



resolution of these challenges. We pledge to leave no stone unturned in our review of these issues, and to communicate with you when decisions are made.

# Real Progress in 05

## Dear Fellow Stockholder:

I begin my first letter to you as CEO of your company with three main thoughts: We're listening to you. We're taking action to unlock the value of your investment. And we're committed to clearly communicating our progress and our results to you throughout the year.

In 2005, we continued to transform NiSource; a transformation that is necessary, given our financial realities, a challenging economy and the evolving energy industry. Key first steps in our transformation were establishing a new base earnings level for NiSource and launching our Four-Point Platform for Growth. One year ago we predicted that 2005 would be both rewarding and challenging. Our outlook proved to be accurate.

Looking forward to the remainder of 2006 and beyond, we are building momentum toward our aspiration of becoming the Premier Regulated Energy Company in North America. Our business plan, which has now been in place for more than a year, is based on our solid portfolio of low-risk, regulated assets capable of producing steady, consistent growth. Already, our plan is on target for delivering long-term, sustainable growth, with notable successes being realized from each of our four key components:

- Expansion and commercial growth in the pipeline and storage business;
- Regulatory and commercial initiatives;
- Financial management; and
- Process and expense management.

Yet we recognize that we have lingering issues to address. As of this writing, our stock is trading at a discount to our peers due to the overhang of several challenges, including limited financial flexibility, high gas prices that have caused reduced customer gas usage and may impact the timing of regulatory initiatives, and ongoing losses at Whiting Clean Energy. We have charged small, high-level working groups within our senior leadership team to define plans for the fast-track

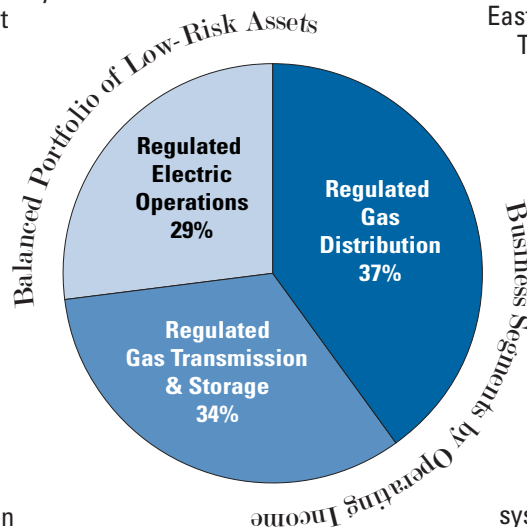
Despite the impact of the most active hurricane season on record, which contributed to record high natural gas prices, and an uneven economy, NiSource made significant progress during 2005 on each of the four key components of our platform for growth.

## Expansion and Commercial Growth in the Pipeline and Storage Business

We are poised to strengthen our position as a key player in meeting the growing need for increased pipeline and storage capacity in the Mid-Atlantic and Eastern United States. The NiSource Gas Transmission and Storage group has unparalleled strategic reach: access to North America's key supply basins and supply corridors, and access to the nation's largest energy consuming markets. This valuable footprint is strategically enhanced by a substantial market area storage position, which provides unique operating flexibility and commercial optimization opportunities.

Our strategy for this segment is two-pronged: constant optimization of our system and aggressive expansion of our physical network. Several important projects hit milestones in 2005, with others making announcements in early 2006:

- A newly restructured management team with an enhanced focus on market development and commercial optimization is now leading the NiSource Gas Transmission and Storage group. The Houston-based commercial team is responsible for market development, utilization and pricing of service offerings to maximize the value of NiSource's pipeline assets. With the addition of well-known industry veterans to our already highly talented leadership team, we are positioned to grow earnings by unlocking the full value of our current assets and by making disciplined capital decisions.
- The Hardy Storage Project in West Virginia received its Federal Energy Regulatory Commission (FERC) certificate in November, has begun construction, and is on track to initiate customer storage injections in the spring of 2007. This project, a joint effort between



Columbia Gas Transmission and a subsidiary of Piedmont Natural Gas, will convert an existing natural gas production field in Hardy and Hampshire counties in West Virginia into a new underground gas storage field. When complete, Hardy Storage will have the capacity to store about 12 billion cubic feet of natural gas and the capability to deliver up to about 176 million dekatherms (Dth) of firm storage service per day. The storage customers include Washington Gas Light, Piedmont Natural Gas, Baltimore Gas and Electric and the city of Charlottesville, Va.

- The Millennium Pipeline has signed Consolidated Edison and KeySpan as anchor customers, and is moving forward in the FERC approval process. Columbia Gas Transmission remains a major sponsor of Millennium Pipeline, along with units of KeySpan and DTE Energy. The pipeline's first phase will be a 182-mile section from Corning, N.Y., to Ramapo, N.Y., offering access to new sources of natural gas supply including local production, enhanced storage options and added delivery capacity for Northeast utilities and, ultimately, their customers. Pending receipt of necessary approvals, Millennium is targeting a November 2007 in-service date.
- Columbia Gas Transmission's Eastern Market Expansion is moving toward a 2009 in-service date, based on definitive agreements with four East Coast customers. The Eastern Market Expansion is a development project to expand existing NiSource storage and transmission assets to provide nearly 100,000 Dth/day of storage to Eastern growth markets.
- Beyond these specific projects, the Gas Transmission

and Storage group is in active discussions with a variety of market participants concerning the continued expansion and extension of its network of transmission and storage assets.

## Regulatory and Commercial Initiatives

NiSource's gas and electric utilities continue to be recognized for their steady growth and innovative regulatory and commercial programs. Our core strategy is to cultivate win-win strategies that benefit all our stakeholders, including our distribution customers and our stockholders, by supporting profitable customer growth and infrastructure investments. We also seek to develop pricing structures and mechanisms that are better aligned with contemporary market conditions, provide value-added tariffs and services and constantly optimize our asset portfolio, which is among the most extensive in the industry.

We added 32,000 net gas and electric customers to our system last year, and despite choppy economic conditions, our large industrial and commercial margins were on par with the previous year. Our gas supply management team had another strong year of optimizing our capacity positions for the benefit of our customers as well as the company. Our electric generation and transmission team also performed well in bulk power sales and wheeling services in the developing Midwest Independent System Operator (MISO) market.

In the regulatory arena, our utilities continue to pursue a wide variety of initiatives ranging from traditional rate cases, to programs to assist low-income customers, to margin expansion efforts. We benefited from several of these initiatives during 2005:



### Executive Team

**Robert C. Skaggs, Jr.**, President & Chief Executive Officer

**Robert D. Campbell**, Senior VP, Human Resources

**Peter V. Fazio, Jr.**, Executive VP & General Counsel

**Larry J. Francisco**, VP, Audit

**Jerry L. Godwin**, Senior VP, Electric Generation and Transmission

**Christopher A. Helms**, Pipeline Group President

**Glen L. Kettering**, Senior VP, Corporate Affairs

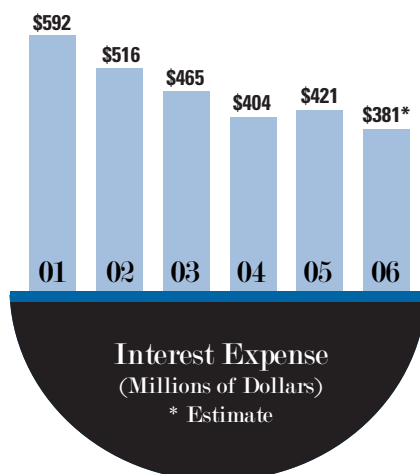
**Harris H. Marple**, Senior VP, Distribution Operations

**Michael W. O'Donnell**, Executive VP & Chief Financial Officer

**Kathleen O'Leary**, Senior VP, Energy Distribution Regulated Revenue

**Violet G. Sistovaris**, Senior VP, Administrative Services

- NiSource has established several state-of-the-art trackers, which are rate mechanisms that allow for the recovery of certain costs without extensive regulatory process. Trackers increase net revenues by allowing timely recovery of rising operating expenses. Other trackers allow for return on required investments. For example, our environmental cost tracker in Indiana will allow us to recover up to \$306 million in capital and operation and maintenance expenses associated with the installation and operation of NOx pollution control equipment on our electric generating stations. In our Ohio jurisdiction, a tracker allows for the recovery of current bad debt expense, as well as for previously deferred uncollected accounts receivable.
- Last November, our Bay State Gas Company team secured regulatory approval of an \$11.1 million annual revenue increase in Massachusetts. The newly approved rate structure includes an attractive performance-based rate plan that will be in place for 10 years and contains earnings-sharing provisions as well as a pension adjustment mechanism.
- Northern Indiana Public Service Company (NIPSCO) worked with regulators and consumer representatives to extend its natural gas alternative regulatory plan through April 2010. The plan, initially approved in 1997, allows the utility's natural gas customers to participate



in optional gas purchasing and billing programs. NIPSCO is the only utility in Indiana that offers these competitive products and services. More than 16 percent of its natural gas customers participate in the programs.

- NIPSCO received regulatory approval of an extension of its Winter Warmth plan to assist low-income customers. The program will direct up to \$7.8 million in bill and deposit assistance to customers with low incomes or those experiencing a hardship.
- Columbia Gas of Kentucky renewed its Customer Choice Program through March 2009. The program, which began in 2000 as a pilot, provides residential and small commercial customers with the ability to choose their natural gas supplier.

### Financial Management

After much work to stabilize our credit ratings in 2002, 2003 and 2004, we had a unique opportunity to continue to improve NiSource's financial profile during 2005. The NiSource team refinanced \$2.4 billion in long-term debt in 2005, which is expected to result in approximately \$43 million in annual interest expense savings beginning in 2006. In addition, we put in place short-term credit facilities that will significantly bolster our liquidity and at the same time further reduce our borrowing costs. We will require no major refinancings until 2010.



**Gary L. Neale**, Chairman  
NiSource Inc.

**Robert C. Skaggs, Jr.**, President & CEO  
NiSource Inc.

**Dr. Steven C. Beering**, President Emeritus  
Purdue University

**Richard L. Thompson**  
Retired Group President  
Caterpillar Inc.

**Dennis E. Foster**, Retired Vice Chairman  
ALLTEL Corp.

**Robert J. Welsh**, Chairman & CEO  
Welsh Holdings, LLC

**Peter McCausland**, Chairman & CEO  
Airgas, Inc.

**Dr. Carolyn Y. Woo**  
Martin J. Gillen Dean &  
Ray & Milann Siegfried Professor of  
Entrepreneurial Studies  
Mendoza College of Business  
University of Notre Dame

**Steven R. McCracken**  
Chairman, President & CEO  
Owens-Illinois, Inc.

**Ian M. Rolland**, Lead Director  
Retired Chairman & CEO  
Lincoln National Corp.

**Roger A. Young**, Retired Chairman  
Bay State Gas Co.

Looking forward, our strategy is to optimize and enhance our long-term credit and equity capacity. In December 2005, our credit ratings were affirmed, with a stable outlook, by both Moody's and Standard & Poor's. To ensure that we borrow at the lowest possible rates and maintain a strong balance sheet, we will continually seek new means to fund our business needs and reduce our cost of capital. In addition, we will aggressively manage our costs to meet working capital requirements, which have increased in recent months due to high commodity prices.

### Process and Expense Management

Building on our tradition of cost and process discipline, employees throughout the organization continue to hold the line on expenses, as we continue to implement business process changes to further enhance productivity. Our strategy is premised on operational excellence, and is driven by a focus on continuous improvement, employee development, state-of-the-art technology and selective outsourcing.

As a means to re-deploy capital toward growth opportunities, transform our administrative infrastructure, infuse new technologies and reduce operating costs, NiSource in 2005 moved forward with a landmark contract to outsource many back-office processes to IBM. I am pleased to report that we are on track to save \$395 million in operating expenses and capital costs over 10 years, net of costs to achieve. Since July 2005, we have been transitioning to IBM the operation of support functions including human resources, finance and accounting, supply chain (procurement), customer contact centers, meter-to-cash and information technology. Over the next 18 months, we will be replacing a variety of poorly interconnected legacy systems with a suite of fully integrated financial, transactional, planning, commercial and operating systems that will literally transform the way our employees perform their jobs every day. This transformation will allow the NiSource team to focus our resources on the core competencies necessary to provide safe, reliable utility and pipeline services, and support execution of our Four-Point Platform for Growth.

In late 2005, we began implementing additional cost reduction measures as a means of further improving our earnings outlook for 2006. This set of actions includes streamlining our executive ranks, realigning executive compensation, rationalizing corporate budgets, consolidating facilities and reducing the amount we spend on employee travel.

## Opportunities for the Future

As you can see, we have accomplished much. Our team is executing on our Four-Point Platform for Growth. We have resolved many of the significant issues that faced

us over the last several years, and we are now addressing the remaining concerns. As we continue to make progress on all these fronts, we believe that we will grow earnings and that, in turn, will enable us to eventually increase the dividend.

For 2006, we have high expectations for the further success of our business plan, with employees at all levels and functions of the organization contributing to the execution of the plan. Each function and subsidiary of NiSource has a specific operating plan and financial plan for 2006, linked to the corporation's overall objectives. Each employee's personal goals are tied to those operating and financial plans, and achievement of those goals will be evaluated regularly, with incentives aligned with results.

## OUR Commitment

I would like to take this opportunity to thank our Chairman, Gary Neale, for his outstanding contributions to NiSource during his 16-year tenure with the company. Gary, who was the architect of NiSource's growth from a single-state utility to a Fortune 500, integrated energy holding company operating from the Gulf Coast through the Midwest to New England, retired from the company at the end of June 2005 and remains Chairman of the Board. His commitment to growth and innovation continues to inspire our efforts.

I also would like to thank our employees for their ongoing commitment and contributions to serving our customers safely and reliably. Furthermore, I thank you, our stockholders, for your continued support. As I stated at the outset, I believe we are fundamentally undervalued compared to our industry peers. We're looking intensely at how to remedy that situation. We are committed to enhancing the value of your investment and to transparency in communicating to you our progress in making that happen.

In closing, let me assure you that NiSource continues to be on the right track. We are addressing our financial realities. We are focused on achieving realistic business plans and targets. We are doing what it takes to deliver results. We are committed to becoming the Premier Regulated Energy Company in North America.

Sincerely,



Robert C. Skaggs, Jr.  
President and Chief Executive Officer



NiSource Inc. common stock is listed and traded on the New York Stock Exchange under the symbol NI. The shares are listed in financial stock quotations as NISOURCE. As of Dec. 31, 2005, NiSource Inc. had 46,451 registered common stockholders.

### **Anticipated Dividend Record and Payment Dates**

#### **NiSource Common Stock**

<b>Record Date</b>	<b>Payment Date</b>
04-28-06	05-19-06
07-31-06	08-18-06
10-31-06	11-20-06
01-31-07	02-20-07

#### **Common Stock Dividend Declared**

At its meeting on Jan. 6, 2006, the board of directors declared a quarterly dividend of \$0.23 per share, equivalent to \$0.92 per share on an annual basis.

#### **Investor and Financial Information**

Financial analysts and investment professionals should direct written and telephone inquiries to NiSource Investor Relations at 801 E. 86th Ave., Merrillville, IN 46410 or (219) 647-6083.

Copies of NiSource's financial reports are available by writing or calling the Investor Relations department at the address or phone number listed above. The materials are also available at [www.nisource.com](http://www.nisource.com).

### **Stockholder Services**

Questions about stockholder accounts, stock certificates, transfer of shares, dividend payments, automatic dividend reinvestment and stock purchase plan, and electronic deposit may be directed to Mellon Investor Services at the following:

#### **Mellon Investor Services**

P.O. Box 3315  
South Hackensack, NJ 07606  
or  
480 Washington Boulevard  
Jersey City, NJ 07310-1900

**(888) 884-7790**

TDD for Hearing Impaired  
(800) 231-5469

Foreign Stockholders  
(201) 680-6610

TDD Foreign Stockholders  
(201) 680-6578

[www.melloninvestor.com](http://www.melloninvestor.com)

On June 3, 2005, NiSource's Chief Executive Officer submitted to the New York Stock Exchange ("NYSE") an annual certification stating that as of that date he was not aware of any violation by the company of the New York Stock Exchange's corporate governance listing standards, as required by Section 303A.12(a) of the NYSE's Listed Company Manual. NiSource's Chief Executive Officer and Chief Financial Officer have provided certifications to the U.S. Securities and Exchange Commission as required by Section 302 of the Sarbanes-Oxley Act of 2002. These certifications are included as Exhibits 31.1 and 31.2 to the company's 10-K for the year ended December 31, 2005.

## Contact Us

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This document contains "forward-looking statements," including earnings guidance for fiscal year 2006. For a discussion of factors that could cause actual results to differ materially from those contained in such statements, please see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the NiSource Inc. annual report on Form 10-K included herein.