

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

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 1-13265

CENTERPOINT ENERGY RESOURCES CORP.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of  
incorporation or organization)

76-0511406

(I.R.S. Employer Identification No.)

1111 LOUISIANA  
HOUSTON, TEXAS 77002

(Address and zip code of principal  
executive offices)

(713) 207-1111

(Registrant's telephone number,  
including area code)

-----  
CENTERPOINT ENERGY RESOURCES CORP. MEETS THE CONDITIONS SET FORTH IN GENERAL  
INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM 10-Q  
WITH THE REDUCED DISCLOSURE FORMAT.

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 whether the registrant is an accelerated filer (as  
defined in Rule 12b-2 of the Exchange Act). Yes  No

As of May 1, 2005, all 1,000 shares of CenterPoint Energy Resources Corp. common  
stock were held by Utility Holding, LLC, a wholly owned subsidiary of  
CenterPoint Energy, Inc.

CENTERPOINT ENERGY RESOURCES CORP.  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED MARCH 31, 2005

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

From time to time we make statements concerning our expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are not historical facts. These statements are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed or implied by these statements. You can generally identify our forward-looking statements by the words "anticipate," "believe," "continue," "could," "estimate," "expect," "forecast," "goal," "intend," "may," "objective," "plan," "potential," "predict," "projection," "should," "will," or other similar words.

We have based our forward-looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that assumptions, beliefs, expectations, intentions and projections about future events may and often do vary materially from actual results. Therefore, we cannot assure you that actual results will not differ materially from those expressed or implied by our forward-looking statements.

The following are some of the factors that could cause actual results to differ materially from those expressed or implied in forward-looking statements:

- state and federal legislative and regulatory actions or developments, constraints placed on our activities or business by the Public Utility Holding Company Act of 1935, as amended (1935 Act), changes in or application of laws or regulations applicable to other aspects of our business:
  - allowed rates of return;
  - rate structures;
  - recovery of investments; and
  - operation and construction of facilities;
- timely rate increases, including recovery of costs;
- industrial, commercial and residential growth in our service territory and changes in market demand and demographic patterns;
- the timing and extent of changes in commodity prices, particularly natural gas;
- changes in interest rates or rates of inflation;
- weather variations and other natural phenomena;
- the timing and extent of changes in the supply of natural gas;
- commercial bank and financial market conditions, our access to capital, the costs of such capital, receipt of certain financing approvals under the 1935 Act, and the results of our financing and refinancing efforts, including availability of funds in the debt capital markets;
- actions by rating agencies;
- inability of various counterparties to meet their obligations to us;
- non-payment of our services due to financial distress of our customers;
- our ability to control costs;
- the investment performance of CenterPoint Energy's employee benefit plans;
- our internal restructuring or other restructuring options that may be pursued;
- our potential business strategies, including acquisitions or dispositions of assets or businesses, which cannot be assured to be completed or beneficial to us; and

- other factors we discuss in "Risk Factors" beginning on page 11 of the CenterPoint Energy Resources Corp. Annual Report on Form 10-K for the year ended December 31, 2004.

Additional risk factors are described in other documents we file with the Securities and Exchange Commission.

You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement.

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES  
 (AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY, INC.)  
 STATEMENTS OF CONSOLIDATED INCOME  
 (THOUSANDS OF DOLLARS)  
 (UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
REVENUES.....	\$ 2,196,585	\$ 2,415,090
EXPENSES:		
Natural gas.....	1,762,240	1,948,335
Operation and maintenance.....	181,833	173,275
Depreciation and amortization.....	46,526	49,176
Taxes other than income taxes.....	45,394	42,411
Total.....	2,035,993	2,213,197
OPERATING INCOME.....	160,592	201,893
OTHER INCOME (EXPENSE):		
Interest and other finance charges.....	(42,282)	(45,454)
Other, net.....	2,600	4,634
Total.....	(39,682)	(40,820)
INCOME BEFORE INCOME TAXES.....	120,910	161,073
Income Tax Expense.....	(46,719)	(65,116)
NET INCOME.....	\$ 74,191	\$ 95,957

See Notes to the Company's Interim Financial Statements

CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES  
(AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY, INC.)  
CONSOLIDATED BALANCE SHEETS  
(THOUSANDS OF DOLLARS)  
(UNAUDITED)

ASSETS

	DECEMBER 31, 2004	MARCH 31, 2005
	-----	-----
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	\$ 140,466	\$ 253,927
Accounts and notes receivable, net.....	612,708	613,247
Accrued unbilled revenue.....	502,163	316,298
Accounts and notes receivable - affiliated companies, net.....	11,987	145,561
Materials and supplies.....	25,017	25,331
Natural gas inventory.....	174,232	75,324
Non-trading derivative assets.....	50,219	85,664
Taxes receivable.....	155,155	141,371
Deferred tax asset.....	12,256	--
Prepaid expenses.....	8,308	11,606
Other.....	92,160	46,304
	-----	-----
Total current assets.....	1,784,671	1,714,633
	-----	-----
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Property, plant and equipment.....	4,296,061	4,331,226
Less accumulated depreciation.....	(461,978)	(477,704)
	-----	-----
Property, plant and equipment, net.....	3,834,083	3,853,522
	-----	-----
<b>OTHER ASSETS:</b>		
Goodwill.....	1,740,510	1,740,510
Other intangibles, net.....	19,719	19,376
Non-trading derivative assets.....	17,682	44,153
Accounts and notes receivable - affiliated companies, net.....	18,197	17,240
Other.....	118,089	118,936
	-----	-----
Total other assets.....	1,914,197	1,940,215
	-----	-----
<b>TOTAL ASSETS.....</b>	<b>\$ 7,532,951</b>	<b>\$ 7,508,370</b>
	=====	=====

See Notes to the Company's Interim Financial Statements

CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES  
 (AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY, INC.)  
 CONSOLIDATED BALANCE SHEETS -- (CONTINUED)  
 (THOUSANDS OF DOLLARS)  
 (UNAUDITED)

LIABILITIES AND STOCKHOLDER'S EQUITY

	DECEMBER 31, 2004	MARCH 31, 2005
	-----	-----
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt.....	\$ 366,873	\$ 361,000
Accounts payable.....	798,661	647,099
Taxes accrued.....	77,802	75,795
Interest accrued.....	57,741	50,824
Customer deposits.....	60,164	60,149
Non-trading derivative liabilities.....	26,323	21,169
Accumulated deferred income taxes, net.....	--	3,941
Other.....	272,996	302,685
	-----	-----
Total current liabilities.....	1,660,560	1,522,662
	-----	-----
<b>OTHER LIABILITIES:</b>		
Accumulated deferred income taxes, net.....	640,780	644,463
Non-trading derivative liabilities.....	6,412	4,425
Benefit obligations.....	128,537	125,620
Other.....	556,819	535,641
	-----	-----
Total other liabilities.....	1,332,548	1,310,149
	-----	-----
LONG-TERM DEBT.....	2,000,696	1,999,999
	-----	-----
COMMITMENTS AND CONTINGENCIES (NOTES 1 AND 9)		
<b>STOCKHOLDER'S EQUITY:</b>		
Common stock.....	1	1
Paid-in capital.....	2,231,906	2,262,589
Retained earnings.....	305,291	401,248
Accumulated other comprehensive income.....	1,949	11,722
	-----	-----
Total stockholder's equity.....	2,539,147	2,675,560
	-----	-----
<b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY.....</b>	<b>\$ 7,532,951</b>	<b>\$ 7,508,370</b>
	=====	=====

See Notes to the Company's Interim Financial Statements

CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES  
(AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY, INC.)  
STATEMENTS OF CONSOLIDATED CASH FLOWS  
(THOUSANDS OF DOLLARS)  
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income.....	\$ 74,191	\$ 95,957
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	46,526	49,176
Amortization of deferred financing costs.....	2,814	2,266
Deferred income taxes.....	(10,770)	16,440
Changes in other assets and liabilities:		
Accounts receivable and unbilled revenues, net.....	176,189	185,461
Accounts receivable/payable, affiliates.....	1,626	(4,567)
Inventory.....	91,570	98,594
Taxes receivable.....	32,023	44,467
Accounts payable.....	(57,475)	(151,562)
Fuel cost recovery.....	47,528	75,666
Interest and taxes accrued.....	61,115	(8,924)
Net non-trading derivative assets and liabilities.....	6,487	(55,828)
Other current assets.....	26,099	42,557
Other current liabilities.....	(25,216)	(47,448)
Other assets.....	(3,667)	10,464
Other liabilities.....	(23,759)	(36,367)
Other, net.....	(459)	(697)
Net cash provided by operating activities.....	444,822	315,655
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures.....	(52,126)	(62,005)
Increase in notes receivable from affiliates, net.....	(175,065)	(128,049)
Other, net.....	(2,416)	(6,267)
Net cash used in investing activities.....	(229,607)	(196,321)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Decrease in short-term borrowings, net.....	(63,000)	--
Payments of long-term debt.....	--	(5,873)
Debt issuance costs.....	(1,862)	--
Net cash used in financing activities.....	(64,862)	(5,873)
NET INCREASE IN CASH AND CASH EQUIVALENTS.....	150,353	113,461
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD.....	34,447	140,466
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD.....	\$ 184,800	\$ 253,927
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash Payments:		
Interest.....	\$ 46,126	\$ 51,728
Income taxes.....	14,968	418

See Notes to the Company's Interim Financial Statements



CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) BACKGROUND AND BASIS OF PRESENTATION

General. Included in this Quarterly Report on Form 10-Q (Form 10-Q) of CenterPoint Energy Resources Corp. are the consolidated interim financial statements and notes (Interim Financial Statements) of CenterPoint Energy Resources Corp. and its subsidiaries (collectively, CERC Corp. or the Company). The Interim Financial Statements are unaudited, omit certain financial statement disclosures and should be read with the Annual Report on Form 10-K of CERC Corp. for the year ended December 31, 2004 (CERC Corp. Form 10-K).

Background. The Company's operating subsidiaries own and operate natural gas distribution facilities, interstate pipelines and natural gas gathering, processing and treating facilities. The Company's operations of its local distribution companies are conducted by three unincorporated divisions: Houston Gas, Minnesota Gas and Southern Gas Operations. Through wholly owned subsidiaries, the Company owns two interstate natural gas pipelines and gas gathering systems, provides various ancillary services, and offers variable and fixed price physical natural gas supplies to commercial and industrial customers and natural gas distributors.

The Company is an indirect wholly owned subsidiary of CenterPoint Energy, Inc. (CenterPoint Energy), a public utility holding company created on August 31, 2002, as part of a corporate restructuring of Reliant Energy, Incorporated (Reliant Energy) that implemented certain requirements of the Texas Electric Choice Plan. CenterPoint Energy is a registered public utility holding company under the Public Utility Holding Company Act of 1935, as amended (1935 Act). The 1935 Act and related rules and regulations impose a number of restrictions on the activities of CenterPoint Energy and those of its subsidiaries. The 1935 Act, among other things, limits the ability of CenterPoint Energy and its subsidiaries to issue debt and equity securities without prior authorization, restricts the source of dividend payments to current and retained earnings without prior authorization, regulates sales and acquisitions of certain assets and businesses and governs affiliated service, sales and construction contracts.

Basis of Presentation. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company's Interim Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operations for the respective periods. Amounts reported in the Company's Statements of Consolidated Income are not necessarily indicative of amounts expected for a full-year period due to the effects of, among other things, (a) seasonal fluctuations in demand for energy and energy services, (b) changes in energy commodity prices, (c) timing of maintenance and other expenditures and (d) acquisitions and dispositions of businesses, assets and other interests. In addition, certain amounts from the prior year have been reclassified to conform to the Company's presentation of financial statements in the current year. These reclassifications do not affect net income.

Note 2(e) (Regulatory Assets and Liabilities), Note 3 (Regulatory Matters), Note 5 (Derivative Instruments) and Note 9 (Commitments and Contingencies) to the consolidated annual financial statements in the CERC Corp. Form 10-K (CERC Corp. 10-K Notes) relate to certain contingencies. These notes, as updated herein, are incorporated herein by reference.

For information regarding environmental matters and legal proceedings, see Note 9 to the Interim Financial Statements.

(2) NEW ACCOUNTING PRONOUNCEMENTS

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). FIN 47 clarifies that an entity must record a liability for a "conditional" asset retirement obligation if the fair value of the obligation can be reasonably estimated.

FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company does not expect the adoption of this standard to have a material effect on its financial position, results of operations or cash flows.

### (3) REGULATORY MATTERS

#### (a) Rate Cases.

In April 2005, the Railroad Commission of Texas (Railroad Commission) approved a settlement that increased Southern Gas Operations' base rate and service charge revenues by a combined \$2 million in its East Texas and South Texas Divisions.

#### (b) City of Tyler, Texas Dispute.

In July 2002, the City of Tyler, Texas, asserted that Southern Gas Operations had overcharged residential and small commercial customers in that city for gas costs under supply agreements in effect since 1992. That dispute has been referred to the Railroad Commission by agreement of the parties for a determination of whether Southern Gas Operations has properly charged and collected for gas service to its residential and commercial customers in its Tyler distribution system in accordance with lawful filed tariffs during the period beginning November 1, 1992, and ending October 31, 2002. In December 2004, the Railroad Commission conducted a hearing on the matter. On April 15, 2005, the Railroad Commission hearing examiners issued a preliminary finding that the Company had complied with its tariffs, acted prudently in entering into its gas supply contracts, and prudently managed those contracts. The Railroad Commission is expected to issue a final ruling in May 2005. In a parallel action now in the Court of Appeals in Austin, Southern Gas Operations is challenging the scope of the Railroad Commission's inquiry which goes beyond the issue of whether Southern Gas Operations had properly followed its tariffs to include a review of Southern Gas Operations' historical gas purchases. The Company believes such a review is not permitted by law and is beyond what the parties requested in the joint petition that initiated the proceeding at the Railroad Commission. The Company believes that all costs for Southern Gas Operations' Tyler distribution system have been properly included and recovered from customers pursuant to Southern Gas Operations' filed tariffs.

### (4) DERIVATIVE FINANCIAL INSTRUMENTS

The Company is exposed to various market risks. These risks arise from transactions entered into in the normal course of business. The Company utilizes derivative financial instruments such as physical forward contracts, swaps and options to mitigate the impact of changes in cash flows of its natural gas businesses on its operating results and cash flows.

**Cash Flow Hedges.** During the three months ended March 31, 2004 and 2005, hedge ineffectiveness was less than \$1 million from derivatives that qualify for and are designated as cash flow hedges. No component of the derivative instruments' gain or loss was excluded from the assessment of effectiveness. If it becomes probable that an anticipated transaction will not occur, the Company realizes in net income the deferred gains and losses recognized in accumulated other comprehensive income. Once the anticipated transaction occurs, the accumulated deferred gain or loss recognized in accumulated other comprehensive income is reclassified and included in the Company's Statements of Consolidated Income under the caption "Natural Gas." Cash flows resulting from these transactions in non-trading energy derivatives are included in the Statements of Consolidated Cash Flows in the same category as the item being hedged. As of March 31, 2005, the Company expects \$14 million in accumulated other comprehensive income to be reclassified into net income during the next twelve months.

**Other Derivative Financial Instruments.** The Company also has natural gas contracts that are derivatives which are not hedged. Load following services that the Company offers its natural gas customers create an inherent tendency for the Company to be either long or short natural gas supplies relative to customer purchase commitments. The Company measures and values all of its volumetric imbalances on a real-time basis to minimize its exposure to commodity price and volume risk. The aggregate Value at Risk (VaR) associated with these operations is calculated daily and averaged \$0.3 million with a high of \$1 million during the first quarter of 2005. The Company does not engage in proprietary or speculative commodity trading. Unhedged positions are accounted for by adjusting the carrying amount of the contracts to market and recognizing any gain or loss in operating income, net. During the three months ended March 31, 2004 and 2005, the Company recognized net gains (losses)

related to unhedged positions amounting to \$(1) million and \$6 million, respectively. As of December 31, 2004, the Company had recorded short-term risk management assets and liabilities of \$4 million and \$5 million, respectively, included in other current assets and other current liabilities, respectively. As of March 31, 2005, the Company had recorded short-term risk management assets and liabilities of \$4 million and \$3 million, respectively, included in other current assets and other current liabilities, respectively.

(5) GOODWILL AND INTANGIBLES

Goodwill as of December 31, 2004 and March 31, 2005 by reportable business segment is as follows (in millions):

Natural Gas Distribution.....	\$	1,085
Pipelines and Gathering.....		601
Other Operations.....		55
		-----
Total.....	\$	1,741
		=====

The Company completed its annual evaluation of goodwill for impairment as of January 1, 2005 and no impairment was indicated.

The components of the Company's other intangible assets consist of the following:

	DECEMBER 31, 2004		MARCH 31, 2005	
	CARRYING AMOUNT	ACCUMULATED AMORTIZATION	CARRYING AMOUNT	ACCUMULATED AMORTIZATION
	(IN MILLIONS)			
Land use rights.....	\$ 7	\$ (3)	\$ 7	\$ (3)
Other.....	21	(5)	21	(6)
	-----	-----	-----	-----
Total.....	\$ 28	\$ (8)	\$ 28	\$ (9)
	=====	=====	=====	=====

The Company recognizes specifically identifiable intangibles, including land use rights and permits, when specific rights and contracts are acquired. The Company has no intangible assets with indefinite lives recorded as of March 31, 2005. The Company amortizes other acquired intangibles on a straight-line basis over the lesser of their contractual or estimated useful lives that range from 47 to 75 years for land use rights and 4 to 25 years for other intangibles.

Amortization expense for other intangibles for the three months ended March 31, 2004 and 2005 was \$0.4 million and \$0.5 million, respectively. Estimated amortization expense for the remainder of 2005 is approximately \$1.4 million and is approximately \$2 million per year for each of the five succeeding fiscal years.

(6) LONG-TERM DEBT AND RECEIVABLES FACILITY

(a) Long-Term Debt.

Credit Facilities. As of March 31, 2005, the Company had a revolving credit facility that provided for an aggregate of \$250 million in committed credit. The revolving credit facility terminates on March 23, 2007. Borrowings under this facility may be made at the London interbank offered rate (LIBOR) plus 137.5 basis points, including the facility fee, based on current credit ratings and the applicable pricing grid. An additional utilization fee of 12.5 basis points applies to borrowings whenever more than 33% of the facility is utilized. Changes in credit ratings would lower or raise the increment to LIBOR depending on whether ratings improved or were lowered. As of March 31, 2005, such credit facility was not utilized.

Junior Subordinated Debentures (Trust Preferred Securities). In June 1996, a Delaware statutory business trust created by CERC Corp. (CERC Trust) issued \$173 million aggregate amount of convertible preferred securities to the public. CERC Trust used the proceeds of the offering to purchase convertible junior subordinated debentures issued by CERC Corp. having an interest rate and maturity date that correspond to the distribution rate and mandatory redemption date of the convertible preferred securities. The convertible junior subordinated debentures represent CERC Trust's sole asset and its entire operations. CERC Corp. considers its obligation under the Amended and Restated



securities, taken together, to constitute a full and unconditional guarantee by CERC Corp. of CERC Trust's obligations with respect to the convertible preferred securities. The junior subordinated debentures discussed above were included in long-term debt as of December 31, 2004 and March 31, 2005.

The convertible preferred securities are mandatorily redeemable upon the repayment of the convertible junior subordinated debentures at their stated maturity or earlier redemption. Effective January 7, 2003, the convertible preferred securities are convertible at the option of the holder into \$33.62 of cash and 2.34 shares of CenterPoint Energy common stock for each \$50 of liquidation value. As of both December 31, 2004 and March 31, 2005, the liquidation amount of convertible preferred securities outstanding was \$0.3 million. The securities, and their underlying convertible junior subordinated debentures, bear interest at 6.25% and mature in June 2026. Subject to some limitations, CERC Corp. has the option of deferring payments of interest on the convertible junior subordinated debentures. During any deferral or event of default, CERC Corp. may not pay dividends on its common stock to CenterPoint Energy. As of March 31, 2005, no interest payments on the convertible junior subordinated debentures had been deferred.

(b) Receivables Facility.

In January 2005, the Company's \$250 million receivables facility was extended to January 2006 and temporarily increased, for the period from January 2005 to June 2005, to \$375 million to provide additional liquidity to the Company during the peak heating season of 2005, in view of recent levels of, and volatility in, gas prices. As of March 31, 2005, the Company had \$181 million of advances under its receivables facility.

(7) COMPREHENSIVE INCOME

The following table summarizes the components of total comprehensive income (net of tax):

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2004	2005
	(IN MILLIONS)	
Net income.....	\$ 74	\$ 96
Other comprehensive income:		
Net deferred gain from cash flow hedges.....	8	9
Reclassification of deferred loss (gain) from cash flow hedges realized in net income.....	(3)	1
Other comprehensive income.....	5	10
Comprehensive income.....	\$ 79	\$ 106
	=====	=====

The following table summarizes the components of accumulated other comprehensive income:

	DECEMBER 31, 2004	MARCH 31, 2005
	(IN MILLIONS)	
Net deferred gain from cash flow hedges.....	\$ 2	\$ 12
	=====	=====

(8) RELATED PARTY TRANSACTIONS

The following table summarizes receivables from, or payables to, CenterPoint Energy or its subsidiaries:

	DECEMBER 31, 2004	MARCH 31, 2005
	-----	-----
	(IN MILLIONS)	
Accounts receivable from affiliates.....	\$ 4	\$ 4
Accounts payable to affiliates.....	(34)	(29)
Note receivable from affiliates(1).....	42	171
	-----	-----
Accounts and notes receivable - affiliated companies, net.....	\$ 12	\$ 146
	=====	=====
Long-term accounts receivable from affiliates.....	\$ 64	\$ 64
Long-term accounts payable to affiliates.....	(45)	(46)
Long-term notes payable to affiliates.....	(1)	(1)
	-----	-----
Long-term accounts and notes receivable - affiliated companies, net....	\$ 18	\$ 17
	=====	=====

- - - - -

(1) This represents money pool investments.

For the three months ended March 31, 2004 and 2005, the Company had net interest income related to affiliate borrowings of \$1.6 million and \$1.2 million, respectively.

The 1935 Act generally prohibits borrowings by CenterPoint Energy from its subsidiaries, including the Company, either through the money pool or otherwise.

For the three months ended March 31, 2004, the sales and services provided by the Company to Texas Genco Holdings, Inc. (Texas Genco), a former subsidiary of CenterPoint Energy, totaled \$7 million. For the three months ended March 31, 2005, the Company provided no sales or services to CenterPoint Energy or its subsidiaries.

CenterPoint Energy provides some corporate services to the Company. The costs of services have been directly charged to the Company using methods that management believes are reasonable. These methods include negotiated usage rates, dedicated asset assignment, and proportionate corporate formulas based on assets, operating margins, operating expenses and employees. These charges are not necessarily indicative of what would have been incurred had the Company not been an affiliate. Amounts charged to the Company for these services were \$27 million and \$29 million for the three months ended March 31, 2004 and 2005, respectively, and are included primarily in operation and maintenance expenses.

Pursuant to the tax sharing agreement with CenterPoint Energy, in the first quarter of 2005, the Company received an allocation of CenterPoint Energy's tax benefits totaling \$31 million, which was recorded as an increase to additional paid-in capital.

(9) COMMITMENTS AND CONTINGENCIES

(a) Legal Matters.

Natural Gas Measurement Lawsuits. CERC Corp. and certain of its subsidiaries are defendants in a suit filed in 1997 under the Federal False Claims Act alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the federal district court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various individual complaints were filed in numerous courts throughout the country. This case has been consolidated, together with the other similar False Claims Act cases, in the federal district court in Cheyenne, Wyoming.

In addition, CERC Corp. and certain of its subsidiaries are defendants in two mismeasurement lawsuits brought against approximately 245 pipeline companies and their affiliates pending in state court in Stevens County, Kansas. In one case (originally filed in May 1999 and amended four times), the plaintiffs purport to represent a class of royalty owners who allege that the defendants have engaged in systematic mismeasurement of the volume of natural gas for more than 25 years. The plaintiffs amended their petition in this suit in July 2003

in response to an order from the judge denying certification of the plaintiffs' alleged class. In the amendment the plaintiffs dismissed their

claims against certain defendants (including two of the Company's subsidiaries), limited the scope of the class of plaintiffs they purport to represent and eliminated previously asserted claims based on mismeasurement of the Btu content of the gas. The same plaintiffs then filed a second lawsuit, again as representatives of a class of royalty owners, in which they assert their claims that the defendants have engaged in systematic mismeasurement of the Btu content of natural gas for more than 25 years. In both lawsuits, the plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The Company believes that there has been no systematic mismeasurement of gas and that the suits are without merit. The Company does not expect the ultimate outcome to have a material impact on its financial condition, results of operations or cash flows.

Gas Cost Recovery Litigation. In October 2002, a suit was filed in state district court in Wharton County, Texas against the Company, CenterPoint Energy, Entex Gas Marketing Company, and certain non-affiliated companies alleging fraud, violations of the Texas Deceptive Trade Practices Act, violations of the Texas Utilities Code, civil conspiracy and violations of the Texas Free Enterprise and Antitrust Act with respect to rates charged to certain consumers of natural gas in the State of Texas. Subsequently the plaintiffs added as defendants CenterPoint Energy Marketing Inc., CenterPoint Energy Gas Transmission Company, United Gas, Inc., Louisiana Unit Gas Transmission Company, CenterPoint Energy Pipeline Services, Inc., and CenterPoint Energy Trading and Transportation Group, Inc. The plaintiffs allege that defendants inflated the prices charged to certain consumers of natural gas. In February 2003, a similar suit was filed in state court in Caddo Parish, Louisiana against the Company with respect to rates charged to a purported class of certain consumers of natural gas and gas service in the State of Louisiana. In February 2004, another suit was filed in state court in Calcasieu Parish, Louisiana against the Company seeking to recover alleged overcharges for gas or gas services allegedly provided by Southern Gas Operations to a purported class of certain consumers of natural gas and gas service without advance approval by the Louisiana Public Service Commission (LPSC). In October 2004, a similar case was filed in district court in Miller County, Arkansas against the Company, CenterPoint Energy, Entex Gas Marketing Company, CenterPoint Energy Gas Transmission Company, CenterPoint Energy Field Services, CenterPoint Energy Pipeline Services, Inc., Mississippi River Transmission Corp. and other non-affiliated companies alleging fraud, unjust enrichment and civil conspiracy with respect to rates charged to certain consumers of natural gas in at least the states of Arkansas, Louisiana, Mississippi, Oklahoma and Texas. At the time of the filing of each of the Caddo and Calcasieu Parish cases, the plaintiffs in those cases filed petitions with the LPSC relating to the same alleged rate overcharges. The Caddo and Calcasieu Parish cases have been stayed pending the resolution of the respective proceedings by the LPSC. The plaintiffs in the Miller County case seek class certification, but the proposed class has not been certified. In November 2004, the Miller case was removed to federal district court in Texarkana, Arkansas. In February 2005, the Wharton County case was removed to federal district court in Houston, Texas, and in March 2005, the plaintiffs voluntarily moved to dismiss the case and agreed not to refile the claims asserted unless the Miller County case is not certified as a class action or is later decertified. The range of relief sought by the plaintiffs in these cases includes injunctive and declaratory relief, restitution for the alleged overcharges, exemplary damages or trebling of actual damages, civil penalties and attorney's fees. In these cases, the Company, CenterPoint Energy and their affiliates deny that they have overcharged any of their customers for natural gas and believe that the amounts recovered for purchased gas have been in accordance with what is permitted by state regulatory authorities. The Company and CenterPoint Energy do not expect the outcome of these matters to have a material impact on the financial condition, results of operations or cash flows of either the Company or CenterPoint Energy.

(b) Environmental Matters.

Hydrocarbon Contamination. CERC Corp. and certain of its subsidiaries are among the defendants in lawsuits filed beginning in August 2001 in Caddo Parish and Bossier Parish, Louisiana. The suits allege that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer, which lies beneath property owned or leased by certain of the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility," which was formerly operated by a predecessor in interest of CERC Corp. This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution.

Beginning about 1985, the predecessors of certain CERC Corp. defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they owned or leased. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The





plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and, in addition, seek damages for trespass, punitive, and exemplary damages. The Company does not expect the ultimate cost associated with resolving this matter to have a material impact on the financial condition, results of operations or cash flows of the Company.

**Manufactured Gas Plant Sites.** The Company and its predecessors operated manufactured gas plants (MGP) in the past. In Minnesota, the Company has completed remediation on two sites, other than ongoing monitoring and water treatment. There are five remaining sites in the Company's Minnesota service territory. The Company believes that it has no liability with respect to two of these sites.

At March 31, 2005, the Company had accrued \$18 million for remediation of certain Minnesota sites. At March 31, 2005, the estimated range of possible remediation costs for these sites was \$7 million to \$42 million based on remediation continuing for 30 to 50 years. The cost estimates are based on studies of a site or industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites to be remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used. The Company has utilized an environmental expense tracker mechanism in its rates in Minnesota to recover estimated costs in excess of insurance recovery. As of March 31, 2005, the Company has collected or accrued \$13 million from insurance companies and ratepayers to be used for future environmental remediation.

In addition to the Minnesota sites, the United States Environmental Protection Agency and other regulators have investigated MGP sites that were owned or operated by the Company or may have been owned by one of its former affiliates. The Company has been named as a defendant in two lawsuits under which contribution is sought by private parties for the cost to remediate former MGP sites based on the previous ownership of such sites by former affiliates of the Company or its divisions. The Company has also been identified as a PRP by the State of Maine for a site that is the subject of one of the lawsuits. In March 2005, the court considering the other suit for contribution granted the Company's motion to dismiss on the grounds that the Company was not an "operator" of the site as had been alleged. The plaintiff in that case has filed an appeal of the court's dismissal of the Company. The Company is investigating details regarding these sites and the range of environmental expenditures for potential remediation. However, the Company believes it is not liable as a former owner or operator of those sites under the Comprehensive Environmental, Response, Compensation and Liability Act of 1980, as amended, and applicable state statutes, and is vigorously contesting those suits and its designation as a PRP.

**Mercury Contamination.** The Company's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by the Company at some sites in the past, and the Company has conducted remediation at these sites. It is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on experience by the Company and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, the Company does not expect the costs of any remediation of these sites to be material to the Company's financial condition, results of operations or cash flows.

**Other Environmental.** From time to time the Company has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. In addition, the Company has been named from time to time as a defendant in litigation related to such sites. Although the ultimate outcome of such matters cannot be predicted at this time, the Company does not expect, based on its experience to date, these matters, either individually or in the aggregate, to have a material adverse effect on the Company's financial condition, results of operations or cash flows.

(c) Other Proceedings.

In 2005, the Company received a communication from the Minnesota Office of Pipeline Safety indicating that the agency had ordered a predecessor company to remove certain components from a portion of its distribution system prior to the date the Company acquired it. Those components are not in compliance with current state and federal codes, and it is possible that some of those components remain in the Company's system. The Company has

not completed its analysis of the cost to locate and replace such components; however, the Company does not expect the disposition of this matter to have a material adverse effect on the Company's financial condition, results of operations or cash flows.

The Company is involved in other legal, environmental, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business. Some of these proceedings involve substantial amounts. The Company's management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. The Company's management does not expect the disposition of these matters to have a material adverse effect on the Company's financial condition, results of operations or cash flows.

(10) REPORTABLE BUSINESS SEGMENTS

Because CERC Corp. is an indirect wholly owned subsidiary of CenterPoint Energy, the Company's determination of reportable segments considers the strategic operating units under which CenterPoint Energy manages sales, allocates resources and assesses performance of various products and services to wholesale or retail customers in differing regulatory environments.

The Company has identified the following reportable business segments: Natural Gas Distribution, Pipelines and Gathering, and Other Operations. For descriptions of the reportable business segments, see Note 12 to the CERC Corp. 10-K Notes, which is incorporated herein by reference.

The following table summarizes financial data for the Company's reportable business segments:

	FOR THE THREE MONTHS ENDED MARCH 31, 2004			TOTAL ASSETS AS OF DECEMBER 31, 2004
	REVENUES FROM EXTERNAL CUSTOMERS	NET INTERSEGMENT REVENUES	OPERATING INCOME(LOSS)	
	(IN MILLIONS)			
Natural Gas Distribution.....	\$ 2,130(1)	\$ 1	\$ 117	\$ 4,798
Pipelines and Gathering.....	66(2)	36	45	2,637
Other Operations.....	--	3	(2)	792
Eliminations.....	--	(40)	--	(694)
Consolidated.....	\$ 2,196	\$ --	\$ 160	\$ 7,533

	FOR THE THREE MONTHS ENDED MARCH 31, 2005			TOTAL ASSETS AS OF MARCH 31, 2005
	REVENUES FROM EXTERNAL CUSTOMERS	NET INTERSEGMENT REVENUES	OPERATING INCOME(LOSS)	
	(IN MILLIONS)			
Natural Gas Distribution.....	\$ 2,328	\$ 2	\$ 139	\$ 4,889
Pipelines and Gathering.....	84	37	64	2,692
Other Operations.....	3	1	(1)	907
Eliminations.....	--	(40)	--	(980)
Consolidated.....	\$ 2,415	\$ --	\$ 202	\$ 7,508

(1) Sales to Texas Genco for the three months ended March 31, 2004 of \$6 million have been reclassified from sales to affiliates to revenues from external customers due to the sale of Texas Genco by CenterPoint Energy.

(2) Sales to Texas Genco for the three months ended March 31, 2004 of \$1 million have been reclassified from sales to affiliates to revenues from external customers due to the sale of Texas Genco by CenterPoint Energy.

(11)EMPLOYEE BENEFIT PLANS

The Company's employees participate in CenterPoint Energy's postretirement benefit plan. The Company's net periodic cost includes the following components relating to postretirement benefits:

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
	(IN MILLIONS)	
Interest cost.....	\$ 2	\$ 2
Net amortization.....	1	1
Other .....	1	--
Net periodic cost.....	<u>\$ 4</u>	<u>\$ 3</u>

The Company previously disclosed in its financial statements for the year ended December 31, 2004, that it expected to contribute \$16 million to its postretirement benefits plan in 2005. As of March 31, 2005, \$4 million has been contributed.

On January 21, 2005, the Department of Health and Human Services' Centers for Medicare and Medicaid Services (CMS) released final regulations governing the Medicare prescription drug benefit and other key elements of the Medicare Modernization Act (MNA) that will go into effect January 1, 2006. Under the final regulations, it has been determined that a greater portion of benefits offered under the Company's plans meets the definition of actuarial equivalence and therefore qualifies for federal subsidies equal to 28% of allowable drug costs. As a result, the Company has remeasured its obligations and costs to take into account the new regulations.

ITEM 2. MANAGEMENT'S NARRATIVE ANALYSIS OF THE RESULTS OF OPERATIONS

The following narrative analysis should be read in combination with our Interim Financial Statements contained in Item 1 of this report.

We are an indirect wholly owned subsidiary of CenterPoint Energy, Inc. (CenterPoint Energy), a public utility holding company created on August 31, 2002, as part of a corporate restructuring of Reliant Energy, Incorporated (Reliant Energy). CenterPoint Energy is a registered public utility holding company under the Public Utility Holding Company Act of 1935, as amended (1935 Act). For information about the 1935 Act, please read " -- Liquidity -- Certain Contractual and Regulatory Limits on Ability to Issue Securities and Pay Dividends."

We meet the conditions specified in General Instruction H(1)(a) and (b) to Form 10-Q and are therefore permitted to use the reduced disclosure format for wholly owned subsidiaries of reporting companies. Accordingly, we have omitted from this report the information called for by Item 2 (Management's Discussion and Analysis of Financial Condition and Results of Operations) and Item 3 (Quantitative and Qualitative Disclosures About Market Risk) of Part I and the following Part II items of Form 10-Q: Item 2 (Unregistered Sales of Equity Securities and Use of Proceeds), Item 3 (Defaults Upon Senior Securities) and Item 4 (Submission of Matters to a Vote of Security Holders). The following discussion explains material changes in our revenue and expense items between the three months ended March 31, 2004 and the three months ended March 31, 2005. Reference is made to "Management's Narrative Analysis of the Results of Operations" in Item 7 of the Annual Report on Form 10-K of CERC Corp. for the year ended December 31, 2004 (CERC Corp. Form 10-K).

CONSOLIDATED RESULTS OF OPERATIONS

Our results of operations are affected by, among other things, seasonal fluctuations in the demand for natural gas and price movements of energy commodities, the actions of various federal, state and municipal governmental authorities having jurisdiction over rates we charge, competition in our various business operations, debt service costs and income tax expense. For more information regarding factors that may affect the future results of operations of our business, please read "Business -- Risk Factors" in Item 1 of the CERC Corp. Form 10-K and "Management's Narrative Analysis of the Results of Operations -- Certain Factors Affecting Future Earnings" in Item 7 of the CERC Corp. Form 10-K, which are incorporated herein by reference.

The following table sets forth our consolidated results of operations for the three months ended March 31, 2004 and 2005, followed by a discussion of our consolidated results of operations based on operating income. We have provided a reconciliation of consolidated operating income to net income below.

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
	(IN MILLIONS)	
Revenues.....	\$ 2,196	\$ 2,415
Expenses:		
Natural gas.....	1,762	1,948
Operation and maintenance.....	182	173
Depreciation and amortization.....	47	49
Taxes other than income taxes.....	45	43
Total Expenses.....	2,036	2,213
Operating Income.....	160	202
Interest and Other Finance Charges.....	(42)	(45)
Other Income, net.....	3	4
Income Before Income Taxes.....	121	161
Income Tax Expense.....	(47)	(65)
Net Income.....	\$ 74	\$ 96

THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THREE MONTHS ENDED MARCH 31, 2004

We reported net income of \$96 million for the three months ended March 31, 2005 as compared to \$74 million for the same period in 2004. The increase in net income of \$22 million was primarily due to increased operating



income of \$22 million in our Natural Gas Distribution business segment primarily due to rate increases and higher contributions from our competitive natural gas sales business and increased operating income of \$19 million in our Pipelines and Gathering business segment primarily from increased demand for certain transportation and ancillary services related to natural gas price volatility as well as increased throughput and demand for services related to our core gas gathering operations and increased income tax expense primarily driven by state income taxes.

Income Tax Expense. During the three months ended March 31, 2005 and 2004, our effective tax rates were 40.4% and 38.8%, respectively.

#### RESULTS OF OPERATIONS BY BUSINESS SEGMENT

The following table presents operating income for our Natural Gas Distribution and Pipelines and Gathering business segments for the three months ended March 31, 2004 and 2005. Some amounts from the previous year have been reclassified to conform to the 2005 presentation of the financial statements. These reclassifications do not affect consolidated net income. For information regarding factors that may affect the future results of operations of our business segments, please read "Business -- Risk Factors -- Principal Risk Factors Associated with Our Businesses," " -- Risk Factors Associated with Our Consolidated Financial Condition" and " -- Other Risks" in Item 1 of the CERC Corp. Form 10-K, each of which is incorporated herein by reference.

#### NATURAL GAS DISTRIBUTION

The following table provides summary data of our Natural Gas Distribution business segment for the three months ended March 31, 2004 and 2005:

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
	(IN MILLIONS)	
Revenues.....	\$ 2,131	\$ 2,330
Expenses:		
Natural gas.....	1,790	1,975
Operation and maintenance.....	149	140
Depreciation and amortization.....	35	38
Taxes other than income taxes.....	40	38
Total expenses.....	2,014	2,191
Operating Income.....	\$ 117	\$ 139
Throughput (in billion cubic feet (Bcf)):		
Residential.....	85	77
Commercial and industrial.....	83	77
Non-rate regulated.....	139	183
Eliminations(1).....	(10)	(49)
Total Throughput.....	297	288

(1) Elimination of intrasegment sales.

Our Natural Gas Distribution business segment reported operating income of \$139 million for the three months ended March 31, 2005 as compared to \$117 million for the same period in 2004. Increases in operating income of \$2 million from continued customer growth with the addition of approximately 43,000 customers since March 2004, \$11 million from rate increases and increased contributions of \$3 million from our competitive natural gas sales business were partially offset by the \$7 million impact of milder weather and decreased usage. Operation and maintenance expense decreased \$9 million. Excluding an \$8 million charge recorded in the first quarter of 2004 for severance costs associated with staff reductions, which has reduced costs in later periods, operation and maintenance expenses decreased by \$1 million.

PIPELINES AND GATHERING

The following table provides summary data of our Pipelines and Gathering business segment for the three months ended March 31, 2004 and 2005:

	THREE MONTHS ENDED MARCH 31,	
	2004	2005
	(IN MILLIONS)	
Revenues.....	\$ 102	\$ 121
Expenses:		
Natural gas.....	9	7
Operation and maintenance.....	33	34
Depreciation and amortization.....	11	11
Taxes other than income taxes.....	4	5
Total expenses.....	57	57
Operating Income.....	\$ 45	\$ 64
Throughput (in Bcf):		
Natural Gas Sales.....	2	1
Transportation.....	270	271
Gathering.....	75	83
Eliminations (1).....	(2)	(1)
Total Throughput.....	345	354

(1) Elimination of volumes both transported and sold.

Our Pipelines and Gathering business segment reported operating income of \$64 million for the three months ended March 31, 2005 compared to \$45 million for the same period in 2004. Operating margins (revenues less fuel costs) increased by \$21 million primarily due to increased demand for certain transportation and ancillary services related to natural gas price volatility (\$13 million) and increased throughput and demand for services related to our core gas gathering operations (\$5 million).

CERTAIN FACTORS AFFECTING FUTURE EARNINGS

For information on other developments, factors and trends that may have an impact on our future earnings, please read "Management's Narrative Analysis of Results of Operations -- Certain Factors Affecting Future Earnings" in Item 7 of Part II of the CERC Corp. Form 10-K and "Risk Factors" in Item 1 of Part I of the CERC Corp. Form 10-K, each of which is incorporated herein by reference.

LIQUIDITY

Our liquidity and capital requirements are affected primarily by our results of operations, capital expenditures, debt service requirements, and working capital needs. Our principal cash requirements for the remainder of 2005 are approximately \$295 million of capital expenditures and \$361 million principal amount of maturing debt. We expect that borrowings under our credit facility, anticipated cash flows from operations and borrowings from affiliates under the money pool described below will be sufficient to meet our cash needs for 2005. Cash needs may also be met by issuing securities in the capital markets.

The 1935 Act regulates our financing ability, as more fully described in " -- Certain Contractual and Regulatory Limits on Ability to Issue Securities and Pay Dividends" below.

Off-Balance Sheet Arrangements. Other than operating leases, we have no off-balance sheet arrangements. However, we do participate in a receivables factoring arrangement. We have a bankruptcy remote subsidiary, which we consolidate, which was formed for the sole purpose of buying receivables created by us and selling those



receivables to an unrelated third-party. This transaction is accounted for as a sale of receivables under the provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," and, as a result, the related receivables are excluded from the Consolidated Balance Sheet. In January 2005, the \$250 million facility was extended to January 2006 and temporarily increased, for the period from January 2005 to June 2005, to \$375 million. As of March 31, 2005, we had \$181 million of advances under our receivables facility.

**Credit Facilities.** As of March 31, 2005, we had a \$250 million credit facility under which no borrowings had been made. The credit facility terminates on March 23, 2007.

**Securities Registered with the SEC.** At March 31, 2005, we had a shelf registration statement covering \$50 million of debt securities.

**Temporary Investments.** On March 31, 2005, we had temporary external investments of \$230 million.

**Money Pool.** We participate in a "money pool" through which we and certain of our affiliates can borrow or invest on a short-term basis. Funding needs are aggregated and external borrowing or investing is based on the net cash position. The money pool's net funding requirements are generally met by borrowings of CenterPoint Energy. The terms of the money pool are in accordance with requirements applicable to registered public utility holding companies under the 1935 Act and under an order from the SEC dated June 30, 2003 (June 2003 Financing Order) relating to our financing activities. The order expires in June 2005; however, CenterPoint Energy and its subsidiaries, including us, are seeking a new order providing appropriate approval for participation in the money pool by the end of June 2005. Our money pool borrowing limit under existing orders is \$600 million. At March 31, 2005, we had \$171 million invested in the money pool. The money pool may not provide sufficient funds to meet our cash needs.

**Impact on Liquidity of a Downgrade in Credit Ratings.** As of May 1, 2005, Moody's Investors Service, Inc. (Moody's), Standard & Poor's Ratings Services, a division of The McGraw Hill Companies (S&P) and Fitch, Inc. (Fitch) had assigned the following credit ratings to our senior unsecured debt:

MOODY'S		S&P		FITCH	
RATING	REVIEW(1)	RATING	OUTLOOK(2)	RATING	OUTLOOK(3)
Ba1	Possible Upgrade	BBB	Negative	BBB	Stable

- (1) A "review for possible upgrade" from Moody's indicates that a rating is under review for possible change in the short-term, usually within 90 days.
- (2) An S&P rating outlook assesses the potential direction of a long-term credit rating over the intermediate to longer term.
- (3) A "stable" outlook from Fitch encompasses a one-to-two year horizon as to the likely ratings direction.

We cannot assure you that these ratings will remain in effect for any given period of time or that one or more of these ratings will not be lowered or withdrawn entirely by a rating agency. We note that these credit ratings are not recommendations to buy, sell or hold our securities and may be revised or withdrawn at any time by the rating agency. Each rating should be evaluated independently of any other rating. Any future reduction or withdrawal of one or more of our credit ratings could have a material adverse impact on our ability to obtain short- and long-term financing, the cost of such financings, the willingness of suppliers to extend credit lines to us on an unsecured basis and the execution of our commercial strategies.

A decline in credit ratings would increase borrowing costs under our \$250 million revolving credit facility. A decline in credit ratings would also increase the interest rate on long-term debt to be issued in the capital markets and would negatively impact our ability to complete capital market transactions as more fully described in " -- Certain Contractual and Regulatory Limits on Ability to Issue Securities and Pay Dividends" below. Additionally, a decline in credit ratings could increase cash collateral requirements and reduce margins of our Natural Gas Distribution business segment.

Our credit facility contains a "material adverse change" clause which relates to our ability to perform our obligations under the credit agreement.



CenterPoint Energy Gas Services, Inc.(CEGS), one of our wholly owned subsidiaries, provides comprehensive natural gas sales and services to industrial and commercial customers, electric generators and natural gas utilities throughout the central United States. In order to hedge its exposure to natural gas prices, CEGS has agreements with provisions standard for the industry that establish credit thresholds and require a party to provide additional collateral on two business days' notice when that party's rating or the rating of a credit support provider for that party (CERC Corp. in this case) falls below those levels. We estimate that as of March 31, 2005, unsecured credit limits extended to CEGS by counterparties could aggregate \$100 million; however, utilized credit capacity is significantly lower. In addition, we purchase natural gas under supply agreements that contain an aggregate credit threshold of \$100 million based on our S&P Senior Unsecured Long-Term Debt rating of BBB. Upgrades and downgrades from this BBB rating will increase and decrease the aggregate credit threshold accordingly.

Cross Defaults. Under CenterPoint Energy's revolving credit facility, a payment default by us on, or a non-payment default by us that permits acceleration of, any indebtedness exceeding \$50 million will cause a default. Pursuant to the indenture governing CenterPoint Energy's senior notes, a payment default by us in respect of, or an acceleration of, borrowed money and certain other specified types of obligations, in the aggregate principal amount of \$50 million will cause a default. As of May 1, 2005, CenterPoint Energy had issued five series of senior notes aggregating \$1.4 billion in principal amount under this indenture. A default by CenterPoint Energy would not trigger a default under our debt instruments or bank credit facilities.

Other Factors that Could Affect Cash Requirements. In addition to the above factors, our liquidity and capital resources could be affected by:

- cash collateral requirements that could exist in connection with certain contracts, including gas purchases, gas price hedging and gas storage activities of our Natural Gas Distribution business segment, particularly given gas price levels and volatility;
- acceleration of payment dates on certain gas supply contracts under certain circumstances, as a result of increased gas prices and concentration of suppliers;
- increased costs related to the acquisition of gas for storage;
- increases in interest expense in connection with debt refinancings and borrowings under our credit facility;
- various regulatory actions; and
- various of the risks identified in "Risk Factors" in Item 1 of the CERC Corp. Form 10-K.

Certain Contractual and Regulatory Limits on Ability to Issue Securities and Pay Dividends. Limitations imposed on us under the 1935 Act affect our ability to issue securities, pay dividends on our common stock or take other actions to adjust our capitalization.

Our bank facility and our receivables facility limit our debt as a percentage of our total capitalization to 60% and contain an earnings before interest, taxes, depreciation and amortization (EBITDA) to interest covenant.

Our parent, CenterPoint Energy, is a registered public utility holding company under the 1935 Act. The 1935 Act and related rules and regulations impose a number of restrictions on our parent's activities and those of its subsidiaries, including us. The 1935 Act, among other things, limits our parent's ability and the ability of its regulated subsidiaries, including us, to issue debt and equity securities without prior authorization, restricts the source of dividend payments to current and retained earnings without prior authorization, regulates sales and acquisitions of certain assets and businesses and governs affiliated service, sales and construction contracts.

The June 2003 Financing Order and the several subsequent orders we have received that provide additional financing authority are effective until June 30, 2005. These orders establish limits on the amount of external debt and equity securities that can be issued by CenterPoint Energy and its regulated subsidiaries, including us, without additional authorization but generally permit CenterPoint Energy and its regulated subsidiaries, including us, to refinance our existing obligations. We are in compliance with the authorized limits. The orders also permit our

utilization of undrawn credit facilities. As of April 30, 2005, we are authorized to issue an additional \$7 million of debt and an additional aggregate \$250 million of preferred stock and preferred securities. The SEC has reserved jurisdiction over, and must take further action to permit, the issuance of \$430 million of additional debt by us.

The orders require that if CenterPoint Energy or any of its regulated subsidiaries, including us, issue any securities that are rated by a nationally recognized statistical rating organization (NRSRO), the security to be issued must obtain an investment grade rating from at least one NRSRO and, as a condition to such issuance, all outstanding rated securities of the issuer and of CenterPoint Energy must be rated investment grade by at least one NRSRO. The orders also contain certain requirements for interest rates, maturities, issuance expenses and use of proceeds.

CenterPoint Energy and certain of its subsidiaries, including us, have an application currently pending with the SEC for a new financing order which would govern financing by CenterPoint Energy and its subsidiaries after the expiration of the June 2003 Financing Order. We anticipate that the new order will be issued at or before the expiration of the existing order.

The 1935 Act limits the payment of dividends to payment from current and retained earnings unless specific authorization is obtained to pay dividends from other sources. The June 2003 Financing Order requires us to maintain a ratio of common equity to total capitalization of 30%. At March 31, 2005, our ratio was 53%.

Relationship with CenterPoint Energy. We are an indirect wholly owned subsidiary of CenterPoint Energy. As a result of this relationship, the financial condition and liquidity of our parent company could affect our access to capital, our credit standing and our financial condition.

#### CRITICAL ACCOUNTING POLICIES

A critical accounting policy is one that is both important to the presentation of our financial condition and results of operations and requires management to make difficult, subjective or complex accounting estimates. An accounting estimate is an approximation made by management of a financial statement element, item or account in the financial statements. Accounting estimates in our historical consolidated financial statements measure the effects of past business transactions or events, or the present status of an asset or liability. The accounting estimates described below require us to make assumptions about matters that are highly uncertain at the time the estimate is made. Additionally, different estimates that we could have used or changes in an accounting estimate that are reasonably likely to occur could have a material impact on the presentation of our financial condition or results of operations. The circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the effect of matters that are inherently uncertain. Estimates and assumptions about future events and their effects cannot be predicted with certainty. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments. These estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. Our significant accounting policies are discussed in Note 2 to the consolidated financial statements in the CERC Form 10-K (CERC 10-K Notes). We believe the following accounting policies involve the application of critical accounting estimates. Accordingly, these accounting estimates have been reviewed and discussed with the audit committee of the board of directors of CenterPoint Energy.

#### IMPAIRMENT OF LONG-LIVED ASSETS AND INTANGIBLES

We review the carrying value of our long-lived assets, including goodwill and identifiable intangibles, whenever events or changes in circumstances indicate that such carrying values may not be recoverable, and annually for goodwill as required by SFAS No. 142, "Goodwill and Other Intangible Assets." No impairment of goodwill was indicated based on our analysis as of January 1, 2005. Unforeseen events and changes in circumstances and market conditions and material differences in the value of long-lived assets and intangibles due to changes in estimates of future cash flows, regulatory matters and operating costs could negatively affect the fair value of our assets and result in an impairment charge.

Fair value is the amount at which the asset could be bought or sold in a current transaction between willing parties and may be estimated using a number of techniques, including quoted market prices or valuations by third parties, present value techniques based on estimates of cash flows, or multiples of earnings or revenue performance

measures. The fair value of the asset could be different using different estimates and assumptions in these valuation techniques.

#### UNBILLED REVENUES

Revenues related to the sale and/or delivery of natural gas are generally recorded when natural gas is delivered to customers. However, the determination of sales to individual customers is based on the reading of their meters, which is performed on a systematic basis throughout the month. At the end of each month, amounts of natural gas delivered to customers since the date of the last meter reading are estimated and the corresponding unbilled revenue is estimated. Unbilled natural gas sales are estimated based on estimated purchased gas volumes, estimated lost and unaccounted for gas and tariffed rates in effect. As additional information becomes available, or actual amounts are determinable, the recorded estimates are revised. Consequently, operating results can be affected by revisions to prior accounting estimates.

#### NEW ACCOUNTING PRONOUNCEMENTS

See Note 2 to the Interim Financial Statements for a discussion of new accounting pronouncements that affect us.

#### ITEM 4. CONTROLS AND PROCEDURES

In accordance with Exchange Act Rules 13a-15 and 15d-15, we carried out an evaluation, under the supervision and with the participation of management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of March 31, 2005 to provide assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There has been no change in our internal controls over financial reporting that occurred during the three months ended March 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

For a description of certain legal and regulatory proceedings affecting us, please review Notes 3 and 9 to our Interim Financial Statements, "Business --Regulation" and " --Environmental Matters" in Item 1 of the CERC Corp. Form 10-K, Item 3 of the CERC Corp. Form 10-K and Notes 3, 9(c) and (d) to the CERC Corp. 10-K Notes, each of which is incorporated herein by reference.

## ITEM 6. EXHIBITS

The following exhibits are filed herewith:

Exhibits not incorporated by reference to a prior filing are designated by a cross (+); all exhibits not so designated are incorporated by reference to a prior filing as indicated.

EXHIBIT NUMBER	DESCRIPTION	REPORT OR REGISTRATION STATEMENT	SEC FILE OR REGISTRATION NUMBER	EXHIBIT REFERENCE
3.1.1	- Certificate of Incorporation of RERC Corp.	Form 10-K for the year ended December 31, 1997	1-13265	3(a)(1)
3.1.2	- Certificate of Merger merging former NorAm Energy Corp. with and into HI Merger, Inc. dated August 6, 1997	Form 10-K for the year ended December 31, 1997	1-13265	3(a)(2)
3.1.3	- Certificate of Amendment changing the name to Reliant Energy Resources Corp.	Form 10-K for the year ended December 31, 1998	1-13265	3(a)(3)
3.1.4	- Certificate of Amendment changing the name to CenterPoint Energy Resources Corp.	Form 10-Q for the quarter ended June 30, 2003	1-13265	3(a)(4)
3.2	- Bylaws of RERC Corp.	Form 10-K for the year ended December 31, 1997	1-13265	3(b)
4.1	- \$250,000,000 Credit Agreement, dated as of March 23, 2004, among CERC Corp., as Borrower, and the Initial Lenders named therein, as Initial Lenders	Form 8-K dated March 31, 2004	1-13265	4.1
+31.1	- Rule 13a-14(a)/15d-14(a) Certification of David M. McClanahan			
+31.2	- Rule 13a-14(a)/15d-14(a) Certification of Gary L. Whitlock			
+32.1	- Section 1350 Certification of David M. McClanahan			
+32.2	- Section 1350 Certification of Gary L. Whitlock			
+99.1	- Items incorporated by reference from the CERC Corp. Form 10-K. Item 1 "Business -- Regulation," " -- Environmental Matters," and " -- Risk Factors," Item 3 "Legal Proceedings" and Item 7 "Management's Narrative Analysis of the Results of Operations -- Certain Factors Affecting Future Earnings" and Notes 2(e) (Regulatory Assets and Liabilities), 3 (Regulatory Matters), 5 (Derivative Instruments), 9 (Commitments and Contingencies) and 12 (Reportable Business Segments).			

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CENTERPOINT ENERGY RESOURCES CORP.

By: /s/ James S. Brian

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James S. Brian  
Senior Vice President and Chief  
Accounting Officer

Date: May 11, 2005

## EXHIBIT INDEX

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CERTIFICATIONS

I, David M. McClanahan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CenterPoint Energy Resources Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2005

/s/ David M. McClanahan

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David M. McClanahan  
President and Chief Executive Officer

CERTIFICATIONS

I, Gary L. Whitlock, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CenterPoint Energy Resources Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2005

/s/ Gary L. Whitlock

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Gary L. Whitlock  
Executive Vice President and  
Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of CenterPoint Energy Resources Corp. (the "Company") on Form 10-Q for the period ended March 31, 2005 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, David M. McClanahan, Chief Executive Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ David M. McClanahan

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David M. McClanahan  
President and Chief Executive Officer  
May 11, 2005

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of CenterPoint Energy Resources Corp. (the "Company") on Form 10-Q for the period ended March 31, 2005 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Gary L. Whitlock, Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gary L. Whitlock

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Gary L. Whitlock  
Executive Vice President and Chief Financial Officer  
May 11, 2005

## ITEM 1. BUSINESS

## REGULATION

We are subject to regulation by various federal, state and local governmental agencies, including the regulations described below.

## PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

As a subsidiary of a registered public utility holding company, we are subject to a comprehensive regulatory scheme imposed by the Securities and Exchange Commission (SEC) in order to protect customers, investors and the public interest. Although the SEC does not regulate rates and charges under the 1935 Act, it does regulate the structure, financing, lines of business and internal transactions of public utility holding companies and their system companies. In order to obtain financing, acquire additional public utility assets or stock, or engage in other significant transactions, we are generally required to obtain approval from the SEC under the 1935 Act.

CenterPoint Energy received an order from the SEC under the 1935 Act on June 30, 2003 and supplemental orders thereafter relating to its financing activities and those of its regulated subsidiaries, including us, as well as other matters. The orders are effective until June 30, 2005. As of December 31, 2004, the orders generally permitted CenterPoint Energy and its subsidiaries, including us, to issue securities to refinance indebtedness outstanding at June 30, 2003, and authorized CenterPoint Energy and its subsidiaries, including us, to issue certain incremental external debt securities and common and preferred stock through June 30, 2005 in specified amounts, without prior authorization from the SEC. The orders also contain certain requirements regarding ratings of CenterPoint Energy's securities, interest rates, maturities, issuance expenses and use of proceeds. The orders require that we maintain a ratio of common equity to total capitalization of at least 30%. We intend to file an application for approval of our post-June 30, 2005 financing activities.

The United States Congress from time to time considers legislation that would repeal the 1935 Act. We cannot predict at this time whether this legislation or any variation thereof will be adopted or, if adopted, the effect of any such law on our business.

## FEDERAL ENERGY REGULATORY COMMISSION

The FERC has jurisdiction under the Natural Gas Act and the Natural Gas Policy Act of 1978, as amended, to regulate the transportation of natural gas in interstate commerce and natural gas sales for resale in intrastate commerce that are not first sales. The FERC regulates, among other things, the construction of pipeline and related facilities used in the transportation and storage of natural gas in interstate commerce, including the extension, expansion or abandonment of these facilities. The rates charged by interstate pipelines for interstate transportation and storage services are also regulated by the FERC.

Our natural gas pipeline subsidiaries may periodically file applications with the FERC for changes in their generally available maximum rates and charges designed to allow them to recover their costs of providing service to customers (to the extent allowed by prevailing market conditions), including a reasonable rate of return. These rates are normally allowed to become effective after a suspension period and, in some cases, are subject to refund under applicable law until such time as the FERC issues an order on the allowable level of rates.

On November 25, 2003, the FERC issued Order No. 2004, the final rule modifying the Standards of Conduct applicable to electric and natural gas transmission providers, governing the relationship between regulated transmission providers and certain of their affiliates. During 2004, the FERC Order was amended three times. The rule significantly changes and expands the regulatory burdens of the Standards of Conduct and applies essentially the same standards to jurisdictional electric transmission providers and natural gas pipelines. On February 9, 2004, our natural gas pipeline subsidiaries filed Implementation Plans required under the new rule. Those subsidiaries were further required to post their Implementation Procedures on their websites by September 22, 2004, and to be in compliance with the requirements of the new rule by that date.

#### STATE AND LOCAL REGULATION

In almost all communities in which we provide natural gas distribution services, we operate under franchises, certificates or licenses obtained from state and local authorities. The terms of the franchises, with various expiration dates, typically range from 10 to 30 years, though franchises in Arkansas are perpetual. None of our material franchises expire in the near term. We expect to be able to renew expiring franchises. In most cases, franchises to provide natural gas utility services are not exclusive.

Substantially all of our retail natural gas sales by our local distribution divisions are subject to traditional cost-of-service regulation at rates regulated by the relevant state public utility commissions and, in Texas, by the Railroad Commission of Texas (Railroad Commission) and municipalities we serve.

In 2004, the City of Houston, 28 other cities and the Railroad Commission approved a settlement that increased Houston Gas' base rate and service charge revenues by approximately \$14 million annually.

In February 2004, the Louisiana Public Service Commission (LPSC) approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in its South Louisiana Division by approximately \$2 million annually.

In July 2004, Minnesota Gas filed an application for a general rate increase of \$22 million with the Minnesota Public Utilities Commission (MPUC). Minnesota Gas and the Minnesota Department of Commerce have agreed to a settlement of all issues, including an annualized increase in the amount of \$9 million, subject to approval by the MPUC. A final decision on this rate relief request is expected from the MPUC in the second quarter of 2005. Interim rates of \$17 million on an annualized basis became effective on October 1, 2004, subject to refund.

In July 2004, the LPSC approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in its North Louisiana Division by approximately \$7 million annually.

In October 2004, Southern Gas Operations filed an application for a general rate increase of approximately \$3 million with the Railroad Commission for rate relief in the unincorporated areas of its Beaumont, East Texas and South Texas Divisions. The Railroad Commission staff has begun its review of the request, and a decision is anticipated in April 2005.

In November 2004, Southern Gas Operations filed an application for a general rate increase of approximately \$34 million with the Arkansas Public Service Commission (APSC). The APSC staff has begun its review of the request, and a decision is anticipated in the second half of 2005.

In December 2004, the OCC approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in Oklahoma by approximately \$3 million annually.

## DEPARTMENT OF TRANSPORTATION

In December 2002, Congress enacted the Pipeline Safety Improvement Act of 2002 (the Act). This legislation applies to our interstate pipelines as well as our intrastate pipelines and local distribution companies. The legislation imposes several requirements related to ensuring pipeline safety and integrity. It requires pipeline and distribution companies to assess the integrity of their pipeline transmission facilities in areas of high population concentration or High Consequence Areas (HCA). The legislation further requires companies to perform remediation activities, in accordance with the requirements of the legislation, over a 10-year period.

In December 2003, the Department of Transportation Office of Pipeline Safety issued the final regulations to implement the Act. These regulations became effective on February 14, 2004 and provided guidance on, among other things, the areas that should be classified as HCA. Our interstate pipelines developed and implemented a written pipeline integrity management program in 2004, meeting the Department of Transportation Office of Pipeline Safety requirement of having the program in place by December 17, 2004.

Our interstate and intrastate pipelines and our natural gas distribution companies anticipate that compliance with the new regulations will require increases in both capital and operating cost. The level of expenditures required to comply with these regulations will be dependent on several factors, including the age of the facility, the pressures at which the facility operates and the number of facilities deemed to be located in areas designated as HCA. Based on our interpretation of the rules and preliminary technical reviews, we anticipate compliance will require average annual expenditures of approximately \$15 to \$20 million during the initial 10-year period.

### ENVIRONMENTAL MATTERS

Our operations are subject to stringent and complex laws and regulations pertaining to health, safety and the environment. As an owner or operator of natural gas pipelines and gas gathering and processing systems, we must comply with these laws and regulations at the federal, state and local levels. These laws and regulations can restrict or impact our business activities in many ways, such as:

- restricting the way we can handle or dispose of our wastes;
- limiting or prohibiting construction activities in sensitive areas such as wetlands, coastal regions, or areas inhabited by endangered species;
- requiring remedial action to mitigate pollution conditions caused by our operations, or attributable to former operations; and
- enjoining the operations of facilities deemed in non-compliance with permits issued pursuant to such environmental laws and regulations.

In order to comply with these requirements, we may need to spend substantial amounts and devote other resources from time to time to:

- construct or acquire new equipment;
- acquire permits for facility operations;
- modify or replace existing and proposed equipment; and
- clean up or decommission waste disposal areas, fuel storage and management facilities and other locations and facilities.

Failure to comply with these laws and regulations may trigger a variety of administrative, civil and criminal enforcement measures, including the assessment of monetary penalties, the imposition of remedial requirements, and the issuance of orders enjoining future operations. Certain environmental statutes impose strict, joint and several liability for costs required to clean up and restore sites where hazardous substances have been disposed or otherwise released. Moreover, it is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damage allegedly caused by the release of hazardous substances or other waste products into the environment.

The trend in environmental regulation is to place more restrictions and limitations on activities that may affect the environment, and thus there can be no assurance as to the amount or timing of future expenditures for environmental compliance or remediation, and actual future expenditures may be different from the amounts we currently anticipate. We try to anticipate future regulatory requirements that might be imposed and plan accordingly to remain in compliance with changing environmental laws and regulations and to minimize the costs of such compliance.

We do not believe that compliance with federal, state or local environmental laws and regulations will have a material adverse effect on our business, financial position or results of operations. In addition, we believe that the various environmental remediation activities in which we are presently engaged will not materially interrupt or diminish our operational ability. We cannot assure you, however, that future events, such as changes in existing laws, the promulgation of new laws, or the development or discovery of new facts or conditions will not cause us to incur significant costs. The following is a discussion of all material environmental and safety laws and regulations that relate to our operations. We believe that we are in substantial compliance with all of these environmental laws and regulations.

#### AIR EMISSIONS

Our operations are subject to the federal Clean Air Act and comparable state laws and regulations. These laws and regulations regulate emissions of air pollutants from various industrial sources, including our processing plants and compressor stations, and also impose various monitoring and reporting requirements. Such laws and regulations may require that we obtain pre-approval for the construction or modification of certain projects or facilities expected to produce air emissions or result in the increase of existing air emissions, obtain and strictly comply with air permits containing various emissions and operational limitations, or utilize specific emission control technologies to limit emissions. Our failure to comply with these requirements could subject us to monetary penalties, injunctions, conditions or restrictions on operations, and potentially criminal enforcement actions. We may be required to incur certain capital expenditures in the future for air pollution control equipment in connection with obtaining and maintaining operating permits and approvals for air emissions. We believe, however, that our operations will not be materially adversely affected by such requirements, and the requirements are not expected to be any more burdensome to us than to any other similarly situated companies.

#### WATER DISCHARGES

Our operations are subject to the Federal Water Pollution Control Act of 1972, as amended, also known as the Clean Water Act, and analogous state laws and regulations. These laws and regulations impose detailed requirements and strict controls regarding the discharge of pollutants into waters of the United States. The unpermitted discharge of pollutants, including discharges resulting from a spill or leak incident, is prohibited. The Clean Water Act and regulations implemented thereunder also prohibit discharges of dredged and fill material in wetlands and other waters of the United States unless authorized by an appropriately issued permit. Any unpermitted release of petroleum or other pollutants from our pipelines or facilities could result in fines or penalties as well as significant remedial obligations.



## HAZARDOUS WASTE

Our operations generate wastes, including some hazardous wastes, that are subject to the federal Resource Conservation and Recovery Act (RCRA), and comparable state laws, which impose detailed requirements for the handling, storage, treatment and disposal of hazardous and solid waste. RCRA currently exempts many natural gas gathering and field processing wastes from classification as hazardous waste. Specifically, RCRA excludes from the definition of hazardous waste produced waters and other wastes associated with the exploration, development, or production of crude oil and natural gas. However, these oil and gas exploration and production wastes are still regulated under state law and the less stringent non-hazardous waste requirements of RCRA. Moreover, ordinary industrial wastes such as paint wastes, waste solvents, laboratory wastes, and waste compressor oils may be regulated as hazardous waste. The transportation of natural gas in pipelines may also generate some hazardous wastes that are subject to RCRA or comparable state law requirements.

## LIABILITY FOR REMEDIATION

The Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA), also known as "Superfund," and comparable state laws impose liability, without regard to fault or the legality of the original conduct, on certain classes of persons responsible for the release of hazardous substances into the environment. Such classes of persons include the current and past owners or operators of sites where a hazardous substance was released, and companies that disposed or arranged for disposal of hazardous substances at offsite locations such as landfills. Although petroleum as well as natural gas is excluded from CERCLA's definition of "hazardous substance," in the course of our ordinary operations we generate wastes that may fall within the definition of a "hazardous substance." CERCLA authorizes the United States Environmental Protection Agency (EPA) and, in some cases, third parties to take actions in response to threats to the public health or the environment and to seek to recover from the responsible classes of persons the costs they incur. Under CERCLA, we could be subject to joint and several liability for the costs of cleaning up and restoring sites where hazardous substances have been released, for damages to natural resources, and for the costs of certain health studies.

## LIABILITY FOR PREEXISTING CONDITIONS

Hydrocarbon Contamination. We and certain of our subsidiaries are among the defendants in lawsuits filed beginning in August 2001 in Caddo Parish and Bossier Parish, Louisiana. The suits allege that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer, which lies beneath property owned or leased by certain of the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility," which was formerly operated by a predecessor in interest of CERC Corp. This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution. Beginning about 1985, the predecessors of certain CERC Corp. defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they owned or leased. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and, in addition, seek damages for trespass, punitive, and exemplary damages. We believe the ultimate cost associated with resolving this matter will not have a material impact on our financial condition or results of operations.

Manufactured Gas Plant Sites. We and our predecessors operated manufactured gas plants (MGP) in the past. In Minnesota, we have completed remediation on two sites, other than ongoing monitoring and water treatment. There are five remaining sites in our Minnesota service territory. We believe that we have no liability with respect to two of these sites.

At December 31, 2004, we had accrued \$18 million for remediation of certain Minnesota sites. At December 31, 2004, the estimated range of possible remediation costs for these sites was \$7 million to \$42 million based on remediation continuing for 30 to 50 years. The cost estimates are based on studies of a site or industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites to be remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used. We have utilized an environmental expense tracker mechanism in our rates in Minnesota to recover estimated costs in excess of insurance recovery. As of December 31, 2004, we have collected or accrued \$13 million from insurance companies and ratepayers to be used for future environmental remediation.

In addition to the Minnesota sites, the EPA and other regulators have investigated MGP sites that we owned or operated or may have been owned or operated by one of our former affiliates. We have been named as a defendant in lawsuits under which contribution is sought by private parties for the cost to remediate former MGP sites based on the previous ownership of such sites by our former affiliates or divisions. We have also been identified as a PRP by the State of Maine for a site that is the subject of one of the lawsuits. We are investigating details regarding these sites and the range of environmental expenditures for potential remediation. However, we believe we are not liable as a former owner or operator of those sites under CERCLA and applicable state statutes, and are vigorously contesting those suits and our designation as a PRP.

Mercury Contamination. Our pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. We have found this type of contamination at some sites in the past, and we have conducted remediation at these sites. It is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on our experience and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, we believe that the costs of any remediation of these sites will not be material to our financial condition, results of operations or cash flows.

Other Environmental. From time to time, we have received notices from regulatory authorities or others regarding our status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. Although their ultimate outcome cannot be predicted at this time, we do not believe, based on our experience to date, that these matters, either individually or in the aggregate, will have a material adverse effect on our financial condition, results of operations or cash flows.

## RISK FACTORS

### PRINCIPAL RISK FACTORS ASSOCIATED WITH OUR BUSINESSES

RATE REGULATION OF OUR BUSINESS MAY DELAY OR DENY OUR ABILITY TO EARN A REASONABLE RETURN AND FULLY RECOVER OUR COSTS.

Our rates for our local distribution companies are regulated by certain municipalities and state commissions based on an analysis of our invested capital and our expenses incurred in a test year. Thus, the rates that we are allowed to charge may not match our expenses at any given time. While rate regulation in the applicable jurisdictions is, generally, premised on providing an opportunity to recover reasonable and necessary operating expenses and to earn a reasonable return on invested capital, there can be no assurance that the regulatory process in which rates are determined will always result in rates that will produce full recovery of our costs and enable us to earn a reasonable return on our invested capital.

OUR BUSINESSES MUST COMPETE WITH ALTERNATIVE ENERGY SOURCES, AND OUR PIPELINES AND GATHERING BUSINESSES MUST COMPETE DIRECTLY WITH OTHERS IN THE TRANSPORTATION, STORAGE, GATHERING, TREATING AND PROCESSING OF NATURAL GAS.

We compete primarily with alternate energy sources such as electricity and other fuel sources. In some areas, intrastate pipelines, other natural gas distributors and marketers also compete directly with us for natural gas sales to end-users. In addition, as a result of federal regulatory changes affecting interstate pipelines, natural gas marketers operating on these pipelines may be able to bypass our facilities and market, sell and/or transport natural gas directly to commercial and industrial customers. Any reduction in the amount of natural gas we market, sell or transport as a result of competition may have an adverse impact on our results of operations, financial condition and cash flows.

Our two interstate pipelines and our gathering systems compete with other interstate and intrastate pipelines and gathering systems in the transportation and storage of natural gas. The principal elements of competition are rates, terms of service, and flexibility and reliability of service. They also compete indirectly with other forms of energy, including electricity, coal and fuel oils. The primary competitive factor is price. The actions of our competitors could lead to lower prices, which may have an adverse impact on our results of operations, financial condition and cash flows.

OUR NATURAL GAS DISTRIBUTION BUSINESS IS SUBJECT TO FLUCTUATIONS IN NATURAL GAS PRICING LEVELS.

We are subject to risk associated with price movements of natural gas. Movements in natural gas prices might affect our ability to collect balances due from our customers and, on the regulated side, could create the potential for uncollectible accounts expense to exceed the recoverable levels built into our tariff rates. In addition, a sustained period of high natural gas prices could apply downward demand pressure on natural gas consumption in the areas in which we operate and increase the risk that our suppliers or customers fail or are unable to meet their obligations. Additionally, increasing gas prices could create the need for us to provide collateral in order to purchase gas.

IF WE WERE TO FAIL TO EXTEND A CONTRACT WITH ONE OF OUR SIGNIFICANT PIPELINE CUSTOMERS, THERE COULD BE AN ADVERSE IMPACT ON OUR OPERATIONS.

Our contract with Laclede Gas Company, one of our pipeline customers, is currently scheduled to expire in 2007. To the extent the pipeline is unable to extend this contract or the contract is renegotiated at rates substantially less than the rates provided in the current contract, there could be an adverse effect on our results of operations, financial condition and cash flows.

A DECLINE IN OUR CREDIT RATING COULD RESULT IN US HAVING TO PROVIDE COLLATERAL IN ORDER TO PURCHASE GAS.

If our credit rating were to decline, we might be required to post cash collateral in order to purchase natural gas. If a credit rating downgrade and the resultant cash collateral requirement were to occur at a time when we were

experiencing significant working capital requirements or otherwise lacked liquidity, we might be unable to obtain the necessary natural gas to meet our contractual distribution obligations, and our results of operations, financial condition and cash flows would be adversely affected.

OUR INTERSTATE PIPELINES' AND NATURAL GAS GATHERING AND PROCESSING BUSINESS' REVENUES AND RESULTS OF OPERATIONS ARE SUBJECT TO FLUCTUATIONS IN THE SUPPLY OF GAS.

Our interstate pipelines and natural gas gathering and processing businesses largely rely on gas sourced in the various supply basins located in the Midcontinent region of the United States. To the extent the availability of this supply is substantially reduced, it could have an adverse effect on our results of operations, financial condition and cash flows.

OUR REVENUES AND RESULTS OF OPERATIONS ARE SEASONAL.

A substantial portion of our revenues are derived from natural gas sales and transportation. Thus, our revenues and results of operations are subject to seasonality, weather conditions and other changes in natural gas usage, with revenues being higher during the winter months.

RISK FACTORS ASSOCIATED WITH OUR CONSOLIDATED FINANCIAL CONDITION

IF WE ARE UNABLE TO ARRANGE FUTURE FINANCINGS ON ACCEPTABLE TERMS, OUR ABILITY TO REFINANCE EXISTING INDEBTEDNESS COULD BE LIMITED.

As of December 31, 2004, we had \$2.4 billion of outstanding indebtedness. As of March 11, 2005, approximately \$518 million principal amount of this debt must be paid through 2006. The success of our future financing efforts may depend, at least in part, on:

- general economic and capital market conditions;
- credit availability from financial institutions and other lenders;
- investor confidence in us and the markets in which we operate;
- maintenance of acceptable credit ratings by us and by CenterPoint Energy;
- market expectations regarding our future earnings and probable cash flows;
- market perceptions of our ability to access capital markets on reasonable terms;
- provisions of relevant tax and securities laws; and
- our ability to obtain approval of specific financing transactions under the 1935 Act.

Our current credit ratings are discussed in "Management's Narrative Analysis of the Results of Operations -- Liquidity -- Impact on Liquidity of a Downgrade in Credit Ratings" in Item 7 of Part II of this report. We cannot assure you that these credit ratings will remain in effect for any given period of time or that one or more of these ratings will not be lowered or withdrawn entirely by a rating agency. We note that these credit ratings are not recommendations to buy, sell or hold our securities. Each rating should be evaluated independently of any other rating. Any future reduction or withdrawal of one or more of our credit ratings could have a material adverse impact on our ability to access capital on acceptable terms.

THE FINANCIAL CONDITION AND LIQUIDITY OF OUR PARENT COMPANY COULD AFFECT OUR ACCESS TO CAPITAL, OUR CREDIT STANDING AND OUR FINANCIAL CONDITION.

Our ratings and credit may be impacted by CenterPoint Energy's credit standing. As of March 11, 2005, CenterPoint Energy and its other subsidiaries have approximately \$1.3 billion principal amount of debt required to

be paid through 2006. This amount excludes amounts related to capital leases, securitization debt and indexed debt securities obligations. We cannot assure you that CenterPoint Energy and its other subsidiaries will be able to pay or refinance these amounts. If CenterPoint Energy were to experience a deterioration in its credit standing or liquidity difficulties, our access to credit and our credit ratings could be adversely affected.

WE ARE AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY. CENTERPOINT ENERGY CAN EXERCISE SUBSTANTIAL CONTROL OVER OUR DIVIDEND POLICY AND BUSINESS AND OPERATIONS AND COULD DO SO IN A MANNER THAT IS ADVERSE TO OUR INTERESTS.

We are managed by officers and employees of CenterPoint Energy. Our management will make determinations with respect to the following:

- our payment of dividends;
- decisions on our financings and our capital raising activities;
- mergers or other business combinations; and
- our acquisition or disposition of assets.

There are no contractual restrictions on our ability to pay dividends to CenterPoint Energy. Our management could decide to increase our dividends to CenterPoint Energy to support its cash needs. This could adversely affect our liquidity. Under the 1935 Act, our ability to pay dividends is restricted by the SEC's requirement that common equity as a percentage of total capitalization must be at least 30% after the payment of any dividend. Under our credit facility and our receivables facility, our ability to pay dividends is restricted by a covenant that debt as a percentage of total capitalization may not exceed 60%.

THE USE OF DERIVATIVE CONTRACTS BY US AND OUR SUBSIDIARIES IN THE NORMAL COURSE OF BUSINESS COULD RESULT IN FINANCIAL LOSSES THAT NEGATIVELY IMPACT OUR RESULTS OF OPERATIONS AND THOSE OF OUR SUBSIDIARIES.

We use derivative instruments, such as swaps, options, futures and forwards, to manage our commodity and financial market risks. We could recognize financial losses as a result of volatility in the market values of these contracts, or if a counterparty fails to perform. In the absence of actively quoted market prices and pricing information from external sources, the valuation of these financial instruments can involve management's judgment or use of estimates. As a result, changes in the underlying assumptions or use of alternative valuation methods could affect the reported fair value of these contracts.

### ITEM 3. LEGAL PROCEEDINGS

For a brief description of certain legal and regulatory proceedings affecting us, please read "Regulation" and "Environmental Matters" in Item 1 of this report and Notes 3, 9(c) and 9(d) to our consolidated financial statements, which information is incorporated herein by reference.

## ITEM 7. MANAGEMENT'S NARRATIVE ANALYSIS OF RESULTS OF OPERATIONS

### CERTAIN FACTORS AFFECTING FUTURE EARNINGS

Our past earnings and results of operations are not necessarily indicative of our future earnings and results of operations. The magnitude of our future earnings and results of our operations will depend on or be affected by numerous factors including:

- state and federal legislative and regulatory actions or developments, constraints placed on our activities or business by the 1935 Act, changes in or application of laws or regulations applicable to other aspects of our business;
- timely rate increases, including recovery of costs;
- industrial, commercial and residential growth in our service territory and changes in market demand and demographic patterns;
- the timing and extent of changes in commodity prices, particularly natural gas;
- changes in interest rates or rates of inflation;
- weather variations and other natural phenomena;
- the timing and extent of changes in the supply of natural gas;
- commercial bank and financial market conditions, our access to capital, the costs of such capital, receipt of certain financing approvals under the 1935 Act, and the results of our financing and refinancing efforts, including availability of funds in the debt capital markets;
- actions by rating agencies;
- inability of various counterparties to meet their obligations to us;
- non-payment of our services due to financial distress of our customers;
- our ability to control costs;
- the investment performance of CenterPoint Energy's employee benefit plans;
- our internal restructuring or other restructuring options that may be pursued;
- our potential business strategies, including acquisitions or dispositions of assets or businesses, which cannot be assured to be completed or beneficial to us; and
- other factors discussed in Item 1 of this report under "Risk Factors."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(e) REGULATORY ASSETS AND LIABILITIES

The Company applies the accounting policies established in SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71) to the accounts of the utility operations of the Natural Gas Distribution business segment and to some of the accounts of the Pipelines and Gathering business segment.

The following is a list of regulatory assets/liabilities reflected on the Company's Consolidated Balance Sheets as of December 31, 2003 and 2004:

	DECEMBER 31,	
	2003	2004
	(IN MILLIONS)	
Regulatory assets in other long-term assets.....	\$ 34	\$ 21
Regulatory liabilities in other long-term liabilities.....	(434)	(433)
Total.....	\$ (400)	\$ (412)

If events were to occur that would make the recovery of these assets and liabilities no longer probable, the Company would be required to write-off or write-down these regulatory assets and liabilities.

The Company's rate-regulated businesses recognize removal costs as a component of depreciation expense in accordance with regulatory treatment. As of December 31, 2003 and 2004, these removal costs of \$415 million and \$428 million, respectively, are classified as regulatory liabilities in the Consolidated Balance Sheets. The Company has also identified other asset retirement obligations that cannot be estimated because the assets associated with the retirement obligations have an indeterminate life.

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3. REGULATORY MATTERS

(a) RATE CASES

In 2004, the City of Houston, 28 other cities and the Railroad Commission of Texas (Railroad Commission) approved a settlement that increased Houston Gas' base rate and service charge revenues by approximately \$14 million annually.

In February 2004, the Louisiana Public Service Commission (LPSC) approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in its South Louisiana Division by approximately \$2 million annually.

In July 2004, Minnesota Gas filed an application for a general rate increase of \$22 million with the Minnesota Public Utilities Commission (MPUC). Minnesota Gas and the Minnesota Department of Commerce have agreed to a settlement of all issues, including an annualized increase in the amount of \$9 million, subject to approval by the MPUC. A final decision on this rate relief request is expected from the MPUC in the second quarter of 2005. Interim rates of \$17 million on an annualized basis became effective on October 1, 2004, subject to refund.

In July 2004, the LPSC approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in its North Louisiana Division by approximately \$7 million annually.

In October 2004, Southern Gas Operations filed an application for a general rate increase of approximately \$3 million with the Railroad Commission for rate relief in the unincorporated areas of its Beaumont, East Texas and South Texas Divisions. The Railroad Commission staff has begun its review of the request, and a decision is anticipated in April 2005.

In November 2004, Southern Gas Operations filed an application for a general rate increase of approximately \$34 million with the Arkansas Public Service Commission (APSC). The APSC staff has begun its review of the request, and a decision is anticipated in the second half of 2005.

In December 2004, the Oklahoma Corporation Commission approved a settlement that increased Southern Gas Operations' base rate and service charge revenues in Oklahoma by approximately \$3 million annually.

(b) CITY OF TYLER, TEXAS DISPUTE

In July 2002, the City of Tyler, Texas, asserted that Southern Gas Operations had overcharged residential and small commercial customers in that city for gas costs under supply agreements in effect since 1992. That dispute has been referred to the Railroad Commission by agreement of the parties for a determination of whether Southern Gas Operations has properly charged and collected for gas service to its residential and commercial customers in its Tyler distribution system in accordance with lawful filed tariffs during the period beginning November 1, 1992, and ending October 31, 2002. In December 2004, the Railroad Commission conducted a hearing on the matter and is expected to issue a ruling in March or April of 2005. In a parallel action now in the Court of Appeals in Austin, Southern Gas Operations is challenging the scope of the Railroad Commission's inquiry which goes beyond the issue of whether Southern Gas Operations had properly followed its tariffs to include a review of Southern Gas Operations' historical gas purchases. The Company believes such a review is not permitted by law and is beyond what the parties requested in the joint petition that initiated the proceeding at the Railroad Commission. The Company believes that all costs for Southern Gas Operations' Tyler distribution system have been properly included and recovered from customers pursuant to Southern Gas Operations' filed tariffs.



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5. DERIVATIVE INSTRUMENTS

The Company is exposed to various market risks. These risks arise from transactions entered into in the normal course of business. The Company utilizes derivative financial instruments such as physical forward contracts, swaps and options (Energy Derivatives) to mitigate the impact of changes in its natural gas businesses on its operating results and cash flows.

(a) NON-TRADING ACTIVITIES

Cash Flow Hedges. To reduce the risk from market fluctuations associated with purchased gas costs, the Company enters into energy derivatives in order to hedge certain expected purchases and sales of natural gas (non-trading energy derivatives). The Company applies hedge accounting for its non-trading energy derivatives utilized in non-trading activities only if there is a high correlation between price movements in the derivative and the item designated as being hedged. The Company analyzes its physical transaction portfolio to determine its net exposure by delivery location and delivery period. Because the Company's physical transactions with similar delivery locations and periods are highly correlated and share similar risk exposures, the Company facilitates hedging for customers by aggregating physical transactions and subsequently entering into non-trading energy derivatives to mitigate exposures created by the physical positions.

During 2004, hedge ineffectiveness of \$0.4 million was recognized in earnings from derivatives that are designated and qualify as Cash Flow Hedges, and in 2003 and 2002, no hedge ineffectiveness was recognized. No component of the derivative instruments' gain or loss was excluded from the assessment of effectiveness. If it becomes probable that an anticipated transaction will not occur, the Company realizes in net income the deferred gains and losses recognized in accumulated other comprehensive loss. Once the anticipated transaction occurs, the accumulated deferred gain or loss recognized in accumulated other comprehensive loss is reclassified and included in the Company's Statements of Consolidated Income under the caption "Natural Gas." Cash flows resulting from these transactions in non-trading energy derivatives are included in the Statements of Consolidated Cash Flows in the same category as the item being hedged. As of December 31, 2004, the Company expects \$5 million in accumulated other comprehensive income to be reclassified into net income during the next twelve months.

The maximum length of time the Company is hedging its exposure to the variability in future cash flows for forecasted transactions on existing financial instruments is primarily two years with a limited amount of exposure up to five years. The Company's policy is not to exceed five years in hedging its exposure.

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Other Derivative Financial Instruments. The Company also has natural gas contracts which are derivatives which are not hedged. Load following services that the Company offers its natural gas customers create an inherent tendency to be either long or short natural gas supplies relative to customer purchase commitments. The Company measures and values all of its volumetric imbalances on a real time basis to minimize its exposure to commodity price and volume risk. The aggregate Value at Risk (VaR) associated with these operations is calculated daily and averaged \$0.2 million with a high of \$1 million during 2004. The Company does not engage in proprietary or speculative commodity trading. Unhedged positions are accounted for by adjusting the carrying amount of the contracts to market and recognizing any gain or loss in operating income, net. During 2004, the Company recognized net gains related to unhedged positions amounting to \$7 million and as of December 31, 2004 had recorded short-term risk management assets and liabilities of \$4 million and \$5 million, respectively, included in other current assets and other current liabilities, respectively.

(b) CREDIT RISKS

In addition to the risk associated with price movements, credit risk is also inherent in the Company's non-trading derivative activities. Credit risk relates to the risk of loss resulting from non-performance of contractual obligations by a counterparty. The following table shows the composition of the non-trading derivative assets of the Company as of December 31, 2003 and 2004 (in millions):

	DECEMBER 31, 2003		DECEMBER 31, 2004	
	INVESTMENT GRADE(1)(2)	TOTAL	INVESTMENT GRADE(1)(2)	TOTAL(3)
Energy marketers.....	\$ 24	\$ 35	\$ 10	\$ 17
Financial institutions.....	21	21	50	50
Other.....	--	1	1	1
	-----	-----	-----	-----
Total.....	\$ 45	\$ 57	\$ 61	\$ 68
	=====	=====	=====	=====

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- (1) "Investment grade" is primarily determined using publicly available credit ratings along with the consideration of credit support (such as parent company guarantees) and collateral, which encompass cash and standby letters of credit.
  - (2) For unrated counterparties, the Company performs financial statement analysis, considering contractual rights and restrictions and collateral, to create a synthetic credit rating.
  - (3) The \$17 million non-trading derivative asset includes a \$6 million asset due to trades with Reliant Energy Services, Inc. (Reliant Energy Services), a former affiliate. As of December 31, 2004, Reliant Energy Services did not have an investment grade rating.

(c) GENERAL POLICY

CenterPoint Energy has established a Risk Oversight Committee composed of corporate and business segment officers that oversees all commodity price and credit risk activities, including the Company's trading, marketing, risk management services and hedging activities. The committee's duties are to establish the Company's commodity risk policies, allocate risk capital within limits established by CenterPoint Energy's board of directors, approve trading of new products and commodities, monitor risk positions and ensure compliance with the Company's risk management policies and procedures and trading limits established by the CenterPoint Energy's board of directors.

The Company's policies prohibit the use of leveraged financial instruments. A leveraged financial instrument, for this purpose, is a transaction involving a derivative whose financial impact will be based on an amount other than the notional amount or volume of the instrument.

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9. COMMITMENTS AND CONTINGENCIES

(a) COMMITMENTS

Environmental Capital Commitments. The Company has various commitments for capital and environmental expenditures. The Company anticipates no significant capital and other special project expenditures between 2005 and 2009 for environmental compliance.

Fuel Commitments. Fuel commitments include several long-term natural gas contracts related to the Company's natural gas distribution operations, which have various quantity requirements and durations that are not classified as non-trading derivative assets and liabilities in the Company's Consolidated Balance Sheets as of December 31, 2004 as these contracts meet the SFAS No. 133 exception to be classified as "normal purchases contracts" or do not meet the definition of a derivative. Minimum payment obligations for natural gas supply contracts are approximately \$807 million in 2005, \$401 million in 2006, \$193 million in 2007, \$29 million in 2008 and \$1 million in 2009.

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(b) LEASE COMMITMENTS

The following table sets forth information concerning the Company's obligations under non-cancelable long-term operating leases, principally consisting of rental agreements for building space, data processing equipment and vehicles, including major work equipment (in millions):

2005.....	\$	20
2006.....		16
2007.....		12
2008.....		11
2009.....		6
2010 and beyond.....		26
		-----
Total.....	\$	91
		=====

Total rental expense for all operating leases was \$31 million, \$28 million and \$30 million in 2002, 2003 and 2004, respectively.

(c) LEGAL MATTERS

Natural Gas Measurement Lawsuits. CERC Corp. and certain of its subsidiaries are defendants in a suit filed in 1997 under the Federal False Claims Act alleging mismeasurement of natural gas produced from federal and Indian lands. The suit seeks undisclosed damages, along with statutory penalties, interest, costs, and fees. The complaint is part of a larger series of complaints filed against 77 natural gas pipelines and their subsidiaries and affiliates. An earlier single action making substantially similar allegations against the pipelines was dismissed by the federal district court for the District of Columbia on grounds of improper joinder and lack of jurisdiction. As a result, the various individual complaints were filed in numerous courts throughout the country. This case has been consolidated, together with the other similar False Claims Act cases, in the federal district court in Cheyenne, Wyoming.

In addition, CERC Corp. and certain of its subsidiaries are defendants in two mismeasurement lawsuits brought against approximately 245 pipeline companies and their affiliates pending in state court in Stevens County, Kansas. In one case (originally filed in May 1999 and amended four times), the plaintiffs purport to represent a class of royalty owners who allege that the defendants have engaged in systematic mismeasurement of the volume of natural gas for more than 25 years. The plaintiffs amended their petition in this suit in July 2003 in response to an order from the judge denying certification of the plaintiffs' alleged class. In the amendment the plaintiffs dismissed their claims against certain defendants (including two of the Company's subsidiaries), limited the scope of the class of plaintiffs they purport to represent and eliminated previously asserted claims based on mismeasurement of the Btu content of the gas. The same plaintiffs then filed a second lawsuit, again as representatives of a class of royalty owners, in which they assert their claims that the defendants have engaged in systematic mismeasurement of the Btu content of natural gas for more than 25 years. In both lawsuits, the plaintiffs seek compensatory damages, along with statutory penalties, treble damages, interest, costs and fees. The Company believes that there has been no systematic mismeasurement of gas and that the suits are without merit. The Company does not expect that the ultimate outcome will have a material impact on its financial condition or results of operations.

Gas Cost Recovery Litigation. In October 2002, a suit was filed in state district court in Wharton County, Texas against the Company, CenterPoint Energy, Entex Gas Marketing Company, and certain non-affiliated companies alleging fraud, violations of the Texas Deceptive Trade Practices Act, violations of the Texas Utilities Code, civil conspiracy and violations of the Texas Free Enterprise and Antitrust Act with respect to rates charged to certain consumers of natural gas in the State of Texas. Subsequently the plaintiffs added as defendants CenterPoint Energy Marketing Inc., CenterPoint Energy Gas Transmission Company, United Gas, Inc., Louisiana Unit Gas Transmission Company, CenterPoint Energy Pipeline Services, Inc., and CenterPoint Energy Trading and Transportation Group, Inc. The plaintiffs allege that defendants inflated the prices charged to certain consumers of natural gas. In February 2003, a similar suit was filed in state court in Caddo Parish, Louisiana against the Company with respect to rates charged to a purported class of certain consumers of natural gas and gas service in the State of Louisiana. In February 2004, another

suit was filed in state court in Calcasieu Parish, Louisiana against the Company seeking to recover alleged overcharges for gas or gas services allegedly provided by Southern Gas

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Operations to a purported class of certain consumers of natural gas and gas service without advance approval by the LPSC. In October 2004, a similar case was filed in district court in Miller County, Arkansas against the Company, CenterPoint Energy, Entex Gas Marketing Company, CenterPoint Energy Gas Transmission Company, CenterPoint Energy Field Services, CenterPoint Energy Pipeline Services, Inc., Mississippi River Transmission Corp. and other non-affiliated companies alleging fraud, unjust enrichment and civil conspiracy with respect to rates charged to certain consumers of natural gas in at least the states of Arkansas, Louisiana, Mississippi, Oklahoma and Texas. At the time of the filing of each of the Caddo and Calcasieu Parish cases, the plaintiffs in those cases filed petitions with the LPSC relating to the same alleged rate overcharges. The Caddo and Calcasieu Parish cases have been stayed pending the resolution of the respective proceedings by the LPSC. The plaintiffs in the Miller County case seek class certification, but the proposed class has not been certified. In November 2004, the Miller case was removed to federal district court in Texarkana, Arkansas. In February 2005, the Wharton County case was removed to federal district court in Houston, Texas, and in March 2005, the plaintiffs in the Wharton County case moved to dismiss the case and agreed not to refile the claims asserted unless the Miller County case is not certified as a class action or is later decertified. The range of relief sought by the plaintiffs in these cases includes injunctive and declaratory relief, restitution for the alleged overcharges, exemplary damages or trebling of actual damages, civil penalties and attorney's fees. In these cases, the Company, CenterPoint Energy and their affiliates deny that they have overcharged any of their customers for natural gas and believe that the amounts recovered for purchased gas have been in accordance with what is permitted by state regulatory authorities. The Company and CenterPoint Energy do not anticipate that the outcome of these matters will have a material impact on the financial condition or results of operations of either the Company or CenterPoint Energy.

(d) ENVIRONMENTAL MATTERS

Hydrocarbon Contamination. CERC Corp. and certain of its subsidiaries are among the defendants in lawsuits filed beginning in August 2001 in Caddo Parish and Bossier Parish, Louisiana. The suits allege that, at some unspecified date prior to 1985, the defendants allowed or caused hydrocarbon or chemical contamination of the Wilcox Aquifer, which lies beneath property owned or leased by certain of the defendants and which is the sole or primary drinking water aquifer in the area. The primary source of the contamination is alleged by the plaintiffs to be a gas processing facility in Haughton, Bossier Parish, Louisiana known as the "Sligo Facility," which was formerly operated by a predecessor in interest of CERC Corp. This facility was purportedly used for gathering natural gas from surrounding wells, separating gasoline and hydrocarbons from the natural gas for marketing, and transmission of natural gas for distribution.

Beginning about 1985, the predecessors of certain CERC Corp. defendants engaged in a voluntary remediation of any subsurface contamination of the groundwater below the property they owned or leased. This work has been done in conjunction with and under the direction of the Louisiana Department of Environmental Quality. The plaintiffs seek monetary damages for alleged damage to the aquifer underlying their property, unspecified alleged personal injuries, alleged fear of cancer, alleged property damage or diminution of value of their property, and, in addition, seek damages for trespass, punitive, and exemplary damages. The Company believes the ultimate cost associated with resolving this matter will not have a material impact on the financial condition or results of operations of the Company.

Manufactured Gas Plant Sites. The Company and its predecessors operated manufactured gas plants (MGP) in the past. In Minnesota, the Company has completed remediation on two sites, other than ongoing monitoring and water treatment. There are five remaining sites in the Company's Minnesota service territory. The Company believes that it has no liability with respect to two of these sites.

At December 31, 2004, the Company had accrued \$18 million for remediation of certain Minnesota sites. At December 31, 2004, the estimated range of possible remediation costs for these sites was \$7 million to \$42 million based on remediation continuing for 30 to 50 years. The cost estimates are based on studies of a site or industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites to be remediated, the participation of other potentially responsible parties (PRP), if any, and the remediation methods used. The Company has utilized an environmental expense tracker mechanism in its rates in Minnesota to recover estimated costs in excess of insurance recovery. As of December 31, 2004, the Company has collected or accrued \$13 million from insurance companies and

ratepayers to be used for future environmental remediation.

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In addition to the Minnesota sites, the United States Environmental Protection Agency and other regulators have investigated MGP sites that were owned or operated by the Company or may have been owned by one of its former affiliates. The Company has been named as a defendant in lawsuits under which contribution is sought by private parties for the cost to remediate former MGP sites based on the previous ownership of such sites by former affiliates of the Company or its divisions. The Company has also been identified as a PRP by the State of Maine for a site that is the subject of one of the lawsuits. The Company is investigating details regarding these sites and the range of environmental expenditures for potential remediation. However, the Company believes it is not liable as a former owner or operator of those sites under the Comprehensive Environmental, Response, Compensation and Liability Act of 1980, as amended, and applicable state statutes, and is vigorously contesting those suits and its designation as a PRP.

Mercury Contamination. The Company's pipeline and distribution operations have in the past employed elemental mercury in measuring and regulating equipment. It is possible that small amounts of mercury may have been spilled in the course of normal maintenance and replacement operations and that these spills may have contaminated the immediate area with elemental mercury. This type of contamination has been found by the Company at some sites in the past, and the Company has conducted remediation at these sites. It is possible that other contaminated sites may exist and that remediation costs may be incurred for these sites. Although the total amount of these costs cannot be known at this time, based on experience by the Company and that of others in the natural gas industry to date and on the current regulations regarding remediation of these sites, the Company believes that the costs of any remediation of these sites will not be material to the Company's financial condition, results of operations or cash flows.

Other Environmental. From time to time the Company has received notices from regulatory authorities or others regarding its status as a PRP in connection with sites found to require remediation due to the presence of environmental contaminants. In addition, the Company has been named from time to time as a defendant in litigation related to such sites. Although the ultimate outcome of such matters cannot be predicted at this time, the Company does not believe, based on its experience to date, that these matters, either individually or in the aggregate, will have a material adverse effect on the Company's financial condition, results of operations or cash flows.

OTHER PROCEEDINGS

In 2005, the Company received a communication from a regulatory agency indicating that the agency had ordered a predecessor company to remove certain components from a portion of its distribution system prior to the date the Company acquired it. Those components are not in compliance with current state and federal codes, and it is possible that some of those components remain in the Company's system. The Company has not completed its analysis of the cost to locate and replace such components; however, the Company believes that the disposition of this matter will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

The Company is involved in other legal, environmental, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business. Some of these proceedings involve substantial amounts. The Company's management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. The Company's management believes that the disposition of these matters will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. REPORTABLE BUSINESS SEGMENTS

Because the Company is an indirect wholly owned subsidiary of CenterPoint Energy, the Company's determination of reportable business segments considers the strategic operating units under which CenterPoint Energy manages sales, allocates resources and assesses performance of various products and services to wholesale or retail customers in differing regulatory environments. The accounting policies of the business segments are the same as those described in the summary of significant accounting policies except that some executive benefit costs have not been allocated to business segments.

The Company's reportable business segments include the following: Natural Gas Distribution, Pipelines and Gathering and Other Operations. Natural Gas Distribution consists of intrastate natural gas sales to, and natural gas transportation and distribution for, residential, commercial, industrial and institutional customers and non-rate regulated retail gas marketing operations for commercial and industrial customers. Pipelines and Gathering includes the interstate natural gas pipeline operations and the natural gas gathering and pipeline services businesses. Other Operations consists primarily of other corporate operations which support all of the Company's business operations.

Long-lived assets include net property, plant and equipment, net goodwill and other intangibles and equity investments in unconsolidated subsidiaries. The Company accounts for intersegment sales as if the sales were to third parties, that is, at current market prices.

CENTERPOINT ENERGY RESOURCES CORP. AND SUBSIDIARIES  
(AN INDIRECT WHOLLY OWNED SUBSIDIARY OF CENTERPOINT ENERGY, INC.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Financial data for business segments and products and services are as follows:

	NATURAL GAS DISTRIBUTION	PIPELINES AND GATHERING	OTHER OPERATIONS	RECONCILING ELIMINATIONS	CONSOLIDATED
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	(IN MILLIONS)				
AS OF AND FOR THE YEAR ENDED					
DECEMBER 31, 2002:					
Revenues from external customers and affiliates.....	3,953 (1)	255 (2)	--	--	4,208
Intersegment revenues.....	7	119	--	(126)	--
Depreciation and amortization.....	126	41	--	--	167
Operating income.....	198	153	2	--	353
Total assets.....	4,428	2,500	206	(685)	6,449
Expenditures for long-lived assets.....	196	70	--	--	266
AS OF AND FOR THE YEAR ENDED					
DECEMBER 31, 2003:					
Revenues from external customers and affiliates.....	5,406 (1)	244 (2)	--	--	5,650
Intersegment revenues.....	29	163	9	(201)	--
Depreciation and amortization.....	136	40	--	--	176
Operating income (loss).....	202	158	(1)	--	359
Total assets.....	4,661	2,519	388	(715)	6,853
Expenditures for long-lived assets.....	199	66	--	--	265
AS OF AND FOR THE YEAR ENDED					
DECEMBER 31, 2004:					
Revenues from external customers and affiliates.....	6,681 (1)	306 (2)	(4)	--	6,983
Intersegment revenues.....	3	145	5	(153)	--
Depreciation and amortization.....	143	44	--	--	187
Operating income (loss).....	222	180	(9)	--	393
Total assets.....	4,798	2,637	792	(694)	7,533
Expenditures for long-lived assets.....	197	73	(1)	--	269

(1) Included in the Natural Gas Distribution revenues from external customers and affiliates are sales to RRI, a former affiliate, of \$9 million for the year ended December 31, 2002, and sales to Texas Genco, of \$26 million, \$28 million and \$20 million for the years ended December 31, 2002, 2003 and 2004, respectively.

(2) Included in the Pipelines and Gathering revenues from external customers and affiliates are sales to RRI, a former affiliate, of \$33 million for the year ended December 31, 2002, and sales to Texas Genco of \$2 million, \$3 million and \$2 million for the years ended December 31, 2002, 2003 and 2004, respectively.

YEAR ENDED DECEMBER 31,		
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2002	2003	2004
-----	-----	-----

(IN MILLIONS)

REVENUES BY PRODUCTS AND SERVICES:

Retail gas sales.....	\$ 3,857	\$ 5,310	\$ 6,583
Gas transportation.....	255	244	306
Energy products and services.....	96	96	94
	-----	-----	-----
Total.....	\$ 4,208	\$ 5,650	\$ 6,983
	=====	=====	=====