NATIONAL FUEL GAS CO
Form 10-K
November 24, 2010

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

Form 10-K

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

For the Fiscal Year Ended September 30, 2010

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

For the Transition Period from to

Commission File Number 1-3880

National Fuel Gas Company
(Exact name of registrant as specified in its charter)

New Jersey *(State or other jurisdiction of incorporation or organization)*	**13-1086010** *(I.R.S. Employer Identification No.)*
6363 Main Street Williamsville, New York *(Address of principal executive offices)*	**14221** *(Zip Code)*

(716) 857-7000

Registrant s telephone number, including area code

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $1 Par Value, and Common Stock Purchase Rights	New York Stock Exchange

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

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

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

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 and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of the voting stock held by nonaffiliates of the registrant amounted to $4,041,725,000 as of March 31, 2010.

Common Stock, $1 Par Value, outstanding as of October 31, 2010: 82,190,871 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for its 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

Glossary of Terms

Frequently used abbreviations, acronyms, or terms used in this report:

National Fuel Gas Companies

Company The Registrant, the Registrant and its subsidiaries or the Registrant s subsidiaries as appropriate in the context of the disclosure

Distribution Corporation National Fuel Gas Distribution Corporation

Empire Empire Pipeline, Inc.

ESNE Energy Systems North East, LLC

Highland Highland Forest Resources, Inc.

Horizon Horizon Energy Development, Inc.

Horizon B.V. Horizon Energy Development B.V.

Horizon LFG Horizon LFG, Inc.

Horizon Power Horizon Power, Inc.

Midstream Corporation National Fuel Gas Midstream Corporation

Model City Model City Energy, LLC

National Fuel National Fuel Gas Company

NFR National Fuel Resources, Inc.

Registrant National Fuel Gas Company

SECI Seneca Energy Canada Inc.

Seneca Seneca Resources Corporation

Seneca Energy Seneca Energy II, LLC

Supply Corporation National Fuel Gas Supply Corporation

Toro Toro Partners, LP

Regulatory Agencies

EPA United States Environmental Protection Agency

FASB Financial Accounting Standards Board

FERC Federal Energy Regulatory Commission

NYDEC New York State Department of Environmental Conservation

NYPSC State of New York Public Service Commission

PaPUC Pennsylvania Public Utility Commission

SEC Securities and Exchange Commission

Other

Bbl Barrel (of oil)

Bcf Billion cubic feet (of natural gas)

Bcfe (or Mcfe) represents Bcf (or Mcf) Equivalent The total heat value (Btu) of natural gas and oil expressed as a volume of natural gas. The Company uses a conversion formula of 1 barrel of oil = 6 Mcf of natural gas.

Board foot A measure of lumber and/or timber equal to 12 inches in length by 12 inches in width by one inch in thickness.

Btu British thermal unit; the amount of heat needed to raise the temperature of one pound of water one degree Fahrenheit.

Cashout revenues A cash resolution of a gas imbalance whereby a customer pays Supply Corporation for gas the customer receives in excess of amounts delivered into Supply Corporation s system by the customer s shipper.

Capital expenditure Represents additions to property, plant, and equipment, or the amount of money a company spends to buy capital assets or upgrade its existing capital assets.

Degree day A measure of the coldness of the weather experienced, based on the extent to which the daily average temperature falls below a reference temperature, usually 65 degrees Fahrenheit.

Derivative A financial instrument or other contract, the terms of which include an underlying variable (a price, interest rate, index rate, exchange rate, or other variable) and a notional amount (number of units, barrels, cubic feet, etc.). The terms also permit for the instrument or
contract to be settled net and no initial net investment is required to enter into the financial instrument or contract. Examples include futures contracts, options, no cost collars and swaps.

Development costs Costs incurred to obtain access to proved oil and gas reserves and to provide facilities for extracting, treating, gathering and storing the oil and gas.

Development well A well drilled to a known producing formation in a previously discovered field.

Dth Decatherm; one Dth of natural gas has a heating value of 1,000,000 British thermal units, approximately equal to the heating value of 1 Mcf of natural gas.

Exchange Act Securities Exchange Act of 1934, as amended

Expenditures for long-lived assets Includes capital expenditures, stock acquisitions and/or investments in partnerships.

Exploitation Development of a field, including the location, drilling, completion and equipment of wells necessary to produce the commercially recoverable oil and gas in the field.

Exploration costs Costs incurred in identifying areas that may warrant examination, as well as costs incurred in examining specific areas, including drilling exploratory wells.

Exploratory well A well drilled in unproven or semi-proven territory for the purpose of ascertaining the presence underground of a commercial hydrocarbon deposit.

Firm transportation and/or storage The transportation and/or storage service that a supplier of such service is obligated by contract to provide and for which the customer is obligated to pay whether or not the service is utilized.

GAAP Accounting principles generally accepted in the United States of America

Goodwill An intangible asset representing the difference between the fair value of a company and the price at which a company is purchased.

Grid The layout of the electrical transmission system or a synchronized transmission network.

Hedging A method of minimizing the impact of price, interest rate, and/or foreign currency exchange rate changes, often times through the use of derivative financial instruments.

Hub Location where pipelines intersect enabling the trading, transportation, storage, exchange, lending and borrowing of natural gas.

Interruptible transportation and/or storage The transportation and/or storage service that, in accordance with contractual arrangements, can be interrupted by the supplier of such service, and for which the customer does not pay unless utilized.

LIBOR London Interbank Offered Rate

LIFO Last-in, first-out

Marcellus Shale A Middle Devonian-age geological shale formation that is present nearly a mile or more below the surface in the Appalachian region of the United States, including much of Pennsylvania and southern New York.

Mbbl Thousand barrels (of oil)

Mcf Thousand cubic feet (of natural gas)

MD&A Management s Discussion and Analysis of Financial Condition and Results of Operations

MDth Thousand decatherms (of natural gas)

MMBtu Million British thermal units

MMcf Million cubic feet (of natural gas)

MMcfe Million cubic feet equivalent

NGA The Natural Gas Act of 1938, as amended; the federal law regulating interstate natural gas pipeline and storage companies, among other things, codified beginning at 15 U.S.C. Section 717.

NYMEX New York Mercantile Exchange. An exchange which maintains a futures market for crude oil and natural gas.

Open Season A bidding procedure used by pipelines to allocate firm transportation or storage capacity among prospective shippers, in which all bids submitted during a defined time period are evaluated as if they had been submitted simultaneously.

Order 636 An order issued by FERC entitled Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission s Regulations.

PCB Polychlorinated Biphenyl

Precedent Agreement An agreement between a pipeline company and a potential customer to sign a service agreement after specified events (called conditions precedent) happen, usually within a specified time.

Proved developed reserves Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

Proved undeveloped reserves Reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required to make those reserves productive.

PRP Potentially responsible party

PUHCA 1935 Public Utility Holding Company Act of 1935

PUHCA 2005 Public Utility Holding Company Act of 2005

Reliable technology Technology that a company may use to establish reserves estimates and categories that has been proven empirically to lead to correct conclusions.

Reserves The unproduced but recoverable oil and/or gas in place in a formation which has been proven by production.
Restructuring Generally referring to partial deregulation of the pipeline and/or utility industry by statutory or regulatory process. Restructuring of federally regulated natural gas pipelines resulted in the separation (or unbundling) of gas commodity service from transportation service for wholesale and large-volume retail markets. State restructuring programs attempt to extend the same process to retail mass markets.
Revenue decoupling mechanism A rate mechanism which adjusts customer rates to render a utility financially indifferent to throughput decreases resulting from conservation.
S&P Standard & Poor s Ratings Service
SAR Stock appreciation right
Spot gas purchases The purchase of natural gas on a short-term basis.
Stock acquisitions Investments in corporations.
Unbundled service A service that has been separated from other services, with rates charged that reflect only the cost of the separated service.
VEBA Voluntary Employees Beneficiary Association

WNC Weather normalization clause; a clause in utility rates which adjusts customer rates to allow a utility to recover its normal operating costs calculated at normal temperatures. If temperatures during the measured period are warmer than normal, customer rates are adjusted upward in order to recover projected operating costs. If temperatures during the measured period are colder than normal, customer rates are adjusted downward so that only the projected operating costs will be recovered.

For the Fiscal Year Ended September 30, 2010

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This Form 10-K contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements should be read with the cautionary statements and important factors included in this Form 10-K at Item 7, MD&A, under the heading Safe Harbor for Forward-Looking Statements. Forward-looking statements are all statements other than statements of historical fact, including, without limitation, statements regarding future prospects, plans, objectives, goals, projections, strategies, future events or performance and underlying assumptions, capital structure, anticipated capital expenditures, completion of construction and other projects, projections for pension and other post-retirement benefit obligations, impacts of the adoption of new accounting rules, and possible outcomes of litigation or regulatory proceedings, as well as statements that are identified by the use of the words anticipates, estimates, expects, forecasts, intends, plans, predicts, proje seeks, will, may and similar expressions.

PART I

Item 1 *Business*

The Company and its Subsidiaries

National Fuel Gas Company (the Registrant), incorporated in 1902, is a holding company organized under the laws of the State of New Jersey. Except as otherwise indicated below, the Registrant owns directly or indirectly all of the outstanding securities of its subsidiaries. Reference to the Company in this report means the Registrant, the Registrant and its subsidiaries or the Registrant s subsidiaries as appropriate in the context of the disclosure. Also, all references to a certain year in this report relate to the Company s fiscal year ended September 30 of that year unless otherwise noted.

The Company is a diversified energy company and reports financial results for four business segments.

1. The Utility segment operations are carried out by National Fuel Gas Distribution Corporation (Distribution Corporation), a New York corporation. Distribution Corporation sells natural gas or provides natural gas transportation services to approximately 728,700 customers through a local distribution system located in western New York and northwestern Pennsylvania. The principal metropolitan areas served by Distribution Corporation include Buffalo, Niagara Falls and Jamestown, New York and Erie and Sharon, Pennsylvania.

2. The Pipeline and Storage segment operations are carried out by National Fuel Gas Supply Corporation (Supply Corporation), a Pennsylvania corporation, and Empire Pipeline, Inc. (Empire), a New York corporation. Supply Corporation provides interstate natural gas transportation and storage services for affiliated and nonaffiliated companies through (i) an integrated gas pipeline system extending from southwestern Pennsylvania to the New York-Canadian border at the Niagara River and eastward to Ellisburg and Leidy, Pennsylvania, and (ii) 27 underground natural gas storage fields owned and operated by Supply Corporation as well as four other underground natural gas storage fields owned and operated jointly with other interstate gas pipeline companies. Empire, an interstate pipeline company, transports natural gas for Distribution Corporation and for other utilities, large industrial customers and power producers in New York State. Empire owns the Empire Pipeline, a 157-mile pipeline that extends from the United States/Canadian border at the Niagara River near Buffalo, New York to near Syracuse, New York, and the Empire Connector, which is a 76-mile pipeline extension from near Rochester, New York to an interconnection with the unaffiliated Millennium Pipeline near Corning, New York. The Millennium Pipeline serves the New York City area. The Empire Connector was placed into service on December 10, 2008.

3. The Exploration and Production segment operations are carried out by Seneca Resources Corporation (Seneca), a Pennsylvania corporation, and by Seneca Western Minerals Corp., a Nevada corporation and an indirect, wholly owned subsidiary of Seneca. Seneca is engaged in the exploration for, and the development and purchase of, natural

gas and oil reserves in California, in the Appalachian region of the United States, and in the shallow waters of the Gulf Coast region of Texas and Louisiana, including offshore areas in federal waters and some state waters. At September 30, 2010, the Company had U.S. proved developed and undeveloped reserves of 45,239 Mbbl of oil and 428,413 MMcf of natural gas.

4. The Energy Marketing segment operations are carried out by National Fuel Resources, Inc. (NFR), a New York corporation, which markets natural gas to industrial, wholesale, commercial, public authority and residential customers primarily in western and central New York and northwestern Pennsylvania, offering competitively priced natural gas for its customers.

Financial information about each of the Company s business segments can be found in Item 7, MD&A and also in Item 8 at Note K Business Segment Information.

The Company s other direct wholly owned subsidiaries are not included in any of the four reported business segments and include the following active companies:

Highland Forest Resources, Inc. (Highland), a New York corporation which, together with a division of Seneca known as its Northeast Division, markets timber from Appalachian land holdings. At September 30, 2010, the Company owned approximately 100,000 acres of timber property and managed an additional 3,424 acres of timber cutting rights;

Horizon Energy Development, Inc. (Horizon), a New York corporation formed to engage in foreign and domestic energy projects through investments as a sole or substantial owner in various business entities. These entities include Horizon s wholly owned subsidiary, Horizon Energy Holdings, Inc., a New York corporation, which owns 100% of Horizon Energy Development B.V. (Horizon B.V.). Horizon B.V. is a Dutch company that is in the process of winding up or selling certain power development projects in Europe;

Horizon Power, Inc. (Horizon Power), a New York corporation which is an exempt wholesale generator under PUHCA 2005 and is operating landfill gas electric generation facilities; and

National Fuel Gas Midstream Corporation (Midstream Corporation), a Pennsylvania corporation formed to build, own and operate natural gas processing and pipeline gathering facilities in the Appalachian region.

No single customer, or group of customers under common control, accounted for more than 10% of the Company s consolidated revenues in 2010.

Rates and Regulation

The Registrant is a holding company as defined under PUHCA 2005. PUHCA 2005 repealed PUHCA 1935, to which the Company was formerly subject, and granted the FERC and state public utility commissions access to certain books and records of companies in holding company systems. Pursuant to the FERC s regulations under PUHCA 2005, the Company and its subsidiaries are exempt from the FERC s books and records regulations under PUHCA 2005.

The Utility segment s rates, services and other matters are regulated by the NYPSC with respect to services provided within New York and by the PaPUC with respect to services provided within Pennsylvania. For additional discussion of the Utility segment s rates and regulation, see Item 7, MD&A under the heading Rate and Regulatory Matters and Item 8 at Note A Summary of Significant Accounting Policies (Regulatory Mechanisms) and Note C Regulatory Matters.

The Pipeline and Storage segment s rates, services and other matters are regulated by the FERC. For additional discussion of the Pipeline and Storage segment s rates and regulation, see Item 7, MD&A under the heading Rate and Regulatory Matters and Item 8 at Note A Summary of Significant Accounting Policies (Regulatory Mechanisms) and Note C Regulatory Matters.

The discussion under Item 8 at Note C Regulatory Matters includes a description of the regulatory assets and liabilities reflected on the Company s Consolidated Balance Sheets in accordance with applicable accounting standards. To the extent that the criteria set forth in such accounting standards are not met by the operations of the Utility segment or the Pipeline and Storage segment, as the case may be, the related regulatory assets and liabilities would be eliminated from the Company s Consolidated Balance Sheets and such accounting treatment would be discontinued.

In addition, the Company and its subsidiaries are subject to the same federal, state and local (including foreign) regulations on various subjects, including environmental matters, to which other companies doing similar business in the same locations are subject.

The Utility Segment

The Utility segment contributed approximately 28.5% of the Company s 2010 income from continuing operations and 27.7% of the Company s 2010 net income available for common stock.

Additional discussion of the Utility segment appears below in this Item 1 under the headings Sources and Availability of Raw Materials, Competition: The Utility Segment and Seasonality, in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

The Pipeline and Storage Segment

The Pipeline and Storage segment contributed approximately 16.7% of the Company s 2010 income from continuing operations and 16.2% of the Company s 2010 net income available for common stock.

Supply Corporation has service agreements for all of its firm storage capacity, totaling 68,408 MDth. The Utility segment has contracted for 27,865 MDth or 40.7% of the total firm storage capacity, and the Energy Marketing segment accounts for another 4,811 MDth or 7.1% of the total firm storage capacity. Nonaffiliated customers have contracted for the remaining 35,732 MDth or 52.2% of the total firm storage capacity. The majority of Supply Corporation s storage and transportation services are performed under contracts that allow Supply Corporation or the shipper to terminate the contract upon six or twelve months notice effective at the end of the contract term. The contracts also typically include evergreen language designed to allow the contracts to extend year-to-year at the end of the primary term. At the beginning of 2011, 88.1% of Supply Corporation s total firm storage capacity was committed under contracts that, subject to 2010 shipper or Supply Corporation notifications, could have been terminated effective in 2011. Supply Corporation received storage contract termination notifications in 2010 totaling approximately 5,300 MDth of storage capacity. Supply Corporation expects to remarket this capacity with service beginning April 1, 2011.

Supply Corporation s firm transportation capacity is not a fixed quantity, due to the diverse web-like nature of its pipeline system, and is subject to change as the market identifies different transportation paths and receipt/delivery point combinations. Supply Corporation currently has firm transportation service agreements for approximately 2,134 MDth per day (contracted transportation capacity). The Utility segment accounts for approximately 1,065 MDth per day or 49.9% of contracted transportation capacity, and the Energy Marketing and Exploration and Production segments represent another 126 MDth per day or 5.9% of contracted transportation capacity. The remaining 943 MDth or 44.2% of contracted transportation capacity is subject to firm contracts with nonaffiliated customers.

At the beginning of 2011, 53.8% of Supply Corporation s contracted transportation capacity was committed under affiliate contracts that were scheduled to expire in 2011 or, subject to 2010 shipper or Supply Corporation notifications, could have been terminated effective in 2011. Based on contract expirations and termination notices received in 2010 for 2011 termination, and taking into account any known contract additions, contracted transportation capacity with affiliates is expected to increase 2.5% in 2011. Similarly, 35.9% of contracted transportation capacity was committed under unaffiliated shipper contracts that were scheduled to expire in 2011 or, subject to 2010 shipper or Supply Corporation notifications, could have been terminated effective in 2011. Based on contract expirations and termination notices received in 2010 for 2011 termination, and taking into account any known contract additions, contracted transportation capacity with unaffiliated shippers is expected to decrease 6.6% in 2011. This expected decrease is due largely to the relative increase in the price of natural gas supplies available at the receipt point on the United States/Canadian border at Niagara compared to the price of supplies at the delivery point of Leidy.

Supply Corporation previously has been successful in marketing and obtaining executed contracts for available transportation capacity (at discounted rates when necessary), though costlier Niagara pricing will make these efforts more challenging in 2011. Supply Corporation expects to add significant incremental contracted transportation capacity in 2012 in connection with the development of the Marcellus Shale by independent producers.

At the beginning of 2011, Empire had service agreements in place for firm transportation capacity totaling up to approximately 686 MDth per day (including capacity on the Empire Connector). The majority of Empire s transportation services are performed under contracts that allow Empire or the shipper to terminate the contract upon six or twelve months notice effective at the end of the contract term. The contracts also typically include evergreen language designed to allow the contracts to extend year-to-year at the end of the primary term. At the beginning of 2011, most of Empire s firm contracted capacity (91.6%) was contracted as long-term full-year deals. One of those contracts expires during 2011, representing approximately 2.5% of Empire s firm contracted capacity. In addition, Empire has some seasonal (winter-only) contracts that extend for multiple years, representing 2.4% of Empire s firm contracted capacity. None of those multi-year, seasonal contracts expires during 2011. Arrangements for the remaining 6.0% of Empire s firm contracted capacity are single-season or single-year contracts that expire during 2011 or potentially expire early in 2012, depending on whether Empire issues or receives termination notices during 2011. Two single-season or single-year contracts expire during 2011, representing 1.1% of Empire s firm contracted capacity. At the beginning of 2011, the Utility segment accounted for 6.1% of Empire s firm contracted capacity, and the Energy Marketing segment accounted for 2.0% of Empire s firm contracted capacity, with the remaining 91.9% of Empire s firm contracted capacity subject to contracts with nonaffiliated customers.

Additional discussion of the Pipeline and Storage segment appears below under the headings Sources and Availability of Raw Materials, Competition: The Pipeline and Storage Segment and Seasonality, in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

The Exploration and Production Segment

The Exploration and Production segment contributed approximately 51.4% of the Company s 2010 income from continuing operations and 49.8% of the Company s 2010 net income available for common stock.

Additional discussion of the Exploration and Production segment appears below under the headings Sources and Availability of Raw Materials and Competition: The Exploration and Production Segment, in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

The Energy Marketing Segment

The Energy Marketing segment contributed approximately 4.0% of the Company s 2010 income from continuing operations and 3.9% of the Company s 2010 net income available for common stock.

Additional discussion of the Energy Marketing segment appears below under the headings Sources and Availability of Raw Materials, Competition: The Energy Marketing Segment and Seasonality, in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

All Other Category and Corporate Operations

The All Other category and Corporate operations incurred a net loss from continuing operations in 2010. The impact of this net loss from continuing operations in relation to the Company s 2010 income from continuing operations was negative 0.6%. The All Other and Corporate category, including both continuing and discontinued operations, contributed approximately 2.4% of the Company s 2010 net income available for common stock.

Additional discussion of the All Other category and Corporate operations appears below in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

Discontinued Operations

In September 2010, the Company sold its landfill gas operations in the states of Ohio, Michigan, Kentucky, Missouri, Maryland and Indiana. The Company s landfill gas operations were maintained under the Company s wholly owned subsidiary, Horizon LFG, which owned and operated these short distance landfill gas pipeline companies. These operations are presented in the Company s financial statements as discontinued operations.

Additional discussion of the Company s discontinued operations appears in Item 7, MD&A and in Item 8, Financial Statements and Supplementary Data.

Sources and Availability of Raw Materials

Natural gas is the principal raw material for the Utility segment. In 2010, the Utility segment purchased 67.1 Bcf of gas for delivery to its customers. Gas purchased from producers and suppliers in the southwestern United States and Canada under firm contracts (seasonal and longer) accounted for 53% of these purchases. Purchases of gas under contracts for one month or less accounted for 47% of the Utility segment s 2010 purchases. Purchases from Chevron Natural Gas (16%), Total Gas & Power North America Inc. (12%) and Tenaska Marketing Ventures (10%) accounted for 38% of the Utility s 2010 gas purchases. No other producer or supplier provided the Utility segment with more than 10% of its gas requirements in 2010.

Supply Corporation transports and stores gas owned by its customers, whose gas originates in the southwestern, mid-continent and Appalachian regions of the United States as well as in Canada. Empire transports gas owned by its customers, whose gas originates in the southwestern and mid-continent regions of the United States as well as in Canada. Additional discussion of proposed pipeline projects appears below under Competition: The Pipeline and Storage Segment and in Item 7, MD&A.

The Exploration and Production segment seeks to discover and produce raw materials (natural gas, oil and hydrocarbon liquids) as further described in this report in Item 7, MD&A and Item 8 at Note K Business Segment Information and Note Q Supplementary Information for Oil and Gas Producing Activities.

The Energy Marketing segment depends on an adequate supply of natural gas to deliver to its customers. In 2010, this segment purchased 59.6 Bcf of gas, including 58.3 Bcf for delivery to its customers. The remaining 1.3 Bcf largely represents gas used in operations. The gas purchased by the Energy Marketing segment originates in either the Appalachian or mid-continent regions of the United States or in Canada.

Competition

Competition in the natural gas industry exists among providers of natural gas, as well as between natural gas and other sources of energy. The natural gas industry has gone through various stages of regulation. Apart from environmental and state utility commission regulation, the natural gas industry has experienced considerable deregulation. This has enhanced the competitive position of natural gas relative to other energy sources, such as fuel oil or electricity, since some of the historical regulatory impediments to adding customers and responding to market forces have been removed. In addition, management believes that the environmental advantages of natural gas have enhanced its competitive position relative to other fuels.

The electric industry has been moving toward a more competitive environment as a result of changes in federal law in 1992 and initiatives undertaken by the FERC and various states. It remains unclear what the impact of any further restructuring in response to legislation or other events may be.

The Company competes on the basis of price, service and reliability, product performance and other factors. Sources and providers of energy, other than those described under this Competition heading, do not compete with the Company to any significant extent.

Competition: The Utility Segment

The changes precipitated by the FERC s restructuring of the natural gas industry in Order No. 636, which was issued in 1992, continue to reshape the roles of the gas utility industry and the state regulatory commissions. With respect to gas commodity service, in both New York and Pennsylvania, Distribution Corporation has retained a substantial majority of small sales customers. Almost all large-volume load, however, is served by unregulated retail marketers. In New York, approximately 20%, and in Pennsylvania, approximately 5%, of Distribution Corporation s small-volume residential and commercial customers purchase their supplies from unregulated marketers. Retail competition for gas commodity service does not pose an acute competitive threat for Distribution Corporation because in both jurisdictions, utility cost of service is recovered through delivery rates and charges, not through charges for gas commodity service. Over the longer run, however, rate design changes resulting from further customer migration to marketer service (e.g., unbundling) can expose utility companies such as Distribution Corporation to stranded costs and revenue erosion in the absence of compensating rate relief.

Competition for transportation service to large-volume customers continues with local producers or pipeline companies attempting to sell or transport gas directly to end-users located within the Utility segment s service territories without use of the utility s facilities (i.e., bypass). In addition, competition continues with fuel oil suppliers.

The Utility segment competes in its most vulnerable markets (the large commercial and industrial markets) by offering unbundled, flexible, high quality services. The Utility segment continues to develop or promote new sources and uses of natural gas or new services, rates and contracts.

Competition: The Pipeline and Storage Segment

Supply Corporation competes for market growth in the natural gas market with other pipeline companies transporting gas in the northeast United States and with other companies providing gas storage services. Supply Corporation has some unique characteristics which enhance its competitive position. Its facilities are located adjacent to Canada and the northeastern United States and provide part of the traditional link between gas-consuming regions of the eastern United States and gas-producing regions of Canada and the southwestern, southern and other continental regions of the United States. While costlier natural gas pricing at Niagara has decreased the importation and transportation of gas from that receipt point, new productive areas in the Appalachian region related to the development of the Marcellus Shale formation offer the opportunity for increased transportation services. Supply Corporation is pursuing its Northern Access pipeline expansion project to receive natural gas produced from the Marcellus Shale and transport it to key markets of Canada and the northeastern United States. For further discussion of this project, refer to Item 7, MD&A under the headings Investing Cash Flow and Rate and Regulatory Matters.

Empire competes for market growth in the natural gas market with other pipeline companies transporting gas in the northeast United States and upstate New York in particular. Empire is well situated to provide transportation of gas received at the Niagara River at Chippawa and, with further expansion, Appalachian-sourced gas. Empire s location provides it the opportunity to compete for an increased share of the gas transportation markets. As noted above, Empire has constructed the Empire Connector project, which expands its natural gas pipeline and enables Empire to serve new markets in New York and elsewhere in the Northeast. Empire is also pursuing its Tioga County Extension project, which will stretch approximately 16 miles south from its existing interconnection with Millennium Pipeline at Corning, New York, into Tioga County, Pennsylvania. Like Supply Corporation s Northern Access project, Empire s Tioga County Extension project is designed to facilitate transportation of Marcellus Shale gas to key markets of Canada and the northeastern United States. For further discussion of this project, refer to Item 7, MD&A under the headings Investing Cash Flow and Rate and Regulatory Matters.

Competition: The Exploration and Production Segment

The Exploration and Production segment competes with other oil and natural gas producers and marketers with respect to sales of oil and natural gas. The Exploration and Production segment also competes, by competitive bidding and otherwise, with other oil and natural gas producers with respect to exploration and development prospects and mineral leaseholds.

To compete in this environment, Seneca originates and acts as operator on certain of its prospects, seeks to minimize the risk of exploratory efforts through partnership-type arrangements, utilizes technology for both exploratory studies and drilling operations, and seeks market niches based on size, operating expertise and financial criteria.

Competition: The Energy Marketing Segment

The Energy Marketing segment competes with other marketers of natural gas and with other providers of energy supply. Competition in this area is well developed with regard to price and services from local, regional and national marketers.

Seasonality

Variations in weather conditions can materially affect the volume of natural gas delivered by the Utility segment, as virtually all of its residential and commercial customers use natural gas for space heating. The effect that this has on Utility segment margins in New York is mitigated by a WNC, which covers the eight-month period from October through May. Weather that is warmer than normal results in an upward adjustment to customers current bills, while weather that is colder than normal results in a downward adjustment, so that in either case projected operating costs calculated at normal temperatures will be recovered.

Volumes transported and stored by Supply Corporation and volumes transported by Empire may vary materially depending on weather, without materially affecting revenues. Supply Corporation s and Empire s allowed rates are based on a straight fixed-variable rate design which allows recovery of fixed costs in fixed monthly reservation charges. Variable charges based on volumes are designed to recover only the variable costs associated with actual transportation or storage of gas.

Variations in weather conditions materially affect the volume of gas consumed by customers of the Energy Marketing segment. Volume variations have a corresponding impact on revenues within this segment.

Capital Expenditures

A discussion of capital expenditures by business segment is included in Item 7, MD&A under the heading Investing Cash Flow.

Environmental Matters

A discussion of material environmental matters involving the Company is included in Item 7, MD&A under the heading Environmental Matters and in Item 8, Note I Commitments and Contingencies.

Miscellaneous

The Company and its wholly owned or majority-owned subsidiaries had a total of 1,859 full-time employees at September 30, 2010. This compares to 1,949 employees in the Company s operations at September 30, 2009.

The Company has agreements in place with collective bargaining units in New York and Pennsylvania. The agreements in New York are scheduled to expire in February 2013 and the agreements in Pennsylvania are scheduled to expire in April 2014 and May 2014.

The Utility segment has numerous municipal franchises under which it uses public roads and certain other rights-of-way and public property for the location of facilities. When necessary, the Utility segment renews such franchises.

The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on