business plan will continue to center on expansion of and commercial growth in the natural gas pipeline and storage business, regulatory and commercial initiatives at its utilities, financial management, and process and expense management. Within that plan, NiSource will place particular emphasis on three important areas during 2008.

Achieving key regulatory initiatives, including gas base rate cases in Pennsylvania and Ohio, as well as Northern Indiana's electric rate case scheduled for filing on July 1, 2008.

Advancing Gas Transmission and Storage Operation growth strategy, including securing approvals and timely construction of announced projects, developing an array of potential new growth opportunities, and continuing with the formation of the MLP.

Executing on major infrastructure enhancement projects, which will constitute a significant portion of NiSource's more than \$1 billion annual capital investment program expected for the 2008 to 2012 period.

Ethics and Controls

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. NiSource's senior management takes an active role in the development of this 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.

Management's evaluation of internal controls for 2007 identified a material weakness in Northern Indiana's unbilled revenue estimating process. Over a period of several years, Northern Indiana used incorrect customer usage data to calculate Northern Indiana's unbilled revenue estimate. As of year-end 2007, these incremental errors caused a cumulative overstatement of Northern Indiana's net revenue. The unbilled revenue estimates were never billed to customers and the error was corrected in the fourth quarter of 2007. Refer to Management's Report on Internal Control Over Financial Reporting included in Item 9A.

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, 2007, NiSource reported income from continuing operations before cumulative effect of change in accounting principle of \$312.0 million, or \$1.14 per basic share, compared to \$313.5 million, or \$1.15 per basic share in 2006. Income from continuing operations before the cumulative change in accounting principle for the twelve months ended December 31, 2005 was \$284.1 million, or \$1.05 per basic share. Including results from discontinued operations and the change in accounting principle, NiSource reported 2007 net income of \$321.4 million, or \$1.17 per basic share, 2006 net income of \$282.2 million, or \$1.04 per basic share, and 2005 net income of \$306.5 million, or \$1.13 per basic share.

Comparability of line item operating results was impacted by regulatory trackers that allow for the recovery in rates of certain costs such as bad debt expenses. Therefore, increases in these tracked operating expenses are offset by increases in net revenues and had essentially no impact on income from continuing operations. An increase in operating expenses of \$21.0 million for the 2007 year was offset by a corresponding increase to net revenues reflecting recovery of these tracked costs. In the 2006 period, an increase in operating expenses of \$55.3 million for trackers was offset by a corresponding increase to net revenues reflecting recovery of these costs. These increases in 2006 and in 2007 were largely attributable to higher uncollectible accounts.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**NiSource Inc.****Net Revenues**

Total consolidated net revenues (gross revenues less cost of sales) for the twelve months ended December 31, 2007 were \$3,263.7 million, a \$139.1 million increase compared with 2006, which includes the impact of \$21.0 million of trackers discussed above. NiSource's operating segments contributed to this overall increase in net revenues as follows: Gas Distribution Operations net revenues increased \$100.1 million; Other Operations increased \$29.6 million; Gas Transmission and Storage Operations contributed \$20.0 million; and, Electric Operations decreased \$10.8 million. Net revenue increases from Gas Distribution Operations were primarily a result of favorable weather of approximately \$73 million, a \$15.8 million increase in revenues from regulatory trackers, which are primarily offset in operating expense and higher net revenues from regulatory initiatives and other service programs of \$10.9 million, partially offset by a \$14.6 million adjustment for estimated unbilled revenues. Increased net revenues from the Whiting Clean Energy facility of \$30.5 million drove the increase in net revenues within Other Operations. Net revenues increased within Gas Transmission Operations as a result of increased firm capacity reservation revenues of \$20.8 million due in large part to the Columbia Gulf mainline pipeline being fully subscribed in 2007. Electric Operations net revenues were impacted by a \$33.5 million settlement related to the cost of power purchased by Northern Indiana in 2006 and 2007, lower industrial margins of \$11.8 million, a \$10.9 million adjustment for estimated unbilled revenues and higher revenue credits of \$5.1 million, which more than offset increases in net revenues due to higher wholesale margins and volumes amounting to \$19.6 million, favorable weather of approximately \$17 million, higher residential and commercial volumes attributable to usage and increased customers of approximately \$15.3 million and lower unrecoverable MISO costs of \$7.1 million. Northern Indiana detected an error in its unbilled revenue calculation and revised its estimate for unbilled electric and gas revenues in the fourth quarter of 2007. Over a period of several years, Northern Indiana used incorrect customer usage data to calculate its unbilled revenue. The unbilled revenue estimates were never billed to customers and the error was corrected in the fourth quarter of 2007.

Total consolidated net revenues (gross revenues less cost of sales) for the twelve months ended December 31, 2006 were \$3,124.6 million, a \$22.0 million decrease compared with 2005, which includes the impact of \$55.3 million of trackers discussed above. The change was principally driven by unfavorable weather compared to 2005, which impacted Gas Distribution Operations net revenues by approximately \$89 million as NiSource's gas markets experienced 14% warmer weather compared to 2005, and decreased Electric Operations net revenues by approximately \$21 million due to the northern Indiana electric market experiencing a 24% cooler summer compared to the 2005 summer cooling season. Gas Distribution Operations net revenues were also significantly affected by decreased residential gas customer usage amounting to approximately \$22 million. In addition, 2005's results benefited from a third party buyout of a bankruptcy claim relating to the rejection of a shipper's long term contract, which amounted to \$8.9 million. These decreases in net revenues were partially offset by increased sales of shorter-term transportation and storage services in Gas Transmission and Storage Operations amounting to \$43.9 million. Electric Operations net revenues increased by \$27.3 million as a result of a reduction in unrecoverable MISO costs included in costs of sales, which included the impact of a favorable regulatory ruling on the recoverability of certain MISO charges, timing of customer credits, proceeds from emission allowances, strong industrial sales and customer growth.

Expenses

Operating expenses were \$2,341.2 million in 2007, a \$108.9 million increase from 2006, which includes \$21.0 million of increased expense that is recovered through regulatory trackers and corresponding increases in net revenues (see discussion above). This increase was primarily due to higher employee and administrative expenses of \$68.7 million, higher expense within Electric Operations for electric generation and storm damage restoration totaling \$13.9 million, higher depreciation of \$10.0 million and increased other taxes of \$13.5 million primarily due to property taxes. The employee and administrative costs include payroll, benefits and higher corporate services costs primarily related to the pricing structure under NiSource's original business services arrangement with IBM. In December 2007, NiSource and IBM finalized a restructuring of their business services agreement. Under the restructured agreement, IBM will

primarily provide information technology services, with a number of other business service functions to be transitioned back to the NiSource organization. The impact of the amended agreement with IBM included a settlement charge of \$9.8 million recorded during the fourth quarter of 2007. Going forward, NiSource will be in a position to more effectively manage its employee and administrative expenses, while ensuring delivery of services needed to meet the company's needs. These increases in expenses were partially offset by the impact of a \$17.0 million accrual recorded in fourth quarter of 2006 in conjunction with the BP contract revision.

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

Operating expenses were \$2,232.3 million in 2006, a \$38.1 million increase from 2005, which includes \$55.3 million of increased expense that is recovered through regulatory trackers and corresponding increases in net revenues (see discussion above). Excluding the impact of trackers, operating expenses decreased primarily due to charges recorded in 2005. These included restructuring charges, transition costs, pension and other postretirement benefit charges, and other costs associated with the IBM outsourcing initiative totaling \$82.8 million, a \$10.9 million charge for obsolete software systems and a \$10.9 million impairment charge related to goodwill at Kokomo Gas. Operating expense increases in 2006 included \$18.1 million for certain legal matters, a \$17 million accrual in conjunction with the BP contract revision, higher employee and administrative expenses of approximately \$17 million, transition and other restructuring charges associated with the IBM agreement of \$12.3 million, generation and maintenance costs of \$9.3 million in Electric Operations, and higher property insurance premiums of \$8.7 million mainly for offshore and onshore facilities located in or near the Gulf of Mexico.

Equity Earnings (Loss) in Unconsolidated Affiliates

Equity Earnings (Loss) in Unconsolidated Affiliates increased 2007 operating income \$9.4 million compared to a loss of \$12.3 million in 2006. Equity Earnings (Loss) in Unconsolidated Affiliates includes investments in Millennium and Hardy Storage which are integral to the Gas Transmission and Storage Operations business. Equity earnings increased \$21.7 million due to Hardy Storage being placed in service in April 2007, higher AFUDC earnings from Millennium and the impact of Millennium recording a \$13.0 million reserve in 2006 related to vacated portions of the original project.

In December 2006, Millennium received FERC approval for a pipeline project. The certificate order approved certain project costs related to the construction and development of the Millennium project. The order also approved the vacating of portions of the original September 2002 Millennium certificate that related to other facilities. The Millennium owners no longer believe the recovery of the capitalized costs related to the vacated portions of the project is probable. Therefore, Millennium fully reserved the capitalized costs related to the development of the vacated portions and NiSource recorded a \$13.0 million charge reflecting its share of Millennium's reserve during the fourth quarter of 2006. Equity Earnings (Loss) in Unconsolidated Affiliates reduced 2006 income \$12.3 million compared to earnings of \$0.2 million in 2005.

Other Income (Deductions)

Other Income (Deductions) in 2007 reduced income \$447.8 million compared to a reduction of \$395.7 million in 2006. This increase in other deductions of \$52.1 million was mainly due to a redemption premium of \$40.6 million related to the early extinguishment of long-term notes for Whiting Clean Energy and to higher short-term interest rates and credit facility fees.

Other Income (Deductions) in 2006 reduced income \$395.7 million compared to a reduction of \$518.9 million in 2005. A loss on early extinguishment of long-term debt of \$108.6 million during 2005 and decreased interest expense of \$32.7 million in 2006 compared to 2005 due to the refinancing of \$2.4 billion in long-term debt at lower rates during 2005 drove the decrease in other deductions. Other, net was a loss of \$6.5 million for 2006 compared to income of \$14.0 million for the comparable 2005 period due to lower interest income and increased costs associated with the sale of accounts receivable. Higher fees, due to higher interest rates, and increased levels of accounts receivable balances resulted in the higher expenses associated with the sale of accounts receivable.

Income Taxes

Income taxes increased by \$1.3 million in 2007 as compared with 2006. Income taxes increased \$21.2 million in 2006 as compared with 2005 primarily due to higher pre-tax income from the prior year. The effective income tax rates were 35.6%, 35.3% and 34.5% in 2007, 2006 and 2005, respectively. The increase in the overall effective tax rate in 2007 versus 2006 is due to increased state income tax expense, offset by higher Section 199 deductions, lower regulatory flow-through depreciation and the capitalization of the tax impact of AFUDC-Equity to a regulatory asset. The overall effective tax rate increase in 2006 versus 2005 was due to favorable state and federal income tax adjustments recorded in 2005 and a reduction in the electric production deduction and low income housing credits

from those recorded in 2005. The increase was partially offset by a lower effective state income tax rate in 2006 due to a reduction in deferred state income tax liabilities.

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

The American Jobs Creation Act of 2004, signed into law on October 22, 2004, created new Internal Revenue Code Section 199 which, beginning in 2005, permits taxpayers to claim a deduction from taxable income attributable to certain domestic production activities. Northern Indiana and Whiting Clean Energy's electric production activities qualify for this deduction. The deduction for the current year is 6% of QPAI, with certain limitations. This deduction was 3% of QPAI for years 2005 and 2006 and increases to 9% of QPAI beginning in 2010 and thereafter. The tax benefit for the Section 199 domestic production activities deduction claimed in NiSource's 2006 consolidated federal income tax return was \$1.5 million and is estimated to be \$2.7 million for 2007.

Discontinued Operations

Discontinued operations reflected income of \$9.4 million, or \$0.03 per basic share, in 2007, an after-tax loss of \$31.7 million, or \$0.11 loss per basic share, in 2006, and income of \$22.7 million, or \$0.08 per basic share, in 2005. The \$9.4 million of income from discontinued operations in 2007 includes a \$7.5 million reduction, net of taxes, in the liability for unrecognized tax benefits and \$0.9 million in related interest, net of taxes, associated with the issuance of additional tax guidance in the first quarter of 2007. Also included is a reduction in interest expense of \$0.6 million, net of taxes, related to the completion of the NiSource consolidated 2003 and 2004 tax audit.

The loss from discontinued operations in 2006 was primarily the result of an increase to legal reserves and the sale of certain low-income housing investments. Results from discontinued operations in 2005, net of taxes, include a gain on disposition of discontinued operations of \$43.5 million partially offset by a loss from discontinued operations of \$20.8 million. The gain on disposition of discontinued operations, net of taxes, resulted from changes to reserves for contingencies related primarily to the previous sales of IWC, former Primary Energy subsidiaries and other dispositions. The loss from discontinued operations in 2005 included changes to reserves for contingencies primarily related to CER and an impairment of assets related to Transcom.

Cumulative Effect of Change in Accounting Principle

The cumulative effect of change in accounting principle in 2006 of \$0.4 million, net of taxes, resulted from the cumulative effect of adopting SFAS No. 123R. Refer to Note 14, "Stock-Based Compensation," in the Notes to Consolidated Financial Statements for additional information regarding the cumulative effect of adopting SFAS No. 123R.

The cumulative effect of change in accounting principle in 2005 of a \$0.3 million loss, net of taxes, resulted from the cumulative effect of adopting FIN 47. Refer to Note 6, "Asset Retirement Obligations," in the Notes to Consolidated Financial Statements for additional information regarding the cumulative effect of adopting FIN 47.

Liquidity and Capital Resources

A significant portion of NiSource's operations, most notably in the gas distribution, gas transportation and electric distribution businesses, are 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 and perform necessary maintenance of facilities. Beginning in 2007, capital expenditures and other investing activities began increasing due to age and condition replacement programs and an increase in growth projects (see discussion below). Future capital expenditures are expected to be funded via a combination of cash flow from operations, expected proceeds from the initial public offering of the new MLP and new long-term debt issuances.

Operating Activities

Net cash from operating activities for the twelve months ended December 31, 2007 was \$757.2 million, a decrease of \$399.0 million from a year ago. The impacts of gas prices and weather significantly impact working capital changes. High gas prices and 5% colder than normal weather in the fourth quarter of 2005 drove significantly higher than normal accounts receivable and unrecovered gas costs balances that were subsequently collected in 2006. Conversely, the fourth quarter of 2006 was 18% warmer than normal, leading to relatively lower accounts

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

receivable and unrecovered gas cost balances at December 31, 2006 and less cash to be collected in 2007. Beyond the changes in working capital, increases in net income and changes in deferred tax balances totaling \$169.1 million improved net cash flow from operating activities in 2007 relative to 2006.

Pension and Other Postretirement Plan Funding. In 2008, NiSource expects to make contributions of approximately \$17.1 million to its pension plans and approximately \$38.3 million to its postretirement medical and life plans.

Investing Activities

Capital Expenditures and Other Investing Activities. The tables below reflect actual capital expenditures and other investing activities by segment for 2007, 2006 and 2005 and estimates for years 2008 through 2012. The other investing activities include investing in equity investments such as Millennium and Hardy Storage.

<i>(in millions)</i>	2007	2006	2005
Gas Distribution Operations	\$ 302.7	\$ 283.4	\$ 278.5
Gas Transmission and Storage Operations	226.8	208.1	167.9
Electric Operations	241.5	151.2	135.6
Other Operations	12.2	5.7	17.0
Total	\$ 783.2	\$ 648.4	\$ 599.0

<i>(in millions)</i>	2008E	2009E	2010E	2011E	2012E
Gas Distribution Operations	\$ 381.4	\$ 471.0	\$ 444.9	\$ 363.2	\$ 356.5
Gas Transmission and Storage Operations	393.4	341.8	396.4	516.8	520.0
Electric Operations	576.1	191.6	223.0	188.6	201.5
Other Operations	6.0	6.3	4.8	3.8	3.9
Total	\$ 1,356.9	\$ 1,010.7	\$ 1,069.1	\$ 1,072.4	\$ 1,081.9

For 2007, capital expenditures and certain other investing activities were \$783.2 million, an increase of 134.8 million over 2006. The increase was primarily due to higher capital expenditures within Electric Operations of \$90.3 million. This increase was primarily due to incremental expenditures at the Electric Operations segment which included higher expenditures for the NOx reduction programs and expenditures to replace key components within electric generation including significant scheduled maintenance work on the Bailly Generating Station Unit 7 for a cyclone burner replacement and other work to improve unit reliability. Additionally, construction also started on installation of selective catalytic reduction equipment on Bailly Unit 7, with the in-service date for the selective catalytic reduction targeted for the spring of 2008.

Capital expenditures within Gas Distribution Operations and Gas Transmission and Storage Operations increased by \$19.3 million and \$18.7 million, respectively. The increase within Gas Distribution Operations segment was due to work completed on the Southwest Delaware County supply line which improved service to a high growth area in the Columbia of Ohio territory. Gas Distribution Operations also experienced incremental capital spending for replacement and betterment of bare steel and cast iron gas mains in the Columbia of Pennsylvania territory. The increase within the Gas Transmission and Storage Operations segment was primarily due to incremental pipeline expenditures including pipeline integrity costs in compliance with the DOT's Integrity Management Rule. The Gas Transmission and Storage Operations segment also invested in new business initiatives to maintain and expand market

share in storage and interstate transportation. Capital expenditures in the Other Operations segment mainly comprise partnership investments and enterprise-wide information technology infrastructure improvement.

For 2008 the projected capital program and certain other investing activities are expected to be \$1,356.9 million, which is \$573.7 million higher than the 2007 level. This higher spending is mainly due to the acquisition of additional electric generation capacity, replacement of bare steel and cast iron facilities at certain distribution companies and an increase in expenditures for growth projects primarily within Gas Transmission and Storage Operations. The program is expected to be funded via a combination of cash flow from operations, expected

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

proceeds from the initial public offering of the new MLP and new long-term debt issuances during 2008. Capital expenditures during the period 2008 through 2012 are expected to be significantly higher than recent years. This is due primarily to increased replacement of bare steel and cast iron mains in the Gas Distribution Operations segment and increased expenditure for growth projects in the Gas Transmission and Storage Operations segment.

Financing Activities

On December 21, 2007, NiSource filed a shelf registration statement with the SEC for an unspecified principal amount of debt securities, common and preferred stock, and other securities. NiSource is classified as a well-known seasoned issuer and the registration statement will be effective for three years.

Long-term Debt. On December 31, 2007, Whiting Clean Energy redeemed \$292.1 of its notes due June 20, 2011, having an average interest rate of 8.30%. The associated redemption premium of \$40.6 million was charged to loss on early extinguishment of long-term debt. The redemption was financed with NiSource borrowings.

On December 3, 2007, Capital Markets redeemed \$72.0 million of its \$75.0 million of 6.78% senior notes due December 1, 2027. The notes contained a provision entitling holders to require Capital Markets to purchase the notes at 100% of the principal amount plus accrued interest on December 1, 2007.

On October 31, 2007, Northern Indiana redeemed \$24.0 million of its Variable Rate Demand Pollution Control Refunding Bonds, Series 1988D, issued by Jasper County, Indiana on behalf of Northern Indiana with a floating interest rate of 3.645% at time of redemption.

On August 31, 2007, NiSource Finance issued \$800.0 million of 6.40%, 10.5-year senior unsecured notes that mature March 15, 2018. The proceeds were used to repay short-term bank borrowings, to fund the redemption of \$24 million of Northern Indiana variable rate pollution control bonds due November 2007, and for capital expenditures and general corporate purposes. The short-term bank borrowings were previously used to fund the redemption of Northern Indiana's preferred stock in 2006, having a total redemption value of \$81.6 million, and for the repayment of an aggregate \$503.5 million of long-term debt in 2006 and the first nine months of 2007.

During August 2007, Northern Indiana redeemed \$20.0 million of its medium-term notes with an average interest rate of 6.77%.

During June 2007, Northern Indiana redeemed \$12.0 million of its medium-term notes with an interest rate of 7.25%.

During April 2007, NiSource redeemed \$27.0 million of Capital Markets medium-term notes, with an average interest rate of 7.49%.

During November 2006, NiSource redeemed \$144.4 million of its senior debentures with an interest rate of 3.628%. Also during November 2006, NiSource Finance redeemed \$250.0 million of its unsecured notes with an interest rate of 3.20%.

During May 2006, NiSource redeemed \$25.0 million of Capital Markets medium-term notes, with an average interest rate of 7.50%.

During April 2006, NiSource redeemed \$15.0 million of Capital Markets medium-term notes, with an average interest rate of 7.75%.

Jasper County Pollution Control Bonds. Northern Indiana has seven series of Jasper County Pollution Control Bonds with a total principal value of \$254 million currently outstanding. Each of the series are remarketed in auctions that take place at either 7, 28, or 35 day intervals. Between February 13, 2008 and February 20, 2008, Northern Indiana received notice that five separate market auctions of four of the series of the Jasper County Pollution Control Bonds had failed. The failed auctions represented an aggregate principal value of \$112 million. The most recent auctions on February 20, 2008 and February 21, 2008 were successful, but resulted in interest rates of 11.96% and 10.47%, respectively, which are well in excess of historical rates.

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

These auction failures are attributable to the recent lack of liquidity in auction rate securities market, largely driven by the recent turmoil in the bond insurance market. The Northern Indiana Pollution Control Bonds are insured by Ambac Assurance Corporation and MBIA Insurance Corporation.

Under the Pollution Control Bond financing documents, Northern Indiana must pay a default rate of interest of between 15%-18% to existing investors whenever the periodic auction process fails. Northern Indiana is currently exploring options to avoid a full refunding of these securities and restore competitive market-based interest rates. NiSource does not believe this issue will have a material impact on its financial results.

Cumulative Preferred Stock. On April 14, 2006, Northern Indiana redeemed all of its outstanding cumulative preferred stock, having a total redemption value of \$81.6 million.

Credit Facilities. During July 2006, NiSource Finance amended its \$1.25 billion five-year revolving credit facility increasing the aggregate commitment level to \$1.5 billion, extending the termination date by one year to July 2011, and reduced the cost of borrowing. The amended facility will help maintain a reasonable cushion of short-term liquidity in anticipation of continuing volatile natural gas prices.

NiSource Finance had outstanding credit facility borrowings of \$1,061.0 million at December 31, 2007, at a weighted average interest rate of 5.43%, and borrowings of \$1,193.0 million at December 31, 2006, at a weighted average interest rate of 5.68%.

As of December 31, 2007 and December 31, 2006, NiSource Finance had \$110.4 million and \$81.9 million of stand-by letters of credit outstanding, respectively. At December 31, 2007, \$24.1 million of the \$110.4 million total outstanding letters of credit resided within a separate bi-lateral letter of credit arrangement with Barclays Bank that NiSource Finance obtained during February 2004. Of the remaining \$86.3 million of stand-by letters of credit outstanding at December 31, 2007, \$83.0 million resided under NiSource Finance's five-year credit facility and \$3.3 million resided under an uncommitted arrangement with another financial institution.

As of December 31, 2007, \$356.0 million of credit was available under the credit facility.

Debt Covenants. NiSource is subject to one financial covenant under its five-year revolving credit facility. NiSource must maintain a debt to capitalization ratio that does not exceed 70%. As of December 31, 2007, the ratio was 56.9%. NiSource is also subject to certain other non-financial covenants under the revolving credit facility. 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 subset of assets equal to \$150 million. 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 facility also includes 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 subset of assets 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 CORC, a wholly owned subsidiary of Columbia of Ohio. CORC, in turn, is party to an agreement with Dresdner Bank AG, also dated May 14, 2004, under the terms of which it sells an undivided percentage ownership interest in the accounts receivable to a commercial paper conduit. On July 1, 2006, the agreement was amended to increase the program limit from \$300 million to \$350 million. The agreement currently expires on June 27, 2008. As of December 31, 2007, \$202.4 million of accounts receivable had been sold by CORC.

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

NiSource Inc.

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.

On December 30, 2003, Northern Indiana entered into an agreement to sell, without recourse, all of its trade receivables, as they originate, to NRC, a wholly-owned subsidiary of Northern Indiana. NRC, in turn, is party to an agreement with Citibank, N.A. under the terms of 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. NRC's agreement with the commercial paper conduit has a scheduled expiration date of December 29, 2008, and can be renewed if mutually agreed to by both parties. As of December 31, 2007, NRC had sold \$200 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 or 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 December 18, 2007, Standard and Poor's lowered its senior unsecured ratings for NiSource and its subsidiaries to BBB-. Standard and Poor's outlook for NiSource and all of its subsidiaries is stable. On December 3, 2007, Moody's Investors Services affirmed the senior unsecured ratings for NiSource at Baa3, and the existing ratings of all other subsidiaries. Moody's changed its ratings outlook for NiSource and its subsidiaries to negative from stable. On July 10, 2007, Fitch Ratings affirmed their BBB senior unsecured rating for NiSource and the BBB+ ratings for Northern Indiana. Fitch's outlook for NiSource and all of its subsidiaries is stable. Although all ratings continue to be investment grade, an additional downgrade by Standard and Poor's or Moody's would result in a rating that is below investment grade.

Certain NiSource affiliates have agreements that 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 \$40 million. In addition to agreements with ratings triggers, there are other agreements that contain adequate assurance or material adverse change provisions that could result in additional credit support such as letters of credit and cash collateral to transact business.

Columbia Energy Services is the principal for two surety bonds issued to guarantee performance in two separate long-term gas supply agreements. The surety, in accordance with the terms of its indemnity agreements, 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, 2007, the total amount of letters of credit required with respect to this transaction was \$24.1 million. The agreement will expire on December 31, 2008.

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

Contractual Obligations. NiSource has certain contractual obligations requiring payments at specified periods. The obligations include long-term debt, lease obligations, energy commodity contracts and purchase obligations for various services including pipeline capacity and IBM outsourcing. The table below excludes all amounts classified as current liabilities on the Consolidated Balance Sheets, other than current maturities of long-term debt and current interest payments on long-term debt. The total contractual obligations in existence at December 31, 2007 and their maturities were:

<i>(in millions)</i>	Total	2008	2009	2010	2011	2012	After
Long-term debt	\$ 5,632.0	\$ 29.9	\$ 461.9	\$ 1,010.8	\$ 27.2	\$ 315.0	\$ 3,787.2
Capital leases	9.0	3.7	3.8	0.6	0.1	0.2	0.6
Interest payments on long-term debt	2,583.6	340.0	335.5	302.7	234.8	232.1	1,138.5
Operating leases	265.8	48.9	45.6	39.6	33.8	27.2	70.7
Energy commodity contracts	1,035.7	487.1	243.7	106.6	39.7	39.7	118.9
Service obligations:							
Pipeline service obligations	1,536.5	260.2	219.3	183.7	163.7	151.3	558.3
IBM service obligations	763.8	131.9	104.6	106.5	99.5	95.6	225.7
Other service obligations	475.8	117.6	67.2	44.2	45.1	37.5	164.2
Other long-term liabilities	55.4	55.4					
Total contractual obligations	\$ 12,357.6	\$ 1,474.7	\$ 1,481.6	\$ 1,794.7	\$ 643.9	\$ 898.6	\$ 6,064.1

NiSource calculated estimated interest payments for long-term debt as follows: for the fixed-rate debt, interest is calculated based on the applicable rates and payment dates; for variable-rate debt, interest rates are used that are in place as of December 31, 2007. For 2008, NiSource projects that it will be required to make interest payments of approximately \$410 million, which includes \$340 million of interest payments related to its long-term debt outstanding as of December 31, 2007. At December 31, 2007, NiSource also had \$1,061.0 million in short-term borrowings outstanding.

NiSource's subsidiaries have entered into various energy commodity contracts to purchase physical quantities of natural gas, electricity and coal. These amounts represent minimum quantities of these commodities NiSource is obligated to purchase at both fixed and variable prices.

NiSource has pipeline service agreements that provide for pipeline capacity, transportation and storage services. These agreements, which have expiration dates ranging from 2008 to 2027, require NiSource to pay fixed monthly charges. In June 2005, NiSource Corporate Services and IBM signed a definitive agreement to provide a broad range of business process and support services to NiSource. On December 12, 2007, NiSource Corporate Services amended its agreement with IBM. Under the amended agreement, NiSource will reassume responsibility for business support functions including human resource administration, payroll, accounts payable, supply chain (procurement), sales centers, and the majority of meter to cash operations (billing and collections). During 2007, NiSource had already begun to bring certain finance and accounting functions back within the company. These functions include general

accounting, fixed asset accounting, and budgeting. In the Customer Contact Centers, interim operational responsibility will be retained by IBM, although NiSource intends to pursue a direct arrangement with Vertex, which currently operates the contact center as a subcontractor for IBM. IBM will retain responsibility for information technology operations. Support functions returning to NiSource will be transitioned in a phased approach throughout 2008. NiSource Corporate Services will continue to pay IBM for the amended services under a combination of fixed or variable charges, with the variable charges fluctuating based actual need for such services. Based on the currently projected usage of these services, NiSource Corporate Services expects to pay approximately \$770 million to IBM in service fees and project costs over the remaining 7.5 year term, of which \$5.8 million is reflected as capital lease payment in the table above. Under the original agreement, NiSource Corporate Services expected to pay IBM approximately \$1.6 billion in services fees and project cost over ten years.

Upon any termination of the agreement by NiSource for any reason (other than material breach by IBM), NiSource may be required to pay IBM a termination charge that could include a breakage fee, repayment of IBM's un-recovered capital investments, and IBM wind-down expense. This termination fee could be a material amount depending on the events giving rise to termination and the timing of the termination.

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

Northern Indiana has contracts with four major rail operators providing for coal transportation services for which there are certain minimum payments. These service contracts extend for various periods through 2013 and are included within, Other service obligations, in the table of contractual commitments.

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 Northern Indiana pays for the services under a combination of fixed and variable charges. 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. Estimated minimum payments for this agreement are included within, Other service obligations, in the table of contractual commitments.

Whiting Clean Energy has a service agreement with General Electric for certain operation and maintenance activities for its cogeneration facility located at BP's Whiting, Indiana refinery for which certain minimum fees are required. The agreement extends through 2023 and is included within, Other service obligations, in the table of contractual commitments. The agreement provides for a \$10 million termination penalty to be paid by Whiting Clean Energy to General Electric to buy out or otherwise terminate the agreement.

NiSource Corporate Services has a license agreement with Rational Systems, LLC for pipeline business software requiring equal annual payments of \$5.0 million per annual period over 10 years beginning in January 2008. While this software was not placed in service as of December 31, 2007, testing was substantially completed and NiSource Corporate Services did not have the ability to terminate the agreement without cause. Final acceptance of the software installation was made on January 2, 2008 and the software is expected to be placed in service in first half of 2008. The payments associated with this license agreement is included within, Other service obligations, in the table of contractual commitments.

NiSource's expected payments related to other long-term liabilities includes employer contributions to pension and other postretirement benefits plans expected to be made in 2008. Plan contributions beyond 2008 are dependant upon a number of factors, including actual returns on plan assets, which cannot be reliably estimated. In 2008, NiSource expects to make contributions of approximately \$17.1 million to its pension plans and approximately \$38.3 million to its postretirement medical and life plans. See Note 11, Pension and Other Postretirement Benefits, in the Notes to Consolidated Financial Statements for more information.

Not included in the table above are \$4.0 million of estimated federal and state income tax liabilities, including interest, recorded in accordance with FIN 48. If or when such amounts may be settled is uncertain and cannot be estimated at this time. See Note 10, Income Taxes, in the Notes to Consolidated Financial Statements for more information.

NiSource cannot reasonably estimate the settlement amounts or timing of cash flows related to long-term obligations classified as, Other Liabilities and Deferred Credits, on the Consolidated Balance Sheets, other than those described above.

NiSource also has obligations associated with income, property, gross receipts, franchise, payroll, sales and use, and various other taxes and expects to make tax payments of approximately \$550 million in 2008.

Off Balance Sheet Items

As a part of normal business, NiSource and certain subsidiaries enter into various agreements providing financial or performance assurance to third parties on behalf of certain subsidiaries. Such agreements include guarantees and stand-by letters of credit.

NiSource has issued guarantees that support up to approximately \$548.8 million of commodity-related payments for its current subsidiaries involved in energy commodity contracts and to satisfy requirements under forward gas sales agreements of current and former subsidiaries. These guarantees were provided to counterparties in order to facilitate physical and financial transactions involving natural gas and electricity. To the extent liabilities exist

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

NiSource Inc.

under the commodity-related contracts subject to these guarantees, such liabilities are included in the Consolidated Balance Sheets.

NiSource has purchase and sales agreement guarantees totaling \$80.0 million, which guarantee performance of the seller's covenants, agreements, obligations, liabilities, representations and warranties under the agreements. No amounts related to the purchase and sales agreement guarantees are reflected in the Consolidated Balance Sheets. Management believes that the likelihood NiSource would be required to perform or otherwise incur any significant losses associated with any of the aforementioned guarantees is remote.

NiSource has other guarantees outstanding. Refer to Note 18-B, Guarantees and Indemnities, in the Notes to Consolidated Financial Statements for additional information about NiSource's off balance sheet arrangements.

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 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 oversight by the Risk Management Committee 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 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.

Commodity Price Risk

NiSource is exposed to commodity price risk as a result of its subsidiaries' operations involving natural gas and power. To manage this market risk, NiSource's subsidiaries use derivatives, including commodity futures contracts, swaps and options. NiSource is not involved in speculative energy trading activity.

Commodity price risk resulting from derivative 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, including gains or losses on these derivative instruments. If states should explore additional regulatory reform, these subsidiaries may begin providing services without the benefit of the traditional rate-making process and may be more exposed to commodity price risk. Some of NiSource's rate-regulated utility subsidiaries offer commodity price risk products to its customers for which derivatives are used to hedge forecasted customer usage under such products. These subsidiaries do not have regulatory recovery orders for these products and are subject to gains and losses recognized in earnings due to hedge ineffectiveness.

TPC, on behalf of Whiting Clean Energy, enters into power and gas derivative contracts to manage commodity price risk associated with operating Whiting Clean Energy. These derivative contracts do not always receive hedge accounting treatment under SFAS No. 133 and variances in earnings could be recognized as a result of marking these derivatives to market.

During 2007 and 2006, gains of \$0.3 million and \$0.1 million, net of taxes respectively, were recognized in earnings due to the ineffectiveness of derivative instruments being accounted for as hedges. No amounts were recognized in earnings in 2007 and 2006 due to losses on derivatives classified as trading. It is anticipated that during the next twelve months the expiration and settlement of cash flow hedge contracts will result in income statement recognition of amounts currently classified in accumulated other comprehensive income of approximately \$23.5 million, net of

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

NiSource Inc.

taxes. Refer to Note 8, Risk Management and Energy Trading Activities, in the Notes to Consolidated Financial Statements for further information on NiSource's various derivative programs for managing commodity price risk.

Interest Rate Risk

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, an increase (or decrease) in short-term interest rates of 100 basis points (1%) would have increased (or decreased) interest expense by \$27.2 million and \$25.3 million for the years 2007 and 2006, respectively.

Contemporaneously with the pricing of the 5.25% and 5.45% notes issued September 16, 2005, NiSource Finance settled \$900 million of forward starting interest rate swap agreements with six counterparties. NiSource paid an aggregate settlement payment of \$35.5 million which is being amortized as an increase to interest expense over the term of the underlying debt, resulting in an effective interest rate of 5.67% and 5.88% respectively.

NiSource has entered into interest rate swap agreements to modify the interest rate characteristics of its outstanding long-term debt from fixed to variable. 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 BBA 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.

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.

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

Credit Risk

Due to the nature of the industry, credit risk is a factor in many of NiSource's business activities. NiSource's extension of credit is governed by a Corporate Credit Risk Policy. Written guidelines approved by NiSource's Risk Management Committee document the management approval levels for credit limits, evaluation of creditworthiness, and credit risk mitigation procedures. Exposures to credit risks are monitored by the Corporate Credit Risk function which is independent of commercial operations. Credit risk arises with 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 obligations and the market value of forward positions. Current credit exposure is generally measured by the notional or principal value of obligations and direct credit substitutes, such as commitments, stand-by letters of credit and guarantees. In determining exposure, NiSource considers collateral that it holds to reduce individual counterparty credit risk.

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 zero during 2007. The daily market exposure for

the gas marketing and trading portfolios on an average, high and low basis was \$0.1 million, \$0.2 million and zero during 2007, respectively. Prospectively, management has set the VaR limit at \$0.8 million for gas marketing. Exceeding this limit would result in management actions to reduce portfolio risk. The VaR limit for power trading

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

was reduced to zero in the third quarter of 2005 with the settlement of all power trading contracts outstanding at that time. Power and gas derivative contracts entered into to manage price risk associated with Whiting Clean Energy are limited to quantities surrounding the physical generation capacity of Whiting Clean Energy and the gas requirements to operate the facility.

Refer to Critical Accounting Policies included in this Item 7 and Note 1-U, Accounting for Risk Management and Energy Trading Activities, and Note 8, Risk Management and Energy Trading Activities, in the Notes to Consolidated Financial Statements for further discussion of NiSource's risk management.

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.

Basis of Accounting for Rate-Regulated Subsidiaries. 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 \$1,261.2 million and \$1,582.4 million at December 31, 2007, and \$1,563.2 million and \$1,551.0 million at December 31, 2006, respectively. For additional information, refer to Note 1-F, 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. 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 \$314.4 million at December 31, 2007. 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 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 accumulated 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 accumulated 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.

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

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.

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 there is a high risk correlation of the changes in fair values of the derivatives and the underlying risks. 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 \$127.4 million and \$287.6 million of price risk management assets, of which \$113.5 million and \$286.4 million related to hedges, at December 31, 2007 and 2006, respectively, and \$82.0 million and \$297.6 million of price risk management liabilities, of which \$55.1 million and \$235.3 million related to hedges, at December 31, 2007 and 2006, respectively. The amount of unrealized gains recorded to accumulated other comprehensive income, net of taxes, was \$7.6 million and \$31.4 million at December 31, 2007 and 2006, respectively.

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, SFAS No. 88 and SFAS No. 106, as amended by SFAS No. 158. 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 11, Pension and Other Postretirement Benefits, in the Notes to Consolidated Financial Statements.

Goodwill Impairment Testing. As of December 31, 2007, NiSource had \$3.7 billion of goodwill on the Consolidated Balance Sheet, which was mainly due to the acquisition of Columbia. NiSource performs its annual impairment test of goodwill in accordance with SFAS No. 142 in June. For the purpose of testing for impairment the goodwill recorded in the acquisition of Columbia, the related subsidiaries were aggregated into two distinct reporting units, one within the Gas Distribution Operations segment and one within the Gas Transmission and Storage Operations segment. NiSource uses the discounted cash flow method to estimate the fair value of its reporting units for the purpose of this test. Refer to Notes 1-J and 5, Goodwill and Other Intangible Assets, in the Notes to Consolidated Financial Statements for additional information.

Long-lived Asset Impairment Testing. NiSource's Consolidated Balance Sheets contain long-lived assets other than goodwill and intangible assets which are not subject to recovery under SFAS No. 71. As a result, NiSource assesses the carrying amount and potential earnings of these assets whenever events or changes in circumstances indicate that the carrying value could be impaired as per SFAS No. 144. When an asset's carrying value exceeds the undiscounted estimated future cash flows associated with the asset, the asset is considered to be impaired to the extent that the asset's fair value is less than its carrying value. Refer to Note 1-K, Long-lived Assets, in the Notes to Consolidated Financial Statements for additional information.

Contingencies. A contingent liability is recognized when it is probable that an environmental, tax, legal or other liability has been incurred and the amount of loss can reasonably be estimated. Accounting for contingencies require significant management judgment regarding the estimated probabilities and ranges of exposure to a potential liability. Estimates of the loss and associated probability are made based on the current facts available, including present laws and regulations. Management's assessment of the contingent liability could change as a result of future events or as more information becomes available. Actual amounts could differ from estimates and can have a material impact on NiSource's results of operations and financial position. Refer to Note 18, Other Commitments and Contingencies, in the Notes to Consolidated Financial Statements for additional information.

Asset Retirement Obligations. NiSource accounts for retirement obligations under the provisions of SFAS No. 143, as amended by FIN 47, which require entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. In the absence of quoted market prices, fair value of asset retirement obligations are estimated using present value techniques, using various assumptions including estimates of the

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

NiSource Inc.

amounts and timing of future cash flows associated with retirement activities, inflation rates and credit-adjusted risk free rates. When the liability is initially recorded, the entity capitalizes the cost, thereby increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted, and the capitalized cost is depreciated over the useful life of the related asset. The rate-regulated subsidiaries defer the difference between the amount recognized for depreciation and accretion and the amount collected in rates as required pursuant to SFAS No. 71 for those amounts it has collected in rates or expects to collect in future rates. Refer to Note 6, Asset Retirement Obligations, in the Notes to Consolidated Financial Statements for additional information.

Recently Adopted Accounting Pronouncements

SFAS No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. In

September 2006, the FASB issued SFAS No. 158 to improve existing reporting for defined benefit postretirement plans by requiring employers to recognize in the statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan, among other changes.

In the fourth quarter of 2006, NiSource adopted the provisions of SFAS No. 158. Based on the measurement of the various defined benefit pension and other postretirement plans assets and benefit obligations at September 30, 2006, the pretax impact of adopting SFAS No. 158 decreased intangible assets by \$46.5 million, decreased deferred charges and other assets by \$1.1 million, increased regulatory assets by \$538.8 million, increased accumulated other comprehensive income by \$239.8 million and increased accrued liabilities for postretirement and postemployment benefits by \$251.4 million. In addition, NiSource recorded a reduction in deferred income taxes of approximately \$96 million. With the adoption of SFAS No. 158 NiSource determined that for certain rate-regulated subsidiaries the future recovery of pension and other postretirement plans costs is probable in accordance with the requirements of SFAS No. 71. These rate-regulated subsidiaries recorded regulatory assets and liabilities that would otherwise have been recorded to accumulated other comprehensive income.

On January 1, 2007, NiSource adopted the SFAS No. 158 measurement date provisions requiring employers to measure plan assets and benefit obligations as of the fiscal year-end. The pre-tax impact of adopting the SFAS No. 158 measurement date provisions increased deferred charges and other assets by \$9.4 million, decreased regulatory assets by \$89.6 million, decreased retained earnings by \$11.3 million, increased accumulated other comprehensive income by \$5.3 million and decreased accrued liabilities for postretirement and postemployment benefits by \$74.2 million. NiSource also recorded a reduction in deferred income taxes of approximately \$2.6 million. In addition, 2007 expense for pension and postretirement benefits reflects the updated measurement date valuations.

FIN 48 Accounting for Uncertainty in Income Taxes. In June 2006, the FASB issued FIN 48 to reduce the diversity in practice associated with certain aspects of the recognition and measurement requirements related to accounting for income taxes. Specifically, this interpretation requires that a tax position meet a more-likely-than-not recognition threshold for the benefit of an uncertain tax position to be recognized in the financial statements and requires that benefit to be measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The determination of whether a tax position meets the more-likely-than-not recognition threshold is based on whether it is probable of being sustained on audit by the appropriate taxing authorities, based solely on the technical merits of the position. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

On January 1, 2007, NiSource adopted the provisions of FIN 48. As a result of the implementation of FIN 48, NiSource recognized a charge of \$0.8 million to the opening balance of retained earnings. Refer to Note 10, Income Taxes, in the Notes to Consolidated Financial Statements for additional information.

SFAS No. 123 (revised 2004) Share-Based Payment. Effective January 1, 2006, NiSource adopted SFAS No. 123R using the modified prospective transition method. SFAS No. 123R requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation over the service period for awards expected to vest. In accordance with the modified prospective transition method, NiSource's consolidated

financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R. Prior to the adoption of SFAS No. 123R, NiSource applied the intrinsic value method of APB No.

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

NiSource Inc.

25 for awards granted under its stock-based compensation plans and complied with the disclosure requirements of SFAS No. 123.

When it adopted SFAS No. 123R in the first quarter of 2006, NiSource recognized a cumulative effect of change in accounting principle of \$0.4 million, net of income taxes, which reflected the net cumulative impact of estimating future forfeitures in the determination of period expense, rather than recording forfeitures when they occur as previously permitted. Other than the requirement for expensing stock options, outstanding share-based awards will continue to be accounted for substantially as they are currently. Refer to Note 14, Share-Based Compensation, in the Notes to Consolidated Financial Statements for additional information.

Recently Issued Accounting Pronouncements

SFAS No. 157 Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157 to define fair value, establish a framework for measuring fair value and to expand disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and should be applied prospectively, with limited exceptions. NiSource will adopt this standard in the first quarter of 2008. NiSource is currently reviewing the provisions of this interpretation and does not anticipate a material impact to the Consolidated Financial Statements.

SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. In February 2007, the FASB issued SFAS No. 159 which permits entities to choose to measure certain financial instruments at fair value that are not currently required to be measured at fair value. Upon adoption, a cumulative adjustment will be made to beginning retained earnings for the initial fair value option remeasurement. Subsequent unrealized gains and losses for fair value option items will be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and should not be applied retrospectively, except as permitted for certain conditions for early adoption. NiSource is currently reviewing the provisions of SFAS No. 159 to determine whether to elect fair value measurement for any of its financial assets or liabilities when it adopts this standard in 2008.

SFAS No. 141R Business Combinations. In December 2007, the FASB issued SFAS No. 141R to improve the relevance, representational faithfulness, and comparability of information that a reporting entity provides in its financial reports regarding business combinations and its effects, including recognition of assets and liabilities, the measurement of goodwill and required disclosures. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and earlier adoption is prohibited. NiSource is currently reviewing the provisions of SFAS No. 141R to determine the impact on future business combinations.

SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. In December 2007, the FASB issued SFAS No. 160 to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements regarding non-controlling ownership interests in a business and for the deconsolidation of a subsidiary. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and earlier adoption is prohibited. NiSource is currently reviewing the provisions of SFAS No. 160 to determine the impact it may have on the Consolidated Financial Statements and Notes to Consolidated Financial Statements.

FSP FIN 39-1 FASB Staff Position Amendment of FASB Interpretation No. 39. In April 2007, the FASB posted FSP FIN 39-1 to amend paragraph 3 of FIN 39 to replace the terms *conditional contracts* and *exchange contracts* with the term *derivative instruments* as defined in SFAS No. 133. This FSP also amends paragraph 10 of FIN 39 to permit a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting arrangement. This FSP is effective for fiscal years beginning after November 15, 2007, with early application permitted. NiSource is currently reviewing the provisions of FSP FIN 39-1 to determine the impact it may have on the Consolidated Balance Sheets.

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

NiSource Inc.

Environmental Matters

NiSource affiliates have retained environmental liability, including cleanup liability, associated with some of its former operations including those of propane operations, petroleum operations, certain LDCs and CER. More significant environmental liability relates to former MGP sites whereas less significant liability is associated with former petroleum operations and metering stations using mercury-containing measuring equipment.

The ultimate liability in connection with the contamination at known sites will depend upon many factors including the extent of environmental response actions required, the range of technologies that can be used for remediation, other potentially responsible parties and their financial viability, and indemnification from previous facility owners. NiSource's environmental liability includes those corrective action costs considered probable and reasonably estimable under SFAS No. 5 and consistent with SOP 96-1. NiSource's estimated remediation liability will be refined as events in the remediation process occur and actual remediation costs may differ materially from NiSource's estimates due to the dependence on the factors listed above.

Proposals for voluntary initiatives and mandatory controls are being discussed both in the United States and worldwide to reduce so-called greenhouse gases such as carbon dioxide, a by-product of burning fossil fuels, and methane, a component of natural gas. Certain NiSource affiliates engage in efforts to voluntarily report and reduce their greenhouse gas emissions. NiSource is currently a participant in the EPA's Climate Leaders program and will continue to monitor and participate in developments related to efforts to register and potentially regulate greenhouse gas emissions.

Bargaining Unit Contract

As of December 31, 2007, NiSource had 7,607 employees of which 3,384 were subject to collective bargaining agreements. Agreements were reached with the respective unions whose collective bargaining agreements were set to expire during 2007. In 2008, three collective bargaining agreements, covering approximately 79 employees are set to expire.

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

NiSource Inc.

RESULTS AND DISCUSSION OF SEGMENT OPERATIONS

Presentation of Segment Information

Operating segments are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The NiSource Chief Executive Officer is the chief operating decision maker.

NiSource's operations are divided into four primary business segments. The Gas Distribution Operations segment provides natural gas service and transportation for residential, commercial and industrial customers in Ohio, Pennsylvania, Virginia, Kentucky, Maryland, Indiana, Massachusetts, Maine and New Hampshire. The Gas Transmission and Storage Operations segment offers gas transportation and storage services for LDCs, marketers and industrial and commercial customers located in northeastern, mid-Atlantic, midwestern and southern states and the District of Columbia. The Electric Operations segment provides electric service in 20 counties in the northern part of Indiana. The Other Operations segment primarily includes gas and power marketing, and ventures focused on distributed power generation technologies, including cogeneration facilities, fuel cells and storage systems.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**NiSource Inc.****Gas Distribution Operations**

Year Ended December 31, (<i>in millions</i>)	2007	2006	2005
Net Revenues			
Sales Revenues	\$ 4,998.9	\$ 4,698.6	\$ 5,122.0
Less: Cost of gas sold (excluding depreciation and amortization)	3,477.2	3,277.0	3,617.1
Net Revenues	1,521.7	1,421.6	1,504.9
Operating Expenses			
Operation and maintenance	781.4	731.9	721.4
Depreciation and amortization	234.5	231.4	224.6
Impairment and (gain) loss on sale of assets	(0.7)	(0.3)	12.5
Other taxes	173.7	168.6	178.2
Total Operating Expenses	1,188.9	1,131.6	1,136.7
Operating Income	\$ 332.8	\$ 290.0	\$ 368.2
Revenues (\$ in Millions)			
Residential	\$ 2,798.2	\$ 2,854.4	\$ 3,191.4
Commercial	1,018.2	1,058.8	1,159.4
Industrial	295.1	306.4	362.4
Off-System Sales	629.6	415.6	200.1
Other	257.8	63.4	208.7
Total	\$ 4,998.9	\$ 4,698.6	\$ 5,122.0
Sales and Transportation (MMDth)			
Residential sales	274.8	241.8	289.1
Commercial sales	177.9	163.9	176.0
Industrial sales	380.8	365.4	375.8
Off-System Sales	88.1	54.9	22.6
Other	1.4	0.9	0.9
Total	923.0	826.9	864.4
Heating Degree Days			
Normal Heating Degree Days	4,815	4,347	5,035
% Colder (Warmer) than Normal	4,941 (3%)	4,933 (12%)	4,939 2%

Customers

Residential	3,080,799	3,074,115	3,059,783
Commercial	293,322	292,566	292,232
Industrial	8,171	8,268	8,445
Other	71	73	59
Total	3,382,363	3,375,022	3,360,519

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**NiSource Inc.****Gas Distribution Operations (continued)****Competition**

Gas Distribution Operations compete with investor-owned, municipal, and cooperative electric utilities throughout its service area, and to a lesser extent with other regulated natural gas utilities and propane and fuel oil suppliers. Gas Distribution Operations continues to be a strong competitor in the energy market as a result of strong customer preference for natural gas. Competition with providers of electricity is generally strongest in the residential and commercial markets of Kentucky, southern Ohio, central Pennsylvania and western Virginia where electric rates are primarily driven by low-cost, coal-fired generation. In Ohio and Pennsylvania, gas on gas competition is also common. Gas competes with fuel oil and propane in the New England markets mainly due to the installed base of fuel oil and propane-based heating which, over time, has comprised a declining percentage of the overall market.

Market Conditions

Spot prices for the winter of 2007-2008 were primarily in the range of \$6.60 – \$8.46/Dth. This was an increase when compared to the prices experienced during the winter of 2006-2007 that were in the \$5.00-\$8.00/Dth range, attributed mainly to late winter cold weather and slightly higher demand.

Entering the 2007-2008 winter season, storage levels were comparable to the prior year inventory levels, which were at the high end of the five-year range, due in part to an increase in overall storage capacity and the spread between summer and winter gas prices. During the summer of 2007, prices ranged between \$5.30 and \$7.97/Dth. Through December 2007, the winter of 2007-2008 price levels were primarily between \$6.60 and \$7.54/Dth while weather was generally normal.

All NiSource Gas Distribution Operations companies have state-approved recovery mechanisms that provide a means for full recovery of prudently incurred gas costs. Gas costs are treated as pass-through costs and have no impact on the net revenues recorded in the period. The gas costs included in revenues are matched with the gas cost expense recorded in the period and the difference is recorded on the Consolidated Balance Sheets as under-recovered or over-recovered gas cost to be included in future customer billings. During times of unusually high gas prices, throughput and net revenue have been adversely affected as customers may reduce their usage as a result of higher gas cost.

The Gas Distribution Operations companies have pursued non-traditional revenue sources within the evolving natural gas marketplace. These efforts include both the sale of products and services upstream of their service territory, the sale of products and services in their service territories and gas supply cost incentive mechanisms for service to their core markets. The upstream products are made up of transactions that occur between an individual Gas Distribution Operations company and a buyer for the sales of unbundled or rebundled gas supply and capacity. The on-system services are offered by NiSource to customers and include products such as the transportation and balancing of gas on the Gas Distribution Operations company system. The incentive mechanisms give the Gas Distribution Operations companies an opportunity to share in the savings created from such things as gas purchase prices paid below an agreed upon benchmark and its ability to reduce pipeline capacity charges. The treatment of the revenues generated from these types of transactions vary by operating company with some sharing the benefits with customers and others using these revenues to mitigate transition costs occurring as the result of customer choice programs described below under Regulatory Matters.

Capital Expenditures and Other Investing Activities

The table below reflects actual capital expenditures and other investing activities by category for 2007 and estimates for years 2008 through 2012.

<i>(in millions)</i>	2007	2008E	2009E	2010E	2011E	2012E
System Growth	\$ 82.8	\$ 83.7	\$ 94.0	\$ 83.9	\$ 83.9	\$ 84.1
Betterment	45.3	20.8	47.5	27.5	24.0	20.2

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Replacement	110.4	211.9	264.5	259.9	210.4	210.8
Maintenance & Other	64.2	65.0	65.0	73.5	44.9	41.4
Total	\$ 302.7	\$ 381.4	\$ 471.0	\$ 444.8	\$ 363.2	\$ 356.5

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

NiSource Inc.

Gas Distribution Operations (continued)

The Gas Distribution Operations segment's net capital expenditures and other investing activities were \$302.7 million in 2007 and are projected to be approximately \$381.4 million in 2008. This increase in the capital expenditure budget is mainly due to higher spending for the replacement of bare steel and cast iron pipe at certain distribution companies and an expected increase in expenditures for modernizing and upgrading facilities as well as the implementation of a standardized work management system at certain distribution companies as part of a multi-year plan.

Regulatory Matters

Significant Rate Developments. On January 28, 2008, Columbia of Pennsylvania filed a base rate case with the Pennsylvania Public Utilities Commission, seeking an increase of approximately \$60 million annually. On February 1, 2008, Columbia of Ohio filed its Notice of Intent to File An Application For Increase in Rates. The Columbia of Ohio Application was filed on March 3, 2008, requesting an increase in base rates in excess of \$80 million.

At Bay State, the Massachusetts Department of Public Utilities approved a \$5.9 million annual increase in the company's base rates, effective November 1, 2007, under the company's performance-based rate mechanism. On October 17, 2007, Bay State petitioned the Massachusetts Department of Public Utilities to allow the company to collect an additional \$7.5 million in annual revenue related to usage reductions occurring since its last rate case. Bay State also requested approval of a steel infrastructure tracker that would allow for recovery of ongoing infrastructure replacement program investments. The Massachusetts Department of Public Utilities is scheduled to hold hearings on this matter in the first quarter of 2008.

On August 29, 2007, the Kentucky Public Service Commission approved a stipulation and settlement, authorizing Columbia of Kentucky to increase its base rates by \$7.25 million annually.

On May 9, 2007, the IURC approved Northern Indiana's petition to simplify rates, stabilize revenues and provide for energy efficiency funding. The order adopts a new rate structure that enhances Northern Indiana's ability to increase revenues and provides incremental funding for an energy efficiency program.

Cost Recovery and Trackers. A significant portion of the distribution companies' revenue is related to the recovery of gas costs, the review and recovery of which occurs via standard regulatory proceedings. All states require periodic review of actual gas procurement activity to determine prudence and to permit the recovery of prudently incurred costs related to the supply of gas for customers. NiSource distribution companies have historically been found prudent in the procurement of gas supplies to serve customers.

Certain operating costs of the NiSource distribution companies are significant, recurring in nature, and generally outside the control of the distribution companies. Some states allow the recovery of such costs via cost tracking mechanisms. Such tracking mechanisms allow for abbreviated regulatory proceedings in order for the distribution companies to implement charges and recover appropriate costs. Tracking mechanisms allow for more timely recovery of such costs as compared with more traditional cost recovery mechanisms. Examples of such mechanisms include gas cost recovery adjustment mechanisms, tax riders, and bad debt recovery mechanisms. Gas Distribution Operations revenue is increased by the implementation and recovery of costs via such tracking mechanisms.

Comparability of Gas Distribution Operations line item operating results is impacted by these regulatory trackers that allow for the recovery in rates of certain costs such as bad debt expenses. Increases in the expenses that are the subject of trackers result in a corresponding increase in net revenues and therefore have essentially no impact on total operating income results.

Certain of the NiSource distribution companies are embarking upon plans to replace significant portions of their operating systems that are nearing the end of their useful lives. Those companies are currently evaluating requests for increases in rates in order to allow recovery of the additional capital expenditures required for such plans. Each LDC's approach to cost recovery may be unique, given the different laws, regulations and precedent that exist in each jurisdiction.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**NiSource Inc.****Gas Distribution Operations (continued)**

Certain types of natural gas risers, which are owned by customers, on Columbia of Ohio's distribution system have been evaluated under a study required by the PUCO, and have been found prone to leak natural gas under certain conditions. On February 1, 2007, Columbia of Ohio announced plans to identify and replace these risers on its distribution system. As of December 31, 2007, Columbia of Ohio deferred \$5.9 million of costs associated with the study and identification of these natural gas risers as a regulatory asset and currently has budgeted approximately \$142 million for the cost to identify and replace the risers. On October 26, 2007, Columbia of Ohio and the PUCO Staff filed a Joint Stipulation and Recommendation that provided for Columbia of Ohio's assumption of financial responsibility for the repair or replacement of customer-owned service lines and the replacement of risers prone to leak. In addition, the Stipulation provides for Columbia of Ohio to capitalize its investment in the service lines and risers, as well as the establishment of a tracking mechanism that would provide for the recovery of operating and maintenance costs related to Columbia of Ohio's capitalized investment and its expenses incurred in identifying risers prone to leak. On December 28, 2007, Columbia of Ohio entered into a Stipulation with the Ohio Consumers' Counsel and Ohio Partners for Affordable Energy, addressing the issues of Columbia of Ohio's authority to assume responsibility for repair or replacement of hazardous customer owned service lines, the establishment of accounting authority for costs related to such activities, and the establishment of a mechanism to recover such costs. The parties have recommended approval of the Stipulation to the PUCO.

On December 28, 2007, Columbia of Ohio entered into a Stipulation with the Ohio Consumers' Counsel and PUCO Staff and other stakeholders resolving litigation concerning a pending Gas Cost Recovery audit of Columbia of Ohio. The Stipulation calls for an accelerated pass back to customers of \$36.6 million that will occur from January 31, 2008 through January 31, 2009, generated through off-system sales and capacity release programs, the development of new energy efficiency programs for introduction in 2009, and the development of a wholesale auction process for customer supply to take effect in 2010. The Stipulation also resolves issues related to pending and future Gas Cost Recovery Management Performance audits through 2008. The PUCO approved this agreement on January 23, 2008.

Customer Usage. The NiSource distribution companies have experienced declining usage by customers, due in large part to the sensitivity of sales to increases in commodity prices. A significant portion of the LDC's operating costs are fixed in nature. Historically, rate design at the distribution level has been structured such that a large portion of cost recovery is based upon throughput, rather than in a fixed charge. Many of NiSource's LDCs are evaluating mechanisms that would de-couple the recovery of fixed costs from throughput, and implement recovery mechanisms that more closely link the recovery of fixed costs with fixed charges. Each of the states in which the NiSource LDCs operate has different requirements regarding the procedure for establishing such changes.

Environmental Matters

Currently, various environmental matters impact the Gas Distribution Operations segment. As of December 31, 2007, reserves have been recorded to cover probable environmental response actions. Refer to Note 18-E, Environmental Matters, in the Notes to Consolidated Financial Statements for additional information regarding environmental matters for the Gas Distribution Operations segment.

Restructuring

Payments made for all restructuring initiatives within Gas Distribution Operations amounted to \$0.7 million during 2007 and the restructuring liability remaining at December 31, 2007 was \$0.9 million. In the third quarter of 2006, an adjustment was made to the restructuring reserve for leased office space, reducing the reserve by \$5.2 million. This adjustment was made in connection with a reallocation of office space and assessment of office facilities. Refer to Note 3, Impairments, Restructuring and Other Charges, in the Notes to Consolidated Financial Statements for additional information regarding restructuring initiatives for the Gas Distribution Operations segment.

Pending Sale of Northern Utilities and Granite State Gas

On February 15, 2008, NiSource reached a definitive agreement under which Unitil Corporation will acquire NiSource subsidiaries Northern Utilities and Granite State Gas for \$160 million plus net working capital at the time of

closing. Historically, net working capital has averaged approximately \$25 million. Under the terms of the transaction, Unifil Corporation will acquire Northern Utilities, a local gas distribution company serving 52 thousand customers in 44 communities in Maine and New Hampshire and Granite State Gas, an 86-mile FERC regulated gas

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

NiSource Inc.

Gas Distribution Operations (continued)

transmission pipeline primarily located in Maine and New Hampshire. The transaction, expected to be complete by the end of 2008, is subject to federal and state regulatory approvals. During the quarter ended March 31, 2008, NiSource expects to recognize an after tax loss of approximately \$65 million related to the pending sale and to account for Northern Utilities and Granite State Gas as discontinued operations.

NiSource acquired Northern Utilities and Granite State Gas in 1999 as part of the company's larger acquisition of Bay State. NiSource is retaining its ownership of Bay State as a core component of the company's long-term, investment-driven growth strategy.

Weather

In general, NiSource calculates the weather related revenue variance based on changing customer demand driven by weather variance from normal heating degree-days. Normal is evaluated using heating degree days across the NiSource distribution region. While the temperature base for measuring heating degree-days (i.e. the estimated average daily temperature at which heating load begins) varies slightly across the region, the NiSource composite measurement is based on 62 degrees.

Weather in the Gas Distribution Operations service territories for 2007 was approximately 3% warmer than normal and 11% colder than 2006, increasing net revenues by approximately \$73 million for the year ended December 31, 2007 compared to 2006.

Weather in the Gas Distribution Operations service territories for 2006 was approximately 12% warmer than normal and 14% warmer than 2005, decreasing net revenues by approximately \$89 million for the year ended December 31, 2006 compared to 2005.

Throughput

Total volumes sold and transported for the year ended December 31, 2007 were 923.0 MMDth, compared to 826.9 MMDth for 2006. This increase reflected higher sales to residential, commercial, and industrial customers, which was attributable mainly to cooler weather, an increase in residential and commercial customers and usage, and higher off-system sales.

Total volumes sold and transported for the year ended December 31, 2006 were 826.9 MMDth, compared to 864.4 MMDth for 2005. This decrease reflected lower sales to residential, commercial, and industrial customers, which was attributable mainly to the milder weather and decreased residential customer usage, partially offset by increased off-system sales.

Net Revenues

Net revenues for 2007 were \$1,521.7 million, an increase of \$100.1 million from 2006. This increase in net revenues was due primarily to the impact of cooler weather amounting to approximately \$73 million, a \$15.8 million increase in revenues from regulatory trackers, which are primarily offset in operating expense, increased revenues from regulatory initiatives and other service programs of \$10.9 million and approximately \$8 million from customer growth. These increases in net revenues were partially offset by an adjustment for estimated unbilled revenues of \$14.6 million. Northern Indiana detected an error in its unbilled revenue calculation and revised its estimate for unbilled electric and gas revenues in the fourth quarter of 2007. Over a period of several years, Northern Indiana used incorrect customer usage data to calculate its unbilled revenue. The unbilled revenue estimates were never billed to customers and the error was corrected in the fourth quarter of 2007.

Net revenues for 2006 were \$1,421.6 million, a decrease of \$83.3 million from 2005. This decrease in net revenues was due primarily to the impact of warmer weather amounting to approximately \$89 million and a decline in residential usage of approximately \$22 million. Additionally, 2005 revenue was favorably impacted \$12.1 million from a buyout of a large customer gas contract. These decreases in net revenues were partially offset by a \$46.7 million increase in revenues from regulatory trackers, which are primarily offset in operating expenses.

Operating Income

For the twelve months ended December 31, 2007, operating income for the Gas Distribution Operations segment was \$332.8 million, an increase of \$42.8 million compared to the same period in 2006 primarily attributable to

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

NiSource Inc.

Gas Distribution Operations (continued)

increased net revenues described above, partially offset by higher operating expenses of \$57.3 million. The increase in operating expenses includes \$14.9 million of expenses recoverable through regulatory trackers that are primarily offset in revenues. Operating expenses also increased primarily due to higher employee and administrative costs of \$28.6 million, increased outside service expense of \$5.9 million, higher environmental reserves of \$5.0 million, and increased property taxes of \$4.5 million. The comparable period last year was impacted by transition expenses associated with the IBM agreement of \$8.5 million partially offset by a reversal of a restructuring reserve for leased office space of \$5.2 million. The employee and administrative costs include payroll, benefits and higher corporate services costs primarily related to the pricing structure under NiSource's original business services arrangement with IBM.

For the twelve months ended December 31, 2006, operating income for the Gas Distribution Operations segment was \$290.0 million, a decrease of \$78.2 million compared to the same period in 2005 largely attributable to reduced net revenues described above. The increase in operating expenses included \$50.5 million recoverable through regulatory trackers that are primarily offset in revenues. The comparable 2005 period was impacted by transition costs, restructuring charges and a pension and other postretirement benefits charge totaling \$49.4 million associated with the IBM agreement, and a \$10.9 million goodwill impairment loss related to Kokomo Gas. Operating expenses were impacted in 2006 by higher employee and administrative costs of \$11.9 million, expenses associated with the IBM agreement of \$8.5 million primarily for transition services and higher depreciation expense of \$6.8 million, partially offset by a reversal in the third quarter of a restructuring reserve for leased office space of \$5.2 million and lower uncollectible accounts. The employee and administrative costs include payroll, benefits and higher corporate services costs primarily related to NiSource's business services arrangement with IBM.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)**NiSource Inc.****Gas Transmission and Storage Operations**

Year Ended December 31, (<i>in millions</i>)	2007	2006	2005
Operating Revenues			
Transportation revenues	\$ 686.7	\$ 681.6	\$ 646.6
Storage revenues	179.4	176.8	177.9
Other revenues	4.4	6.1	10.6
Total Operating Revenues	870.5	864.5	835.1
Less: Cost of gas sold (excluding depreciation and amortization)		14.0	24.6
Net Revenues	870.5	850.5	810.5
Operating Expenses			
Operation and maintenance	337.2	327.4	297.2
Depreciation and amortization	117.1	114.9	114.1
Impairment and (gain) loss on sale of assets	7.9	0.5	(0.1)
Other taxes	55.7	54.6	55.1
Total Operating Expenses	517.9	497.4	466.3
Equity Earnings (Loss) in Unconsolidated Affiliates	9.4	(12.3)	0.2
Operating Income	\$ 362.0	\$ 340.8	\$ 344.4

Throughput (MMDth)