

## CORPORATE PARTICIPANTS

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## CONFERENCE CALL PARTICIPANTS

**Scott Soler***Morgan Stanley - Analyst***Craig Shere***Calyon Securities - Analyst***Paul Freemont***Jefferies & Co. - Analyst***Jay Yannello***UBS - Analyst***Steve Fleishman***Merrill Lynch - Analyst***Leslie Rich***Columbia Management Group - Analyst***Matthew Akman***CIBC World Markets - Analyst***Maureen Howe***RBC Capital Markets - Analyst***Ashar Khan***SAC Capital - Analyst***Vic Khaitan***Deutsche Asst Management - Analyst***Dan Eggers***Credit Suisse First Boston - Analyst***Allie Agha***Wells Fargo Securities - Analyst***Michael Goldenberg***Luminous Management - Analyst***Zach Schreiber***Duquesne Capital - Analyst*

## PRESENTATION

**Operator**

Good day, everyone, and welcome to the Duke Energy third-quarter earnings conference call. Today's call is being recorded. At this time for opening remarks, I will turn the call over to the Vice President of Investor and Shareholder Relations for Duke Energy, Mr. Greg Ebel. Mr. Ebel, please go ahead, sir.

**Greg Ebel - Duke Energy – VP of Investor and Shareholder Relations**

Good morning and thank you for joining us this morning. With me today are Paul Anderson, CEO and Chairman of Duke Energy and David Hauser, group vice president and CFO of Duke Energy. In addition, Fred Fowler – Chief Operating Officer, Keith Butler – Corporate Controller, and Myron Caldwell, our Treasurer are with us to assist with questions you may have today.

Today's call will be focused on the results for the third quarter of 2004 and our progress against our financial goals nine months into the year.

Before we start today let me read our Safe Harbor Statement.

Some of the things we will discuss in today's call concerning future company performance will be forward-looking statements within the meaning of securities laws. Actual results may materially differ from those discussed in these forward-looking statements, and you should refer to the additional information contained in our SEC filings concerning factors that could cause those results to be different than contemplated in today's discussion.

In addition, a reconciliation of any non-GAAP measure to the most directly comparable GAAP measure will be made available on our investor relations website at: [www.duke-energy.com](http://www.duke-energy.com).

Following Paul's and David's prepared comments we will open the lines for questions.

Now I'll turn to Paul for opening comments.

**Paul Anderson - Duke Energy - Chairman & CEO**

Let me begin by pointing out that I rejoined Duke Energy on November 1, 2003 – just 1 year and 2 days ago. We were just beginning to set out a plan to get the company back on the right track and moving in a positive direction. Today I feel very good about the results I've seen and you should, too. There were many who questioned our ability to meet the financial goals we laid out earlier this year. Three quarters into the year, not only have we already met many of these goals, in several instances we have

exceeded them. I can say with confidence Duke Energy is on the right track and headed back toward a leadership position in our industry.

To date, we have closed on asset sales totaling about \$3 billion in proceeds and tax benefits, we have reduced debt by approximately \$2.4 billion through the first nine months of the year and today we are reporting solid third quarter earnings.

This morning Duke Energy reported earnings per share of 41 cents for the third quarter, which included 3 cents for special items. These special items were primarily related to additional tax benefits on the Southeast asset sale resulting from the Duke Energy Americas restructuring. This was partially offset by an impairment charge at Field Services. Ongoing earnings were 38 cents per share.

Reported earnings for the third quarter of 2003 were 5 cents per share and ongoing earnings were 35 cents per share.

Our largest business segments continued to report solid results for another quarter. Franchised Electric and Natural Gas Transmission generated good earnings and strong cash flows. Field Services had an outstanding third quarter benefiting from the continued high prices for natural gas liquids. They appear positioned to have a record year in 2004.

Despite little or no help from weather this summer the folks at DENA continued to make headway toward reducing losses.

DENA's mark-to-market portfolio continues to be affected by changing commodity prices. In the third quarter, price changes for both gas and power combined to benefit this book for about \$40 million. This gain along with the second quarter gain of \$24 million partially offsets the \$87 million loss we experienced in the first quarter. Even though the mark-to-market earnings were positive for the quarter we are still working to reduce our exposure in this area.

Currently, we have mitigated more than 80% of the MTM portfolio associated with our disqualified hedges that existed at the beginning of the year. While we will always have a small element of MTM earnings in our results, neutralizing the exposure related to the disqualified hedges should greatly reduce the earnings volatility.

With that, let me turn things over to David to review the details for the third quarter.

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**David Hauser - Duke Energy - CFO & Group VP**

Thank you, Paul. Let me begin with Franchised Electric.

Duke Power reported segment EBIT of \$453 million for the third quarter of 2004 compared with \$436 million for the same period in 2003. Results for the third quarter last year included \$75 million in special charges related to severance and related costs, and the settlement with the South Carolina Public Service Commission.

Primary drivers for the lower results this quarter were higher non-nuclear O&M expenses primarily related to inventory write-downs and approximately \$10 million in storm costs. Lower bulk power sales also had a negative impact on the quarter.

On a positive note, industrial sales picked up this quarter by 3.6% driven by those industrial businesses outside the textile sector. Gigawatt-hour sales to residential and commercial customers increased 0.5% and 1% for the quarter, respectively.

The North Carolina Clean Air amortization expense was approximately \$109 million during the third quarter of 2004, compared with \$53 million last year. In the third quarter of 2003, the Catawba purchased capacity levelization was \$54 million. For the full year 2004 we'd expect to book in excess of \$210 million of Clean Air amortization.

Now let me move on to Natural Gas Transmission.

Our gas transmission businesses in the US and Canada delivered \$265 million in segment EBIT for the third quarter of 2004 compared with \$280 million in the third quarter of 2003.

Ongoing EBIT for the third quarter of 2004 was \$258 million, excluding a \$7 million gain on asset sales and equity investments. Ongoing EBIT for the third quarter of 2003 was \$267 million, excluding \$13 million related to gains on asset sales and severance and related costs.

Earnings contributions from business expansion projects, namely the Patriot and HubLine projects, were offset by the reduction of certain ad valorem tax reserves in the prior year.

Foreign currency translation of the Canadian dollar contributed \$12 million more to EBIT for the quarter. However, this benefit was partially offset by the foreign currency translation on interest and taxes at the Duke Energy consolidated level.

Gas Transmission's Moss Bluff natural gas storage facility in Texas experienced a fire in the third quarter this year. While this was a significant operational incident, the impact of this event was not material to Gas Transmission's segment EBIT or cash flow as a result of normal business insurance. The total impact was less than \$3 million. Future earnings and cash flow impacts are not expected to be significant.

Two of the three storage caverns at Moss Bluff were returned to service yesterday. The remaining cavern is undergoing repairs and is expected to return to service during the first half of 2005.

Now let me turn to Field Services.

Once again Field Services delivered another great quarter, reporting EBIT from continuing operations of \$67 million for the third quarter primarily driven by strong Natural Gas Liquids (NGL) prices. This compares with \$51 million for the third quarter of 2003. Results for this year's quarter included a \$26 million impairment charge. Ongoing EBIT from continuing operations, excluding special charges, was \$92 million for the third quarter of 2004.

Field Services realized strong margins from its processing business, especially on percent-of-proceeds and keep-whole contracts which increased more than \$93 million in total over last year's third quarter.

These higher margins were attributable to higher NGL prices which averaged 72¢ this quarter compared with 49¢ for the third quarter last year.

Direct operating and G&A costs during the quarter were slightly more than \$150 million and in-line with expectations for the year. For the full year 2004, we expect direct operating and G&A expenses to be between \$575 million and \$600 million.

As we disclosed in an 8-K on October 5<sup>th</sup>, the \$26 million impairment charge was largely related to Field Services' periodic review of the carrying value of its assets and equity investments as well as the disposal of certain assets during the quarter.

For the remainder of 2004 we are hedged approximately 85%. As such, moves in NGL prices for the remainder of the year will not materially impact EBIT at Field Services.

For 2005 we have hedged 48% of production as of September 30<sup>th</sup>. At the Duke Energy level, without additional hedging, the operating income sensitivity for a 1¢ change in NGL prices is approximately \$7 million for the full year 2005.

Given the strong pricing environment for crude oil through next year, Field Services is poised to deliver another year of exceptional earnings in 2005. Based on the hedge position at the end of September, Field Services would earn over \$500 million in EBIT in 2005 at the Duke Energy level if oil prices stay at or above \$40/barrel and assuming the correlation between NGLs and crude oil holds at historical levels. If the correlation holds and oil prices drop to \$30/barrel, Field Services would still earn over \$300 million in EBIT at the Duke Energy level.

One final item for the third quarter is that Duke Energy Field Services paid a cash dividend to its parent companies. The total dividend was \$140 million of which Duke Energy received \$98 million. This brings the total dividends paid this year to \$277 million and Duke's portion to \$193 million.

Now let me turn your attention to Duke Energy North America.

DENA's results for the quarter continue to reflect poor market conditions for the merchant energy business. Low spark spreads and cooler summer weather continued to limit DENA's ability to capture value in the marketplace.

DENA reported a third quarter segment EBIT loss from continuing operations of \$17 million compared with a segment EBIT loss from continuing operations of \$411 million last year. DENA realized lower margins from energy generation which was partially offset by lower overall operating expenses.

Special charges for the quarter included a \$6 million loss on asset sales, primarily due to a true-up on the sale of the Southeast generation assets. Changes in the mark-to-market portfolio benefited the quarter by \$40 million.

DENA's segment EBIT from continuing operations, excluding the special items and the mark-to-market gain, was a \$51 million loss for the quarter.

Let me turn to the next slide to provide a more detailed look at the quarter.

At Duke Energy North America, gross margin realized from the accrual book in the third quarter of 2004 amounted to \$83 million. This result was in line with our expectations in achieving \$320 million of low-risk gross margin for the full year 2004.

Total expenses for the third quarter totaled \$134 million. Depreciation expense was lower in the third quarter primarily due to the sale of the southeast generation assets. O&M and G&A expenses were also lower in the quarter.

Absent the effect of MTM earnings and special items, we continue to believe that DENA's 2004 EBIT loss from continuing operations will be approximately \$300 million.

On October 13, DENA closed on the sale of its Moapa merchant facility in Nevada which will result in a gain of approximately \$130 million in the fourth quarter. In addition, the company will also realize tax benefits of approximately \$148 million.

We still expect to make a final decision on the disposition of the two remaining deferred construction projects by the end of this year.

Now let's turn to International Energy.

For the third quarter of 2004, Duke Energy's international businesses reported segment EBIT from continuing operations of \$64 million compared with \$44 million last year. The increase was driven by better results at National Methanol, due mainly to

stronger MTBE prices, and a reduction in environmental reserves in Brazil.

Now let me move on to Crescent Resources.

Crescent Resources, our real estate business, delivered segment EBIT from continuing operations of \$43 million during the third quarter of 2004, compared with \$39 million in the third quarter last year.

Solid results for the quarter were driven by higher commercial and residential land sales partially offset by lower legacy land sales.

For the year to date Crescent reported segment EBIT from continuing operations of \$190 million and we now expect Crescent's results for the full year 2004 to exceed \$200 million. Crescent's net cash flow from operating and investing activities should total approximately \$400 million this year.

Segment EBIT for 2005 and beyond should trend back to their historical levels of approximately \$150 million per year and in line with the EBIT guidance we provided in February. On a cash flow basis, we expect Crescent to typically generate positive net cash flow from operating and investing activities of at least \$100 million annually.

That completes the review of our operations – now let me talk a little about the progress we've made on our debt reduction plan.

As of the third quarter of 2004 we have reduced our overall debt position by \$2.4 billion at Duke Energy.

Approximately \$890 million of the reduction is attributable to the sale of the Australian business. Debt at Duke Energy was reduced by approximately \$800 million – through a combination of trust preferred securities and retail notes. Debt at Duke Capital was reduced by \$550 million in trust preferred securities, bonds and floating rate notes. Another \$75 million in preferred shares was retired at Westcoast.

And the remaining balance is due to other non-cash changes and foreign exchange.

We feel very good about our financial standing and strong cash position. With that in mind, we now expect the 2004 debt reduction to exceed \$4 billion.

For the full year 2004 we still expect interest expense to be approximately \$1.3 billion which will be \$100 million lower than our 2003 interest expense. The accelerated debt reductions contributed to lower interest expense this quarter.

At September 30, we had cash and cash equivalents on hand totaling \$2.9 billion. We expect to keep at least \$1 billion of cash and cash equivalents on hand throughout the end of the year.

During the quarter, the company reduced its income tax expense by \$48 million due to the sale of Southeast generation assets as a result of the restructuring of Duke Energy Americas.

The effective tax rate for the full year 2004 is still expected to be unusually low. However, next year should see a return to a more typical effective tax rate in the low to mid-30's.

The income tax benefit related to the sale of the SE plants and Moapa is approximately \$650 million. There will be a tax loss carry-forward into 2005 of more than \$500 million.

Now I'd like to tell you about a couple of items for the fourth quarter this year. The first item is that we made a voluntary cash contribution of \$250 million to the company's U.S. pension fund last week. As a result of making this contribution, the company will not be required to make a contribution to this plan in 2005.

The final tranche of our mandatory convertible securities will mature in a couple of weeks at which time we will issue another 18.7 million shares of common stock at a price equivalent of \$40.125 per share. We have already remarketed the debt associated with these securities.

You may have noticed that the financial statements included in the earnings release were condensed versions of what you are normally used to getting with the release. In the new world of Sarbanes Oxley we will want to provide the detailed financial statements at the time we file the 10Q – which will be on November 9<sup>th</sup>. We trust you can understand our approach with this and certainly appreciate your patience.

Now let me turn the call back over to Paul for his closing remarks.

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**Paul Anderson - Duke Energy - Chairman & CEO**

With the close of 2004 drawing near I am encouraged by the outstanding work of the team at Duke Energy. Our employees have maintained their focus on the job at hand and you can see the results. I feel good about the progress Duke Energy has made toward reaching and, in some cases, exceeding the goals we outlined for you earlier this year.

As I have mentioned before, we nearly doubled our asset sales goal for the year by generating total proceeds of about \$3 billion, including tax benefits. We now anticipate debt reductions to exceed \$4 billion by the end of the year. To date, we've paid down debt by approximately \$2.4 billion. And with the strong results for the third quarter, we will exceed our EPS incentive target for the year.

Everyone across the company has worked very hard to put Duke Energy back on a positive trajectory. Some of the most difficult

challenges we faced were at DENA. The employees at DENA continue to make progress in winding down Duke Energy Trading & Marketing and mitigating the risks associated with the mark-to-market portfolio. We remain optimistic that DENA will see improved results going forward.

Duke Energy's other businesses are performing well. Our regulated businesses are delivering solid earnings and strong cash flows. Field Services continues to have a banner year with the strong NGL price environment. Crescent Resources has been able to capitalize on the strong market for residential properties in the Carolinas and commercial properties in the Washington, DC area. And International Energy keeps delivering steady results from its Latin American and National Methanol operations.

While we have made significant strides in putting Duke Energy on solid footing with a strong financial position, there is work still to be done to regain our leadership position within the industry. I believe that goal is close at hand. Duke Energy is well positioned to pursue opportunities in the marketplace and to increase shareholder value.

With that, let me open the lines for your questions.

## QUESTION AND ANSWER

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### Operator

Our first question comes from Scott Soler of Morgan Stanley.

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### Scott Soler - *Morgan Stanley - Analyst*

I had really just one very broad question, and I'll click off. In terms of looking at the opportunities for cost savings, I want to look at more of an untraditional area for you, in terms of this focus, is really in Franchised Electric and Gas Transmission. Are there areas in those two businesses, that you all think there are opportunities for significant cost savings? Because I know the focus has really been on DENA and DEI in terms of probably analysts focusing on where you guys could potentially cut out costs. I was hoping you could maybe spend a few moments on that.

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### Paul Anderson - *Duke Energy - Chairman & CEO*

Sure. I guess on a big picture point of view of the Company, I think we have, considerably, cost savings opportunities across the board in terms of our processes and systems. In fact, one of the things that Sarbanes-Oxley has done for us is to make us focus on how complex some of our systems are and how much they are costing us by having the complexity of the business that we have. So next year, one of our objectives will be to focus on that. And I believe, if there are significant cost reductions, they're not low-hanging fruit, but they are there.

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### Scott Soler - *Morgan Stanley - Analyst*

Okay, can you give a little bit of an update on DEI in terms of your progress in looking at your contracts in Brazil?

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### Paul Anderson - *Duke Energy - Chairman & CEO*

Well, the actual auction will be, I believe, the first week of December. I might just turn it over to Fred. He's a little closer to the specifics of that. But I think it's a little early to call what the impact of that is going to be.

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### Fred Fowler - *Duke Energy - COO*

Yes, we're right in the middle of trying to figure that out, as to where this thing is going to go. It is scheduled, I believe it's for December the 10th. I wouldn't be surprised to see it get delayed a few days. But I do think it will happen this year. Under law, that auction does have to happen this year. So I think it will happen. It's kind of an interesting dynamic.

We kind of have a twofold strategy in Brazil as far as contracting. Obviously, we're interested in the auctions. But we also have a very major ongoing effort and have had one since we started having capacity roll off, dealing direct with third-party industrials. And that's where we have renewed a lot of our contracts so far, of the 50 percent that's rolled off to-date.

It's kind of interesting. That market, in the short-term, it's oversupplied. The spot market is pretty soft. But if you get out into the multiyear contractual market, you're seeing people unwilling to sign up for prices, really, much less than in I'd say 50 to 70 Real range. Whereas spot markets are probably as low as 20 cents. So while we've lived through this oversupplied short-term spot market, we haven't really had to lock in our longer-term contracts.

Obviously, you do have a new wild-card that's coming in with this auction. And the fact that you never know how people are going to react in an auction. And especially when you consider that 85 percent of this capacity is still government-owned. I think that's kind of a two-edged sword. While you don't know how government is going to play it, I think it's clearly in their best interests, both from a standpoint of revenue generation off those assets, to have fairly decent prices.

And I think the second point is they want to make sure that they send a good signal to the market about what returns can be down there to attract capital for the new investment that's needed so that they avoid the kind of rationing that they had here a few years ago. That's kind of one of their top concerns.

So it's hard for me to tell you right now. We are in the middle of strategizing how we are going to do it. The thing that I want to make sure that we don't do is get ourselves tied up in some bad long-term contracts. But we don't have our final strategy laid out at this point.

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**Scott Soler - Morgan Stanley - Analyst**

Okay. Alright. Well thank you.

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**Operator**

Our next question comes from Craig Shere of Calyon Securities.

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**Craig Shere - Calyon Securities - Analyst**

Hi. Solid quarter. A couple of quick questions on the dirty hedges at DEFS. One is, I'm not totally clear on how the accounting works here. Does it actually increase mark-to-market exposures? And secondly, some other companies have expressed some discomfort with the risks associated with dirty hedges. Are you all

comfortable enough that at some point you extend hedge positions out into the '06 period?

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**David Hauser - Duke Energy - CFO & Group VP**

Craig, this is David. Let me answer that a couple of ways. If you look at our barrel that comes out of DEFS, roughly 40 percent of that barrel is very tightly correlated with oil. So we feel very good about that correlation. If there was hedging effectiveness, it would hit mark to market, as you've suggested. But for that first 40 percent, that's very unlikely.

The second thing we do as we get above 40 percent, we hedge using propane. I think propane is 28 percent of the barrel, something like that. And as we use propane, that is, of course, not a dirty hedge. It's a very direct hedge. And so you don't have that mark to market issue. With regard to 2006, we're certainly looking at that. And you could get comfortable hedging probably the first 40 percent from a purely correlation issue. The propane liquid market really is not very strong in 2006, so it would be harder to do.

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**Craig Shere - Calyon Securities - Analyst**

You mean as far as liquidity for contracts further out?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Yes, the prices are strong. It's just that there's not much volume out there.

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**Craig Shere - Calyon Securities - Analyst**

Great. Thank you.

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**Operator**

We will now go to Paul Freemont of Jefferies.

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**Paul Freemont - Jefferies & Co. - Analyst**

Two questions quickly. One is, if I add back the tax adjustment, it looks as if the tax rate came in somewhere around 35 percent. Is that sort of the tax rate that we should be looking for on a going-forward basis?

The second question is, if I take the current trailing 12 months of \$1.37, it's significantly above '04 consensus of \$1.27. Is there anything in the fourth quarter that would be expected to come in materially weaker than last year's 22 cents in the fourth quarter?

**David Hauser - Duke Energy - CFO & Group VP**

Let me speak to the tax rate. Of course, our statutory federal rate is 35 percent and then our most important state tax rate is North Carolina, which is 6.9 percent. We would expect, though, there are always a few items that are scheduling reductions on the tax return that are not deferred but are permanent differences. So we would expect our consolidated tax rate to be in the low 30s on an ongoing basis. If you use 33, 34 kind of number, you would be very close.

**Paul Freemont - Jefferies & Co. - Analyst**

Okay. And the other question on the trailing 12 month earnings versus consensus right now for '04?

**Paul Anderson - Duke Energy - Chairman & CEO**

Well, we haven't been giving guidance, and we probably don't intend to give guidance going forward. I would just say that there's nothing particularly unusual in the fourth quarter that we are expecting. But we're not going to step out to starting to give some guidance here.

**Paul Freemont - Jefferies & Co. - Analyst**

Right. But at least on a quarter-over-quarter comparison, the fourth quarter should show sort of a continuing trend of improvement at Field Services, right?

**Paul Anderson - Duke Energy - Chairman & CEO**

Well, we've told the world that we're 85 percent hedged in Field Services at this point in time. So, you know, Field Services should have a good solid fourth quarter, and is pretty much hedged up. But, you know, beyond that, I don't want to get into the back end of the guidance business.

**Fred Fowler - Duke Energy - COO**

Probably the biggest swing factor we have for the fourth quarter is Canadian weather. If you have a very mild winter, you'd have some downside. If you have a good early winter, you'll have some upside.

**Paul Freemont - Jefferies & Co. - Analyst**

Thank you.

**Operator**

Our next question comes from Jay Yannello of UBS.

**Jay Yannello - UBS - Analyst**

Good morning. If we could have just a little insight on the carrying value of energy contracts on the book. It went up by roughly \$251 million, particularly in owned assets. Is that primarily gas positions or gas hedges? Can we just have a little insight on that?

**David Hauser - Duke Energy - CFO & Group VP**

You're looking at the CCRO tables that we put out?

**Jay Yannello - UBS - Analyst**

Yes. I think the book went to \$914 million from \$663 at the end of June.

**David Hauser - Duke Energy - CFO & Group VP**

Yes, if you looked at the owned assets section of that, the vast majority is gas hedges and they did improve.

**Jay Yannello - UBS - Analyst**

Okay, thank you. My next question I guess is for Paul. Paul, there's been a lot of discussion of potentially JV-ing [joint venturing] the DENA plants with maybe one or two other parties. Just in broad terms, can you give us some insight on how the discussions are or not going? And what are kind of the key variables in potentially sealing the deal down the road?

**Paul Anderson - Duke Energy - Chairman & CEO**

Well, I would say we're just starting down the road. And our objective will be to come up with a more permanent position for DENA next year. It's a 2005 objective that we have. What we're looking for are the characteristics we've talked about before. We're looking for someone with fuel diversity and geographic diversity; financial strength so that we can support a trading operation; something that gives scope and scale to be able to spread overhead and to be able to support a trading operation; and also enough scope that we can actually influence or, at least be a voice that is heard, in terms of developing energy policy going forward, in terms of merchant generation. Because right now, the way that merchant generation is treated is very much an evolving situation in that the market or the regulators have not yet figured out how capacity is going to be paid for other than through direct power purchases. So we are in the early stages. I would say that maybe in January, we'll bring Jim Mogg to New York and he can tell you

some of his thoughts on that, because that's going to be his number one objective for next year.

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**Operator**

Steve Fleishman of Merrill Lynch has the next question.

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**Steve Fleishman - Merrill Lynch - Analyst**

Yes, thank you. One of your other EBIT lines is the kind of "Other Net," and that's showing a pretty substantial improvement this year. Last year was over \$200 million negative and now it's only about \$50 million negative. Can you talk about what's driven that improvement?

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**David Hauser - Duke Energy - CFO & Group VP**

Help me with where you are there.

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**Steve Fleishman - Merrill Lynch - Analyst**

You know, the other line – where the corporate and "Duke net" and all that stuff and the "Other EBIT."

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**David Hauser - Duke Energy - CFO & Group VP**

Oh, okay. You're looking at the number that was \$25 million negative this year and was \$88 million negative last year?

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**Steve Fleishman - Merrill Lynch - Analyst**

Right. And then also looking at the year-to-date. And I know last year, that number ended up in about negative \$220 or something. And you're only negative \$56 so far this year.

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**David Hauser - Duke Energy - CFO & Group VP**

Okay. Let me make sure I've got a couple things. First of all, in the quarter, let me talk about that first. Let me make sure you know what all's in there. This is our subsidiaries, like Duke/Fluor Daniel, Duke Energy Merchants. And it is corporate governance. So if you look at the quarter, last year, had significant severance costs in it. So that's one driver of how we've improved quarter to quarter from the \$88 down to the \$25.

I need to look at why we got \$205 to \$56. So Duke Energy Merchants was in there, and that had a substantial impact going from last year to this year also. So I think it's Duke/Fluor Daniel, Duke Energy Merchants, and then this year, we actually had some gains on the year-to-date associated with the CNC sale. That was our facility in the Caribbean. And I think that's the big items if you

look at it. So several moving pieces, but it's all our miscellaneous subsidiaries, if you will.

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**Steve Fleishman - Merrill Lynch - Analyst**

Okay. And I guess secondly, I know this was asked before, you said ongoing tax rate in the low 30s, 33 percent or so. But I think you said this year, the tax rate is going to be lower than that?

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**David Hauser - Duke Energy - CFO & Group VP**

The effective tax rate will be lower because of two significant items, the benefit of the restructuring of \$48 million that we talked about this time; and the benefit of \$52 million, I believe it was last time of reserves that we reversed. So you had essentially \$100 million of items that were special this year.

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**Steve Fleishman - Merrill Lynch - Analyst**

Okay. But you've excluded those from your operating earnings.

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**David Hauser - Duke Energy - CFO & Group VP**

Yes. So, well, let's segregate, segregate two things. The \$48 million of tax is excluded from ongoing operating earnings. The \$52 million of reserve reversal is not excluded; that occurred last quarter. The \$48 million occurred this quarter. Does that make sense?

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**Steve Fleishman - Merrill Lynch - Analyst**

Okay. That makes sense.

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**David Hauser - Duke Energy - CFO & Group VP**

Okay.

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**Steve Fleishman - Merrill Lynch - Analyst**

Okay. And I guess one last question on Crescent, that you mentioned you're already at \$190 million and you think you'll do over \$200 million. Last year, my recollection is, you hadn't done very much and then had a very big fourth quarter of asset sales. I mean, do you expect you could produce as much as you did last year? Or did you end up booking a lot earlier in the year this year?

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**Paul Anderson - Duke Energy - Chairman & CEO**

We had a real good second quarter at Crescent. The fourth quarter traditionally sees a lot of deals close that have been building up

during the year. Some of those, we closed during the course of the year. So it won't be quite the buildup that we've had in prior years. But it will be a solid quarter.

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**Steve Fleishman - Merrill Lynch - Analyst**

Okay, thank you.

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**Operator**

We will now go to Leslie Rich of Colombia Management Group.

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**Leslie Rich - Colombia Management Group - Analyst**

Hi, I just have one quick question. What was your short-term debt balance at September 30?

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**David Hauser - Duke Energy - CFO & Group VP**

Let's see. We had a little CP outstanding. I think it was less than \$300 million. We normally keep \$150, and had a little bit more outstanding at the end.

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**Leslie Rich - Colombia Management Group - Analyst**

Okay, thank you.

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**Operator**

Matthew Akman of the CIBC is next.

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**Matthew Akman - CIBC World Markets - Analyst**

I had a question about your use of free cash for 2005. And specifically, there's a comment in the quarterly release about successful open seasons held on some of the transmission businesses. So I'm wondering about any specific expansion plans or potential there. And then more broadly, I guess if you had to invest in the three main regions -- South America, U.S., or Canada, what are your preferences and where do you see the best opportunity? Thanks.

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well, as far as the open seasons go, it's probably a little premature to say what they might translate into that would be short-term investments. Typically, on open season, it takes a while to mature to the point that you actually have projects on the drawing boards and agreements. It's unusual to be able to do something that

quickly. So I would not say that the open season is necessarily going to lead to a major cash requirement.

In terms of where our preference would be to invest, my preference, between those three regions would probably be to invest in Canada a little bit. And then the U.S., and then South America. But it would depend very much on the opportunity and how it compared to the cost of capital. I would say as far as availability of investments, in the U.S., they will probably be greater in terms of those investments that are likely to meet our cost of capital. But there's a shortage of investments in Canada. And we haven't been very successful in meeting our cost of capital in Latin America. So we don't intend to invest further there until we actually can achieve our cost capital.

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**Matthew Akman - CIBC World Markets - Analyst**

Okay, great. Thanks a lot. I'll let someone else go.

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**Operator**

We will then go to Maureen Howe of RBC Capital Markets.

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**Maureen Howe - RBC Capital Markets - Analyst**

Thanks very much. I have a couple of just sort of -- I guess almost picky questions. Can you tell us what the FX impact was on interest expense -- corporate interest expense?

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**David Hauser - Duke Energy - CFO & Group VP**

I've got that number. It's not a big number. It is, it looks like it's \$4 million.

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**Maureen Howe - RBC Capital Markets - Analyst**

Okay, thanks very much. And also, I'm just wondering if you can break down the quarterly change relative to last year's Q3 in terms of the International business, with respect to the change in MTBE prices and with respect to the environmental reserve in Brazil. I think last year, you said it was \$7 million in Brazil for the reserve.

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**Fred Fowler - Duke Energy - COO**

Yes, Maureen, this is Fred. It's about half and half. About half of it is the reserve reversal in Brazil. About half of it is methanol prices.

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**Maureen Howe - RBC Capital Markets - Analyst**

Methanol prices or MTBE prices?

**David Hauser - Duke Energy - CFO & Group VP**

It's both MTBE and methanol were up. But our production was not as strong for methanol in Saudi Arabia.

**Maureen Howe - RBC Capital Markets - Analyst**

Okay. And so just in terms of the dollar amount, can you just tell us what that is?

**Fred Fowler - Duke Energy - COO**

About \$7 million each.

**Maureen Howe - RBC Capital Markets - Analyst**

About \$7 million each? So that means then I guess in the quarter, Fred, there was no environmental reserve provision taken in Brazil?

**Fred Fowler - Duke Energy - COO**

No, we reversed a provision this year. Last year, we took one. This year, we reversed one. So the actual swing, year-on-year, purely for reserves, would be \$14 million.

**Maureen Howe - RBC Capital Markets - Analyst**

Okay, thanks. And then just my final question, in Duke Energy Field Services, I just want to ensure that on the detail that's broken out, there is a \$50 million charge that's related to Field Services activities. Does that reflect the hedging activities at Field Services?

**David Hauser - Duke Energy - CFO & Group VP**

You need to tell us where you're looking.

**Maureen Howe - RBC Capital Markets - Analyst**

Okay. So on the detail for Duke Energy Field Services, where you give us the breakout between percentage of proceeds and keep-whole and gas and NGL, right at the bottom there, it says Duke Energy, 100 percent Field Services activities. There's a Note 8. And the Note 8 says, includes TEPPCO LP plus allocated risk management activity. And it's a charge of \$50 million.

**David Hauser - Duke Energy - CFO & Group VP**

Yes. What you concluded is exactly right. The loss is on corporate hedging because the prices went up above where we had hedged.

**Maureen Howe - RBC Capital Markets - Analyst**

Okay. And that was done at the corporate level. Is that correct?

**David Hauser - Duke Energy - CFO & Group VP**

Yes.

**Maureen Howe - RBC Capital Markets - Analyst**

Okay. Thank you very much.

**Operator**

We'll go to Ashar Khan of SAC Capital.

**Ashar Khan - SAC Capital - Analyst**

Good morning, and congrats on a good quarter. David, can you just share with us the interest expense. I know you gave us in February a \$1.1 billion, if I remember from memory, interest expense number for '05. What that number would be based on your debt reduction targets for the end of the year? And then the second, I just wanted to just revisit what you had mentioned, if I'm right, \$150 million EBIT loss for DENA for next year. Whether that is still a good enough number as we use for '05?

**David Hauser - Duke Energy - CFO & Group VP**

Your memory is exactly right. We said interest expense would be \$1.3 billion this year and \$1.1 billion next year. The \$1.1 billion will be a little better than that because of our increased debt retirements. But in fact, our debt retirements -- the extra debt retirements were at fairly low rates. So it's not going to be a lot below \$1.1 billion I would stick with the \$1.1 billion for right now.

**Ashar Khan - SAC Capital - Analyst**

Okay. And then for DENA for next year?

**Fred Fowler - Duke Energy - COO**

Yes, I think at this point, \$150 million is still a good number to use.

**Ashar Khan - SAC Capital - Analyst**

Okay. And then if I heard you right, you said you have some tax loss carry-forwards which you utilized in '05. So can we then expect that the tax rate in '05 should be lower than the 33 percent because of those loss carry-forwards being utilized?

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**David Hauser - Duke Energy - CFO & Group VP**

No. You can expect we'll get the cash in the door, but the accounting is already done. So you shouldn't have any impact on the effective tax rate in the accounting records. But you will get the cash.

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**Ashar Khan - SAC Capital - Analyst**

Okay. And Paul, can I just get a little bit -- I know DENA is an objective for '05, but could you just share your objectives for the other businesses going into '05. What we should be expecting?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well, I think we're a little premature on that. Just to give you sort of our timeframe here, we have our review with the Board in December, where we set '05 objectives. And that will include setting the earnings target for the incentive system and individual objectives for each one of the business units. And following that, I would expect that we will go through those objectives with the street. First of all, we're going to discuss them with the people that have to carry them out, which is probably appropriate. And then shortly after the first of the year, we'll work out a mechanism that we can convey those to the street.

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**Ashar Khan - SAC Capital - Analyst**

Okay. Thank you very much.

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**Operator**

We will now go to Vic Khaitan of Deutsche Asset Management.

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**Vic Khaitan - Deutsche Asst Management - Analyst**

Yes, thank you. And again, very good progress this year, Paul and others. The question really is that as you start building up free cash flow and your debt reduction is quite good, will the free cash flow go mostly back to the shareholders? Or what maybe the prospect for even a dividend increase?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well, I guess my order of priorities when we have free cash flow is assuming that we have an appropriate balance sheet and have

debt reduced, is to first of all look for profitable investments that obviously get more than their cost of capital and allow us to grow the Company. To the extent that we have more cash than we can utilize that way, there's no question that it ought to be returned to the shareholders. And the alternative as to how you return it will really depend on two things. One is the tax regime at that point in time, and secondly, what's the price of our shares. If the price of the shares is unusually low, then it might make sense for share buyback. But given a robust share price and a favorable tax regime, dividends look pretty attractive.

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**Vic Khaitan - Deutsche Asst Management - Analyst**

Okay. And the other question is regarding your main business, the core business. Are there any issues with respect to environmental spending or anything else which might cause some pickup there?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well, we have outlined the spending that we have under the Clean Air Act and what we're doing in terms of actually getting out of ahead of that in the Carolinas. But there's nothing coming down the pike that we're aware of right now that would surprise us or derail us.

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**Vic Khaitan - Deutsche Asst Management - Analyst**

Thank you very much.

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**Operator**

Our next question is from Dan Eggers of Credit Suisse First Boston.

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**Dan Eggers - Credit Suisse First Boston - Analyst**

Good morning. First question. On Crescent, just to make sure I understand this -- it sounds like the net cash flow numbers this year are quite strong, and quite a bit better than what normalized levels would be, even with a smaller deviation in earnings between this year and normalized. Can you help explain what's accounting for that difference?

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**David Hauser - Duke Energy - CFO & Group VP**

Well, this year, we had set out to achieve \$400 million of net positive cash. And so that was the game plan at the beginning. We had been making significant investments over the last few years, especially up in the Arlington area and the Palmetto Bluffs area. And so we have had some good success, especially in the Arlington area, with property sales. So that's what drives the net

\$400 million. On a run rate basis, we expect to deploy capital into Crescent and pull capital out of Crescent. But net of all of those, we expect to have \$100 million net cash coming back to the parent each year. So that's where we're heading. This year was abnormally large as far as the amount coming back to the parent.

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**Dan Eggers - Credit Suisse First Boston - Analyst**

What is the asset base or I guess the inventory of real estate at book for you guys at Crescent right now?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well, we've continued to build the inventory. It's not like we've depleted the inventory. We just called on some high cash sales, if you will, to be able to get some cash back. I don't know that we have an actual number.

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**David Hauser - Duke Energy - CFO & Group VP**

I don't have the number of acres. The book value is well over \$1 billion at Crescent.

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**Paul Anderson - Duke Energy - Chairman & CEO**

There's still plenty of inventory out there. And long-term, we have said we would expect Crescent to generate in the neighborhood of about \$150 million a year segment EBIT, and have free cash back to the parent company of about \$100 million a year. It was just for this year, because there was so much question around maintaining the dividend. I basically struck the deal with Art Fields, that it's your year to make a big contribution. And he seems to be stepping up to the plate.

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**David Hauser - Duke Energy - CFO & Group VP**

Dan, let me give you one other data point. If you look at on our balance sheet, we'll have investments in residential and commercial and multifamily as a separate line when we do the 10Q. And that number will be right at \$1.3 billion.

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**Dan Eggers - Credit Suisse First Boston - Analyst**

Got it. Thank you. Will you do me a favor and remind what the debt-to-cap targets are for you guys just as you continue to generate cash and pay down debt?

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**David Hauser - Duke Energy - CFO & Group VP**

Well we've started the year with Duke Energy at 58 percent debt. Now we're 55 percent debt. We would expect to be 51 percent by

year end. If we look going forward, if we had a 50-50 kind of balance sheet, that would be a very strong balance sheet. Keep in mind that we have substantial Canadian operations that are much more leveraged than 50-50, and are regulated in nature. So you're really not going to change those leverages. So if you got the total balance sheet to 50-50, that means things other than the Canadian operations are leveraged less than 50-50.

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**Dan Eggers - Credit Suisse First Boston - Analyst**

Just one last one. If you look at interest expense at \$1.3 billion for this year and take the first nine months, that maps out to about \$265 million for the fourth quarter. Is that a bad number to use? Or should we bump it up, assuming you go a little over \$1.3 for the year?

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**David Hauser - Duke Energy - CFO & Group VP**

I would not assume we'd end up over \$1.3 for the year.

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**Dan Eggers - Credit Suisse First Boston - Analyst**

Got it. Thank you.

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**Operator**

We will now go to Allie Agha of Wells Fargo Securities.

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**Allie Agha - Wells Fargo Securities - Analyst**

Thank you. I wanted to clarify some of the goals that you've laid out for DENA for quite a while with us. You know, in the past, you always said your goal was to get to breakeven for DENA in '06. Some of your recent slides I saw mentioned that the goal was to get DENA breakeven by the end of '06. I just wanted to clarify there was a change in your thinking, as far as the breakeven target.

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**Paul Anderson - Duke Energy - Chairman & CEO**

I think we've always thought by the end of '06. I don't know that all of our material has necessarily specified end of '06 as opposed to '06, but it is the end of '06. Actually, as I've said on many occasions, we really don't have the patience to wait to the end of '06. We'll be trying to restructure DENA or look for a transaction during '05. And, if we're successful, DENA will be in a very different shape during '06.

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**Allie Agha - Wells Fargo Securities - Analyst**

Okay. And also, when you've given us the data on the amount of the output of capacity at DENA that's hedged for '05 and '06,

you've given in terms of the pricing that goes with that. Can you give us a little better flavor of the underlying spot spread? Does that get any better? Is it flat? Is it worse than how '04 hedge spot spread looked?

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**Fred Fowler - Duke Energy - COO**

Basically, on our older hedges, they will be worse. On the newer stuff that we're putting on, we're putting on some better stuff at this point.

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**Allie Agha - Wells Fargo Securities - Analyst**

On average, would it be fair to say it trends down a bit?

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**Fred Fowler - Duke Energy - COO**

Yes.

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**Allie Agha - Wells Fargo Securities - Analyst**

Okay. And my final question, David, I just want to clarify on the interest expense, if the numbers I look at are right, sequentially, interest expense went up slightly from Q2 of '04. Can you remind me of why that was the case?

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**Myron Caldwell - Duke Energy - Treasurer**

There were really two items that were special items. One was the cost associated with the equity units re-marketing efforts. We did an exchange and there were some premiums that were expensed. And then second, we also expensed some costs associated with fees that were incurred when we issued the trust preferred. We normally amortize those over time. So we'd have to write those off. So those are the two special items.

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**Allie Agha - Wells Fargo Securities - Analyst**

I see. Thank you.

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**Operator**

Michael Goldenberg of Luminous Management is next.

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**Michael Goldenberg - Luminous Management - Analyst**

Hey, good morning, guys. Congrats on the good quarter. And actually, I just wanted to touch a bit on the mark to market. I guess when you talk about DENA for '05 and you have this \$150 million

number, just wanted to make sure, does that include any potential shifts from mark to market? Or is that basically uncontrolled and whatever happens happens?

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**Paul Anderson - Duke Energy - Chairman & CEO**

We would expect to basically be down to just normal mark-to-market movements. But the '05 objective would include those normal mark-to-market movements.

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**Michael Goldenberg - Luminous Management - Analyst**

What is normal?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Well just, in the course of doing business, we have a movement here and a movement there. But the disqualified hedges are where we got the big movements earlier this year and in fact, we've been seeing throughout the year, which is where we ended up with the hedges that got disqualified when we sold our Southeast and discontinued operations, or at least listed them as discontinued. And those were an unusually large book of mark-to-market exposure. But the normal mark-to-market exposure will be much less.

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**David Hauser - Duke Energy - CFO & Group VP**

Yes, let me just add one thing. You will always have the potential for a little bit of hedge ineffectiveness. And in the business, you also have a little bit of mark to market going forward even after you solve the issues surrounding the disqualified hedges. In the \$150 million, that's extremely inconsequential to us.

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**Michael Goldenberg - Luminous Management - Analyst**

So basically, \$150 million roughly doesn't include mark to market, nor do you expect mark to market to be anything significant in 2005?

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**David Hauser - Duke Energy - CFO & Group VP**

That's a fair way to say it. While the mark to market movements are in the \$150 EBIT loss, we do not expect them to be significant.

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**Michael Goldenberg - Luminous Management - Analyst**

Okay. And the \$40 million that happened this quarter, just to be sure, that's not considered normal?

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**Paul Anderson - Duke Energy - Chairman & CEO**

That's not considered normal. There was a little bit of normal in there, but the vast majority is because of the disqualified hedges.

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**Michael Goldenberg - Luminous Management - Analyst**

Okay. And nothing like that is expected in '05?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Right.

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**Michael Goldenberg - Luminous Management - Analyst**

Thank you very much.

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**Operator**

And we'll go to Zach Schreiber of Duquesne Capital.

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**Zach Schreiber - Duquesne Capital - Analyst**

Just a question on this open season. I was just wondering if you can tell us sort of how much of your pipeline capacity is sort of up for recontracting in this open season? Can you sort of paint a picture for us on this pipeline capacity, how much of it is sort of at the maximum for allowable tariff? If that capacity in the market right now, based on the base of spreads, is trading at a premium to the maximum tariff, or a discount? And generally speaking, should we be expecting a ratcheting up in the growth for natural gas transmission from this open season? A ratcheting down if that market is oversupplied? Or just a sort of normal 4 to 5 percent growth rate out of that business with this sort of roll off and repricing of that capacity? Thank you.

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**Fred Fowler - Duke Energy - COO**

Yes, I think the open season really, as Paul said a little earlier this is geared more toward probably three years out. It will primarily be at regulated type returns at full rates. This is a guess at this period, but just based on the nature of the kinds of business, I would say it would probably come on somewhat ratably over a three or four-year period.

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**Paul Anderson - Duke Energy - Chairman & CEO**

Just to clarify, because based on your question, I'm not sure that your view of an open season is quite what we did. The idea of an

open season is to let people bid for new capacity as opposed to rebidding the capacity that's already there.

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**Zach Schreiber - Duquesne Capital - Analyst**

Got it. So the open season is on some of the expansion projects that you've done?

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**Paul Anderson - Duke Energy - Chairman & CEO**

Right. Yes, it's what new capacity would customers like as opposed to putting up the existing capacity for some kind of rebidding.

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**Zach Schreiber - Duquesne Capital - Analyst**

I got you. So basically what the open season would do is it would support the underlying economic rationale to commit more capital for that business.

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**Paul Anderson - Duke Energy - Chairman & CEO**

Exactly. Yes, so you don't build on spec; that's the basic idea.

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**Zach Schreiber - Duquesne Capital - Analyst**

Got it. Just following up then, to get to my misguided first question, where are we? It was an issue five years ago or so, in this whole sort of glut of capacity that seems like it sort of got burned off, or all those fears went away. Where are we in sort of the contract roll off of the existing pipeline? Are we under maximum allowable rates for the next 20 years? Or is that something that you're thinking about as this stuff rolls off and kind of retaking some of the existing stuff to market, not building new stuff against the open season?

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**Fred Fowler - Duke Energy - COO**

Yes, we have capacity that does roll off every year and a half for, literally since the implementation of 436 and 636. We continue on our systems to sell it out each year. We have not had to discount it to sell out that capacity. I think the average life on all of our systems, I think approaches nine years.

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**Zach Schreiber - Duquesne Capital - Analyst**

So it's safe to say then that as the contracts roll off, they're rolling off at the deferred maximum allowable rate? And when they're rolling back on, they're rolling on at deferred maximum allowable rate?

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**Fred Fowler - Duke Energy - COO**

Yes, it has been going through this phenomenon now for probably five years. And we've not had a year where we didn't renew it at the max allowed rate.

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**Zach Schreiber - Duquesne Capital - Analyst**

So it's about 10, 15 percent a year that rolls off?

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**Fred Fowler - Duke Energy - COO**

Somewhere in that range. Yes, several years ago, we had some kind of big cliffs, and we went out and renegotiated contracts with our customers to more levelize how they rolled off.

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**Zach Schreiber - Duquesne Capital - Analyst**

So when we model up, natural gas transmission, this is not a major issue for us to think about. But we ought to be thinking about is sort of the open season, expansion projects, and if there's enough interest to support new capital investment?

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**Fred Fowler - Duke Energy - COO**

Yes.

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**Zach Schreiber - Duquesne Capital - Analyst**

Got it. Thanks so much, guys.

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**Operator**

And I'll turn the call back over to Mr. Ebel for closing remarks.

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**Greg Ebel - Duke Energy - VP of Investor and Shareholder Relations**

Thanks very much, everybody, for joining us. And as usual, the investor relations team here at Duke is available to take any of your questions throughout the day and the coming days. Thanks very much. See you next quarter.

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**Operator**

This concludes our conference for today. We thank you for your participation. You may disconnect at this time.