

# Chairman's Letter to Stakeholders

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**Dear fellow investors, customers, employees and all who have an interest in our success — our partners, suppliers, policymakers, regulators and communities:**

Last year, I wrote about how we are building an environmentally advanced generation and distribution system as a bridge to a low-carbon future. But that was before the credit crisis of 2008. Has the current economic crisis impacted our plans? Absolutely. We have delayed some capital spending and are reducing our operating costs every way we can.

But even in this economic crisis, we must continue to execute the long-term plans we have described in past annual reports. We will continue to act decisively to transition Duke Energy's business model from one reflecting 20th century needs to a new model based on 21st century realities.

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## REDEFINING OUR BOUNDARIES

These new realities include the need for increased energy efficiency, cleaner coal technologies, distributed generation, new nuclear energy and renewables, including wind, solar and biomass. In 2008, I challenged our employees to work together to develop these initiatives by redefining our boundaries.

We made progress. We learned that some boundaries are imagined and some are real. The imagined ones usually show up in conversations ending with: "Well, we've always done it that way." The real boundaries challenge us to innovate and devise new operating plans. Throughout the year, we continued to execute our core business goals and accelerated our transition to a low-carbon future.

In 2008, the Public Utilities Commission of Ohio approved our save-a-watt energy efficiency and smart grid programs. These initiatives redefine the boundary between our utility equipment and our customers' home and business power networks. In the past, utility service stopped at the meter. No longer. Under the save-a-watt and smart grid programs, we will work with our customers so they can use their energy more efficiently and productively — while reducing their monthly bills.

Last year, we proposed a program that would install photovoltaic solar panels on the rooftops of up to 400 North

Carolina homes and businesses, one of the first such distributed generation ventures in the nation. Together, these units would generate enough power to supply about 1,300 homes. This project could help us to gain experience in installing and operating these on-site electricity generation facilities.

We believe our nation can't achieve significant reductions in its carbon emissions without building new nuclear energy capacity, which emits zero greenhouse gases. We have filed an application for a combined construction and operating license with the U.S. Nuclear Regulatory Commission for a potential new nuclear station — the William States Lee III station in South Carolina. Although a final decision to build a new nuclear station is still in the future, work must continue to ensure this option remains available to meet the growing demand for electricity.

These and other projects are shaped by our over-arching goal: to develop a capital-efficient and environmentally advanced energy system that provides customers with affordable, reliable and increasingly clean energy.

Additionally, we are focused on achieving our low-carbon 21st century goals. In light of that, we are working with influential regulatory, technological and environmental thought leaders. In these partnerships, we examine what needs to be changed and what doesn't. You will meet three of these thought leaders later in this report. Their experience and knowledge are vital to successfully navigate our transition.

For the third year in a row, Duke Energy was named to the Dow Jones Sustainability Index (DJSI) for North American companies in the electric utility sector. In March 2009, Corporate Responsibility Officer magazine named Duke Energy to its 100 Best Corporate Citizens 2009 list. This recognition underscores our fundamental commitment to responsibly serve all of our stakeholders. I invite you to also review our 2008|2009 Sustainability Report, available on our Web site, to learn more about the bold stretch goals we have set.

### Challenges in 2008

We are used to challenges, but 2008 was a standout year. Due to the deepening recession, our kilowatt-hour sales growth declined in all of our regulated service territories. The downturn

in the real estate market also continued to impact Crescent Resources. As a result, we fell short of achieving our 2008 employee incentive target of \$1.27 of adjusted diluted earnings per share (EPS).

But importantly, with the combined 2008 adjusted segment earnings before interest and taxes (EBIT) of U.S. Franchised Electric and Gas, Commercial Power and International Energy, and our employees' efforts to control costs, we achieved a total 2008 adjusted diluted EPS of \$1.21.

Last year, our employees delivered on our most important metric of all. It was our best year ever for employee safety. Our Total Incident Case Rate, a common industry standard used to measure safety performance, dropped to 1.15, an 8 percent improvement over 2007. All major operational groups hit their safety targets. Even more importantly, we had no work-related fatalities last year, and serious injuries were down.

Our employees also delivered an excellent year from an operations standpoint. They responded heroically in September when the remnants of Hurricane Ike tore through our Midwest service territory. With about 1.1 million of our 1.6 million customers impacted, this was easily the largest storm-related incident in our history for this region. Despite the widespread damage to our system, we were able to safely restore service to every customer within eight days.

Last year, our stock performance was down but we still outperformed the overall markets. Duke Energy's 2008 total shareholder return was -21.7 percent, compared to -37.0 percent for the S&P 500 and -27.2 percent for the Philadelphia Utility Index. While there is some consolation in out-performing the market in 2008, our goal remains to deliver sustainable growth over the long term.

No one knows just how long this recession will last or how severe it will be. With double-digit national unemployment forecast for 2009, there is a lot of belt tightening going on in homes and businesses throughout the country. At Duke Energy, we will continue to take the necessary steps to maintain our strong balance sheet.

### **Maintaining Our Liquidity and Cash Positions**

Efficient capital attraction and deployment is our lifeblood — it is the key to our future earnings growth. Electric utilities are one of the most capital-intensive of all U.S. industries. During the unprecedented tightening of the credit markets in 2008, we continued to access capital markets.

From Jan. 1, 2008, through Jan. 31, 2009, we issued about \$4.5 billion of fixed-rate debt at a weighted average rate of 6.05 percent, with an average maturity of 15.2 years. To put this in context, it should be compared with the weighted average cost of our total long-term debt at year-end. The 2008 year-end cost of our total portfolio was 5.65 percent with an average maturity of 12.7 years. We also continue to maintain investment-grade credit ratings.

We will continue to allocate cash to our growth projects as well as to maintain and grow our dividend. We are proud that 2008 was the 82nd consecutive year that Duke Energy paid a quarterly cash dividend on its common stock. Last year, the Board of Directors increased the quarterly dividend payment from 22 cents to 23 cents per share.

### **Investing in the Future**

We have the potential to invest nearly \$25 billion over the next five years to modernize our regulated operations and to grow our commercial businesses. About \$7 billion is committed capital, including the dollars allocated for completing our two new advanced coal-fired plants. Roughly \$13 billion is for ongoing capital spending, such as maintenance, which has some flexibility as to when it is spent. The remaining \$5 billion of our potential investment is discretionary growth capital. We won't invest these discretionary dollars unless 1) we secure constructive regulatory treatment for projects in our regulated businesses, or 2) our return expectations are met for projects in our commercial businesses.

We believe we can grow earnings through more creative legislative and regulatory frameworks — such as save-a-watt approval and cash recovery of construction work in progress. This will allow us to recover financing, construction and energy efficiency costs on a timely basis to earn fair and competitive returns on capital over time. As a result, we remain committed to growing adjusted diluted earnings per share at a compound annual growth rate of 5 to 7 percent through 2013, assuming a rebound in the economy.

### **An Evolving Mission**

Today, the electric utility industry is at a crossroads. Energy policies over the 20th century promoted investment in large generating plants fueled by low-cost fossil fuels, primarily coal and natural gas. They also fostered the development of nuclear power. The success of this effort was essential to the United States' emergence as a world economic superpower.

With the mission of providing universal access to electricity accomplished, we face new challenges. Our mission for this century is to redefine our boundaries — to go beyond the meter, creating new customer partnerships and providing universal access to clean and efficient energy.

To accomplish this mission we are:

1. Promoting investment in customer programs to accelerate the contribution of energy efficiency to meet future demand
2. Building a new fleet of efficient power plants using diverse fuels to meet growing demand and to increase our reliability, while retiring older higher-emitting plants to significantly decrease our environmental impact, and
3. Pushing for the approval of legislative and regulatory policies that will ease the transition to an industry with significantly fewer greenhouse gas emissions.

Our mission for this century is to redefine our boundaries — to go beyond the meter, creating new customer partnerships and providing universal access to clean and efficient energy.

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## GOING BEYOND THE METER:

Promoting investment in customer programs to accelerate the contribution of energy efficiency to meet future demand.

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We consider energy efficiency to be our “fifth fuel.” Of course, it’s not like water, coal, natural gas or uranium. You can’t touch or smell energy efficiency, but you can understand why it is vital to our future. By making our entire system more efficient, we will save money because we will need fewer power plants. At the same time, we will maintain high-quality service and reliability.

However, existing regulations create disincentives for investing in energy efficiency. Most utilities earn returns on capital only when they build new plants. But regulators, such as those in Ohio, are shifting this paradigm. The save-a-watt model they have approved helps create a level playing field for energy efficiency and investments in new plants.

The new model promotes energy efficiency investments by allowing us to recover the money and earn a return on the savings realized by *not* having to build a new plant. This is called the “avoided cost.”

Everyone wins under this new program. Our customers win because they save money from increased energy efficiency. Investors win because the returns they earn on efficiency investments are comparable to those earned by investing in a new plant. Society and communities win because we will need to build fewer power plants, which will reduce emissions, including greenhouse gases. As a result, customers as a whole will enjoy even more reliable power and new time-saving services and conveniences.

### The Save-A-Watt Model

Save-a-watt is entirely performance-based. If the investments in more efficient lighting, heating and cooling systems don’t save energy — which will be verified by an independent third party every year — we don’t get paid. Customers who participate directly in the programs could see their bills go down on average by about \$5 per month.

We filed our save-a-watt plan in Kentucky in December 2008. In early 2009, South Carolina regulators rejected our save-a-watt plan, but we expect to re-file, as they showed strong support for energy efficiency and a willingness to expedite their review of a revised plan. North Carolina regulators requested additional information on our save-a-watt filing, but they also approved our proposed energy efficiency programs. In late February and early March 2009, Indiana regulators held hearings on save-a-watt. We expect an order later in 2009.

### Modernizing Our Distribution System

To fully benefit from our save-a-watt investments, we need to upgrade our transmission and distribution system. Our nation’s power grid has used the same analog switches, controls and meters for more than 100 years. This equipment has served us well, but it will not be adequate to connect to new energy-efficient smart appliances and equipment. This requires a digital two-way interconnection — a “smart grid.” When this technology is in place, our customers will be able to manage their appliances and equipment more efficiently.

Over the next five years, subject to constructive regulatory treatment, we plan to invest about \$1 billion in smart grid equipment in homes and businesses. By mid-2009, we will have installed more than 70,000 smart electric meters in three states and about 40,000 digital gas meters in the Midwest. As I noted earlier, we have received approval to begin the deployment of smart grid technology in Ohio, including installing 700,000 smart meters over the next five years. We are also seeking approval to install up to 800,000 smart meters throughout our Indiana service territory.

### Maintaining Customer Comfort and Convenience

Smart grid technology will give our customers the opportunity to optimize their energy consumption while we more efficiently manage our overall generation load. For example, digitally connecting appliances such as air conditioners, water heaters and dishwashers to smart meters allows these devices to be programmed to briefly turn off and on during times of peak demand. This will better balance our loads, and in turn, save customers money.

Our obligation to meet the needs of our customers for affordable, reliable and increasingly clean energy cannot be fulfilled without coal in our fuel mix. Building more efficient and cleaner coal units and retiring older ones serves as a bridge to the future.

These systems are largely invisible. There is no sacrifice in comfort or convenience. In fact, some customers in ongoing pilot programs didn't realize these systems were even operating until they saw the associated cost savings on their electric bills. Eventually, customers who want more control over their energy consumption and savings potential will be able to view their real-time energy usage through an energy portal that can be displayed on a home computer, a television set or a smart phone.

We expect to achieve similar efficiency improvements and savings on our side of the meter. These investments will allow us to automatically balance loads and isolate overloads to prevent outages.

### Visiting the Future

In 2008, we opened our Envision Center in Erlanger, Ky., just a few miles from our Ohio offices. Here our stakeholders can experience the 21st century utility firsthand. Visitors learn about many energy management devices, including smart meters, storage batteries, solar panels and other emerging technologies.

The center includes our "smart garage," where plug-in hybrid electric vehicle manufacturers offer demonstrations of their prototypes. As you will see on page 16 of this report, I've visited the center and you should, too — it brings energy efficiency and the smart grid to life.

We've since opened our second Envision Center in Raleigh, N.C., and we are field-testing some of these new technologies at a subdivision in Charlotte, N.C.

Along with our smart meter initiative, these demonstration sites are providing us with real-time experience to make sure the homes, businesses and communities we serve are significantly more energy efficient.



By Duke Energy

### MEETING FUTURE NEEDS THROUGH SUPPLY:

Building a new fleet of efficient power plants using diverse fuels to meet growing demand and to increase our reliability, while retiring older higher-emitting plants to significantly decrease our environmental impact.

We take our responsibility for meeting our customers' needs in a sustainable way very seriously. As proof, consider that today we are the third largest generator of electricity among the top 20 U.S.-based investor-owned utilities. Not surprisingly, we also rank third in this group for total tons of carbon dioxide (CO<sub>2</sub>) emitted. However, when you look at carbon intensity, which is simply the amount of CO<sub>2</sub> emitted per unit of energy produced, based on the latest available 2007 data, eight other companies within this group had higher carbon intensities than we did.

As we transition to a low-carbon future and grow our system to meet future demand, carbon intensity will be a good way to judge our progress in decarbonizing our generation fleet.

### Replacing Old Coal with New Cleaner-Burning Coal Technologies

Why are we building coal and other fossil fuel plants if we want to lead in energy efficiency as well as in reducing greenhouse gas emissions? The answer is simple: Our obligation to meet the needs of our customers for affordable, reliable and increasingly clean energy cannot be fulfilled without coal in our fuel mix. Building more efficient and cleaner coal units and retiring older ones serves as a bridge to the future.

To put it another way, we don't know what inventor working in his or her garage might come up with a "silver bullet" invention to control carbon emissions, or if anyone ever will. To hedge this uncertainty, we have adopted a "silver buckshot" strategy. We are continuing to expand our power supply options with a diverse portfolio that includes cleaner coal, nuclear, natural gas, renewables and energy efficiency. This balanced approach protects our customers from the availability and pricing volatility of any one fuel.

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Just over 50 percent of our regulated generation capacity is fueled by coal. In the Midwest, approximately 95 percent of our energy sales come from coal-fired assets. We are building two new advanced coal-fired plants — about a \$5 billion investment — to replace older coal units.

At year-end 2008, the new 825-megawatt Cliffs Unit 6 coal project in North Carolina was nearly 30 percent complete. When it is finished in 2012, it will eventually replace more than 1,000 megawatts of older, less efficient and higher-emitting coal units. As we retire older coal units and take other actions, we expect this plant to be carbon-neutral by 2018.

In Indiana, the 630-megawatt Edwardsport coal gasification plant was about 20 percent complete at year-end 2008. When finished in 2012, it will replace 160-megawatts of existing coal units built in the 1940s and 1950s. Importantly, we hope to use developing technology for carbon capture and storage near this plant site. We are seeking a portion of the funds authorized for cleaner coal technologies in the federal stimulus package enacted in February 2009 for this part of the project.

Additionally, we are building two lower-emitting 620-megawatt combined cycle natural gas-fired plants at two existing facilities in North Carolina. When completed in 2012, these new units will retire a total of about 250 megawatts of older coal-fired units as part of the 1,000 megawatts referenced above.

Baseload coal and nuclear power plants are the workhorses of power generation. Unlike wind and solar power, they typically supply power 24 hours a day.

By 2013, when we will have completed our two new coal plants, the two new gas-fired plants and shut down the older units, we will reduce our carbon intensity by roughly 10 percent. If we proceed with the new Lee Nuclear Station and can bring it on line by 2020, we will have reduced our carbon intensity by about 20 percent.

### **Advancing Renewable Energy**

Our utility companies are increasing the amount of renewable energy in their mix to meet both existing and anticipated renewable portfolio standards. Over the last two years, we have issued requests for proposals in the Carolinas, Ohio and Indiana, seeking bids for power generated from solar, wind, water, biomass and other renewable sources. Last year, a new wind farm in northern Indiana began supplying our Indiana customers with up to approximately 100 megawatts of electricity. Our agreement to receive power from this wind farm extends for 20 years.

To ensure that power from a growing number of new wind farms in the Midwest reaches our service territory, we formed a 50-50 joint venture with American Electric Power to site, build and operate a 240-mile ultra-high-voltage 765-kilovolt transmission line in Indiana. Besides linking new and existing generation in the northern and southern parts of the state,

the \$1 billion project will also help alleviate grid congestion in the Midwest. The earliest possible completion date for the project is 2015.

We also signed a 20-year agreement to purchase the full output of what will be one of the nation's largest photovoltaic solar farms to be built in North Carolina. Construction will begin in 2009, and the facility is expected to be operational by year-end 2010.

Additionally, we have agreed to purchase five megawatts of electricity generated from methane gas from a landfill in Durham, N.C., and one near Greenville, S.C. Producing electricity from methane gas not only uses a renewable fuel, but it also destroys the methane, which has a global warming impact 20 times greater than CO<sub>2</sub>.

On the commercial side of our business, we are expanding into biopower with a joint venture with French energy giant AREVA. This new company, ADAGE, will develop plants in the United States powered by wood waste. AREVA will design and build the plants, and Duke Energy will operate and manage them. We are aiming to start construction on the first plant in 2010.

Over the last several years, Commercial Power acquired two wind energy companies, and last year we began operations at our first two wind farms in Wyoming and Texas. We are also co-owner of the Sweetwater project in Texas — one of the largest wind farms in the world.

In a unique agreement with Wal-Mart, beginning in the second quarter of 2009 and for the next four years, our Texas facility will supply wind energy for a portion of the total energy used by more than 350 stores in Texas.

At the end of last year, we had close to 400 megawatts of wind power in operation and a potential wind development pipeline of more than 5,000 megawatts in 14 states.

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## **THE CLIMATE CHALLENGE:**

**Pushing for the approval of legislative and regulatory policies that will ease the transition to an industry with significantly fewer greenhouse gas emissions.**

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Long-term investors know that we see climate change as one of our nation's greatest challenges. I believe we need to regulate CO<sub>2</sub> and other greenhouse gas emissions, and we need to do it now. I have been an advocate of a cap-and-trade system to regulate and reduce CO<sub>2</sub> emissions since the beginning of this decade.

Rather than a patchwork of policies focused on a few industries or regions of the country, we are pushing for enactment of federal cap-and-trade legislation applied equally to all parts of the economy, including power generation, manufacturing facilities, commercial businesses and motor vehicles.



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To permit the economy to adjust rationally to the policy, legislation should establish a long-term program that first slows the growth of emissions, stops them and then reverses them by creating a gradually declining emissions cap. This will provide the time needed for the development and deployment of new lower- and zero-emitting technologies. Legislation should also include adequate cost containment measures to protect our economy.

Duke Energy is one of the more than two-dozen member companies in the U.S. Climate Action Partnership. Along with environmental and other advocacy groups, we worked for two years to craft a blueprint for action that is workable and fair. It protects consumers by smoothing out the energy price increases that will result from capping carbon emissions. We presented our plan to Congress in January 2009 and we are aggressively pushing for its enactment. I urge you to review it at [www.us-cap.org](http://www.us-cap.org).

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## A PRIVILEGE TO SERVE

On Oct. 27, 2008, I celebrated my 20th year as a utility CEO. This milestone was possible because I've had the privilege to work over these years with so many supportive stakeholders — our employees, investors, customers, suppliers, bankers, regulators and communities. I am grateful for your continuing confidence. I have also been blessed with great management teams and dedicated board members throughout this time.

One such board member was Mary Schapiro, who served as a director of Cinergy and then Duke Energy since 1999. In December of 2008, she was nominated by President Obama to chair the U.S. Securities and Exchange Commission (SEC). She was unanimously confirmed by the U.S. Senate to that position in January 2009. We miss Mary's insights and thoughtful debate on our board, but we know she will excel at the SEC. We thank her for her 10 years of service to our company.

## Judging Our Performance

In this business, we are judged every day when our customers throw their switches and expect power to flow into their lives. We are judged monthly on the affordability of our product when customers open up or download their bills. We are judged by investors when they look up our stock price and receive their dividend checks. We are judged by the communities we serve, who expect us to keep our rates competitive and the environment clean.

But I think the toughest judgment will come from the future — it's what I call "the grandchildren's test." When my eight grandchildren look back, I want them to understand why we pushed so hard for clean air and climate change legislation, why we introduced innovative plans like our save-a-watt program to save energy and reduce emissions. I want them to know that we always tried to do the right thing.

We live in uncertain times, but our value proposition remains unchanged. We are maintaining a strong balance sheet, investing in the future, and protecting and growing our dividend. I look forward to continuing our journey as we work to redefine our boundaries and meet our challenges. Thank you for your continued interest and investment in Duke Energy.

James E. Rogers  
Chairman, President and Chief Executive Officer

March 12, 2009