



ENERGY NEWS

October, 2008

THE U.S. CREDIT/ECONOMIC CRISIS AND ITS IMPACT ON THE NATURAL GAS INDUSTRY

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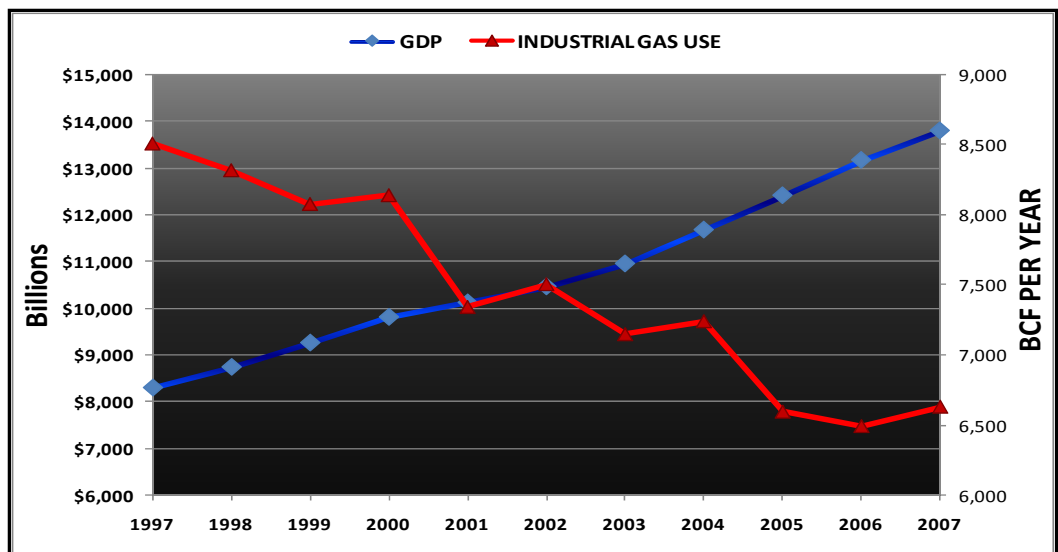
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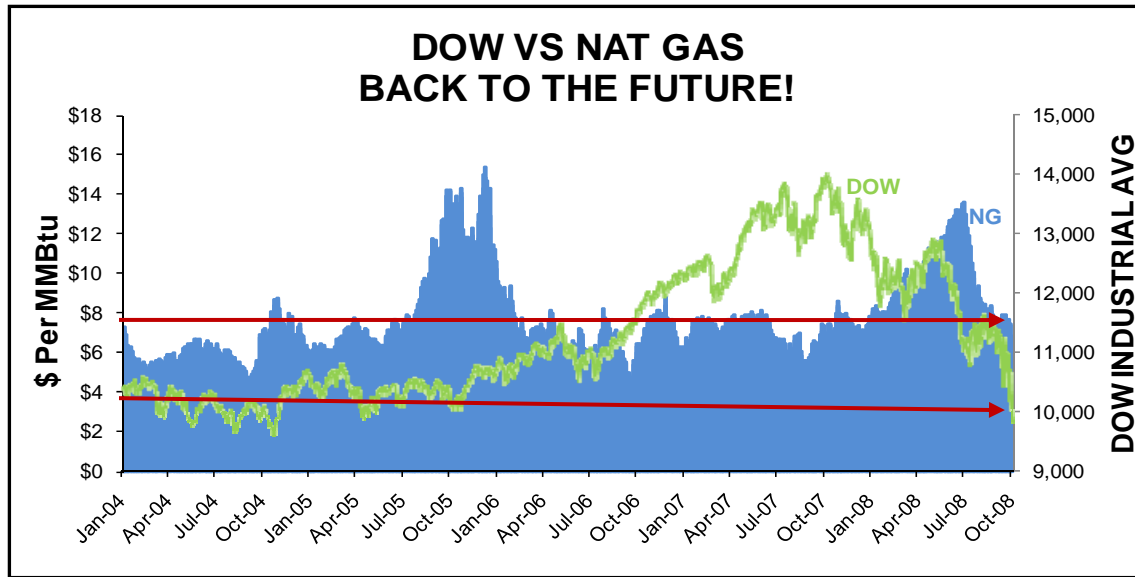
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During the last few weeks, you can't watch the news or read the paper without being inundated with headlines about companies attempting to stave off credit and liquidity problems. Companies which had been around for decades are no longer, others have been driven to the brink of collapse only to be rescued by government led "bailouts" and the likes of Warren Buffet. Many firms have been able to survive, but have had to announce different measures in order to stay afloat in these rough financial waters. These include: the suspension of dividends, the establishment of new, but expensive lines of credit as previous providers went bankrupt, and reductions in future capital expenditures. Meanwhile, smaller companies are struggling just to make payroll while trying to maintain "normal" day-to-day operations. Up and down "main street", people can't get loans for cars or new home purchases. Banks continue to charge more to each other to lend money because they trust each other's balance sheet less and less. This has resulted in availability of less capital, paralyzing the credit market and changing the way companies do business.



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US Economy and Industrial Natural Gas Consumption

The effects of the “credit crisis” are already being felt across America in the form of an economic slowdown, some may even call it a recession. The definition of a recession is two consecutive quarters of negative GDP growth which we haven’t seen yet. What we have witnessed over the last 10 years is US GDP rapidly increasing while industrial natural gas usage has been trending downward (see chart on page 1). Recent weakness in the US dollar and continuing global economic expansion has led to a resurgence in US exports, helping to stabilize industrial gas demand over the last year. However, as the saying goes, “When America sneezes, the rest of the world catches a cold”. The US’s credit problems have infected other markets abroad and, coupled with a global economic slowdown, US industrial gas demand appears to be set for another decline. This decrease in demand coupled with the continued domestic supply increases could stabilize and even put further downward pressure on natural gas prices. Speaking of gas prices and the economy, taking a look back one can note something of interest. The most liquid economic indicator for which the US economy is gauged is the DOW Jones Industrial Index. Most check it at the end of the day lately to judge the degree of turmoil in the day’s market. There isn’t a strong correlation between natural gas prices and the DOW, but looking back a few years provides an interesting observation. As of October 6, the DOW and natural gas are within 5% of where they were almost 5 years ago! By examining the chart above, these two mostly moved in opposite directions from each other up until 2008 as conventional wisdom calls for commodities to serve as a hedge against inflation during market downturns. However, this year both have moved more in tandem and have experienced extreme volatility while retreating back to ’04 levels.

The Future Impact on Gas Prices

With all of the turmoil in the credit markets and the impending economic slowdown, what does the future hold for gas prices? Currently, record drilling is continuing to occur and the “shale plays” are providing a seemingly unlimited supply of natural gas. However, a lack of market liquidity coupled with lower natural gas prices could be the recipe for the year-over-year supply increases to begin to level off next year. The leading producer of natural gas in the US recently announced billions of dollars in reduced future capital expenditures to drill in the shale regions. Expect similar announcements from other producers as balance sheet liquidity becomes an ever more important barometer of financial health. Future pipeline projects to enhance natural gas infrastructure will have more difficulty getting funded. This will cause many projects not to make it past the drawing board, while others will have to be joint ventures or partnerships in order to share the risk of building billion dollar pipelines. Tighter credit constraints and smaller netbacks may begin to squeeze the small independent drilling companies which will also lead to reduced drilling. Although the economy is slowing, natural gas demand could see significant increases in the years to come. A new President and new Congress will have the reduction of CO₂ emissions on the agenda next year, which should lead to increased gas demand for power generation. The Pickens’ plan to wean the US off of foreign oil may gain strength and natural gas vehicles may become more prominent on the roadways. There are many unknowns and factors at play in today’s market and the future of gas prices remains uncertain, but as was the case looking forward back in 2004, we will no doubt be in for a bumpy ride! If you need any assistance in planning or getting ready for this upcoming winter, please feel free to contact your CES representative and he/she will be glad to assist you or answer any questions you might have.

REGIONAL REPORTS

ILLINOIS/INDIANA UPDATE

Customers Fired Up Over Nicor Bills: Crain's Chicago Business is reporting that hundreds of Nicor customers are fuming over their gas bills due to infrequent meter readings.

Consumer watchdog Citizens Utility Board has fielded almost 500 complaints on the issue over the past six months, an 83% increase from the year-earlier period. The Illinois Commerce Commission, which oversees utilities, has received more than 360 such complaints for the year to date vs. 280 for all of last year.

Customers say Naperville-based Nicor Inc. isn't reading their meters for months at a time (sometimes for a year or longer) and is under-estimating their usage. Then, after the company reads the meter, customers see eye popping increases in their bills without explanation.

Under state rules, utilities are supposed to read meters at least once every two months and adjust for the fluctuating price of gas over time.

One customer was blown away when his July gas bill for his business topped \$3,580. Until then, his monthly bill this year had ranged from \$92 to \$911. The reason he was given for the increase: The meter hadn't been read since January.

Nicor, which has 2.2 million customers, says it tries to read meters every other month but sometimes can't. Nicor reported that it employed 165 meter readers as of the end of July compared with 160 at the same time last year. Its internal data show that employees are reading 94% of meters at least every 60 days, as required. Last year that figure was 93%. Kevin Kirby, vice-president of customer care for Nicor, attributes the spike in complaints to heightened awareness of gas prices spurred by the rise in energy costs.

PENNSYLVANIA UPDATE

Revitalizing The Pennsylvania Market: Nearly three years ago the Pennsylvania Public Utilities Commission (PUC) declared that effective competition in the state's retail gas market no longer existed. They appointed a state study group to present recommendations that would revitalize the all-but-dead retail gas market in Pennsylvania.

Last week, the study group presented a report urging the adoption of a business plan based on a model developed by the North American Energy Standards Board (NAESB). The report to the commission suggests that marketers need a business climate "conducive to more participation" than currently exists. To achieve that end, the group said the PUC should consider "certain NAESB procedures/rules to bring uniformity to supplier and local distribution company (LDC) interactions." The study group, which consisted of representatives from LDC's, marketers and pipeline companies, noted that NAESB's best business practices "could be defined and memorialized in a generic supplier's tariff or promulgated in commission regulations."

Gas suppliers in Pennsylvania believe differences in operation among various LDC's "act as a barrier" to their entry and participation in markets served by multiple LDC's and "some level of standardization would be helpful" the report said. In addition to making it easier for a supplier to enter the market and secure customers on one or more LDC systems, the more a supplier can rely on known standards and protocols for the expected interactions, the less chance there is for errors, the report noted.

The group said one way to make that possible "would be to require all LDC's to adopt a preferred model with system operation and other business practices standardized across the state." However, the group stressed that ordering the LDC's to revise their systems to one preferred model would be a monumental task requiring a

considerable expenditure of financial and political capital.

A more workable solution would be to adopt NAESB practices in PUC regulations, or through a generic base rate case, the report said. Such changes "would require less time to implement and would incur lower costs because of previous work on NAESB that has already been completed."

Voting to study the recommendations, the PUC agreed to take some interim measures, including urging the state legislature to make changes in the state law regarding pipeline capacity assignment and release.

WISCONSIN UPDATE

Wisconsin Factories Strong: A recent report examining manufacturing in eight states (Illinois, Indiana, Michigan, Missouri, North Carolina, Ohio, Pennsylvania and Wisconsin) found Wisconsin output grew 28.5% from 1997-2007. The unadjusted for inflation data showed a 26.2% growth nationally. During the period Wisconsin lost 13.6% of their industrial workers, compared to a 20.3% decrease nationwide. Wisconsin has almost 21% of its economic output generated by manufacturing compared to less than 12 % nationally.

ATC Plans: ATC (American Transmission Company) says it will spend \$2.7 billion in the next 10 years to upgrade, maintain and build new power lines, primarily in eastern Wisconsin and the Upper Peninsula of Michigan. The plan calls for \$1.3 billion to be allocated towards new power lines and upgrading existing lines. \$1.4 billion will be spent on maintenance and connecting lines to power plants. Last year they had estimated a \$2.8 billion cost. The trend represents a shift from building new facilities to maintaining current assets.



Customer Corner

Bomarko, Inc. is a leading producer of medical and flexible packaging. Located in Plymouth, IN Bomarko produces items such as food-grade waxed and coated papers as well as foil laminations used in various confectionary applications, medical packaging including bandage wrappers, heat and cold seal coated paper, and cohesive coated film.

In addition, they produce small square wax paper used to separate meat patties. Today, the patty paper division includes a vast array of waxed, coated and printed papers converted for a variety of uses including separating meat and poultry, cheese, bakery, and MAP Systems. By combining the latest science and technology with highly skilled,

dedicated people, Bomarko Inc. is able to bring the best packaging solutions to its customers.

Bomarko, Inc. has been a CenterPoint Energy customer since January 2008 and is served by Michelle Crepeau.



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