

CINERGY CORP.
2008 Second Quarter Financial Report

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CINERGY CORP.

JUNE 30, 2008

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CINERGY CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In millions)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Operating Revenues				
Regulated electric	\$ 801	\$ 777	\$ 1,657	\$ 1,500
Non-regulated electric, natural gas and other	491	451	930	829
Regulated natural gas	113	108	470	447
Total operating revenues	1,405	1,336	3,057	2,776
Operating Expenses				
Fuel used in electric generation and purchased power	410	492	856	886
Cost of natural gas and coal sold	60	70	322	322
Operation, maintenance and other	351	341	677	671
Depreciation and amortization	195	175	389	348
Property and other taxes	79	78	172	168
Total operating expenses	1,095	1,156	2,416	2,395
Gains (Losses) on Sales of Other Assets and Other, net	33	-	49	(11)
Operating Income	343	180	690	370
Other Income and Expenses				
Equity in earnings of unconsolidated affiliates	6	6	14	12
Other income and expenses, net	36	28	68	51
Total other income and expenses	42	34	82	63
Interest Expense	64	63	129	131
Income from Continuing Operations Before Income Taxes	321	151	643	302
Income Tax Expense from Continuing Operations	110	76	225	132
Income from Continuing Operations	211	75	418	170
Income from Discontinued Operations, net of tax	16	13	24	24
Net Income	\$ 227	\$ 88	\$ 442	\$ 194

See Notes to Unaudited Consolidated Financial Statements

CINERGY CORP.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In millions)

	June 30, 2008	December 31, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 86	\$ 109
Receivables (net of allowance for doubtful accounts of \$4 at June 30, 2008 and December 31, 2007)	673	755
Inventory	389	365
Assets held for sale	-	2
Unrealized gains on mark-to-market and hedging transactions	200	42
Other	216	400
Total current assets	1,564	1,673
Investments and Other Assets		
Restricted funds held in trust	63	72
Investments in unconsolidated affiliates	422	375
Goodwill	4,347	4,349
Intangibles, net	634	677
Notes receivable	101	117
Unrealized gains on mark-to-market and hedging transactions	117	48
Assets held for sale	-	115
Other	368	385
Total investments and other assets	6,052	6,138
Property, Plant and Equipment		
Cost	18,724	18,093
Less accumulated depreciation and amortization	5,098	4,871
Net property, plant and equipment	13,626	13,222
Regulatory Assets and Deferred Debits		
Deferred debt expense	67	70
Regulatory assets related to income taxes	158	144
Other	792	869
Total regulatory assets and deferred debits	1,017	1,083
Total Assets	\$ 22,259	\$ 22,116

See Notes to Unaudited Consolidated Financial Statements

CINERGY CORP.
CONSOLIDATED BALANCE SHEETS - (continued)
(Unaudited)
(In millions, except share and per share amounts)

	June 30, 2008	December 31, 2007
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	\$ 890	\$ 932
Notes payable	279	548
Taxes accrued	252	233
Interest accrued	64	63
Liabilities associated with assets held for sale	-	114
Current maturities of long-term debt	545	564
Unrealized losses on mark-to-market and hedging transactions	131	46
Other	265	337
Total current liabilities	2,426	2,837
Long-term Debt		
	4,165	4,135
Deferred Credits and Other Liabilities		
Deferred income taxes	2,153	2,086
Investment tax credits	32	34
Accrued pension and other postretirement benefit costs	819	769
Unrealized losses on mark-to-market and hedging transactions	99	68
Liabilities associated with assets held for sale	-	3
Asset retirement obligations	46	45
Other	926	984
Total deferred credits and other liabilities	4,075	3,989
Commitments and Contingencies		
Common Stockholder's Equity		
Common stock, \$0.01 par value; 1,000 shares authorized, 100 shares issued and outstanding at June 30, 2008 and December 31, 2007	-	-
Additional paid-in capital	10,788	10,786
Retained earnings	863	421
Accumulated other comprehensive loss	(58)	(52)
Total common stockholder's equity	11,593	11,155
Total Liabilities and Common Stockholder's Equity	\$ 22,259	\$ 22,116

See Notes to Unaudited Consolidated Financial Statements

CINERGY CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In millions)

	Six Months Ended June 30,	
	2008	2007
Cash Flows from Operating Activities		
Net income	\$ 442	\$ 194
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	392	368
(Gains) losses on sales of other assets	(72)	11
Deferred income taxes	62	20
Equity earnings of unconsolidated affiliates	(14)	(12)
Regulatory asset/liability amortization	19	29
Accrued pension and postretirement benefit costs	47	59
Contribution to company sponsored pension and other post-retirement benefit plans	-	(350)
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(182)	(4)
Receivables	118	38
Inventory	(12)	(14)
Other current assets	(23)	(1)
Increase (decrease) in:		
Accounts payable	59	86
Taxes accrued	144	(140)
Other current liabilities	14	(56)
Regulatory asset/liability deferrals	(17)	(80)
Other assets	(4)	146
Other liabilities	(81)	(6)
Net cash provided by operating activities	<u>892</u>	<u>288</u>
Cash Flows from Investing Activities		
Capital expenditures	(822)	(605)
Investment expenditures	(1)	(3)
Acquisitions, net of cash acquired	-	(53)
Purchases of available-for-sale securities	(9)	(15)
Proceeds from sales and maturities of available-for-sale securities	8	14
Purchases of emission allowances	(24)	(60)
Sales of emission allowances	79	32
Net proceeds from the sales of other assets and sales of and collections on notes receivable	76	27
Change in restricted cash	34	77
Other	9	-
Net cash used in investing activities	<u>(650)</u>	<u>(586)</u>
Cash Flows from Financing Activities		
Payments for the redemption of long-term debt	(145)	(348)
Contribution from parent	-	204
Notes payable and commercial paper	(119)	575
Dividends to parent	-	(135)
Other	(1)	-
Net cash (used in) provided by financing activities	<u>(265)</u>	<u>296</u>
Net decrease in cash and cash equivalents	(23)	(2)
Cash and cash equivalents at beginning of period	<u>109</u>	<u>167</u>
Cash and cash equivalents at end of period	<u>\$ 86</u>	<u>\$ 165</u>
Significant non-cash transactions:		
Accrued capital expenditures	\$ 58	\$ 59
Reclassification of money pool borrowings to long-term debt	\$ 150	\$ -

See Notes to Unaudited Consolidated Financial Statements

CINERGY CORP.
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(Unaudited)
(In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Foreign Currency Adjustments	Accumulated Other Comprehensive Income (Loss)			Other	Total
					Net (Losses) Gains on Cash Flow Hedges	SFAS No. 158 Adjustment			
Balance at December 31, 2006	\$ -	\$ 10,581	\$ 106	\$ (2)	\$ (36)	\$ (42)	\$ 2	\$ 10,609	
Net income	-	-	194	-	-	-	-	194	
Other comprehensive income									
Unrealized gains on available-for-sale securities ^(a)	-	-	-	-	-	-	2	2	
Cash flow hedges ^(c)	-	-	-	-	7	-	-	7	
Other	-	-	-	-	-	(1)	-	(1)	
Total comprehensive income								202	
Capital contribution from parent	-	204	-	-	-	-	-	204	
Dividends to parent	-	-	(135)	-	-	-	-	(135)	
Adoption of SFAS No. 158 - measurement date provision ^(e)	-	-	(11)	-	-	(50)	-	(61)	
Other	-	1	-	-	-	-	-	1	
Balance at June 30, 2007	\$ -	\$ 10,786	\$ 154	\$ (2)	\$ (29)	\$ (93)	\$ 4	\$ 10,820	
Balance at December 31, 2007	\$ -	\$ 10,786	\$ 421	\$ 1	\$ (33)	\$ (21)	\$ 1	\$ 11,155	
Net income	-	-	442	-	-	-	-	442	
Other comprehensive loss									
Foreign currency translation adjustment ^(b)	-	-	-	(2)	-	-	-	(2)	
Unrealized losses on available-for-sale securities ^(a)	-	-	-	-	-	-	(4)	(4)	
Cash flow hedges ^(c)	-	-	-	-	(1)	-	-	(1)	
SFAS No. 158 amortization ^(d)	-	-	-	-	-	1	-	1	
Total comprehensive income								436	
Other	-	2	-	-	-	-	-	2	
Balance at June 30, 2008	\$ -	\$ 10,788	\$ 863	\$ (1)	\$ (34)	\$ (20)	\$ (3)	\$ 11,593	

(a) Net of \$4 tax benefit in 2008 and \$1 tax expense in 2007.

(b) Net of \$2 tax benefit in 2008.

(c) Net of \$1 tax benefit in 2008 and \$4 tax expense in 2007.

(d) Net of \$2 tax expense in 2008.

(e) Net of \$31 tax benefit in 2007.

Notes To Unaudited Consolidated Financial Statements

1. Basis of Presentation

Nature of Operations and Basis of Consolidation. Cinergy Corp. (collectively with its subsidiaries, Cinergy), a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy), is an energy company primarily located in Ohio, Indiana, Kentucky and Texas. Cinergy directly or indirectly owns all outstanding common stock of its regulated public utility subsidiaries, Duke Energy Ohio, Inc. (Duke Energy Ohio), which includes Duke Energy Ohio's wholly-owned public utility subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), and Duke Energy Indiana, Inc. (Duke Energy Indiana). Additionally, Cinergy owns Cinergy Investments, Inc. (Investments), a non-regulated investment holding company involved in cogeneration and energy efficiency investments, renewable energy and energy marketing, and Duke Energy Shared Services (DESS), which provides administrative, management and support services to Cinergy's subsidiaries. On July 1, 2008, DESS was merged into a consolidated affiliate of Duke Energy. In conjunction with this transaction, approximately \$206 million of assets and approximately \$419 million of liabilities were transferred to a consolidated affiliate of Duke Energy, including \$18 million of intercompany receivables and \$103 million of intercompany liabilities that were eliminated in Cinergy's consolidated balance sheet at June 30, 2008.

These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Cinergy and all majority-owned subsidiaries where Cinergy has control, as well as those variable interest entities where Cinergy is the primary beneficiary. These Consolidated Financial Statements also reflect Cinergy's proportionate share of certain generation and transmission facilities.

These Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America (U.S.) for interim financial information. Accordingly, these Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for annual financial statements. Because the interim Consolidated Financial Statements and Notes do not include all of the information and footnotes required by GAAP for annual financial statements, the Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Cinergy's Year-End Financial Report for the year ended December 31, 2007.

These Consolidated Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Cinergy's financial position and results of operations. Amounts reported in the interim Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, regulatory rulings, the timing of maintenance on electric generating units, changes in mark-to-market valuations, changing commodity prices and other factors.

Use of Estimates. To conform with GAAP in the U.S., management makes estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and Notes. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Reclassifications. Certain prior period amounts on the Consolidated Balance Sheets have been reclassified in connection with the adoption of Financial Accounting Standards Board (FASB) Staff Position (FSP) No. FIN 39-1, "Amendment of FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts," (FSP No. FIN 39-1) on January 1, 2008, as discussed below, the effects of which require retrospective application to the Consolidated Balance Sheets.

Netting of Cash Collateral and Derivative Assets and Liabilities Under Master Netting Arrangements. On January 1, 2008, Cinergy adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Cinergy offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Prior to the adoption of FSP No. FIN 39-1, Cinergy offset the fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement in accordance with FIN 39, "Offsetting of Amounts Related to Certain Contracts," but presented cash collateral on a gross basis within the Consolidated Balance Sheets. At June 30, 2008 and December 31, 2007, Cinergy had receivables related to the right to reclaim cash collateral of approximately \$17 million and \$5 million, respectively, and had payables related to obligations to return cash collateral of approximately \$82 million and an insignificant amount, respectively, that have been offset against net derivative positions in the Consolidated Balance Sheets. Cinergy had insignificant cash collateral receivables and payables under master netting arrangements that have not been offset against net derivative positions at June 30, 2008 or December 31, 2007.

Unbilled Revenue. Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled revenues are estimated by applying an average revenue per kilowatt hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt hours or Mcf's delivered but not billed. The amount of unbilled revenues can vary significantly period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are included in Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales within Cinergy's non-regulated businesses and were approximately \$68 million and \$51 million at June 30, 2008 and December 31, 2007, respectively. Additionally, receivables for unbilled revenues of approximately \$193 million and \$230 million at June 30, 2008 and December 31, 2007, respectively, related to retail accounts receivable at Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail accounts receivable and related collections to Cinergy Receivables, a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125," and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

Other Regulatory Assets and Deferred Debits. Cinergy accounts for certain of its regulated operations under the provisions of SFAS No. 71, "Accounting for Certain Types of Regulation" (SFAS No. 71). The economic effects of regulation can result in a regulated company recording assets for costs that have been or are expected to be approved for recovery from customers in a future period or recording liabilities for amounts that are expected to be returned to customers in the rate-setting process in a period different from the period in which the amounts would be recorded by an unregulated enterprise. Accordingly, Cinergy records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Management continually assesses whether regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, recent rate orders applicable to other regulated entities and the status of any pending or potential deregulation legislation. Additionally, management continually assesses whether any regulatory

Notes To Unaudited Consolidated Financial Statements

liabilities have been incurred. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery and that no regulatory liabilities, other than those recorded, have been incurred. These regulatory assets and liabilities are primarily classified in the Consolidated Balance Sheets as Regulatory Assets and Deferred Debits, and Deferred Credits and Other Liabilities. Cinergy periodically evaluates the applicability of SFAS No. 71, and considers factors such as regulatory changes and the impact of competition. If cost-based regulation ends or competition increases, Cinergy may have to reduce its asset balances to reflect a market basis less than cost and write-off their associated regulatory assets and liabilities.

The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the Public Utilities Commission of Ohio (PUCO) approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a Regulatory Transition Charge (RTC) designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001 and ending December 2010. Accordingly, application of SFAS No. 71, "Accounting for Certain Types of Regulation" (SFAS No. 71), was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC related regulatory asset balance of approximately \$191 million and \$239 million as of June 30, 2008 and December 31, 2007, respectively, which is classified in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

2. Stock-Based Compensation

Cinergy is allocated stock-based compensation expense from Duke Energy as certain of its employees participate in Duke Energy's stock-based compensation programs. Cinergy accounts for stock-based compensation under the provisions of SFAS No. 123(R), "Share-Based Payment" (SFAS No. 123(R)). SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee and certain nonemployee services. Accordingly, for employee awards, equity classified stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period.

Cinergy recorded pre-tax stock-based compensation expense included in Income From Continuing Operations for each of the three and six months ended June 30, 2008 and 2007 as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Stock Options	\$ -	\$ 1	\$ 1	\$ 3
Phantom Awards	2	1	3	2
Performance Awards	2	2	4	3
Total	\$ 4	\$ 4	\$ 8	\$ 8

The tax benefit associated with the recorded expense in Income from Continuing Operations for each of the three months ended June 30, 2008 and 2007 was approximately \$1 million. The tax benefit associated with the recorded expense in Income from Continuing Operations for each of the six months ended June 30, 2008 and 2007 was approximately \$3 million.

Duke Energy Stock Option Activity

	Options (in thousands)	Weighted- Average Exercise Price
Outstanding at December 31, 2007	5,916	\$ 15
Exercised	(73)	13
Forfeited or expired	(2)	16
Outstanding at June 30, 2008	5,841	15
Exercisable at June 30, 2008	4,661	\$ 14

There were no options granted during the six months ended June 30, 2008 or 2007.

At June 30, 2008, Cinergy had approximately \$1 million of unrecognized compensation expense which is expected to be recognized over a weighted-average period of 1 year.

Duke Energy Phantom Stock Awards

Duke Energy awarded 208,990 shares to Cinergy employees (fair value of approximately \$4 million, based on the market price of Duke Energy's common stock at the grant dates) during the six months ended June 30, 2008. Duke Energy awarded 281,380 shares to Cinergy employees (fair value of approximately \$5 million, based on the market price of Duke Energy's common stock at the grant dates) during the six months ended June 30, 2007.

Notes To Unaudited Consolidated Financial Statements

The following table summarizes information about Duke Energy phantom stock awards issued to Cinergy employees and outstanding at June 30, 2008:

	<u>Shares (in thousands)</u>
Number of Phantom Stock Awards:	
Outstanding at December 31, 2007	497
Granted	209
Vested	(164)
Forfeited	(1)
Outstanding at June 30, 2008	541

At June 30, 2008, Cinergy had approximately \$5 million of unrecognized compensation expense which is expected to be recognized over a weighted-average period of 2.1 years.

Duke Energy Performance Awards

Duke Energy awarded 712,485 shares (fair value of approximately \$11 million) to Cinergy employees during the six months ended June 30, 2008. Duke Energy awarded 422,430 shares (fair value of approximately \$6 million) to Cinergy employees during the six months ended June 30, 2007.

The following table summarizes certain information about Duke Energy stock-based performance awards issued to Cinergy employees and outstanding at June 30, 2008:

	<u>Shares (in thousands)</u>
Number of Stock-based Performance Awards:	
Outstanding at December 31, 2007	811
Granted	712
Vested	(108)
Forfeited	(3)
Outstanding at June 30, 2008	1,412

At June 30, 2008, Cinergy had approximately \$13 million of unrecognized compensation expense which is expected to be recognized over a weighted-average period of 1.8 years.

3. Acquisitions and Dispositions of Businesses and Sales of Other Assets

Acquisitions. Cinergy consolidates assets and liabilities from acquisitions as of the purchase date and includes earnings from acquisitions in consolidated earnings after the purchase date. Assets acquired and liabilities assumed are recorded at estimated fair values on the purchase date. The purchase price minus the estimated fair value of the acquired assets and liabilities meeting the definition of a business as defined in Emerging Issues Task Force Issue No. 98-3, "*Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*" is recorded as goodwill. The allocation of the purchase price may be adjusted if additional, requested information is received during the allocation period, which generally does not exceed one year from the consummation date; however, it may be longer for certain income tax items.

On June 26, 2008, Duke Energy announced that it had executed a definitive agreement to acquire Catamount Energy Corporation, a leading wind power company located in Rutland, Vermont, from funds affiliated with Diamond Castle Holdings, LLC. The acquisition price is approximately \$240 million, plus the assumption of approximately \$80 million of debt. The acquisition would include over 300 megawatts (MW) of power generating assets, including 283 MW of Phases 1-5 of the Sweetwater wind power facility in West Texas, and 20 MW of cogeneration and biomass generation in New England. The acquisition would also include approximately 1,750 MW of wind assets under development in the U.S. and United Kingdom. Having obtained early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 on July 21, 2008, and approval by the Federal Energy Regulatory Commission (FERC) on August 7, 2008, Cinergy anticipates that, pending approval by the Public Utilities Commission of Texas, the transaction will close in the third quarter of 2008.

On August 8, 2008, Cinergy announced the formation of a 50-50 joint venture, called Pioneer Transmission LLC (Pioneer Transmission), with American Electric Power Company, Inc. (AEP) to build and operate 240 miles of extra-high-voltage 765-kilovolt (KV) transmission lines and related facilities in Indiana. Pioneer Transmission will be regulated by the FERC. Both Cinergy and AEP own an equal interest in the joint venture and will share equally in the project costs, which are currently estimated at approximately \$1 billion, of which \$500 million is anticipated to be financed by Pioneer Transmission and the remaining amount split equally between Cinergy and AEP. The joint venture will operate in Indiana as a transmission utility and seek rate approval for the project from the FERC in the third quarter of 2008. The earliest possible in-service date for the project is in 2014 or 2015.

In May 2007, Cinergy acquired the wind power development assets of Energy Investor Funds from Tierra Energy. The purchase included more than 1,000 MW of wind assets in various stages of development in the Western and Southwestern U.S. and supports Cinergy's strategy to increase its investment in renewable energy. A significant portion of the purchase price was for intangible assets. Three of the development projects, totaling approximately 240 MW, are located in Texas and Wyoming and are anticipated to be in commercial operation in late 2008 or 2009.

Dispositions. In December 2006, Duke Energy Indiana agreed to sell one unit of its Wabash River Power Station (Unit 1) to the Wabash Valley Power Association. The sale was approved by the Indiana Utility Regulatory Commission (IURC), the FERC, the Federal Trade Commission and the U.S. Department of Justice (DOJ) during 2007. On December 31, 2007, Duke Energy Indiana received proceeds of approximately \$114 million, which was equivalent to the net book value of Unit 1 at the time of sale. Since, pursuant to the terms of the purchase and sale agreement, the effective date of the sale was January 1, 2008, the assets of Unit 1 were reflected as Assets Held for Sale within Current Assets and also within Investments and Other Assets on the Consolidated Balance Sheets at December 31, 2007 and a corresponding liability equal to the cash received was included in Liabilities Associated with Assets Held for Sale within Current Liabilities on the Consolidated Balance Sheets at December 31,

Notes To Unaudited Consolidated Financial Statements

2007. Since the sales price was equal to the net book value of Unit 1 at the transaction date, no gain or loss was recognized on the sale. The sale was completed on January 1, 2008.

Other Asset Sales. For the three months ended June 30, 2008, the sale of other assets resulted in approximately \$44 million in proceeds and net pre-tax gains of approximately \$33 million recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the six months ended June 30, 2008, the sale of other assets resulted in approximately \$63 million in proceeds and net pre-tax gains of approximately \$49 million recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to sales of zero cost basis emission allowances.

For the three months ended June 30, 2007, the sale of other assets resulted in approximately \$2 million in proceeds and net pre-tax gains of an insignificant amount recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the six months ended June 30, 2007, the sale of other assets resulted in approximately \$24 million in proceeds and net pre-tax losses of approximately \$11 million recorded in Gains (Losses) on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to sales of emission allowances acquired in connection with Cinergy's merger with Duke Energy in April 2006, which were written up to fair value as part of purchase accounting.

4. Inventory

Inventory consists primarily of coal held for electric generation, materials and supplies, and natural gas held in storage for transmission and sales commitments. Inventory is recorded primarily using the average cost method.

	June 30, 2008	December 31, 2007
	(in millions)	
Coal held for electric generation	\$ 193	\$ 164
Materials and supplies	134	132
Natural gas	62	69
Total inventory	\$ 389	\$ 365

5. Debt and Credit Facilities

In August 2008, Duke Energy Indiana issued \$500 million principal amount of first mortgage bonds, which carries a fixed interest rate of 6.35% and matures August 15, 2038. Proceeds from the issuance will be used to fund capital expenditures and for general corporate purposes, including the repayment of short-term notes and to redeem first mortgage bonds maturing in September 2008.

Intercompany Debt and Money Pool Arrangement. Cinergy receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Cinergy, Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Cinergy, Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of June 30, 2008 and December 31, 2007, Cinergy and its subsidiaries collectively had net short-term and long-term borrowings of approximately \$429 million and \$548 million, respectively, of which \$279 million is classified within Notes payable and \$150 million is classified within Long-Term Debt in the accompanying Consolidated Balance Sheets. During the six months ended June 30, 2008 and 2007, the \$119 million decrease and \$575 million increase in the money pool borrowings, respectively, are reflected in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

At June 30, 2008, approximately \$307 million of certain pollution control bonds and \$150 million of intercompany loans between Cinergy and Duke Energy associated with borrowings via the money pool, both of which are short-term obligations by nature, are classified as Long-term Debt on the Consolidated Balance Sheets due to Cinergy's intent and ability to utilize such borrowings as long-term financing. Duke Energy's credit facilities with non-cancelable terms in excess of one year as of the balance sheet date give Cinergy the ability to refinance these short-term obligations on a long-term basis.

At December 31, 2007, approximately \$307 million of certain pollution control bonds were classified as Long-Term Debt on the Consolidated Balance Sheets for the reasons noted above.

Available Credit Facilities and Restrictive Debt Covenants. In March 2008, Duke Energy entered into an amendment to its \$2.65 billion master credit facility whereby the borrowing capacity was increased by \$550 million to \$3.2 billion. Pursuant to the amendment, the additional credit capacity of \$550 million specifically increased the borrowing sub limits for Duke Energy Ohio (excluding Duke Energy Kentucky) and Duke Energy Indiana to \$750 million and \$700 million, respectively. In May 2008, Duke Energy reallocated the borrowing sub limits under the master credit facility and reduced the borrowing sub limits of Duke Energy Ohio (excluding Duke Energy Kentucky) and Duke Energy Indiana by \$50 million to \$700 million and \$650 million, respectively. The borrowing sub limit of Duke Energy Kentucky did not change.

The amount available to Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky under their sublimits to Duke Energy's master credit facility is reduced by borrowings through the money pool arrangement, issuances of letters of credit and other borrowings.

Duke Energy's credit agreement contains various financial and other covenants, including, but not limited to, a covenant regarding the debt-to-total capitalization ratio at Duke Energy, Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky to not exceed 65%. Cinergy's debt agreements also contain various financial and other covenants. Failure to meet those covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of June 30, 2008, Duke Energy, Cinergy, Duke Energy Ohio, Duke Energy Indiana and Duke Energy Kentucky were in compliance with all covenants that would impact Cinergy's ability to borrow funds under its debt and credit facilities. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

Notes To Unaudited Consolidated Financial Statements

6. Employee Benefit Obligations

Qualified Pension Plans

The following table shows the components of the net periodic pension costs for the Cinergy qualified pension plans.

Components of Net Periodic Pension Costs: Qualified Pension Costs

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008 ^(a)	2007 ^(a)	2008 ^(b)	2007 ^(b)
	(in millions)			
Service cost	\$ 10	\$ 9	\$ 19	\$ 20
Interest cost on projected benefit obligation	32	29	60	57
Expected return on plan assets	(35)	(36)	(69)	(63)
Amortization of prior service cost	2	3	3	3
Other	2	2	4	4
Net periodic pension costs	<u>\$ 11</u>	<u>\$ 7</u>	<u>\$ 17</u>	<u>\$ 21</u>

- (a) Net periodic qualified pension costs for the three months ended June 30, 2008 and 2007 exclude approximately \$4 million and \$6 million, respectively, of regulatory asset amortization resulting from purchase accounting associated with Cinergy's merger with Duke Energy in April 2006.
- (b) Net periodic qualified pension costs for the six months ended June 30, 2008 and 2007 exclude approximately \$6 million and \$12 million, respectively, of regulatory asset amortization resulting from purchase accounting associated with Cinergy's merger with Duke Energy in April 2006.

Cinergy's policy is to fund amounts for its qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Cinergy did not make contributions to its U.S. qualified or non-qualified pension plans during the three and six months ended June 30, 2008 and Cinergy does not anticipate making contributions to its qualified or non-qualified pension plans during the remainder of 2008. During the three and six months ended June 30, 2007, Cinergy made qualified pension benefit contributions of approximately \$350 million to its qualified pension plans.

Non-Qualified Pension Plans

The following table shows the components of the net periodic pension costs for the Cinergy non-qualified pension plans.

Components of Net Periodic Pension Costs: Non-Qualified Pension Costs

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Service cost	\$ 1	\$ —	\$ 1	\$ 1
Interest cost on projected benefit obligation	1	2	3	3
Amortization of loss	1	—	1	—
Net periodic pension costs	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ 5</u>	<u>\$ 4</u>

Other Post-Retirement Benefit Plans

The following table shows the components of the net periodic other post-retirement benefit costs for the Cinergy other post-retirement benefit plans.

Components of Net Periodic Post-Retirement Benefit Costs

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008 ^(a)	2007 ^(a)	2008 ^(b)	2007 ^(b)
	(in millions)			
Service cost benefit	\$ 1	\$ 2	\$ 3	\$ 4
Interest cost on accumulated post—retirement benefit obligation	7	7	14	14
Expected return on plan assets	—	—	(1)	—
Net periodic post-retirement benefit costs	<u>\$ 8</u>	<u>\$ 9</u>	<u>\$ 16</u>	<u>\$ 18</u>

- (a) Net periodic other post-retirement benefit costs for the three months ended June 30, 2008 and 2007 excludes approximately \$1 million and \$2 million, respectively, of regulatory asset amortization resulting from purchase accounting associated with Cinergy's merger with Duke Energy in April 2006.
- (b) Net periodic other post-retirement benefit costs for the six months ended June 30, 2008 and 2007 exclude approximately \$3 million and \$4 million, respectively, of regulatory asset amortization resulting from purchase accounting associated with Cinergy's merger with Duke Energy in April 2006.

Notes To Unaudited Consolidated Financial Statements

Cinergy also sponsors employee savings plans that cover substantially all U.S. employees. Cinergy made pre-tax employer matching contributions of approximately \$7 million and \$14 million during the three and six months ended June 30, 2008, respectively. Cinergy made pre-tax employer matching contributions of approximately \$4 million and \$9 million during the three and six months ended June 30, 2007, respectively.

7. Intangibles

Intangible Assets

The carrying amount and accumulated amortization of intangible assets as of June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(in millions)	
Emission allowances	\$ 391	\$ 421
Gas, coal, and power contracts	295	295
Other	62	62
Total gross carrying amount	748	778
Accumulated amortization—gas, coal, and power contracts	(106)	(94)
Accumulated amortization—other	(8)	(7)
Total accumulated amortization	(114)	(101)
Total intangible assets, net	\$ 634	\$ 677

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Cinergy's merger with Duke Energy and emission allowances purchased by Cinergy. Additionally, Cinergy is allocated certain zero cost emission allowances on an annual basis. The carrying value of emission allowances sold or consumed during the three months ended June 30, 2008 and 2007 were \$37 million and \$56 million, respectively. The carrying value of emission allowances sold or consumed during the six months ended June 30, 2008 and 2007 were \$65 million and \$147 million, respectively. See Note 3 for discussion of gains and losses on sales of emission allowances during the three and six months ended June 30, 2008 and 2007.

Amortization expense for gas, coal and power contracts and other intangible assets for the three months ended June 30, 2008 and 2007 was approximately \$6 million and \$14 million, respectively. Amortization expense for gas, coal and power contracts and other intangible assets for the six months ended June 30, 2008 and 2007 was approximately \$13 million and \$27 million, respectively.

On July 11, 2008, the U.S. Court of Appeals for the District of Columbia issued a decision vacating the Clean Air Interstate Rule (CAIR). See Note 13 for a discussion of the decision. Cinergy is currently evaluating the effect of the decision on the carrying value of emission allowances held by its regulated and non-regulated businesses. Based on current market prices for sulfur dioxide (SO₂) allowances, and the uncertainty associated with future federal requirements to reduce emissions, management believes that it is possible that Cinergy may incur an impairment of the carrying value of emission allowances held by certain Cinergy non-regulated businesses of up to \$100 million in the third quarter of 2008. This current estimate is based on total allowances held by these non-regulated businesses as of June 30, 2008 compared to amounts projected to be utilized in operations through 2037. Additionally, Cinergy's regulated businesses have emission allowances and certain commitments to purchase emission allowances that could result in a quantity of emission allowances in excess of the amounts projected to be utilized for operations; however, management expects to seek regulatory recovery of any losses incurred as a result of any impairment or other charges recorded as a result of the vacating of CAIR.

Intangible Liabilities

In connection with the merger with Duke Energy in April 2006, Cinergy recorded an intangible liability of approximately \$113 million associated with the market based standard service offer (MBSSO) in Ohio, which is being recognized in earnings over the remaining regulatory period that ends on December 31, 2008. The carrying amount of this intangible liability was approximately \$34 million and \$67 million at June 30, 2008 and December 31, 2007, respectively. Cinergy also recorded approximately \$56 million of intangible liabilities associated with other power sale contracts in connection with the merger. The carrying amount of this intangible liability was approximately \$19 million and \$22 million at June 30, 2008 and December 31, 2007, respectively. During the three and six months ended June 30, 2008, Cinergy amortized approximately \$18 million and \$36 million, respectively, to income related to these intangible liabilities. During the three and six months ended June 30, 2007, Cinergy amortized approximately \$10 million and \$14 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

8. Severance

During the three months ended June 30, 2008 and 2007, Cinergy recorded severance charges under Duke Energy's ongoing severance plan of insignificant amount and approximately \$5 million, respectively. During the six months ended June 30, 2008 and 2007, Cinergy recorded severance charges under Duke Energy's ongoing severance plan of approximately \$1 million and \$6 million, respectively. Future severance costs under Duke Energy's ongoing severance plan, if any, are currently not estimable.

Notes To Unaudited Consolidated Financial Statements

	Balance at December 31, 2007	Provision/ Adjustments	Cash Reductions	Balance at June 30, 2008
Severance reserve ^(a)	\$ 4	\$ 1	\$ (2)	\$ 3
	(in millions)			

(a) Severance provisions are expected to be paid within one year from the date that the provision was recorded.

9. Discontinued Operations and Assets Held for Sale

Due to the expiration of certain tax credits, Cinergy ceased all synthetic fuel (synfuel) operations as of December 31, 2007. Accordingly, the results of operations for synfuel have been reclassified to discontinued operations for the three and six months ended June 30, 2007. See Note 13 for further information on the synfuel operations.

In February 2008, Cinergy entered into an agreement to sell its 480 MW natural gas-fired peaking generating station located near Brownsville, Tennessee to Tennessee Valley Authority for approximately \$55 million. This transaction, which was subject to FERC approval, closed in April 2008. This transaction resulted in Cinergy recognizing an approximate \$23 million pre-tax gain at closing.

The following table summarizes the results classified as Income From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

Discontinued Operations (in millions)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions)			
Operating Revenues	\$ 1	\$ 78	\$ 4	\$ 130
Operating Income				
Pre-tax Operating Loss	\$ -	\$ (29)	\$ -	\$ (51)
Income Tax Benefit	(1)	(47)	(9)	(81)
Operating Income, Net of Tax	\$ 1	\$ 18	\$ 9	\$ 30
Net Gain (Loss) on Dispositions				
Pre-tax Gain (Loss) on Dispositions	\$ 23	\$ -	\$ 23	\$ (1)
Income Tax Expense	8	5	8	5
Gain (Loss) on Dispositions, Net of Tax	15	(5)	15	(6)
Income from Discontinued Operations, Net of Tax	\$ 16	\$ 13	\$ 24	\$ 24

The following table presents the carrying values of the major classes of Assets Held for Sale and related Liabilities Associated with Assets Held for Sale in the Consolidated Balance Sheets as of December 31, 2007, which primarily relate to Duke Energy Indiana's Wabash River Power Station, the sale of which was completed in January 2008 (see Note 3). There were no Assets Held for Sale and related Liabilities Associated with Assets Held for Sale in the Consolidated Balance Sheets as of June 30, 2008.

Summarized Balance Sheet Information for Assets Held for Sale and Related Liabilities Associated with Assets Held for Sale (in millions)

	December 31, 2007
Current assets	\$ 2
Property, plant and equipment, net	115
Total assets held for sale	\$ 117
Current liabilities	\$ 114
Deferred credits and other liabilities	3
Total liabilities associated with assets held for sale	\$ 117

Notes To Unaudited Consolidated Financial Statements

10. Related Party Transactions

Cinergy engages in related party transactions, which are generally performed at cost and in accordance with the applicable state and federal commission regulations. Balances due to or due from related parties included in the Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(in millions)	
Current assets due from affiliated companies ^{(a)(b)}	\$ 80	\$ 201
Current liabilities due to affiliated companies ^{(a)(c)}	\$ (281)	\$ (168)
Net deferred tax liabilities to Duke Energy ^{(a)(d)}	\$ (1,926)	\$ (1,853)

- (a) Balances exclude assets or liabilities associated with Cinergy Receivables and money pool arrangements, all of which are discussed below.
- (b) Of the balance at June 30, 2008, approximately \$1 million is classified as Receivables and approximately \$79 million is classified as Other within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Other within Current Assets on the Consolidated Balance Sheets.
- (c) The balance at June 30, 2008 and December 31, 2007 is classified as Accounts payable on the Consolidated Balance Sheets.
- (d) Of the balance at June 30, 2008, approximately \$(1,946) million is classified as Deferred income taxes, approximately \$(32) million is classified as Investment tax credits, and approximately \$52 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately \$(1,878) million is classified as Deferred income taxes, approximately \$(34) million is classified as Investment tax credits, and approximately \$59 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Cinergy is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. These amounts are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations. Additionally, Duke Energy and its subsidiaries are allocated their proportionate share of corporate governance costs from a consolidated affiliate of Cinergy. As discussed in Note 1, on July 1, 2008, this consolidated affiliate of Cinergy was merged with a consolidated affiliate of Duke Energy. Corporate governance and other shared services costs are primarily allocations of corporate costs, such as human resources, legal and accounting fees, as well as other third party costs. These amounts are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations. Cinergy also recognizes recoveries of direct and allocated corporate governance and shared service costs charged to affiliates. These recoveries are primarily reflected as an offset within Operating Expenses on the Consolidated Statements of Operations. The recoveries and expenses associated with corporate governance and other service costs were as follows:

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions)			
Corporate governance and shared services charged to affiliates	\$ 24	\$ 28	\$ 51	\$ 58
Corporate governance and other shared service expenses	\$ 77	\$ 69	\$ 142	\$ 127

Cinergy incurs expenses related to its property insurance coverage through Bison Insurance Company Limited, Duke Energy's wholly-owned captive insurance subsidiary. These expenses, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations, were approximately \$6 million and \$21 million for the three months ended June 30, 2008 and 2007, respectively, and approximately \$12 million and \$27 million for the six months ended June 30, 2008 and 2007, respectively.

As discussed in Note 1, certain trade receivables have been sold by Cinergy to Cinergy Receivables. The proceeds obtained from the sales of receivables are largely cash, but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Consolidated Balance Sheets and was approximately \$192 million and \$299 million, as of June 30, 2008 and December 31, 2007, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Consolidated Statements of Operations, was approximately \$8 million and \$9 million for three months ended June 30, 2008 and 2007, respectively, and approximately \$20 million and \$21 million for the six months ended June 30, 2008 and 2007, respectively.

During the second quarter of 2007, Cinergy received a \$204 million capital contribution from its parent, Duke Energy. Additionally, during the second quarter of 2007, Cinergy paid dividends to its parent, Duke Energy, of \$135 million.

As discussed further in Note 5, Cinergy participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations, were approximately \$2 million and an insignificant amount for the three months ended June 30, 2008 and 2007, respectively, and approximately \$7 million and an insignificant amount for the six months ended June 30, 2008 and 2007, respectively.

Notes To Unaudited Consolidated Financial Statements

11. Risk Management Instruments

As discussed in Note 1, on January 1, 2008, Cinergy adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Cinergy offsets fair value amounts (or amounts that approximate fair value) recognized on its Consolidated Balance Sheets related to cash collateral amounts receivable or payable against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting agreement. Amounts presented in the table below exclude cash collateral amounts which are disclosed separately in Note 1.

The following table shows the carrying value of Cinergy's derivative portfolio as of June 30, 2008, and December 31, 2007.

Net Derivative Portfolio Assets (Liabilities) reflected in the Consolidated Balance Sheets:

	June 30, 2008	December 31, 2007
	(in millions)	
Hedging	\$ (30)	\$ (21)
Undesignated	182	(7)
Total	\$ 152	\$ (28)

The amounts in the table above represent the combination of assets and (liabilities) for unrealized gains and losses on mark-to-market and hedging transactions on Cinergy's Consolidated Balance Sheets.

The \$189 million increase in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market gains, primarily as a result of higher coal prices.

Commodity Cash Flow Hedges. As of June 30, 2008, approximately \$45 million of the pre-tax unrealized net losses on derivative instruments related to commodity cash flow hedges included on the Consolidated Balance Sheet in Accumulated Other Comprehensive Loss are expected to be recognized in earnings during the next 12 months as the hedged transactions occur. However, due to the volatility of the commodities markets, the corresponding values in Accumulated Other Comprehensive Loss will likely change prior to their reclassification into earnings.

No gains or losses due to hedge ineffectiveness were recorded during the three and six months ended June 30, 2008 and 2007, respectively. The amount recognized for transactions that no longer qualified as cash flow hedges was insignificant for the three and six months ended June 30, 2008 and June 30, 2007, respectively.

See Note 15 for additional information related to the fair value of Cinergy's derivative instruments.

12. Regulatory Matters

Regulatory Merger Approvals

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated to create a newly formed company, Duke Energy Holding Corp. (subsequently renamed Duke Energy Corporation). As a condition to the merger approval, the PUCO, and the Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Cinergy, Duke Energy Ohio and Duke Energy Kentucky to meet additional conditions. While the merger itself was not subject to approval by the IURC, the IURC approved certain affiliate agreements in connection with the merger subject to certain conditions. Key elements of these conditions include:

- The PUCO required that Duke Energy Ohio provide (i) a rate reduction of approximately \$15 million for one year to facilitate economic development in a time of increasing rates and market prices and (ii) a reduction of approximately \$21 million to its gas and electric consumers in Ohio for one year, with both credits beginning January 1, 2006. During the first quarter of 2007, Duke Energy Ohio completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately \$2 million of the rate reductions was passed through to customers during the six months ended June 30, 2007.
- The KPSC required that Duke Energy Kentucky provide \$8 million in rate reductions to its customers over five years, ending when new rates are established in the next rate case after January 1, 2008. Approximately \$1 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2008, respectively. Approximately less than \$1 million and \$1 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2007, respectively.
- The IURC required that Duke Energy Indiana provide a rate reduction of \$40 million to its customers over a one year period and \$5 million over a five year period for low-income energy assistance and clean coal technology. In April 2006, Citizens Action Coalition of Indiana, Inc. (CAC), an intervenor in the merger proceeding, filed a Verified Petition for Rehearing and Reconsideration claiming that Duke Energy Indiana should be ordered to provide an additional \$5 million in rate reduction to customers to be consistent with the terms of the North Carolina Utilities Commission's order approving the merger. In May 2006, the IURC denied the petition for rehearing and reconsideration. As of April 30, 2007, Duke Energy Indiana had completed its merger related reductions and filed a notice with the IURC to terminate the merger credit rider. Approximately \$1 million and \$13 million of the rate reduction was passed through to customers during the three and six months ended June 30, 2007.
- The FERC approved the merger without conditions.

Rate Related Information. The IURC and KPSC approve rates for retail electric and gas services within their states. The PUCO approves rates and market prices for retail gas and electric service within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

Duke Energy Ohio Electric Rate Filings. Duke Energy Ohio operates under a RSP, a MBSSO approved by the PUCO in November 2004. In March 2005, the Office of the Ohio Consumers' Council (OCC) appealed the PUCO's approval of the MBSSO to the Supreme Court of Ohio which issued its decision in November 2006. It upheld the MBSSO in virtually every respect but remanded to the PUCO on two issues. The Supreme Court of Ohio ordered the PUCO to support a certain portion of its order with reasoning and record evidence and to require Duke Energy Ohio to disclose certain confidential commercial agreements with other parties previously requested by the OCC. Duke Energy Ohio has complied with the disclosure order.

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In October 2007, the PUCO issued its ruling affirming the MBSSO, with certain modifications, and maintaining the current price. The ruling provided for continuation of the existing rate components, including the recovery of costs related to new pollution control equipment and capacity costs associated with power purchase contracts to meet customer demand, but provided customers an enhanced opportunity to avoid certain pricing components if they are served by a competitive supplier. The ruling also attempted to modify the statutory requirement that Duke Energy Ohio transfer its generating assets to an exempt wholesale generator (EWG) and ordered Duke Energy Ohio to retain ownership for the remainder of the RSP period. The ruling also incorrectly implied that Duke Energy Ohio's nonresidential RTC will terminate at the end of 2008. On November 23, 2007, Duke Energy Ohio filed an application for rehearing on the portions of the PUCO's ruling relating to whether certain pricing components may be avoided by customers, the right to transfer generating assets, and the termination date of the RTC. On December 19, 2007, the PUCO issued its Entry on Rehearing granting in part and denying in part Duke Energy Ohio's Application for Rehearing. Among other things, the PUCO modified and clarified the applicability of various rate riders during customer shopping situations. It also clarified that the residential RTC terminates at the end of 2008 and that the nonresidential RTC terminates at the end of 2010 and agreed to give further consideration to whether Duke Energy Ohio may transfer its generating assets to an EWG.

On February 15, 2008, Duke Energy Ohio filed a notice of appeal with the Ohio Supreme Court challenging a portion of the PUCO's decision on remand regarding Duke Energy Ohio's RSP. The October 2007 order permits non-residential customers to avoid certain charges associated with the costs of Duke Energy Ohio standing ready to serve such customers if they return after being served by another supplier. Duke Energy Ohio believes the PUCO exceeded its authority in modifying the charges that may be avoided, resulting in Duke Energy Ohio having to subsidize Ohio's competitive electric market. Duke Energy Ohio has asked the Ohio Supreme Court to reverse the PUCO ruling and require that non-residential customers pay the charges associated with Duke Energy Ohio standing ready to serve them should they return from a competitive supplier. On March 28, 2008, Duke Energy Ohio voluntarily withdrew its appeal. The OCC filed a notice of appeal challenging the PUCO's October 2007 decision as unlawful and unreasonable. The OCC and Ohio Partners for Affordable Energy (OPAE) also filed appeals from the PUCO's November 20, 2007 order approving Duke Energy Ohio's MBSSO riders. Duke Energy Ohio has intervened in each appeal. Pending the Ohio Supreme Court's consideration of its initial appeal, the OCC requested that the PUCO stay implementation of the Infrastructure Maintenance Fund charge to be collected from customers approved in the October 2007 order. The Commission denied the OCC's request and the OCC filed a similar request with the Ohio Supreme Court. On July 9, 2008, the court denied the OCC's request to stay implementation of the Infrastructure Maintenance Fund. On April 30, 2008, the Ohio Supreme Court granted Duke Energy Ohio's motion to intervene in the OCC's appeal. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision. Additionally, Duke Energy Ohio cannot predict the outcome of the MBSSO rider appeal; however, Duke Energy Ohio does not anticipate the resolution of this matter will have a material impact on its results of operations, cash flows or financial position.

New legislation (SB 221) was passed on April 23, 2008 and signed by the Governor of Ohio on May 1, 2008. The new law codifies the PUCO's authority to approve an electric utility's standard service offer through an electric security plan (ESP), which would allow for pricing structures similar to the current MBSSO. Electric utilities are required to file an ESP and may also file an application for a market rate option at the same time. The market rate option is a price determined through a competitive bidding process. If a market rate option price is approved, the utility would blend in the MBSSO or ESP price with the market rate option price over a six- to ten-year period, subject to the PUCO's discretion. SB 221 provides for the PUCO to approve non-by-passable charges for new generation, including construction work-in-process from the outset of construction, as part of an ESP. The new law grants the PUCO discretion to approve single issue rate adjustments to distribution and transmission rates and establishes new alternative energy resources (including renewable energy) portfolio standards, such that the utility's portfolio must consist of at least 25% of these resources by 2025. SB 221 also provides a separate requirement for energy efficiency, which must reduce 22% of the utility's load by 2025. The utility's earnings under the ESP can be subject to an annual earnings test and the PUCO must order a refund if it finds that the utility's earnings significantly exceed the earnings of benchmark companies with similar business and financial risks. The earnings test acts as a cap to the ESP price. SB 221 also limits the ability of a utility to transfer its dedicated generating assets to an EWG absent PUCO approval.

On July 31, 2008, Duke Energy Ohio filed its ESP, a new generation pricing formula to be effective January 1, 2009, when the current RSP is scheduled to expire. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, including renewables and energy efficiency portfolio standards established by SB 221. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

Duke Energy Ohio Gas Rate Case. In July 2007, Duke Energy Ohio filed an application with the PUCO for an increase in its base rates for gas service. Duke Energy Ohio sought an increase of approximately \$34 million in revenue, or approximately 5.7%, to be effective in the spring of 2008. The application also requested approval to continue tracker recovery of costs associated with the accelerated gas main replacement program. The staff of the PUCO issued a Staff Report in December 2007 recommending an increase of approximately \$14 million to \$20 million in revenue. The Staff Report also recommended approval for Duke Energy Ohio to continue tracker recovery of costs associated with the accelerated gas main replacement program. On February 28, 2008, Duke Energy Ohio reached a settlement agreement with the PUCO Staff and all of the intervening parties on its request for an increase in natural gas base rates. The settlement called for an annual revenue increase of approximately \$18 million in base revenue, or 3% over current revenue, permitted continued recovery of costs through 2018 for Duke Energy Ohio's accelerated gas main replacement program and permitted recovery of carrying costs on gas stored underground via its monthly gas cost adjustment filing. The settlement did not resolve a proposed rate design for residential customers, which involved moving more of the fixed charges of providing gas service, such as capital investment in pipes and regulating equipment, billing and meter reading, from the per unit charges to the monthly charge. On May 28, 2008, the PUCO approved the settlement in its entirety and the proposed rate design. On June 28, 2008, the OCC and OPAE filed Applications for Rehearing opposing the rate design. On July 23, 2008, the Ohio Commission issued an Entry denying the rehearing requests of OCC and OPAE. Duke Energy Ohio does not anticipate the resolution of this matter will have a material impact on its results of operations, cash flows or financial position.

Duke Energy Ohio Electric Distribution Rate Case. On June 25, 2008, Duke Energy Ohio filed notice with the PUCO that it will seek a rate increase for electric delivery service of approximately \$86 million, or 4.8% on total electric revenues, to be effective in the second quarter of 2009. Among other things, the rate request includes a proposal to increase the monthly residential customer charge from \$4.50 to \$10, with an offsetting reduction in the usage-based charge. This change in rate design will make customer bills more even throughout the year. Duke Energy Ohio also proposes a distribution modernization tracker that would allow smaller annual increases to reflect increased investment in the delivery system. It would also facilitate the move to a SmartGrid, which would create an interactive delivery system that provides enhanced system maintenance and automatic meter reading, eliminating the need for estimated meter readings and inside meter reading. SmartGrid technology will also provide customers with real-time usage information to help customers monitor and control their energy usage.

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Duke Energy Kentucky Gas Rate Cases. In 2002, the KPSC approved Duke Energy Kentucky's gas base rate case which included, among other things, recovery of costs associated with an accelerated gas main replacement program. The approval authorized a tracking mechanism to recover certain costs including depreciation and a rate of return on the program's capital expenditures. The Kentucky Attorney General appealed to the Franklin Circuit Court the KPSC's approval of the tracking mechanism as well as the KPSC's subsequent approval of annual rate adjustments under this tracking mechanism. In 2005, both Duke Energy Kentucky and the KPSC requested that the court dismiss these cases.

In February 2005, Duke Energy Kentucky filed a gas base rate case with the KPSC requesting approval to continue the tracking mechanism and for a \$14 million annual increase in base rates. A portion of the increase is attributable to recovery of the current cost of the accelerated gas main replacement program in base rates. In December 2005, the KPSC approved an annual rate increase of \$8 million and re-approved the tracking mechanism through 2011. In February 2006, the Kentucky Attorney General appealed the KPSC's order to the Franklin Circuit Court, claiming that the order improperly allows Duke Energy Kentucky to increase its rates for gas main replacement costs in between general rate cases, and also claiming that the order improperly allows Duke Energy Kentucky to earn a return on investment for the costs recovered under the tracking mechanism which permits Duke Energy Kentucky to recover its gas main replacement costs.

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, and any other annual rate adjustments under the tracking mechanism. To date, Duke Energy Kentucky has collected approximately \$9 million in annual rate adjustments under the tracking mechanism. Duke Energy Kentucky and the KPSC have appealed these cases to the Kentucky Court of Appeals and Duke Energy Kentucky continues to utilize tracking mechanisms in its billed rates to customers. At this time, Duke Energy Kentucky cannot predict the outcome of these proceedings.

Indiana Allowance for Funds Used During Construction (AFUDC) Ruling. Duke Energy Indiana recovers financing and other operating costs associated with certain environmental control property through a rate adjustment mechanism. In January 2008 the IURC approved the inclusion of an accounting adjustment for AFUDC affecting the value of the property. The Indiana Office of Utility Consumer Counselor (OUCC) filed a petition asking the IURC to rehear and reconsider its decision regarding approval of the amount of AFUDC included in the value of the property. The IURC issued an order in the second quarter of 2008 denying the OUCC's request and upholding its original decision. The IURC's Order on Reconsideration is currently on appeal before the Indiana Court of Appeals. Cinergy recorded the favorable impacts of this IURC ruling as a component of Other income and expenses, net on the Consolidated Statements of Operations, which amounted to approximately \$18 million and \$25 million during the three and six months ended June 30, 2008.

Energy Efficiency. On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). The DSM Program consists of ten residential and two commercial programs. Implementation of the programs has begun. The programs were first proposed in 2006 and were endorsed by the Duke Energy Community Partnership, which is a collaborative group made up of representatives of organizations interested in energy conservation, efficiency and assistance to low-income customers. The programs' costs will be recouped through a cost recovery mechanism that will be adjusted annually to reflect the previous year's activity. Duke Energy Ohio is permitted to recover lost revenues, program costs and shared savings (once the programs reach 65% of the targeted savings level) through the cost recovery mechanism based upon impact studies to be provided to the Staff of the PUCO.

In October 2007, Duke Energy Indiana filed its petition with the IURC requesting approval of an alternative regulatory plan to increase its energy efficiency efforts in the state. Duke Energy Indiana seeks approval of a plan that will be available to all customer groups and will compensate Duke Energy Indiana for verified reductions in energy usage. Under the plan, customers would pay for energy efficiency programs through an energy efficiency rider that would be included in their power bill and adjusted annually through a proceeding before the IURC. The energy efficiency rider will be based on the avoided cost of generation not needed as a result of the success of Duke Energy Indiana's energy efficiency programs. A number of parties have intervened in the proceeding. On August 1, 2008, Duke Energy Indiana filed a notice of settlement with the IURC that the OUCC and Duke Energy Indiana had reached an agreement in principle resolving all issues in the case between Duke Energy Indiana and the OUCC. On August 1, 2008, Duke Energy reached a settlement agreement with the OUCC; the settlement agreement was filed with the IURC on August 15, 2008. The IURC has scheduled an evidentiary hearing for the settlement agreement for November 20-24, 2008.

On November 15, 2007, Duke Energy Kentucky filed its annual application to continue existing energy efficiency programs, consisting of nine residential and two commercial and industrial programs, and to true-up its gas and electric tracking mechanism for recovery of lost revenues, program costs and shared savings. On February 11, 2008, Duke Energy Kentucky filed a motion to amend its energy efficiency programs and applied to reinstitute a low income Home Energy Assistance Program. The KPSC bifurcated the proposed Home Energy Assistance Program from the other energy efficiency programs. On May 14, 2008, the KPSC approved the energy efficiency programs. An order on the Home Energy Assistance Program is expected in the third quarter of 2008.

Capital Expansion Projects

Edwardsport Integrated Gasification Combined Cycle (IGCC) Plant. On September 7, 2006, Duke Energy Indiana and Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc. (Vectren) filed a joint petition with the IURC seeking a Certificate of Public Convenience and Necessity (CPCN) for the construction of a 630 MW IGCC power plant at Duke Energy Indiana's Edwardsport Generating Station in Knox County, Indiana. The petition describes the applicants' need for additional base load generating capacity and requests timely recovery of all construction and operating costs related to the proposed generating station, including financing costs, together with certain incentive ratemaking treatment. In April 2007, Duke Energy Indiana and Vectren filed a Front End Engineering and Design Study Report which included an updated estimated cost for the IGCC project of approximately \$2 billion (including approximately \$120 million of AFUDC). In June 2007, Vectren decided not to proceed with the CPCN petition, and in August 2007, Vectren formally withdrew its participation in the IGCC plant. In June 2007, a hearing was conducted on the CPCN petition based on Duke Energy Indiana owning 100% of the project. On November 20, 2007, the IURC issued an order granting Duke Energy Indiana a CPCN for the proposed IGCC project, approved the cost estimate of \$1.985 billion and approved the timely recovery of costs related to the project. The IURC also approved Duke Energy Indiana's proposal to initiate a proceeding in May 2008 concerning proposals for the study of partial carbon capture, sequestration and/or enhanced oil recovery for the Edwardsport IGCC Project. On January 25, 2008, Duke Energy Indiana received the final air permit from the Indiana Department of Environmental Management. The Citizens Action Coalition of Indiana, Inc., Sierra Club, Inc., Save the Valley, Inc., and Valley Watch, Inc., all interveners in the CPCN proceeding, have appealed the IURC Order to the Indiana Court of Appeals and also appealed the air permit. The Joint Brief of the Appellants was filed on

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May 30, 2008 and the Duke Energy Indiana Brief of Appellant was filed on July 23, 2008 in the appeal of the IURC CPCN Order. These appeals are pending.

On May 1, 2008, Duke Energy Indiana filed its first semi-annual IGCC Rider and ongoing review proceeding with the IURC as required under the CPCN Order issued by the IURC in November 2007, which approved the IGCC Project. In its filing, Duke Energy Indiana requested approval of a new cost estimate for the IGCC Project of \$2.35 billion (including approximately \$125 million of AFUDC) and for approval of plans to study carbon capture, sequestration and/or enhanced oil recovery, as required by the IURC's November 2007 CPCN Order. An evidentiary hearing was conducted on August 25, 2008. Proposed orders will be submitted by the parties in September and an order is expected later this year. Under the CPCN Order and statutory provisions, Duke Energy Indiana is entitled to recover the costs reasonably incurred in reliance on the CPCN Order. Duke Energy Indiana has begun construction on the Edwardsport IGCC plant.

Federal Advanced Clean Coal Tax Credits. Duke Energy Indiana has been awarded approximately \$134 million of federal advanced clean coal tax credits associated with its construction of the Edwardsport IGCC plant. Since these credits were issued, Appalachian Voices and The Canary Coalition of Sylva have filed suit in a Washington federal court attempting to block tax credits issued to Duke Energy and other utilities that are in the process of constructing clean-coal technology plants throughout the United States, citing that the Department of Energy (DOE) violated the National Environmental Protection Act in granting these credits. The groups are seeking a preliminary injunction requiring the DOE to suspend the credits until the merits of the suit can be heard. Duke Energy Indiana believes these credits were properly awarded.

Other Matters

Power Hedging. Duke Energy Indiana recovers its actual fuel costs quarterly through a rate adjustment mechanism. In a recent fuel clause proceeding, certain industrial customers and the Consumer Advisory Council have intervened and a subdocket has been established to address an issue raised by the OUCC and the intervenors concerning the recovery of costs associated with certain power hedging activities. This subdocket has now been resolved. An evidentiary hearing in the power hedging proceeding was held in June 2007. A settlement agreement between the OUCC and Duke Energy Indiana was filed with the IURC in May 2008 and on June 25, 2008, the IURC issued a decision approving the settlement agreement, thereby resolving all disputed issues related to Duke Energy Indiana's power hedging activities. Among other matters, the settlement agreement provided for a one-time credit of \$1 million reflected in Duke Energy Indiana's next fuel clause proceeding (FAC77). Under the settlement agreement and resulting order, the "subject to refund" provisions contained in prior FAC orders related to power hedging costs has been removed. In addition, the settlement agreement and order provide for an on-going hedging methodology, beginning August 1, 2008, continuing until permanent hedging protocols are developed and approved by the IURC.

Ohio Riser Leak Investigation. In April 2005, the PUCO issued an order opening a statewide investigation into riser leaks in gas pipeline systems throughout Ohio. The investigation followed four explosions since 2000 caused by gas riser leaks, including an April 2000 explosion in Duke Energy Ohio's service area. In November 2006, the PUCO Staff released the expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. The PUCO Staff recommended that natural gas companies continue to monitor the situation and study the cause of any further riser leaks to determine whether further remedial action is warranted. Duke Energy Ohio has approximately 87,000 of these risers on its distribution system. If the PUCO orders natural gas companies to replace all of these risers, Duke Energy Ohio estimates a replacement cost of approximately \$40 million. As part of the rate case filed in July 2007 (see "Duke Energy Ohio Gas Rate Case" above), Duke Energy Ohio requested approval from the PUCO to accelerate its riser replacement program. The riser replacement program is contained in the settlement reached with all intervenors and will be completed at the end of 2012.

SmartGrid and Distributed Renewable Generation Demonstration Project. On May 23, 2008, Duke Energy Indiana filed a petition with the IURC requesting approval for SmartGrid and Distributed Renewable Generation Demonstration Project investments and related costs along with a request to annually update distribution rates and include a lost revenue recovery mechanism. Hearings are anticipated to be held in February 2009.

Gibson Unit 4 Outage. In another recent fuel clause proceeding, the IURC granted a motion by the Industrial Group and Nucor to establish a subdocket to examine whether imprudence in Duke Energy Indiana's maintenance practices led to a forced outage at Gibson Station Unit 4 during January-March 2008. The outage contributed to notably higher fuel and purchased power costs during the outage. The IURC authorized Duke Energy Indiana to collect through rates the costs for which it sought recovery in the subdocket proceeding subject to refund (similar to prior subdockets) pending the outcome of this new subdocket. A procedural schedule for this proceeding has been established and the hearing is scheduled for January 2009.

Ohio Smart Metering Evaluation. In December 2005, the PUCO initiated an investigation into implementing certain provisions of the Energy Policy Act of 2005, including whether to adopt a statewide standard for implementing smart metering. After an investigation, the PUCO issued a March 2007 order requiring all electric utilities to offer tariffs to all customer classes which are differentiated, at a minimum, based on on-peak and off-peak wholesale price periods. The PUCO noted that time-of-use meters should be available for customers subscribing to these tariffs. The order instructed PUCO Staff to conduct workshop meetings to study the costs/benefits of deploying smart metering. These workshop meetings are in progress. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

FERC 203 Application. On April 23, 2008, Duke Energy Ohio and certain affiliates filed an application with the FERC requesting approval to transfer Duke Energy Ohio's electric generating facilities, some of which are designated to serve Ohio customers, to affiliate companies. The affiliate companies would be consolidated by Duke Energy, but may not be consolidated by Duke Energy Ohio. The FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and management is in the process of evaluating the potential transfer. Management believes the proposed asset transfer could provide greater financial flexibility for the assets. The asset transfer complies with Duke Energy Ohio's Corporate Separation Plan that was amended by the PUCO in 2007. As previously discussed, SB 221 limits the ability of a utility to transfer its designated generating assets to an EWG absent PUCO approval. The filing does not impact Duke Energy Ohio's current rates.

Midwest Independent Transmission System Operator, Inc. (Midwest ISO) Resource Adequacy Filing. On December 28, 2007, the Midwest ISO filed its Electric Tariff Filing Regarding Resource Adequacy in compliance with the FERC's request of Midwest ISO to file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal includes establishment of a resource adequacy requirement in the form of planning reserve margin. On March 26, 2008, the FERC ruled on the Midwest ISO's Resource Adequacy filing and ordered that the new Module E tariff be effective March 27, 2008. This action established a Midwest ISO-wide resource adequacy requirement for the first Planning Year, which begins June 2009. In the Order, the FERC, among other things, clarified that States have the authority to set their own Planning Reserve Margins, as long as they are not inconsistent with any reliability standard approved by the FERC. Cinergy does not believe the resource adequacy requirement will have a material impact on its consolidated results of operations, cash flows or financial position.

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Midwest ISO's Establishment of an Ancillary Services Market. On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ancillary services market (ASM), including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of Balancing Authority for the entire Midwest ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 Balancing Authorities. The Midwest ISO delayed the ASM launch date, previously scheduled for September 9, 2008, indefinitely. In January 2008, Duke Energy Indiana and three other Indiana utilities filed a joint petition with the IURC, requesting, among other things, authority to transfer additional balancing authority functions to the Midwest ISO and for recovery of costs incurred under the ASM. On August 13, 2008, the Commission issued an order authorizing the Joint Petitioners to transfer additional balancing authority functions to the Midwest ISO, to participate in the Ancillary Services Market and to defer ASM costs pending a final order in the case. A hearing is scheduled on the cost recovery issues on September 24 and 26, 2008. At this time, Cinergy does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its consolidated results of operations, cash flows or financial position.

PJM Interconnection Reliability Pricing Model (RPM) Buyers' Complaint. On May 30, 2008, a group of public utility commissions, state consumer counsels, industrial power customers and load serving entities, known collectively as the RPM Buyers, filed a complaint at FERC. The complaint asks FERC to find that the results of the three transitional base residual auctions conducted by PJM to procure capacity for its RPM capacity market during the years 2008-2011 are unjust and unreasonable because, allegedly, they have produced excessive capacity prices, have failed to prevent suppliers from exercising market power, and have not produced benefits commensurate with costs. In their complaint, the RPM Buyers propose revised, administratively determined auction clearing prices. Certain Duke Energy Ohio revenues are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008 Duke filed a response to the complaint with the FERC. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

13. Commitments and Contingencies

Environmental

Cinergy is subject to federal, state and local regulations regarding air and water quality, hazardous and solid waste disposal and other environmental matters. These regulations can be changed from time to time, imposing new obligations on Cinergy.

Remediation Activities. Cinergy and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Cinergy operations, sites formerly owned or used by Cinergy entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Cinergy or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Cinergy may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Cinergy believes that completion or resolution of these matters will have no material adverse effect on its consolidated results of operations, cash flows or financial position.

Clean Water Act 316(b). The U.S. Environmental Protection Agency (EPA) finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Fourteen of the 23 coal and nuclear-fueled generating facilities in which Cinergy is either a whole or partial owner are affected sources under that rule. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit issued its opinion in *Riverkeeper, Inc. v. EPA*, Nos. 04-6692-ag(L) et. al. (2d Cir. 2007) remanding most aspects of the EPA's rule back to the agency. The court effectively disallowed those portions of the rule most favorable to industry, and the decision creates a great deal of uncertainty regarding future requirements and their timing. On April 14, 2008, the U.S. Supreme Court issued an order granting review of the case and briefs were filed on July 14, 2008. A decision is not likely until 2009. If the Supreme Court upholds the lower court decision, it is expected that costs will increase as a result of the court's decision, although Cinergy is unable to estimate its costs to comply.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR was to have limited total annual and summertime nitrogen oxides (NO_x) emissions and annual SO₂ emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 was to begin in 2009 for NO_x and in 2010 for SO₂. Phase 2 was to begin in 2015 for both NO_x and SO₂. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. Nearly all aspects of the rule were challenged, but Duke Energy challenged only the portions pertaining to SO₂ allowance allocations. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA has until September 24, 2008 to appeal the decision. The D.C. Circuit's decision creates uncertainty regarding future NO_x and SO₂ emission reductions requirements and their timing. Although as a result of the decision there may be a delay in the timing of federal requirements to reduce emissions, it is expected that electric sector emission reductions at least as stringent as those imposed by CAIR will be required in the near future, through new federal rules and/or individual state requirements. CAIR remains in effect until the Court issues its mandate, which will not be before the period for petitions for rehearing runs. Cinergy's plan had been to spend approximately \$300 million between 2008 and 2012 (approximately \$150 million in each of Ohio and Indiana) to comply with Phase 1 of CAIR and approximately \$200 million in Indiana for CAIR Phase 2 compliance costs over the period 2008-2017. It has not been determined how the court's decision will affect these planned expenditures. The IURC issued an order in 2006 granting Duke Energy Indiana approximately \$1.07 billion in rate recovery to cover its estimated Phase 1 compliance costs of CAIR/Clean Air Mercury Rule (CAMR) in Indiana. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 12).

Cinergy is unable to estimate the costs to comply with any new rule EPA may issue as a result of this decision. See Note 7 for a discussion of the potential impact of the D.C. Circuit Court's decision to vacate CAIR on the carrying value of emission allowances.

Clean Air Mercury Rule (CAMR). The EPA finalized its CAMR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the U.S. through a two-phased cap-and-trade program beginning in 2010. On February 8, 2008, the D.C. Circuit issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. Requests for rehearing were denied. Parties have until September 17, 2008 to request U.S. Supreme Court review of the D.C. Circuit's

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decision. The D.C. Circuit's decision creates uncertainty regarding future mercury emission reduction requirements and their timing, but makes it fairly certain that there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants. At this point, Cinergy is unable to estimate the costs to comply with any future mercury regulations that might result from the D.C. Circuit's decision.

Coal Combustion Product (CCP) Management. Cinergy currently estimates that it will spend approximately \$215 million over the period 2008-2012 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

Zimmer Generating Station Clean Air Act Notice of Violation/Finding of Violation. On March 10, 2008, the EPA issued a Clean Air Act Notice of Violation/Finding of Violation (NOV/FOV) asserting noncompliance with SO₂ emission limits, opacity standards, and permitting requirements at Duke Energy Ohio's Zimmer Generating Station. The NOV/FOV also asserts that a Prevention of Significant Deterioration (PSD) permit should have been obtained for the installation in 2004 of a pollution control project in order to comply with the EPA's regional cap-and-trade program for NO_x emissions. Duke Energy Ohio disputes the legal and factual basis for the NOV/FOV. Cinergy is unable to predict at this time what, if any, remedies or potential penalties may result from the NOV/FOV.

Comprehensive Environmental Response, Compensation, and Liability Act Matter. In August 2008, Duke Energy Ohio received a notice from the EPA that it has been identified as a potentially responsible party under the Comprehensive Environmental Response, Compensation, and Liability Act at the LWD, Inc., Superfund Site in Calvert City, Kentucky. At this time, Duke Energy Ohio does not have any further information regarding the scope of potential liability associated with this matter.

Extended Environmental Activities and Accruals. Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately \$22 million and \$18 million as of June 30, 2008 and December 31, 2007, respectively. These accruals represent Cinergy's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Cinergy believes that completion or resolution of these matters will have no material impact on its consolidated results of operations, cash flows or financial position.

Litigation

New Source Review (NSR). In 1999-2000, the U.S. DOJ, acting on behalf of the EPA and joined by various citizen groups and states, filed a number of complaints and notices of violation against multiple utilities across the country for alleged violations of the NSR provisions of the Clean Air Act (CAA). Generally, the government alleges that projects performed at various coal-fired units were major modifications, as defined in the CAA, and that the utilities violated the CAA when they undertook those projects without obtaining permits and installing the best available emission controls for SO₂, NO_x and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various allegedly violating generating units, and unspecified civil penalties in amounts of up to \$32,500 per day for each violation. A number of Cinergy's plants have been subject to these allegations. Cinergy asserts that there were no CAA violations because the applicable regulations do not require permitting in cases where the projects undertaken are "routine" or otherwise do not result in a net increase in emissions.

In November 1999, the U.S. brought a lawsuit in the U.S. Federal District Court for the Southern District of Indiana against Cinergy, Duke Energy Ohio and Duke Energy Indiana alleging various violations of the CAA for various projects at six of Cinergy owned and co-owned generating stations in the Midwest. Three northeast states and two environmental groups have intervened in the case. A jury trial commenced on May 5, 2008 and jury verdict was returned on May 22, 2008. The jury found in favor of Cinergy, Duke Energy Ohio and Duke Energy Indiana, Inc. on all but three units at Wabash River. The remedy phase for the three Wabash River units is expected to commence in December 2008. Based on previous rulings by the judge in this case, the Wabash River units are not subject to civil penalties; and therefore, the remedy phase will address only the appropriate injunctive relief. Additionally, the plaintiffs had claimed that Cinergy violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's State Implementation Plan (SIP) provisions governing particulate matter at Duke Energy Ohio's W.C. Beckjord Station. The judge previously granted summary judgment against Cinergy with respect to this allegation and it will be considered during the December 2008 remedy phase as well.

Cinergy and Duke Energy Ohio have been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a NOV to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, Columbus Southern Power Company (CSP), and Duke Energy Ohio. The NOV indicated the EPA may issue an order requiring compliance with the requirements of the Ohio SIP, or bring a civil action seeking injunctive relief and civil penalties of up to \$27,500 per day for each violation. In September 2004, Marilyn Wall and the Sierra Club brought a lawsuit against Duke Energy Ohio, DP&L and CSP for alleged violations of the CAA at this same generating station. Trial of this case was originally scheduled to commence in August 2008, however, the parties have reached an agreement in principle to settle this matter, subject to comment by the EPA and the U.S. DOJ, and court approval. The proposed settlement will not have a material adverse effect on Cinergy's consolidated results of operations, cash flows or financial position.

On April 3, 2008, the Sierra Club filed another lawsuit in the U.S. District Court for the Southern District of Indiana against Duke Energy Indiana and certain affiliated companies claiming NSR violations at the Edwardsport generating station in Knox County, Indiana. Sierra Club claims that Duke Energy Indiana violated the CAA when it undertook various unnamed maintenance projects at Edwardsport without obtaining permits and installing the best available emission controls. Sierra Club further states that it intends to file suit for additional alleged violations of the CAA and the Indiana State Implementation Plan. On June 30, 2008, defendants filed a motion to dismiss, or alternatively to stay, this litigation on jurisdictional grounds. A decision on the motion is pending. It is not possible to predict with certainty whether Cinergy will incur any liability or to estimate the damages, if any, that Cinergy might incur in connection with these matters. Ultimate resolution of these matters relating to NSR, even in settlement, could have a material adverse effect on Cinergy's consolidated results of operations, cash flows or financial position. However, Cinergy will pursue appropriate regulatory treatment for any costs incurred in connection with such resolution.

Section 126 Petitions. In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Ohio and Indiana, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP), that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial. In the D.C. Circuit's CAIR decision noted above, the Court reinstated North Carolina's petition. At this time, Cinergy cannot predict the outcome of this proceeding.

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Carbon Dioxide (CO₂) Litigation. In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO₂ from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO₂. The plaintiffs are seeking an injunction requiring each defendant to cap its CO₂ emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral arguments were held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Cinergy will incur any liability or to estimate the damages, if any, that Cinergy might incur in connection with this matter.

Zimmer Generating Station (Zimmer Station) Lawsuit. In November 2004, a citizen of the Village of Moscow, Ohio, the town adjacent to Duke Energy Ohio's Zimmer Station, brought a purported class action in the U.S. District Court for the Southern District of Ohio seeking monetary damages and injunctive relief against Duke Energy Ohio for alleged violations of the CAA, the Ohio SIP, and Ohio laws against nuisance and common law nuisance. The plaintiffs have filed a number of additional notices of intent to sue and two lawsuits raising claims similar to those in the original claim. One lawsuit was dismissed on procedural grounds, and the remaining two have been consolidated. On December 28, 2006, the District Court certified this case as a class action. Discovery in the case continues. At this time, Cinergy cannot predict whether the outcome of this matter will have a material impact on its consolidated results of operations, cash flows or financial position. Cinergy intends to defend this lawsuit vigorously in court.

Manufactured Gas Plant (MGP) Sites. Coal tar residues, related hydrocarbons, and various metals have been found in at least 23 sites that Duke Energy Indiana or its predecessors previously owned and sold in a series of transactions with Northern Indiana Public Service Company (NIPSCO) and Indiana Gas Company, Inc. (IGC). The 23 sites are in the process of being studied and will be remediated, if necessary. In 1998 NIPSCO, IGC, and Duke Energy Indiana entered into Site Participation and Cost Sharing Agreements to allocate liability and responsibilities among them. Thus far, Duke Energy Indiana has primary responsibility for investigating, monitoring, and, if necessary, remediating nine of these sites. In December 2003, Duke Energy Indiana entered into a voluntary remediation plan with the state of Indiana, providing a formal framework for the investigation and cleanup of the nine sites. The Indiana Department of Environmental Management oversees investigation and cleanup of all of these sites. In 2007, Duke Energy Indiana purchased four parcels of property adjacent to one of the MGP sites because of evidence of migration of groundwater contamination.

Duke Energy Indiana has accrued costs related to investigation, remediation, and groundwater monitoring for those sites where such costs are probable and can be reasonably estimated. Duke Energy Indiana will continue to investigate and remediate the sites as outlined in the voluntary remediation plan. As additional facts become known and investigation is completed, Duke Energy Indiana will assess whether the likelihood of incurring additional costs becomes probable. Until all investigation and remediation is complete, Cinergy is unable to determine the overall impact on its consolidated results of operations, cash flows or financial position.

Dunavan Waste Superfund Site. In July and October 2005, Duke Energy Indiana received notices from the EPA that it has been identified as a de minimus potentially responsible party under the Comprehensive Environmental Response, Compensation, and Liability Act at the Dunavan Waste Oil Site in Oakwood, Vermilion County, Illinois. At this time, Duke Energy Indiana does not have any further information regarding the scope of potential liability associated with this matter.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the U.S. District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their appeal to the Fifth Circuit Court of Appeals and oral argument was heard on August 6, 2008. Due to the late refusal of one of the judges on the Fifth Circuit panel, the Court has calendared the second oral argument for the week of November 3, 2008. It is not possible to predict with certainty whether Cinergy will incur any liability or to estimate the damages, if any, that Cinergy might incur in connection with this matter.

Ohio Antitrust Lawsuit. In January 2008, four plaintiffs, including individual, industrial and non-profit customers, filed a lawsuit against Duke Energy Ohio in federal court in the Southern District of Ohio. Plaintiffs allege that Duke Energy Ohio (then The Cincinnati Gas & Electric Company (CG&E)), conspired to provide inequitable and unfair price advantages for certain large business consumers by entering into non-public option agreements with such consumers in exchange for their withdrawal of challenges to Duke Energy Ohio's (then CG&E's) pending RSP, which was implemented in early 2005. Duke Energy Ohio denies the allegations made in the lawsuit. Following Duke Energy Ohio's filing of a motion to dismiss plaintiffs' claims, plaintiffs amended their complaint on May 30, 2008. Plaintiffs now contend that the contracts at issue were an illegal rebate which violate antitrust and RICO statutes. Defendants have again moved to dismiss the claims. It is not possible to predict with certainty whether Cinergy will incur any liability or to estimate the damages, if any, that Cinergy might incur in connection with this matter.

Asbestos-related Injuries and Damages Claims. Duke Energy Indiana and Duke Energy Ohio have been named as defendants or co-defendants in lawsuits related to asbestos at its electric generating stations. The impact on Cinergy's consolidated results of operations, cash flows or financial position of these cases to date has not been material. Based on estimates under varying assumptions concerning uncertainties, such as, among others: (i) the number of contractors potentially exposed to asbestos during construction or maintenance of Duke Energy Indiana and Duke Energy Ohio generating plants; (ii) the possible incidence of various illnesses among exposed workers; and (iii) the potential settlement costs without federal or other legislation that addresses asbestos tort actions, Cinergy estimates that the range of reasonably possible exposure in existing and future suits over the foreseeable future is not material. This estimated range of exposure may change as additional settlements occur and claims are made and more case law is established.

EI UK Holdings, Inc. In March, 2004, EI UK Holdings, Inc., a subsidiary of FirstEnergy Corp, filed a complaint in Ohio State Court. The complaint alleged that Cinergy, and an affiliate, had breached certain agreements and sought indemnification from Cinergy. The case went to trial and on February 14, 2008, the jury returned a verdict in favor of EI UK Holdings and against Cinergy and its affiliate and awarded EI UK Holdings \$15 million, plus interest. Post judgment motions were denied and Cinergy paid the verdict and prejudgment interest in June 2008.

Notes To Unaudited Consolidated Financial Statements

Other Litigation and Legal Proceedings. Cinergy and its subsidiaries are involved in other legal, tax and regulatory proceedings arising in the ordinary course of business, some of which involve substantial amounts. Cinergy believes that the final disposition of these proceedings will not have a material adverse effect on its consolidated results of operations, cash flows or financial position.

Cinergy has exposure to certain legal matters that are described herein. As of June 30, 2008 and December 31, 2007, Cinergy has recorded insignificant reserves for these proceedings and exposures. Cinergy expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

Synfuel. Cinergy produced synfuel from facilities that qualified for tax credits (through 2007) in accordance with Section 29/45K of the Internal Revenue Code if certain requirements were satisfied. Section 29/45K provided for a phase-out of the credit if the average price of crude oil during a calendar year exceeded a specified threshold. The phase-out was based on a prescribed calculation and definition of crude oil prices. The exposure to synfuel tax credit phase-out was monitored as Cinergy was able to reduce or cease synfuel production based on the expectation of any potential tax credit phase-out. The objective of these activities was to reduce potential losses incurred if the reference price in a year exceeded a level triggering a phase-out of synfuel tax credits.

These credits reduced Cinergy's income tax liability and, therefore, Cinergy's tax expense recorded in Income From Discontinued Operations, net of tax (see Note 9). Cinergy's sale of synfuel had generated \$339 million in tax credits through December 31, 2005. After reducing for the possibility of phase-out, the amount of additional credits generated during the years ended December 31, 2007 and 2006 were approximately \$84 million and \$20 million, respectively. Cinergy ceased production of synfuel upon the expiration of the tax credits at the end of 2007.

The Internal Revenue Service (IRS) has completed the audit of Cinergy for the 2002, 2003, and 2004 tax years, including the synfuel facility owned during that period, which represents \$222 million of tax credits generated during the aforementioned audit period. The IRS has not proposed any adjustment that would disallow the credits claimed during that period. Subsequent periods are still subject to audit. Cinergy believes that it operated in conformity with all the necessary requirements to be allowed such credits under Section 29/45K.

DEGS of Narrows, L.L.C. Investigation. In October 2006, Cinergy began an internal investigation into improper data reporting to the EPA regarding air emissions under the NO_x Budget Program at Cinergy's DEGS of Narrows, L.L.C. power plant facility in Narrows, Virginia. The investigation has revealed evidence of falsification of data by an employee relating to the quality assurance testing of its continuous emissions monitoring system to monitor heat input and NO_x emissions. In December 2006, Cinergy voluntarily disclosed the potential violations to the EPA and Virginia Department of Environmental Quality (VDEQ), and in January 2007, Cinergy made a full written disclosure of the investigation's findings to the EPA and the VDEQ. In December 2007, the EPA issued a notice of violation. Cinergy has taken appropriate disciplinary action, including termination, with respect to the employees involved with the false reporting. It is not possible to predict with certainty whether Cinergy will incur any liability or to estimate the damages, if any, that Cinergy might incur in connection with this matter.

General. Cinergy enters into various fixed-price, non-cancelable commitments to purchase or sell power (tolling arrangements or power purchase contracts) that may or may not be recognized on the Consolidated Balance Sheets.

14. Guarantees and Indemnifications

Cinergy has various financial and performance guarantees and indemnifications, discussed below, which are issued in the normal course of business. Cinergy enters into these arrangements to facilitate a commercial transaction with a third party by enhancing the value of the transaction to the third party.

Cinergy has issued performance guarantees to customers and other third parties that guarantee the payment and performance of other parties, including certain non-wholly-owned consolidated entities, as well as guarantees of debt of certain non-consolidated entities and less than wholly-owned consolidated entities. If such entities were to default on payments or performance, Cinergy would be required under the guarantees to make payment on the obligation of the less than wholly-owned entity. The maximum potential amount of future payments Cinergy could have been required to make under these performance guarantees as of June 30, 2008 was approximately \$344 million. Approximately \$276 million of the performance guarantees expire between 2008 and 2039, with the remaining performance guarantees having no contractual expiration.

Cinergy has entered into various indemnification agreements related to purchase and sale agreements and other types of contractual agreements with vendors and other third parties. These agreements typically cover environmental, tax, litigation and other matters, as well as breaches of representations, warranties and covenants. Typically, claims may be made by third parties for various periods of time, depending on the nature of the claim. Cinergy's potential exposure under these indemnification agreements can range from a specified amount, such as the purchase price, to an unlimited dollar amount, depending on the nature of the claim and the particular transaction. Cinergy is unable to estimate the total potential amount of future payments under these indemnification agreements due to several factors, such as the unlimited exposure under certain guarantees.

At June 30, 2008, the amounts of the fair value recorded for the guarantees and indemnifications mentioned above are insignificant, both individually and in the aggregate.

15. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Cinergy adopted SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). Cinergy's adoption of SFAS No. 157 is currently limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 for one year for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. There was no cumulative effect adjustment to retained earnings for Cinergy as a result of the adoption of SFAS No. 157.

SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosure requirements about fair value measurements. Under SFAS No. 157, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition under SFAS No. 157 focuses on an exit price, which is the price that would be received by Cinergy to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. Although SFAS No. 157 does not require additional fair value measurements, it applies to other accounting pronouncements that require or permit fair value measurements.

Cinergy determines fair value of financial assets and liabilities based on the following fair value hierarchy, as prescribed by SFAS No. 157, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

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Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Cinergy has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information. Cinergy does not adjust quoted market prices on Level 1 inputs for any blockage factor.

Level 2 inputs – inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates.

Level 3 inputs – unobservable inputs for the asset or liability.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115" (SFAS No. 159), which permits entities to elect to measure many financial instruments and certain other items at fair value. For Cinergy, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Cinergy does not currently have any financial assets or financial liabilities for which the provisions of SFAS No. 159 have been elected. However, in the future, Cinergy may elect to measure certain financial instruments at fair value in accordance with this standard.

The following table provides the fair value measurement amounts for assets and liabilities recorded in both current and non-current Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Cinergy's Consolidated Balance Sheets at fair value at June 30, 2008. Amounts presented in the table below exclude cash collateral amounts which are disclosed separately in Note 1.

	Total Fair Value Amounts at June 30, 2008	Level 1	Level 2	Level 3
	(in millions)			
Description				
Other long-term available for sale securities ^(a)	\$ 130	\$ 100	\$ 30	\$ —
Derivative assets ^(b)	400	110	—	290
Total Assets	\$ 530	\$ 210	\$ 30	\$ 290
Derivative liabilities ^(c)	\$ (248)	\$ —	\$ (4)	\$ (244)
Net Assets	\$ 282	\$ 210	\$ 26	\$ 46

(a) Included in Other within Investments and Other Investments in the Consolidated Balance Sheets.

(b) Included in Unrealized gains on mark-to-market and hedging transactions within Current Assets and Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets in the Consolidated Balance Sheets.

(c) Included in Unrealized losses on mark-to-market and hedging transactions within Current Liabilities and Unrealized losses on mark-to-market and hedging transactions within Deferred Credits and Other Liabilities in the Consolidated Balance Sheets.

The following table provides a reconciliation of beginning and ending balances of assets and liabilities measured at fair value on a recurring basis where the determination of fair value includes significant unobservable inputs (Level 3):

Rollforward of Level 3 Measurements

	Derivatives (net)
	(in millions)
Three Months Ended June 30, 2008	
Balance at April 1, 2008	\$ (29)
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated	65
Total pre-tax losses included in other comprehensive income	(6)
Net purchases, sales, issuances and settlements	(17)
Total gains included on balance sheet as regulatory asset or liability or as non-current liability	33
Balance at June 30, 2008	\$ 46
Six Months Ended June 30, 2008	
Balance at January 1, 2008	\$ (38)
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated	77
Total pre-tax losses included in other comprehensive income	(9)
Net purchases, sales, issuances and settlements	(31)
Total gains included on balance sheet as regulatory asset or liability or as non-current liability	47
Balance at June 30, 2008	\$ 46
Pre-tax amounts included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at June 30, 2008:	
Revenue, non-regulated	63
Total	\$ 63

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Valuation methods of the primary fair value measurements disclosed above are as follows:

Investments in equity securities: Investments in equity securities are typically valued at the closing price in the principal active market as of the last business day of the quarter. Principal active markets for equity prices include published exchanges such as NASDAQ, NYSE, NYMEX and Chicago Board of Trade, as well as pink sheets, which is an electronic quotation system that displays quotes for broker-dealers for many over-the-counter securities. Foreign equity prices are translated from their trading currency using the currency exchange rate in effect at the close of the principal active market. Cinergy does not adjust prices to reflect for after-hours market activity. Cinergy's investments in equity securities are valued using Level 1 measurements.

Investments in debt securities: Most debt investments are valued based on a calculation using interest rate curves and credit spreads applied to the terms of the debt instrument (maturity and coupon interest rate) and consider the counterparty credit rating. Most debt valuations are Level 2 measures. If the market for a particular fixed income security is relatively inactive or illiquid, the measurement is a Level 3 measurement. U.S. Treasury debt is typically a Level 1 measurement.

Commodity derivatives: The pricing for commodity derivatives is primarily a calculated value which incorporates the forward price and is adjusted for liquidity (bid-ask spread), credit or non-performance risk (after reflecting credit enhancements such as collateral) and discounted to present value. The primary difference between a Level 2 and a Level 3 measurement has to do with the level of activity in forward markets for the commodity. If the market is relatively inactive, the measurement is deemed to be a Level 3 measurement. Some commodity derivatives are NYMEX contracts, which Cinergy classifies as Level 1 measurements.

16. New Accounting Standards

The following new accounting standards were adopted by Cinergy subsequent to June 30, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

SFAS No. 157. Refer to Note 15 for a discussion of Cinergy's adoption of SFAS No. 157.

SFAS No. 159. Refer to Note 15 for a discussion of Cinergy's adoption of SFAS No. 159.

FSP No. FIN 39-1. Refer to Note 1 for a discussion of Cinergy's adoption of FSP No. FIN 39-1.

The following new accounting standards have been issued, but have not yet been adopted by Cinergy as of June 30, 2008:

SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141R). In December 2007, the FASB issued SFAS No. 141R, which replaces SFAS No. 141, "Business Combinations." SFAS No. 141R retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. This statement also establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination or gain recognized from a bargain purchase. For Cinergy, SFAS No. 141R must be applied prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. The impact to Cinergy of applying SFAS No. 141R for periods subsequent to implementation will be dependent upon the nature of any transactions within the scope of SFAS No. 141R. SFAS No. 141R changes the accounting for income taxes related to prior business combinations, such as Duke Energy's merger with Cinergy. Subsequent to the effective date of SFAS No. 141R, the resolution of tax contingencies relating to Cinergy that existed as of the date of the merger will be required to be reflected in the Consolidated Statements of Operations instead of being reflected as an adjustment to the purchase price via an adjustment to goodwill.

SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin (ARB) No. 51" (SFAS No. 160). In December 2007, the FASB issued SFAS No. 160, which amends ARB No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in a consolidated entity that should be reported as equity in the consolidated financial statements. This statement also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. In addition, SFAS No. 160 establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation. For Cinergy, SFAS No. 160 is effective as of January 1, 2009, and must be applied prospectively, except for certain presentation and disclosure requirements which must be applied retrospectively. The impact to Cinergy of applying SFAS No. 160 for periods subsequent to implementation will be dependent upon the nature of any transaction within the scope of SFAS No. 160.

SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment to FASB Statement No. 133" (SFAS No. 161). In March 2008, the FASB issued SFAS No. 161, which amends and expands the disclosure requirements for derivative instruments and hedging activities prescribed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. Cinergy will adopt SFAS No. 161 as of January 1, 2009 and SFAS No. 161 encourages, but does not require, comparative disclosure for earlier periods at initial adoption. The adoption of SFAS No. 161 will not have any impact on Cinergy's consolidated results of operations, cash flows or financial position.

17. Income Taxes and Other Taxes

The taxable income of Cinergy is reflected in Duke Energy's U.S. federal and state income tax returns. Cinergy has a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses and benefits to the subsidiaries whose investments or results of operations provide these tax expenses and benefits. The accounting for income taxes essentially represents the income taxes that Cinergy would incur if Cinergy were a separate company filing its own tax return as a C-Corporation.

Notes To Unaudited Consolidated Financial Statements

The following table details the changes in Cinergy's unrecognized tax benefits from January 1, 2008 to June 30, 2008.

	Increase/ (Decrease)
	(in millions)
Unrecognized Tax Benefits—January 1, 2008	\$ 79
Unrecognized Tax Benefits Changes	
Gross decreases—tax positions in prior periods	(2)
Unrecognized Tax Benefits—June 30, 2008	\$ 77

At June 30, 2008 and December 31, 2007, an insignificant portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Additionally, at June 30, 2008, Cinergy has approximately \$9 million of unrecognized tax benefits related to pre-merger tax positions that, if recognized prior to the adoption of SFAS No. 141R, would affect goodwill. It is reasonably possible that Cinergy will reflect an approximate \$55 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the three and six months ended June 30, 2008, Cinergy recognized an insignificant amount and \$1 million of net interest expense, respectively, related to income taxes. At June 30, 2008, Cinergy's Consolidated Balance Sheets included approximately \$8 million of interest payable, which reflects all interest related to income taxes, and no amount has been accrued for the payment of penalties.

Cinergy has the following tax years open:

Jurisdiction	Tax Years
Federal	2000 and after
State	Closed through 2001, with the exception of any adjustments related to open federal years

The effective tax rate for the three months ended June 30, 2008 was approximately 34.2% as compared to the effective tax rate of 50.2% for the same period in 2007. The effective tax rate for the six months ended June 30, 2008 was approximately 35.0% as compared to the effective tax rate of 43.7% for the same period in 2007. The decrease in the effective tax rate for both the three and six months ended June 30, 2008 is due primarily to less of an effect to the effective tax rate calculation from permanent items in 2008 as compared to 2007 as a result of significantly higher pre-tax income in 2008.

Excise Taxes. Certain excise taxes levied by state or local governments are collected by Cinergy from its customers. These taxes, which are required to be paid regardless of Cinergy's ability to collect from the customer, are accounted for on a gross basis. When Cinergy acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis. Cinergy's excise taxes accounted for on a gross basis and recorded as Operating Revenues in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007 were as follows:

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in millions)			
Excise Taxes	\$ 36	\$ 33	\$ 82	\$ 77

18. Comprehensive Income and Total Comprehensive Income

Comprehensive Income. Comprehensive income includes net income and all other non-owner changes in equity. The table below provides the components of other comprehensive income and total comprehensive income for the three months ended June 30, 2008 and 2007. Components of other comprehensive income and total comprehensive income for the six months ended June 30, 2008 and 2007 are presented in the Consolidated Statements of Common Stockholder's Equity and Comprehensive Income.

Total Comprehensive Income (Loss)

	Three Months Ended June 30,	
	2008	2007
	(in millions)	
Net Income	\$ 227	\$ 88
Other comprehensive (loss) income		
Unrealized (losses) gains on available-for-sale securities ^(a)	(4)	2
Cash flow hedges ^(b)	(2)	3
SFAS No. 158 amortization ^(c)	1	—
Other comprehensive (loss) income, net of tax	(5)	5
Total Comprehensive Income	\$ 222	\$ 93

- (a) Net of \$4 million tax benefit and \$1 million tax expense for the three months ended June 30, 2008 and 2007, respectively.
 (b) Net of \$1 million tax benefit and \$2 million tax expense for the three months ended June 30, 2008 and 2007, respectively.
 (c) Net of \$1 million tax expense for the three months ended June 30, 2008.

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19. Subsequent Events

For information on subsequent events related to basis of presentation, acquisitions and dispositions of businesses and sales of other assets, debt and credit facilities, intangibles, regulatory matters and commitments and contingencies, see Notes 1, 3, 5, 7, 12 and 13, respectively.