



Conference Call Transcript

DUK - Q3 2009 Duke Energy Corporation Earnings Conference Call

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CORPORATE PARTICIPANTS

Stephen De May

Duke Energy Corporation - SVP - IR, Treasurer

Jim Rogers

Duke Energy Corporation - Chairman, President, CEO

Lynn Good

Duke Energy Corporation - Group Executive, CFO

CONFERENCE CALL PARTICIPANTS

Jonathan Arnold

Deutsche Bank - Analyst

Lasan Johong

RBC Capital Markets - Analyst

Michael Lapidès

Goldman Sachs - Analyst

Paul Patterson

Glenrock Associates - Analyst

Dan Jenkins

State of Wisconsin Investment Board - Analyst

Ashar Khan

Incremental Capital - Analyst

Daniele Seitz

Dudack Research - 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 and introductions I would like to turn the call over to Mr. Stephen De May, Senior Vice President - Investor Relations and Treasurer. Please go ahead sir.

Stephen De May - Duke Energy Corporation - SVP - IR, Treasurer

Thank you Jamie and good morning everyone and welcome to Duke Energy's third quarter 2009 earnings review. Leading our discussion today are Jim Rogers, chairman, president and chief executive officer; and Lynn Good, group executive and chief financial officer. Jim will begin today's presentation by providing a general overview of the quarter's results. Then Lynn will provide more detail and context around the quarterly results for each of our businesses including an update on our sales volumes. Jim will close with updates on our key regulatory initiatives and our major capital programs. He will also have an update on federal climate legislation currently being debated in the U.S. Senate. Following those prepared remarks, we will open the lines for your questions.

But before we begin, let me take a moment to remind you that some of the things we will discuss today concern future company performance and include forward-looking statements within the meanings of the securities laws. Actual results may materially differ from those discussed in these forward-looking statements. You should refer to the additional information contained in Duke Energy's 2008 Form 10-K filed with the SEC, as well as our other SEC filings, concerning factors that could cause those results to be different than contemplated in today's discussion. In addition, today's discussion includes certain non-GAAP financial measures as defined under SEC Regulation G. A reconciliation of those measures to the most directly comparable GAAP measures is available on our Investor Relations' website at www.duke-energy.com. With that business out of the way I'll turn the call over to Jim.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Thank you, Stephen. Good morning everyone. Thank you for joining us today and thank you for your interest and investment in Duke Energy. Before I begin, let me formally introduce Stephen De May to all of you, many of you already know Stephen in his role as Senior Vice President and Treasurer. Recently he assumed additional responsibility for Investor Relations. Stephen has been with Duke Energy since 1990 and has had increasing responsibilities in our Treasury and Finance areas. Most recently he also served as our Chief Risk Officer. Bill Currens, our General Manager of Investor Relations will report to Stephen in his new role. Combining Treasury and Investor Relations creates a strong focus for serving our debt and equity investors.

Turning to slide 3 we announced adjusted diluted earnings per share of \$0.40 for the third quarter of 2009 versus \$0.33 in the third quarter of 2008. Reported results for the third quarter were \$0.08 compared to \$0.17 for the same period last year. As Lynn will review with you in a few moments, the reported results were impacted by non-cash impairment charges of approximately \$400 million or \$0.31, primarily related to goodwill associated with our non regulated generation operations in the Midwest.

Despite continued lower electricity sales during the quarter, our strong focus on cost control measures and operational performance continued to yield positive results. With the third quarter- historically our most significant quarter- behind us, we remain slightly ahead of our internal plan. Except for any unforeseen developments, we are on track to achieve our 2009 employee incentive target of \$1.20 earnings per share on an adjusted diluted basis. Achievement of the incentive target assumes normal weather, continued success with our cost control efforts, strong operational performance and no deterioration in the economy for the remainder of the year.

I'm very pleased with where we are at this point. We remain on target to reduce our 2009 operation and maintenance expenses by \$150 million. I am especially proud of our employees' continued focus on executing on our business strategy for the long-term, despite the near-term challenges posed by the sluggish economy. The recent proposed settlement of our North Carolina rate case which I will discuss in more detail later is an excellent example of how we are executing on our strategy in a manner that balances the needs of our customers and our investors. Let me now turn it over to Lynn to discuss in detail the quarterly results for each of our businesses.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Thank you Jim, let me begin with slide 4 and review the results of our largest segment, US Franchised Electric & Gas. For the third quarter 2009, the segment reported adjusted EBIT of \$716 million this compared to \$726 million in the prior year. The decline in the segment's results was driven by unfavorable weather, the expiration of a one-time rider in North Carolina in 2008, and lower weather-normalized sales volumes across all jurisdictions. These negative drivers were partially offset by lower operation and maintenance costs, increased rates and riders in Indiana, lower depreciation rates in the Carolinas, and increased Equity Allowance for Funds Used during Construction or AFUDC.

When compared to the same quarter last year, weather had a \$46 million negative impact on the segment's results. As we indicated in our last earnings call we experienced an unusually mild July in both the Carolinas and the Midwest. Cincinnati for example experienced its coolest July on record while Indianapolis experienced its second coolest July on record. The weather in both the Carolinas and the Midwest returned to near normal conditions in August and September. The expiration at the end of 2008 of a one-time rider related to the sharing of merger savings in North Carolina also had a negative impact on the segment's results. During the third quarter of last year, \$27 million was collected in rates under this rider. As we discussed on our previous calls this year, the decreased weather-adjusted sales volumes are being driven largely by our industrial customers who continue to feel the effects of the downturn in the economy. On a weather-normalized basis, lower sales volumes had a negative quarter-on-quarter impact of approximately \$22 million on the segment's results. I'll talk more about sales volumes in just a moment.

These negative drivers were largely offset by \$33 million in lower O&M costs principally due to prior year storm restoration costs of \$48 million related to wind damage in the Midwest from the remnants of Hurricane Ike. Hurricane Ike is the single largest driver to our year over year variance. But as I look at the underlying operating and maintenance expenses for the quarter, our operation's team continues to exercise great cost discipline and we are on target to achieve our reductions in O&M for the year.

Rate changes in Indiana continue to have an overall positive EBIT impact due to increases of approximately \$21 million primarily related to riders for the environmental capital and IGCC costs. In addition revised depreciation rates in the Carolinas resulting from updated depreciation studies resulted in a \$16 million reduction in depreciation and amortization. Lastly as a result of our capital expenditure program, including Cliffside in the Carolinas and Edwardsport in Indiana, equity AFUDC for the third quarter 2009 was \$43 million, an increase of approximately \$8 million.

I would now like to provide additional context around our sales volumes and this quarter, I'm going to review industrial volumes first because I believe we are seeing further signs of stabilization. On slide 5 we have highlighted sales volumes for each of our top three industrial classes, as well as our total industrial class from 2007 to the present. As you know weather does not typically have a material impact on industrial volumes but I should point out that this data is not weather-normalized. You can see that volumes began to drop in the fourth quarter of last year. However you will also notice that from the second quarter to the third quarter of 2009 volumes increased in each of our major industrial classes – primary metals, textiles and chemicals– and returned to levels we had not experienced since the fourth quarter of last year. The increase in total industrial volumes from second quarter 2009 to third quarter was approximately 11%.

As we look to the future it is difficult to determine whether this level of growth is sustainable or to predict the timing of a permanent resurgence in demand. But we believe we may have seen the worst and are seeing clearer signs of stabilization. As we did in July, we surveyed our largest industrial customers about their production plans for the balance 2009 and 2010. A few customers see moderate improvement. Others see current production levels being maintained for the remainder of 2009 continuing in '10. However the overall mood of our industrial customers seems to be somewhat more optimistic than it was in July. We will continue to have ongoing discussions with our major industrial customers to identify trends for the future.

Now let me step back from industrial volumes and talk about our overall sales volumes for the quarter. On an overall basis our weather-normalized electric volumes were down approximately 3% or \$22 million when compared to the third quarter of 2008. The net margin impact of the volume decline was just over 1%, quarter-over-quarter. The percentage decline in retail sales volumes is less than what we experienced in the first half of 2009 primarily due to the improvement in industrial sales that I outlined in the last slide and the continued positive contribution from our residential class. On a weather-normalized basis during the third quarter, our residential sales volumes remain slightly positive increasing approximately 2%, while our commercial volumes remain slightly unfavorable. Compared to the prior-year third quarter, we have continued to experience a moderate increase in our customer base in the Carolinas. However, in the Midwest, we have experienced a slight decrease. The pace in customer additions continues to slow as compared to previous periods. As we look to the fourth quarter we expect industrial volumes to be at a level that is consistent with our experience in the third quarter and residential and commercial weather-normalized volumes to be consistent with the fourth quarter of 2008. We will continue to closely analyze monthly and quarterly results over the balance of the year and share our expectations for longer term retail load growth with you in February at our annual analyst conference.

With that I'll move on to slide 7 and review Commercial Power's results. Adjusted segment EBIT for Commercial Power for the quarter was \$182 million compared to \$93 million in the third quarter of '08. Commercial Power's favorable results were driven by an increased contribution from our Midwest gas-fired assets and improved retail margins. During the quarter, our Midwest gas-fired assets contributed \$32 million of adjusted EBIT, due to higher generation volumes and PJM capacity revenues. Third quarter sales volumes were approximately 250% higher than prior-year sales volumes. The absence of \$15 million in receivable write-offs recorded in the third quarter of 2008 on power sales to Lehman Brothers also drove the improved contribution from our Midwest gas-fired assets.

The improved retail margins were primarily due to increased rates in Ohio of \$24 million, resulting from the implementation of the Electric Security Plan or ESP at the beginning of this year and the absence of unfavorable timing of the collection of fuel and purchased power costs of \$28 million which occurred in the prior year. These positive drivers to retail margins were partially offset by a \$14 million decrease in retail volumes and a \$13 million negative impact from milder weather. Another positive driver for Commercial Power was \$13 million of gains on non-native coal sales.

Now let me take a few minutes to discuss the impairment charge of approximately \$400 million primarily related to goodwill and associated with our non-regulated generation operations in the Midwest. I'll point out that the charge has been excluded from adjusted diluted EPS for the quarter. First, I'll provide a little background. Goodwill impairment tests require point-in-time estimates of the fair value of our businesses based on observable market values, internal forecasts, and other factors. The tests are performed annually as of the same date each year, and our annual assessment date is August 31st. As of that date we had \$4.7 billion of goodwill on our books, approximately \$900 million of which is related to our non-regulated generation operations in the Midwest. The remaining goodwill is related to our regulated businesses, our wind business, and our international business.

The principal factors that contributed to the recognition of the goodwill impairment were depressed, current and forward power prices and reduced customer load, reflecting the impact of the current recession. Further, we considered a range of potential outcomes on the fair value of the business, resulting from the impact of future carbon legislation and post-Electric Security Plan pricing in Ohio. Since we performed our goodwill assessment in August of 2008 these factors have had a greater impact on our operations, reflecting the effect of the current recession on load and commodity prices, progress on climate legislation and developments in the Ohio market. This impairment represented less than 10% of our consolidated goodwill balances and is a non-cash charge. It does not impact our liquidity or compliance with any of our debt or credit

facilities. Let me move to slide 8 and close the discussion of our commercial businesses with an update on customer switching in Ohio. As we pointed out during our second quarter earnings call, the competitive market in Ohio and low wholesale power prices has resulted in an increase in customer switching. Overall on a gross basis the percentage of customer volumes that have switched from our Electric Security Plan rate in Ohio rose from 10% at the end of the second quarter to around 30% as of September 30th. Our competitive retail arm, Duke Energy Retail Sales has been very active in the Ohio market, retaining customers inside our service territory and attracting new customers outside of our service territory. As a measure of our success to date we believe it is appropriate to consider our net switching percentages, after consideration of the customers retained by Duke Energy Retail Sales. Through the end of September, our net switching percentage across all customer classes, after consideration of the volumes sold by Duke Energy Retail Sales, was around 10%. For the third quarter, the financial impact of net customer switching was not significant.

The competitive market in Ohio is driving down generation margins, but we are successfully competing and retaining customers at a profit. Taking into consideration switching levels through September 30th, we estimate that the negative earnings per share impact of customer switching for 2009 will be modest in the range of \$0.02 to \$0.03 reflecting the offsetting impact of margins earned by Duke Energy Retail Sales and incremental margins earned in the wholesale market. For Commercial Power as a whole, we still expect to achieve the 2009 adjusted segment EBIT target of \$470 million. As the competitive pressures in Ohio have accelerated we have acted accordingly through Duke Energy Retail Sales to retain our customers and maximize our margins. You can expect that we will continue to actively manage our business in Ohio.

Now let me turn to slide 9 and discuss the results of our International business segment. For the third quarter of 2009 Duke Energy International reported adjusted segment EBIT of approximately \$100 million, compared to \$77 million in last year's third quarter. DEI's favorable results were driven by a \$35 million improvement in Peru operations due to lower commodity costs and improved dispatch of generation. In addition, improved results in our Central American operations had a \$22 million positive impact on DEI's results primarily due to favorable plant dispatch as a result of hydrology. These positive drivers were partially offset by a reduced contribution from our operations in Brazil of \$14 million due primarily to a prior year transmission credit adjustment, and a \$12 million reduced contribution from National Methanol driven by lower commodity prices. In addition, unfavorable average foreign exchange rates had an \$8 million negative impact on DEI's results.

Next I'll review our Other segment on slide 10, which primarily includes costs associated with corporate governance, Duke Energy's captive insurance company and our real estate joint venture, Crescent Resources. Other reported a third-quarter 2009 adjusted net expense from continuing operations of \$57 million, compared to \$70 million in the third quarter of 2008. The \$13 million decrease and Other's net expense was primarily due to the absence of a \$10 million adjusted equity earnings loss at Crescent incurred in the third quarter of 2008. I'll re-emphasize that Duke Energy has no material exposure to Crescent performance guarantees and continues to have a zero book basis in its investment in Crescent. Further, Crescent's debt is non-recourse to Duke Energy.

I also want to touch briefly on a few items that are in the appendix of this presentation. The first is our strong balance sheet and liquidity position. As of September 30, we have total available of liquidity of approximately \$2.6 billion. During the quarter, we continued to have strong access to the credit markets. This is evidenced by our issuance of fix-rate financings during the third quarter of 2009 of \$1.1 billion at a weighted-average rate of 4.5%. A portion of these financings represent prefunding of our anticipated 2010 cash needs. Additionally, our strong liquidity will be further bolstered by approximately \$400 million from tax incentives that we expect mostly in 2009 under the provisions of the stimulus package and cash tax benefits of approximately \$300 million, related to repairs deductions due to an IRS approved change in our method of capitalization for tax purposes. As a result of our strong liquidity position, we are evaluating the prefunding of a 2010 pension contribution of up to approximately \$300 million in 2009. This would be an acceleration of a contribution we otherwise had planned for 2010.

The next item in the appendix that I want to point out is a change in our effective tax rate. We now expect our effective tax rate for 2009 to be approximately 42%. This reflects the effect of the non-cash goodwill impairment which is not deductible for tax purposes. Excluding the effect of the goodwill impairment charge, we expect the effective tax rate to be approximately 35% for 2009. More details on our credit and liquidity as well as our other non-operating financial items can be found in the appendix.

I'll close by saying that we believe we have managed through the challenges we've faced this year. As we have shared with you during the year, we have worked aggressively to respond to the current economic conditions. We are on target to achieve the \$150 million reduction in our 2009 O&M expenses. Even with signs of potential economic recovery we expect that the final months of '09 will be challenging. So for the remainder of the year, we will continue to do what we have been doing, focusing on those things we can control such as our costs, capital spending and operational performance. Those efforts will keep us on track to achieve our employee incentive of \$1.20 per share on an adjusted diluted basis. And with that I'll turn the call back over to Jim.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Thank you, Lynn. Let me now update you on some of the key regulatory legislative and other initiatives we are pursuing. I'll start with the two major rate cases we have pending, one in North Carolina and the other in South Carolina. The outcome of these filings are obviously very important to the company's financial health and strength going forward as we seek to add over \$3.1 billion of rate base in the Carolinas. Last week we announced that we had reached a settlement with the Public Staff in our North Carolina proceeding. I am pleased to report that since that announcement two groups representing our large industrial customers have also signed on to the settlement agreement. We filed the settlement with the North Carolina Utilities Commission and just this week concluded hearings on the case and the proposed settlement. We are hopeful that the Commission will issue an order by the end of the year. Let me discuss the key points of the settlement agreement.

As slide 11 shows, the proposed settlement calls for a base rate increase of \$315 million, or almost 8% primarily phased in over two years. This will be our first increase in base rates since 1991, and results in the inclusion of about \$1.7 billion of new plant additions into our rate base. The settlement provides for a 10.7% return on equity and a capital structure consisting of 52.5% equity. In addition, we will collect approximately \$14 million of carrying costs on our coal inventory balances. As you all know, coal inventories are up for the remainder of '09 as the weak economy has reduced plant output.

We took several intentional steps to mitigate the impact of the proposed increase on customers' bills in these challenging economic times. First, we agreed to a one-year deferral of the revenues associated with the Construction Work in Progress on our new Cliffside Unit 6 project. Under the settlement, cash recovery of Cliffside CWIP will begin January 1, 2011. In addition to the one-year delay in collecting Cliffside CWIP, we agreed to accelerate the return of a fuel over-collection and certain insurance dividends. I should note that while these rate-reducing mechanisms do affect cash they are earnings neutral to the company. We believe that the proposed settlement, if approved by the Commission, represents a constructive outcome that strikes a balance on behalf of our customers and investors. This is especially important in this recessionary environment. The settlement results in rate base growth and effective cost recovery for us, while phasing in the bill impact to our customers. From our customers' perspective, this means an average increase to customer bills of 3.8% in 2010, and an additional 3.2% in 2011. As part of the settlement, we also agreed not to implement another base rate increase prior to January 1, 2012. This settlement positions us well for the future, and reflects our focus on improving our earned returns over time. Because of the strength of our balance sheet, we were able to slightly delay certain cash collections in recognition of the economic environment, while, at the same time, achieving the inclusion of all plant additions requested by the company and updated through September, 2009. We expect our earned returns in the Carolinas to increase in 2010 by roughly 50 to 100 basis points over 2009.

Let's turn to slide 12. In South Carolina, we have requested a \$128 million increase in base rates. Our filing included a proposal to reduce the requested increase to approximately \$100 million. This is due to our plan to refund money collected from customers in excess of costs incurred for past energy efficiency and demand side management programs. We have proposed to return the money through monthly bills over approximately five years. Like North Carolina, our request in South Carolina seeks our first base rate increase since 1991. The filing includes a proposed return on equity of 11.5% and a capital structure reflecting a 53% equity ratio. Our South Carolina filing also requests cost recovery under our save-a-watt plan of our energy efficiency programs which were approved by the Commission. The Office of Regulatory Staff and intervenors are scheduled to file their testimony next Monday. We will file our rebuttal testimony November 12th. The Commission will start its evidentiary hearings on November 30th. January 27th is the statutory deadline for the South Carolina Commission to rule and issue its order. We expect the new rates to be in effect in early 2010. As we did in our North Carolina rate case, we continue to work with the parties involved to explore opportunities for a constructive settlement. As we've said before, even with our proposed increases both our North Carolina and South Carolina rates will remain well below the national average. We have made good progress on our other regulatory initiatives this year as well as evidenced by the regulatory update we have included in the appendix to this presentation.

Let me now turn to slide 13 to give you an update on our two largest capital projects, Cliffside in North Carolina, and Edwardsport in Indiana. Let me first say that in light of the EPA's intention, announced just last week, to issue new air pollution rules for older coal and oil-fired power plants, our fleet modernization strategy has never looked better. The supercritical pulverized coal plant with state-of-the-art pollution control technology at Cliffside, and the super-clean IGCC plant at Edwardsport, are the lynch-pins of our resource strategy. They will bridge us to a low-carbon world, and prepare us for more stringent regulations of emissions from our coal plants in the future. The construction of both of these plants gives us the ability to retire older, smaller and less efficient coal units on our system while continuing to meet our customers' growing demand for electricity in a reliable and cost-effective manner. For the Cliffside Unit 6 construction as of September 30th, we have spent approximately \$900 million of the estimated \$1.8 billion in capital excluding AFUDC. The overall modernization project is almost 50% complete and is on schedule to serve our customers in the summer of 2012. Recall that in addition to building a new Unit 6, the Cliffside Modernization Project also includes the addition of a scrubber on the existing Unit 5 and the retirements of Unit 1 through 4 when the new Unit 6 comes on line. At Edwardsport in Indiana, as of September the 30th, we spent approximately \$900 million of the estimated \$2.2 billion in capital, excluding AFUDC, and the project is approximately 40% complete. It is also on schedule to serve our customers in the summer of 2012.

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As you may recall we have CWIP riders in place for the Edwardsport project. The rider is updated every six months to recover the financing costs associated with the plant's construction. Our third CWIP rider, filed in May and awaiting Commission approval, would bring the cumulative plant amount on which we can collect financing costs from retail customers to approximately \$500 million, or about \$50 million in annual revenues. We expect to file a fourth CWIP rider in early November using the September plant balances. In our May CWIP update filing with the IURC, we discussed certain cost pressures we're experiencing at the site. These pressures have continued due in part to design and scope changes as the project moves from the engineering phase into the construction phase. In our November CWIP filing with the Commission we will provide updated estimates to the projected project costs taking into account these recent developments. Recall that the Commission has engaged a consultant, Black & Veatch, which has personnel on site at Edwardsport closely monitoring every step of our progress on this important project. One final note about Edwardsport, you may recall that last summer we filed plans with the Indiana Commission proposing to invest approximately \$121 million for a detailed, three-year study to explore the capture and permanent storage of a portion of the CO₂ produced at the Edwardsport site. Today we will file our rebuttal testimony for this plan and, hearings are scheduled for November 9th and 10th.

Before I close, let me give you my view on where the Senate's climate change bill is headed. The latest version of the bill was released just -- late last week. Our focus continues to be on cost containment, and whether the bill does enough to protect consumers in high-coal using states in the industrial Midwest and Southeast, through its emissions allocation formula. We're also focused on the early days of the carbon market to ensure that it will work smoothly and there will be sufficient offsets to minimize costs. We have concerns with the current form of the Environmental and Public Works Committee bill as it takes too many allowances away from utility consumers. The bill also doesn't do enough to ensure that costs will be contained in the early years of the program. On the other hand, the consideration by the Committee is just the start of the process. Once out of Committee, the bill will continue to be changed to secure the necessary 60 votes needed for passage. In this regard, we were pleased to see an op-ed in the New York Times earlier this month, co-authored by Senator Lindsey Graham, Republican of South Carolina, and Senator John Kerry, Democrat of Massachusetts. Their column proposed an approach for creating a bi-partisan consensus for a fair and workable climate legislation. The proposals they outlined can serve as a framework for a bill that receives the necessary support of both Democrats and Republicans. Of note these two Senators, who have very different political views, were united in recognizing that a strong emphasis on developing new nuclear plants must be part of any strategy to decarbonize U.S. power generation. I agree with this view. I look forward to working with these two Senators and others to craft final legislation that will protect the environment and our customers. I would also like to highlight the agreement we signed last week with China-based ENN Group to jointly develop large-scale and distributed commercial solar power projects in the U.S. This agreement complements our growing wind energy and other renewable energy businesses. We were also pleased to learn this week that the Department of Energy allocated more than \$200 million in stimulus funding for our Midwest smart grid deployment and our Carolinas transmission projects.

In closing, the last three quarters have been challenging, but we are pleased with our performance year-to-date. We continue to focus on what we can control, including improving our operational performance and managing our costs. In the appendix to this presentation, you will find our updated Operations Score Card. We didn't cover it today, but I want to emphasize that we have been able to achieve our cost control objectives while at the same time, operating our assets efficiently and safely to deliver reliable electricity and gas to our customers. To summarize through September 30th, '09, one, we are on track to achieve our 2009 employee incentive target of a \$1.20 of adjusted diluted earnings per share. Two, we have raised \$2.75 billion in debt at favorable rates. Three, we currently have a dividend yield of approximately 6%. Four, through September 30th, 2009 our total return to shareholders has outperformed the Philadelphia Utility Index on a year-to-date one-year and three-year annualized basis. Additionally through yesterday we had year-to-date TSR of 12.5% as compared to 1.5% for the Philadelphia Utility Index. Finally, we continue to have one of the strongest balance sheets in our industry and we are committed to keeping it strong. Let me remind you that we will be at the EEI Financial Conference next week. We look forward to seeing many of you all there. Additionally, we will hold our analyst meeting in February in New York City. Look for the details about that meeting shortly. Now, let's take your questions.

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QUESTION AND ANSWER

Operator

(Operator Instructions) We'll first hear from Jonathan Arnold with Deutsche Bank.

Jonathan Arnold - Deutsche Bank - Analyst

Good morning guys.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Good morning Jonathan.

Jonathan Arnold - Deutsche Bank - Analyst

I wanted to ask about Ohio and what you have said about competition. And specifically, you mentioned that you think it is going to be a drag of \$0.02 to \$0.03 in 2009. And I imagine the pace of switching and the like didn't really kind of get under full way until sometime in the year, so is it reasonable to assume like a similar drag into 2010 as you get a full year impact? Or something less? Something more? How should we think about that?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Jonathan, good question, you know the \$0.02 to \$0.03 as you indicated represents the downward pressure for this year. And the switching began to pick up about half way through the year. I think that is a reasonable basis for you to consider as you think about '10. But we will give you a fuller perspective on guidance for '10 when we come back in February. Because the segment in total has many moving parts to it, gas assets, capacity revenues, wholesale prices and our wind business over time will contribute in that area as well. So I think those are the factors that you should be thinking about for '10.

Jonathan Arnold - Deutsche Bank - Analyst

And if I could follow up on the switching, are you seeing a moderation in the pace of the gross switching currently? Or -- is it still going as kind of full tilt?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

You know it is difficult to measure pace, Jonathan, because we're talking about something that has occurred over a month or two. I think we'll have a better sense as we have more time passing.

Jonathan Arnold - Deutsche Bank - Analyst

Okay. And if I may, just on another topic, if you do pre-fund the pension would you anticipate an earnings benefit, in turn, and could you maybe give some quantification around that and does any part of the write-down of the Commercial Power assets, is it all goodwill or is some of it PP&E that it would reduce D&A going forward?

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Lynn Good - Duke Energy Corporation - Group Executive, CFO

On the pension, modest impact to earnings in '10. We typically make our pension contribution around the first quarter, so it's a slight acceleration Jonathan. And a modest amount of the impairment is PP&E, less than \$50 million.

Jonathan Arnold - Deutsche Bank - Analyst

Okay thank you very much.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Thank you.

Operator

Next we'll hear from with Lasan Johong with RBC Capital Markets.

Lasan Johong - RBC Capital Markets - Analyst

Just wondering about the economics -- between Duke Energy Ohio and Duke Energy Retail Services. Does Duke care who holds the customer?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Good question. The customers always remain a customer of our T&D business so they're a customer of Duke Energy Ohio for T&D at a minimum. I think it is fair to say that the margins under the Electric Security Plan are higher than what we're achieving with Duke Energy Retail Sales or in the wholesale market. So all things being equal, the Electric Security Plan customer is more profitable.

Lasan Johong - RBC Capital Markets - Analyst

Then kind of how can we figure out on a forward-looking basis without checking in with you every so often whether the economics of switching is in Duke's favor or not. Meaning can we track it based on gas prices, can we track it based on GDP? I mean is there some way we can track it or figure out how the economics work?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

You know I think the best information we can give you at this point is the \$0.02 to \$0.03 I talked about a moment ago. That represents what we have seen -- and are projecting to see over the balance of this year. And you know we'll give you a fuller update in 2010. I think the fair points are we're competing and working actively to preserve margin.

Lasan Johong - RBC Capital Markets - Analyst

Okay. Quick question on coal. Stockpiles are going up. What kind of flexibility do you have to defer or cancel coal shipments?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

We have been very active in managing our coal position to the extent we have had a basis to cancel contract, we have done so. We have also deferred tons. It's been an area of active focus throughout '09.

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Lasan Johong - RBC Capital Markets - Analyst

Are you experiencing increasing coal stocks relative to what you thought you should be at this time of year? Or are you working it off or -- can you give a little bit more color?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Yes, the coal stocks are higher than they have been historically, and as Jim mentioned in his remarks that was something we discussed and included in our rate case and actually have achieved a rider for incremental carrying costs that will contribute to our earnings as well as we go forward.

Lasan Johong - RBC Capital Markets - Analyst

Okay thank you.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Thank you.

Operator

And now we'll hear from Michael Lapidés with Goldman Sachs.

Michael Lapidés - Goldman Sachs - Analyst

Hey Jim, can you talk a little bit about what's happening at the EPA regarding emissions controls and rules coming out by November '11 for mercury, and obviously a new version of CAIR likely coming or at least being proposed in 2010. And what this means given the commodity price environment both for regulated and even merchant coal.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Michael that's really good question and let me look into crystal ball a little bit with you and kind of project what the EPA is - where they're headed. It is clear that the EPA is going to issue proposed regulations that are more stringent with respect to the emissions of SO₂, NO_x and mercury. It also is clear that they're going to propose regulations with respect to ash ponds and probably additional regulations on water discharge from plants. So we see increased scrutiny with respect to coal plants in the United States. One of the reasons that we have moved forward with this modernization strategy, not just because of the carbon issue, but we have seen for a while the possibility of much tougher regulations on coal plants and we needed to be in a position to retire some of our older coal plants. And as we look at our fleet today, these two new plants really facilitate our ability to retire some of these older units most of which are fully depreciated.

Michael Lapidés - Goldman Sachs - Analyst

Do you think we're going to see a wave or a flood of retirements of the small to mid-sized coal plants across the country?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

I do. I think over the next five to 10 years you're going to see virtually every plant that hasn't been retrofitted for SO₂ or NO_x retired. And for companies like ours as we look out, that is roughly 4,500 megawatts across our system. And in fact as we move forward with Cliffside and Edwardsport, it gives us a flexibility to retire up to 1,400 megawatts to 1,500 megawatts of that amount as we make this transition that I think will

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occur over the next decade. So I think this is going to require significant building of additional generation, whether it is natural gas or nuclear, to be able to maintain reliable service for companies across the country.

Michael Lapidès - Goldman Sachs - Analyst

Got it. Thank you Jim.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Thank you.

Operator

And next we will hear from Paul Patterson with Glenrock Associates.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Good morning Paul.

Paul Patterson - Glenrock Associates - Analyst

Good morning, how are you? Fine.

Paul Patterson - Glenrock Associates - Analyst

Just wanted to follow up on the shopping. It sounds like most of this \$0.02 to \$0.03 is really going to be occurring in the fourth quarter. Am I right about that?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Paul, we've seen modest amounts in the second and third quarter but it has not been consequential enough to really talk about in either quarter, so there will be an impact in fourth as well.

Paul Patterson - Glenrock Associates - Analyst

Now the opt-out aggregation, which we've seen so big in northern Ohio, which you don't have that much of an institutional history for. How has that been going recently?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

We have had a couple of townships switch. We have had a couple of townships coming to ballot in November. It has not been consequential. Nothing of the magnitude of what has been experienced in northern Ohio.

Paul Patterson - Glenrock Associates - Analyst

This is mostly industrial and commercial customers correct?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

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Yes, it is.

Paul Patterson - Glenrock Associates - Analyst

Okay and I think you said there was a 30% -- could you repeat the gross number? I saw the net number of 10% --

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Yes, the gross number is 30% at September 30th.

Paul Patterson - Glenrock Associates - Analyst

Okay. And what kind of level of discount should we be thinking about that these guys are getting, with the price to compare?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

That is a tough one to answer, Paul, because it is customer-specific in certain circumstances. I think you know the only financial measure I would share with you is the impact overall that is projected to have on our margins which is the \$0.02 to \$0.03, I referenced formerly.

Paul Patterson - Glenrock Associates - Analyst

Okay and then the coal sales, I saw you guys had a gain on that and it also sounds like you're deferring some of the more expensive coal perhaps into the future years, is that correct?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

The comment on deferrals was within the construct of managing coal inventories in general. So you know bringing coal inventory levels down. So I think those items are really quite separate. The \$13 million that we referenced in Ohio was just part of our active management program where we will choose to liquidate a commodity, sell power, et cetera as part of that ongoing management of that business.

Paul Patterson - Glenrock Associates - Analyst

We see with some companies have reported that they're deferring the delivery or the burning and therefore the expense of higher cost coal contracts. Are you guys seeing anything like that?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

No, we have deferred some coal and in certain circumstances that will result in a slight increase in cost. But it is not consequential at this point and not something that we've commented on specifically.

Paul Patterson - Glenrock Associates - Analyst

And then finally South Carolina, you guys had a settlement in North Carolina. South Carolina has been known to settle in the past. The filing for intervenor testimony et cetera was delayed until Monday. Is there a possibility you might see settlement in that case?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

We're working very hard to reach settlement in South Carolina. And we have made some progress, but more work to do.

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Paul Patterson - Glenrock Associates - Analyst

Do you think we'll get one before Monday or do you think we'll see intervenor testimony?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

I can't handicap that. I know our guys are working hard and continuously with the various parties in South Carolina. But I suspect we will not have a settlement prior to Monday.

Paul Patterson - Glenrock Associates - Analyst

Okay. Thank you very much.

Operator

Now we'll hear from Dan Jenkins with State of Wisconsin Investment Board.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Good morning, I also had a question on the North Carolina settlement. I was just curious, are there any parties that are still contesting the case? And if so who are they? And also have they set a schedule to -- to decide on the settlement proposal?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Well we have already had hearings on the settlement proposal. And the -- there really -- the Attorney General has not signed on yet. And some of the environmental groups of the state --

Dan Jenkins - State of Wisconsin Investment Board - Analyst

And what is the Attorney General's position that -- they're still contesting? Do you know what that is? Or can you tell us what that is?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

I think their focus has really been on ROE and cap structure. That has been their only focus.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

And so is -- has the Commission itself set a time table to discuss this and decide whether they're going to accept it?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

We have already been through the hearing process on all of this. And the record is closed. And now it is before the Commission to act.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay, so basically -- are there choices then to -- either accept the settlement or try to work something out based on the position that the AG and the -- and environmental groups have versus what the settlement is? Is that essentially what is left to be decided?

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Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

We continue to work with the environmental groups as well as the Attorney General as this thing is being reviewed by the Commission. But at the end of the day, the Commission is in a position to rule on the settlement, but I think what is really significant is the Public Staff supports it. The two major industrial groups support it. So you have got the customers on board with this settlement is something that they think is fair. And so from my standpoint I think that is the critical mass that is needed for the Commission to move forward to approve the settlement.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay thank you.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Thank you.

Operator

We'll now hear from Ashar Khan with Incremental Capital.

Ashar Khan - Incremental Capital - Analyst

Good afternoon, how are you doing? I just wanted to get a sense, if I understand the settlement in the Carolinas correctly, it has an earnings increase in 2010, but there is no incremental earnings increase 2011. Is that correct?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

The revenue requirements Ashar are the same in 2010 and 2011. I think the slide 11 does a really nice job of laying out the increase in rates, the impact on cash, et cetera.

Ashar Khan - Incremental Capital - Analyst

Right, so there is more impact on cash, but there is no earnings impact, that is the way I understand it.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

That is correct, revenue requirements are the same.

Ashar Khan - Incremental Capital - Analyst

So just from our -- you had a slide previously I guess in one of your presentations in terms of different cases and all that, from the different jurisdictions. So what is the plan, how do earnings -- is there any regulatory growth in earnings in '11 from any rate cases from other jurisdictions which would be material? I'm just trying to see how earnings keep on growing on that 7% factor?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Ashar, I think those questions are probably better suited for guidance that we would provide in February where we can really reset expectations on ongoing rate cases, et cetera.

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Ashar Khan - Incremental Capital - Analyst

Okay, but as far as anything scheduled right now is there anything major rate case decision in 2011 contemplated?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

I don't think we contemplate any rate case filings in 2011. But -- you did say 2011, didn't you?

Ashar Khan - Incremental Capital - Analyst

I mean impact in '11. That would mean 2010 rate case filings?

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

No, we don't see any significant rate filings in 2010. Other than the continued accrual of AFUDC on the building of those two plants. .

Ashar Khan - Incremental Capital - Analyst

Could you just give us some sense of what generation under this Ohio plan that we have, does the generation rate step up next year as well. What is the generation rate right now, can you give us some sense?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

You know the generation rate does step up in '10, 2% which was in connection with our original ESP filing in 2008.

Ashar Khan - Incremental Capital - Analyst

Okay, so these customers who are switching, are they switching for like a 12-month period? Or there is a term that they're switching so you -- that has been taken care of?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

The term varies, Ashar.

Ashar Khan - Incremental Capital - Analyst

Okay, okay, so they can come back any time they like. Is that how it works?

Lynn Good - Duke Energy Corporation - Group Executive, CFO

It depends on the type of customer, residential and commercial. It depends on whether customers pay capacity charges, et cetera. I think that is something that we could talk you through off line in terms of the specifics of the Ohio market.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

But at the end of the day we're the provider of last resort. If for whatever reason the suppliers are unable to deliver we have to stand and deliver.

Ashar Khan - Incremental Capital - Analyst

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I understand. I understand. Thank you very much.

Jim Rogers - Duke Energy Corporation - Chairman, President, CEO

Thank you.

Operator

And now we'll hear from Daniele Seitz with Dudack Research

Daniele Seitz - Dudack Research - Analyst

Just wondering a little bit more color on the expectations in terms of industrial demand. You said that you could see a slight uptick, and noticeable in the -- between second and third quarter. Was there any difference between the different areas you serve? And is it difficult to determine.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

You know as we looked at performance in the third quarter, industrial was up about 11% and it was in both areas of our service territory in the Carolinas and the Midwest. It spilled down year on 12% but we think it is a good indication of stabilization. As we look forward to the fourth quarter, we're forecasting a level of industrial sales comparable with third quarter.

Daniele Seitz - Dudack Research - Analyst

And no difference really in the reactions, no delayed -- I mean because it seemed that -- after all of the earnings we heard that the Midwest seems to be picking up faster. Have you -- you have not noticed a difference between the two areas, you serve.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

You know it is not significant enough to really identify as a trend at this point. Of course we're watching this monthly.

Daniele Seitz - Dudack Research - Analyst

Great, thank you very much.

Lynn Good - Duke Energy Corporation - Group Executive, CFO

Thank you.

Operator

Thank you. We'll take our last question -- we have taken our last question. I do apologize. We have no more time for questions today. I'll turn it back to Mr. De May for closing or additional remarks.

Stephen De May - Duke Energy Corporation - SVP - IR, Treasurer

Thank you Jamie, and thank you everyone for joining us today. As usual the Investor Relations team is available to take any follow-up questions. Have a nice day.

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Operator

Ladies and gentlemen, that does conclude our conference for today. We thank you for your participation
