



Conference Call Transcript

DUK - Q2 2009 Duke Energy Corporation Earnings Conference Call

Event Date/Time: Aug. 04. 2009 / 10:00AM ET

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PRESENTATION

Operator

Good day, everyone. Welcome to the Duke Energy second quarter earnings conference call. As a reminder, today's conference is being recorded. At this time for opening remarks, I'd like to turn the call over to Mr. Bill Currens, general manager, Investor Relations. Please go ahead, sir.

Bill Currens - *Duke Energy Corporation - General Manager of IR*

Good morning and welcome to Duke Energy's second quarter 2009 earnings review. Leading our discussion today are Jim Rogers, chairman, president, and chief executive officer; and Lynn Good, group executive and chief financial officer. Jim will begin today's presentation by providing a general overview of the quarter's results. Then Lynn will provide more detail and context around the quarterly results for each of our businesses including an update on our sales volumes as well as our credit and liquidity positions. Jim will close with updates on our operational performance, regulatory initiatives, and our wind energy business. Following those prepared remarks, we will open the lines for your questions.

Before we begin, let me take a moment to remind you that some of the things we will discuss today concern future company performance and include forward-looking statements within the meanings of the securities laws. Actual results may materially differ from those discussed in these forward-looking statements. You should refer to the additional information contained in Duke Energy's 2008 Form 10-K filed with the SEC and our other SEC filings concerning factors that could cause those results to be different than contemplated in today's discussion.

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In addition, today's discussion includes certain non-GAAP financial measures as defined under SEC Regulation G. A reconciliation of those measures to the most directly comparable GAAP measures is available on our Investor Relations website at www.duke-energy.com. With that, I'll turn the call over to Jim.

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

Thank you, Bill. Good morning, everyone. Thank you for joining us today and thank you for your interest and investment in Duke Energy. In our news release this morning, we announced adjusted diluted earnings per share of \$0.26 for the second quarter of 2009 versus \$0.27 in the second quarter of 2008. Our results for the quarter were slightly better than Street consensus. Finally, through the first half of the year we're slightly ahead of our internal plan on an adjusted diluted basis.

I am pleased with our results through the first half of 2009, especially in these very challenging times. Our operational performance and cost management efforts largely offset the impact of lower industrial sales volumes. All of this is a tribute to our employees and I am very proud of their performance in the first half of this year.

The second half of the year looks to be just as challenging as the first half, as we anticipate continued softness in our volume sales when compared to last year. Achievement of our employee incentive target of \$1.20 EPS on an adjusted diluted basis will require continued focus on what we can control, especially our cost management efforts. Of course, as we look forward, we are assuming normal weather for the remainder of 2009, and as you all know so well, the third quarter is normally the largest contributor to our annual sales. As part of our discussion, Lynn will give you an in depth look at our retail and industrial sales volumes and our thoughts on the economy. She will also comment on the results of a survey of our leading industrial customers.

Before I turn it over to Lynn, let me take a moment to thank David Hauser for his 35 years of service to Duke Energy, most recently as our CFO. As you all know, last month, David moved on to become CEO of Fairpoint Communications here in Charlotte. We thank David for his leadership and integrity and his contribution to Duke Energy's success and we wish him the best of luck in his new assignment.

Also, let me introduce Lynn Good, who succeeded David as CFO. Lynn became our Treasurer when the merger closed in 2006. She has led our commercial businesses for the last 18 months. This seamless transition is evidence of the great bench strength we have in our senior management team. Let me now ask Lynn to provide more details on the quarter.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thanks, Jim, and good morning, everyone. Let me begin our financial discussion with our largest segment, U.S. Franchised Electric and Gas. The segment reported second quarter 2009 adjusted segment EBIT of \$500 million, as compared to \$503 million in the prior year. This segment's slightly unfavorable results reflected lower weather-normalized sales volumes across all our jurisdictions and lower off system sales net of sharing. These negative drivers were partially offset by lower operation and maintenance costs. The decreased sales are being largely driven by our industrial customers, who continue to feel the effects of the downturn in the economy. On a weather-normalized basis, lower sales volumes had a negative quarter-on-quarter impact of approximately \$45 million on the segment's results. I'll talk more about sales volumes in a moment.

Lower off-system sales, driven by decreased sales volumes and lower market prices, had a \$13 million negative impact on the segment's results. On the positive side, the segment benefited from \$41 million in lower operation and maintenance costs. In addition, revised depreciation rates in the Carolinas resulting from updated depreciation studies largely drove a \$14 million reduction in depreciation and amortization.

Before I move on to sales volumes, I would like to point out a few drivers that have been mentioned in previous calls that continue to impact the segment's second quarter results. Rate changes in the Midwest continue to have an overall positive impact, primarily due to net increases of approximately \$13 million. These increases are largely related to riders for environmental capital and IGCC costs in Indiana. These positive rate impacts were offset by expiration of a rider in North Carolina at the end of 2008. I should point out that the North Carolina rate order resulting from the 2007 rate review included an \$80 million one-time rider related to the sharing of merger savings. During the second quarter of last year, \$21 million was collected in rates under this rider.

I would now like to provide additional context around our sales volumes and refer you to Slide 5. As I stated, our overall weather-normalized electric volumes were down approximately 6% or \$45 million when compared to the second quarter last year. This decline was driven by a sizeable drop in industrial volumes of about 19% on a weather-normalized basis. However, across all classes of retail customers, the net margin

impact of volume declines was about 3% quarter-over-quarter. Overall, industrial sales represent 24% of our 2009 year-to-date gigawatt hour sales.

Similar to the first quarter of 2009, most of our industrial customer classes were down across all our jurisdictions. Likewise, the rate of decline in industrial activity was fairly consistent with the first quarter of this year, and although this trend may indicate some stabilization, we do not see any immediate signs in upturn in industrial activity.

We have surveyed some of our largest industrial customers including each of our significant industry classes -- textiles, chemicals, and primary metals. We've surveyed them about their production plans for the balance of 2009. Although some see recovery, the preponderance sees production levels consistent with the first half of 2009. So as we look to the future, it's difficult to predict a resurgence, but we believe that it could be 2011 before we see recovery in our industrial usage.

On a weather-normalized basis during the second quarter, our residential sales volumes have continued to be slightly positive, increasing approximately 1%, while commercial volumes have been fairly flat. We have also seen a moderate increase in our customer base. However, the pace of new customer additions has slowed from previous periods. Historically, the impact of economic trends on residential and commercial activity has lagged industrial activity. Residential and commercial sales volumes for the second quarter were positive, but slightly less positive than what we experienced in the first quarter. We will continue to monitor trends in all of our retail customer classes as the year progresses.

As we look forward into the second half of this year, we expect industrial volumes to stabilize at levels consistent with the first half of this year and residential and commercial weather normalized volumes to be consistent with the last half of 2008, when we began to see the impacts of the economic downturn. We will continue to closely analyze monthly and quarterly results to identify trends that will impact our future results. And of course, we will know more at the end of the third quarter, our most significant quarter.

Next, we thought it would be helpful to show you industrial sales volumes for each of our top three industrial classes as well as our total industrial class from 2007 to the present. As you know, weather does not typically have a material impact on industrial volumes, but I should point out that this data is not weather normalized. These charts show the downturn we have experienced in industrial sales volumes, which began to drop noticeably in the fourth quarter of 2008 and continue to drop early in 2009. From the second quarter 2008 to the second quarter 2009, primary metals declined approximately 38%, textiles approximately 24%, and chemicals declined approximately 17%. However, there are signs of stabilization as industrial sales volumes have remained relatively flat from the first quarter to the second quarter of 2009.

On a positive note, there are bright spots. Our economic development teams are active in all of our jurisdictions. A good example of this success is the recent announcement from Apple that it has selected a site in our North Carolina service territory to build a \$1 billion data center. We're excited to have Apple as a customer. We are also encouraged by the potential that this will help create a North Carolina technology corridor that will attract other data centers.

With that, I'll move on and review Commercial Power's results. Adjusted segment EBIT for Commercial Power for the second quarter of 2009 was \$115 million, a decrease of approximately \$13 million when compared to the second quarter of 2008. Commercial Power's lower results were driven by unfavorable wholesale margins and lower retail volumes partially offset by positive impacts related to the Electric Security Plan in Ohio. Unfavorable wholesale margins had a \$19 million negative impact when compared with the same quarter last year. The drop in wholesale margins was primarily due to reduced power prices, decreased volumes, and lower sales and emission allowances during the quarter, partially offset by increased gains on non-native coal sales. In addition, retail volumes dropped \$14 million due to lower industrial volumes as well as customer switching. Partially offsetting these negative variances were improved retail margins of \$8 million driven by increased rates in Ohio, resulting from the implementation of the Electric Security Plan at the beginning of this year.

The improved retail margins were also driven by the absence of unfavorable timing of the collection of fuel and purchased power costs. Under the ESP in Ohio, a portion of the rate riders, such as fuel and purchased power for generation serving our retail customers, now receives regulatory accounting treatment. As a result, the timing of the collection of those riders no longer has an impact on Commercial Power's current results. However, in the second quarter of 2008, the timing of the collection of those riders had a \$12 million negative impact on segment results. This segment has also benefited from a positive adjusted EBIT contribution of \$6 million from our Midwest gas-fired assets due to higher generation volumes and PJM capacity revenues. During the second quarter of 2009, our sales volumes for the Midwest gas-fired assets increased by approximately 300% over the same time last year. We expect these assets to be EBIT positive on an adjusted basis in 2009.

Recently we have seen increased competition in Ohio. The decrease in wholesale power market prices has prompted questions from many of you about customer switching, as current market prices are below the standard service offer price in our ESP. Additionally, some of our competitors in Ohio have recently announced intentions to aggressively target customers in southwestern Ohio. Historically our service territory has

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experienced a lower level of customer switching activity than other areas in Ohio. However, as a result of the competitive pressures I just mentioned, we experienced an uptick in customer switching during the second quarter of 2009. Overall, the percentage of customers who have switched rose from 4% at the end of the first quarter to 10% as of June 30, and as of that date, the breakout by customer class was approximately 5% residential, 6% commercial, and 20% industrial. The financial impact of customer switching during the second quarter was not significant.

As competition throughout the state of Ohio intensifies, we are responding to the increased risk of customer switching. Our competitive retail arm, Duke Energy Retail Sales, is positioned to help preserve our Ohio native customer base. We are also competing to supply power outside of our service territory. This is evidenced by our recent participation in the FirstEnergy auction. We were the winning bidder of 5% of the retail generation needs of FirstEnergy's Ohio operating companies. We will supply those needs from June 1, 2009 through May 31, 2011 at a final wholesale price of \$61.50 per megawatt hour.

Now let me turn to our International business segment. For the second quarter of 2009, Duke Energy International reported adjusted segment EBIT of approximately \$94 million compared to \$116 million in last year's second quarter. The decline in DEI's results was due to an \$18 million reduced contribution from National Methanol driven by lower commodity prices. In addition, unfavorable average foreign exchange rates had an \$8 million negative impact on DEI's results. This is principally due to the weakening of the Brazilian currency against the U.S. dollar late last year. These negative drivers were partially offset by the positive impact of \$9 million resulting from higher average contract prices in Brazil. Over the last three years, our share of National Methanol's results has contributed about 25% to 30% of DEI's adjusted EBIT results. However, as we said in our last earnings call, for 2009, we expect National Methanol's contributions to fall to around 20% due to the lower commodity price environment.

Next, I'll review our Other segment, which primarily includes costs associated with corporate governance, Duke Energy's captive insurance company, and our real estate joint venture, Crescent Resources. Other reported a second quarter 2009 adjusted net expense from continuing operations of \$37 million compared to \$77 million in the second quarter of 2008. The \$40 million decrease in Other's net expense was due to a variety of items, including favorable governance expenses and captive insurance results. The decrease was also driven by the absence of an \$8 million adjusted equity earnings loss at Crescent which occurred in the second quarter of 2008.

The weak real estate market and the overall economic conditions continue to have a negative impact on Crescent. As you're most likely aware, in June, Crescent filed for Chapter 11 bankruptcy. This is a very difficult situation for Crescent, but it is important to emphasize that Duke Energy has no material exposure to Crescent performance guarantees and continues to have a zero book basis in its investment in Crescent. Further, Crescent's debt is non-recourse to Duke Energy.

I'll turn briefly to Slide 11 and review a few important non-operating financial items. Interest expense net of capitalized interest was \$186 million in the second quarter of 2009 as compared to \$194 million in the same period in 2008. This decrease was due primarily to lower interest rates on floating rate debt and commercial paper, partially offset by higher debt balances. The effective tax rate for the quarter was approximately 38% compared to 33% for the same period last year. The higher effective tax rate is primarily due to adjustments of certain tax benefits previously recognized and related to our 2008 tax year. For the full year, our effective tax rate is expected to be 34%.

As I turn to Slide 12 and address credit and liquidity, I want to emphasize one of my key priorities is to continue to maintain our solid balance sheet and strong liquidity position. Our total available liquidity was approximately \$1.5 billion at June 30, 2009, which includes about \$1.3 billion available under our \$3.1 billion master credit facility. It is important to note that our master credit facility does not expire until June 2012. We also ended the quarter with approximately \$150 million of cash, cash equivalents, and short-term investments, excluding approximately \$550 million in foreign jurisdictions. We also continue to issue commercial paper at low rates. At June 30, approximately \$600 million of commercial paper was outstanding at an average rate of 0.7% and an average maturity of 16 days.

During the first half of 2009, we've had very strong access to the capital markets, evidenced by total fixed rate financings of \$1.65 billion. The weighted average rate for these financings was approximately 6.1%. For the remainder of 2009, we will continue to access the capital markets and we'll be opportunistic as to when and where we finance. For example, if we consider the markets to be favorable, we may take the opportunity to pre-fund certain 2010 cash requirements in 2009. Our focus remains on preserving our liquidity and funding our business plan. During the first half of 2009, we generated approximately \$280 million from the dividend reinvestment plan and internal plan equity issuances. For the remainder of the year, we expect to generate at least an additional \$70 million from these sources. Our current five year plan limits these equity issuances to approximately \$600 million.

As you know, we enjoy solid investment grade credit ratings from both S&P and Moody's. Last month, S&P affirmed its A- corporate credit rating on Duke Energy and all its subsidiaries and maintains a positive outlook on those ratings. The ratings affirmation reflects our strong liquidity position, stable balance sheet, and ability to finance our business plans.

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In closing, I'll reiterate Jim's comment that we're pleased with our efforts to date in managing through the challenges presented by the current economy. We are currently in the quarter that has the biggest impact on our results and one in which the results are most frequently influenced by weather. As many of you know, the month of July has been mild in various parts of the country, including the Midwest and the Carolinas. So it is important for us to continue our focus on things we can control, such as our costs and capital spending.

In order to help alleviate the effect lower volumes are expected to have on us in 2009, we are taking the following actions. We are continuing our efforts to reduce O&M costs and we expect to exceed our \$100 million target by \$50 million, for a total reduction of \$150 million in 2009. As we had previously shared with you, we think of our capital in three categories -- committed capital, ongoing capital, and discretionary capital. Our ongoing capital spending, which includes expenditures such as maintenance and customer additions, has some flexibility as to when it is spent, while our discretionary capital is where we have the largest amount of flexibility. This flexibility allows us to respond to trends in our business by either delaying or not spending the dollars. And as a result, we are looking closely at the planned capital spending in the ongoing and discretionary growth capital categories and are targeting a reduction in our capital spending plans in 2009 of \$200 million to \$300 million.

With that, I'll turn the call back over to Jim.

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

Thank you, Lynn. As I did last quarter, I will quickly run through some of the fundamentals supporting our second quarter results, including our operational performance and regulatory initiatives which will set the stage for future growth. As you can see from this slide, our strong focus on cost management, especially of our O&M expenses, is not compromising our operational performance. Our fossil generation fleet continued to perform at a high level in most of our key metrics. Our nuclear fleet set records for the most generation and the highest capacity factors for the first six months of 2009. As I said when we started this call, we appreciate our employees' strong focus on operational excellence during these challenging times. Continuing these efforts will be important as we look forward to the remainder of 2009. Finally, we continued to make progress on our two major construction projects, Cliffside and Edwardsport. They're both scheduled to be in service by 2012. As we have in the past, we will update you as construction continues this year and in 2010 and 2011.

We continue to make significant progress on our key regulatory initiatives. These accomplishments are listed on this slide. It also shows how our regulatory calendar shapes up for the rest of the year. I'm not going to go through all of these but I'd like to highlight a few items.

In Ohio last month, the Commission approved an increase in our electric distribution rates. The increase totals approximately \$55 million and the new rates went into effect on July 13th. This action is in addition to the finalization of our Ohio Electric Security Plan late last year.

We're pleased with our progress in North Carolina. In May, the Commission issued a modified order that lets us move ahead with our rooftop solar distributed generation program. The Commission also approved our pilot test of a virtual power plant and the smart grid here in Charlotte. We also reached a modified settlement with the public staff and environmental groups for our save-a-watt energy efficiency program. These actions illustrate that the North Carolina Commission shares our focus of exploring innovative ways to serve the state's electric customers.

In Indiana, we're waiting for final Commission order on our smart grid initiative after reaching a settlement agreement with the public staff. Additionally, we reached a settlement agreement on our save-a-watt initiative and we're also awaiting a final order. Last month, we asked the Indiana Commission for approval to study the permanent storage of carbon dioxide near Edwardsport where we are building our IGCC plant. We're proposing to invest approximately \$121 million for a detailed characterization of storage sites including the drilling of multiple wells. In January, we applied for a Department of Energy Clean Coal Power Initiative grant, which could potentially offset up to 50% of the cost of the initial installation of carbon capture and storage or CCS technology for the site. Any funds received would be used to reduce customer rate impacts of the project. If the study is successful, we will ask the Commission to approve permanent storage of CO₂ at the site. These plans are conditioned on the project being designated a CCS demonstration site by the DOE.

Let me now turn to our rate case filings in the Carolinas. In early June in North Carolina, we filed our request for a \$496 million or 12.6% average increase in customer base rates. Although we adjust for fuel costs on an annual basis, our last general base rate increase in North Carolina was in 1991. In fact, these rates were actually lowered in 2008 by approximately 4%. In late July in South Carolina, we filed our request for \$104 million, on average 7.2% increase in customer rates. Our South Carolina filing also requests recovery under our save-a-watt plan of the costs of our energy efficiency programs. These programs were recently approved the Commission.

The primary driver of these base rate increases includes capital investments in 1) construction work in progress or CWIP for Cliffside Unit 6; 2) transmission & distribution additions; 3) environmental spending including for the Allen scrubber and the Marshall SCR; and finally other generation related capital additions. These components -- and it's important for me to emphasize this -- comprise over 50% of the revenue requirement requested. As you can see on the slide, the ROE capital structure and test year are the same for both filings.

The primary differences between the two requests are -- in North Carolina, we had about \$287 million rate reductions in 2008 as I mentioned earlier, and in South Carolina, we planned to refund money collected from customers in excess of costs incurred for past energy efficiency and demand side management programs. The money would be returned through monthly bills over approximately five years. A procedural schedule with public hearings set for September and an evidentiary hearing in October has been established for the North Carolina case. Given its recent filing date, the procedural schedule for the South Carolina case has not yet been set. We anticipate the new rates to take effect in both states in early 2010. Even with these increases our retail rates in North and South Carolina will remain significantly below the average retail rates in the Southeast and the nation.

Let me now turn to our growing wind energy business. This slide lists our 2009 accomplishments and I'd like to highlight a couple. In June, we closed on our acquisition of the 70-megawatt North Allegheny project in western Pennsylvania. This is our first wind project in the eastern U.S. and it is expected to begin operation in the third quarter. We also announced a new project for eastern Colorado, our first in that state and our fourth in the region. The 51-megawatt Kit Carson Project will be developed under a long term lease near Burlington, Colorado. We expect the project to be in commercial operation by the end of 2010. Both projects are contracted under long-term purchase power agreements. We believe we are well positioned to bring approximately 250 megawatts of wind energy online annually. By the end of this year, we expect to have more than 700 megawatts in operation, which we expect will make us one of the 10 largest wind operators in the U.S.

Let me also give you an update on the Midwest nuclear project we announced in mid June. Duke Energy, AREVA, UniStar, USEC, and the Southern Ohio Diversification Initiative announced the formation of a Southern Ohio Clean Energy Park Alliance. The Alliance has requested funding from the DOE to complete the site selection process, develop an early site permit application, and prepare licensing documents. These actions will be for a potential nuclear plant at DOE's Portsmouth site in Piketon, Ohio, a former nuclear weapons complex. This project could serve as a model for future public private partnerships and investment. It also has significant potential to be a regional partnership. It is important to clarify that we have not made any commitments but this project is another way to develop the nuclear power option as we work to decarbonize our generation fleet, especially in the Midwest.

Before we take your questions, let me also give you a brief update on federal climate legislation. The Waxman-Markey bill passed by the full House in June includes provisions we worked hard for that help reduce consumer costs and encourage the development and deployment of new energy technologies. Importantly, the bill provides for the significant allocation of emissions allowances to our customers through 2025. The allowances then begin ramping down through 2030. This bill was a tribute to the leadership of Chairman Waxman and Chairman Markey as well as to many Congressmen from states heavily dependent on coal, including Congressmen Boucher of Virginia, Hill of Indiana, and Space of Ohio. We expect the Senate to take up the bill right after Labor Day with committees finishing their markups in the fourth quarter. We will continue to work very hard to ensure a fair allocation of allowances is provided to customers in regions in the country that rely more heavily on coal.

Due to the makeup of the Senate, we believe there will be additional changes to the cost containment provisions of the House bill. One fact will give you a sense of why we expect more focus on the cost containment aspects of the Senate bill. In the House, 25% of the vote for the Waxman-Markey bill came from two states, California and New York. In the Senate, those two states only represent 4% of the vote. Another key fact is that consumers in 25 states are dependent on coal for more than 50% of their electricity. It is obvious to us that this bill faces many tough tests in the months ahead, but we remain committed to its passage.

In closing, as Lynn said earlier, to meet the challenges of the downturn in the economy, we must remain focused on what we can control, improve our operational performance, manage our costs, allocate our capital in a timely fashion, maintain our strong credit and liquidity, and focus on our regulatory strategies and initiatives. In the near term, the economy, weather, and our ability to control costs drive our results. Longer term, our results will be driven by providing affordable and reliable service to our customers, accessing reasonably priced capital, developing opportunity to reinvest in both our commercial and regulated businesses, and successfully executing on our existing as well as future regulatory initiatives. Overall, despite the challenging economic environment our customers and we are facing, I am pleased with where we are halfway through the year.

Now let's take your questions.

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QUESTION AND ANSWER

Operator

(Operator Instructions). We'll hear first from Paul Ridzon with KeyBanc.

Paul Ridzon - KeyBanc Capital Markets/McDonald Investments, Inc. - Analyst

Could you elaborate a little bit more about shopping in Ohio and can you just review the numbers of what you've lost? And then if there's any flavor as to who it is coming in and winning this load, just the profile -- do they own generation or are they more marketers?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Good morning, Paul. This is Lynn. Thanks for your question. The switching that we had experienced as of the end of the second quarter was about 5% residential, 6% for commercial load, and industrial at about 20%. In terms of who is participating, I think FirstEnergy is participating. We've seen FPL's retail arm participating also. And I think the composition of whether they're supplying it with assets or in the market is really beyond what we can comment on.

Paul Ridzon - KeyBanc Capital Markets/McDonald Investments, Inc. - Analyst

Okay, so 20% of your industrial is switched? 5% of your residential are switched, 6% commercial?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Yes.

Paul Ridzon - KeyBanc Capital Markets/McDonald Investments, Inc. - Analyst

Okay, thank you very much.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thank you.

Operator

We'll take our next question from Paul Patterson with Glenrock Associates.

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

Good morning, Paul.

Paul Patterson - Glenrock Associates - Analyst

Good morning. Can you hear me?

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

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Yes.

Paul Patterson - Glenrock Associates - Analyst

I wanted to follow-up on Paul's questions on the shopping. You guys mentioned that you guys are actively monitoring the aggregation activity. And I'm just wondering how many communities are you seeing or how much load is getting involved in that, with the ballot initiatives and what have you? Do we have a sense for that and in terms of your guidance or your -- I'm sorry, the incentive goal, what shopping activity do you guys have in your expectations?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

On the residential aggregation, I'll respond, Jim, on that. Paul, we have visibility to one community that has placed aggregation on the ballot in August for November and it becomes visible in the month of August, and we'll be monitoring whether others place it on the ballot and we'll know more by the end of this month. I'm not going to comment specifically on the switching percentages in the back half. I think the way to think about it is we will be targeting through our Duke Energy Retail services arm retention as many of those customers as we can profitably. And I think the other thing to note is we did participate in the FirstEnergy auction, which will impact the second half results.

Paul Patterson - Glenrock Associates - Analyst

Okay. When we're talking about the customers that have left, how much has Duke gotten of those? Just looking at Slide 8 and the numbers you went over with Paul, how much of that just roughly speaking -- you're talking about 10% of retail load has switched, how much has switched to you I guess? If you follow me.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

It's a good question, Paul. We're not going to comment on how much has switched to us.

Paul Patterson - Glenrock Associates - Analyst

Okay. And then in terms of looking at other areas, I mean if there is load that gets freed up in this manner, what areas might you guys look into to getting? In other words, other regions? Could you give us a little bit of a flavor as to where you see opportunity in that business?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

At this point we are focused on Ohio and have not expanded our aspirations beyond Ohio.

Paul Patterson - Glenrock Associates - Analyst

Okay, great. Thanks a lot.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thank you.

Operator

We'll take our next question from Greg Gordon with Morgan Stanley.

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Greg Gordon - Morgan Stanley - Analyst

Thank you, good morning.

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

Good morning, Greg.

Greg Gordon - Morgan Stanley - Analyst

So just to your disclosures on your year-to-date and expected sales, I thought were pretty clear. But just to reiterate, looking at the slides on pages 5 and 6, you're basically telling us to expect year-over-year declines in industrial in Q3 and Q4, but that on a weather-normalized basis you'd expect stable residential sales. Is that a good synopsis of what you said?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Greg, we're expecting at this point that industrial will be flat to the first half, and we're looking back actually to the last half of 2008 as a reasonable proxy of what we expect on residential and commercial.

Greg Gordon - Morgan Stanley - Analyst

Okay. So flat to the first half means down relative to the comparable quarters in the prior year?

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

That's correct.

Greg Gordon - Morgan Stanley - Analyst

I just want to be sure I understood that. And then even though your residential -- that comment on residential, does that factor in how weak July has been or should we weather adjust off of that flat base for July?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

What we have talked about were weather normalized volumes, Greg, not adjusted for weather.

Greg Gordon - Morgan Stanley - Analyst

Okay, that's clear. Thanks.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thank you.

Greg Gordon - Morgan Stanley - Analyst

On international, just you said that National Methanol had historically been 25% to 30% of EBIT. You're now saying that you'd expect it to be 20% of 2009 EBIT. So basically it's a smaller percentage of a lower base, correct?

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Lynn Good - Duke Energy Corporation - Group Executive & CFO

That's correct.

Greg Gordon - Morgan Stanley - Analyst

Okay, great. The D&A adjustment -- the lower D&A that you talked about on the franchise electric in helping to drive franchise electric, can you refresh my memory? Is that related to the rolloff of amortizations, scrubber amortization or one of the other large amortizations that unwound last year?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

No. Greg, we update depreciation studies typically as others in the industry will do. Periodically our pace is every three to five years, and we updated a study effective the first of 2009. And so you're seeing that lesser depreciation as a result of that study.

Greg Gordon - Morgan Stanley - Analyst

Okay, so that impacted first quarter 2009 and second quarter 2009 and is this a reasonable run rate -- \$14 million a quarter?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

I think that's reasonable. We're expecting \$50 million for all of 2009.

Greg Gordon - Morgan Stanley - Analyst

Okay. And is that factored, is that lower depreciation rate factored into the rate filings in the Carolinas?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Yes, it is.

Greg Gordon - Morgan Stanley - Analyst

Okay. My last question was another tack on the questions that have already been asked. If you were to annualize the impact of switching in Ohio, I know you said there was a de minimis impact in the quarter -- but if you were to annualize that impact and assume that you weren't able to win other customers to offset it, could you give us a sense of what the annual EBIT impact would be?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

I think the maximum based on what we've seen, Greg, would be in the \$0.02 to \$0.03 range on an annual basis without any mitigation from wins by our retail arm or offsetting impact of our participation in the auction.

Greg Gordon - Morgan Stanley - Analyst

Thank you very much.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

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Thank you.

Operator

We'll take our next question from Michael Lapidès with Goldman Sachs.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Good morning.

Michael Lapidès - Goldman Sachs - Analyst

Good morning. Just real quick, can you refresh or go over again the commentary about capital spending, and is it just an 2009 CapEx that you're looking at or are you looking at beyond that? And what parts of the business are you focused on?

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

Sure. Michael, we are looking at 2009 at this point and have been focused on what we call ongoing capital maintenance customer additions as well as some discretionary spending. We're targeting a reduction of \$200 million to \$300 million in 2009, and really are looking at it in the context of preserving resources as we see some challenges on our volumes and usage. In terms of expectations as we go forward, we'll be looking at capital spending in connection with our annual planning process and share more with you as we set expectations for 2010 and beyond.

Michael Lapidès - Goldman Sachs - Analyst

Got it. Okay. One question -- and I hate to do this, I don't mean to beat a dead horse here -- on Ohio, I just want to think about pricing for a second, less volume. The FirstEnergy auction price, low 60s per megawatt hour. If I remember correctly, your ESP price is also in the low 60s per megawatt hour. Can you walk us through the economic differences between what's included in the low 60s in each of those two jurisdictions? Meaning how much of that is just generation versus how much of that is generation T&D?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

I believe those are just generation. The \$61.50 would be certainly be adjusted generation price in the FE auction, and Michael, our standard service offer price in our ESP is above \$61.50.

Michael Lapidès - Goldman Sachs - Analyst

Got it. Okay. Sounds good. We'll follow-up off line.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Okay, thanks so much.

Operator

We'll take our next question from Brian Chin with Citi.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

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Hello, Brian.

Brian Chin - Citigroup - Analyst

Hi, good morning. Any impact from FirstEnergy's move into PJM to you guys in Ohio?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

We're evaluating that at this point, Brian -- a very recent announcement as you know. I think FirstEnergy has highlighted a number of reasons why they think it fits better with their business. We do have assets in both MISO and PJM, and routinely analyze the impact of the RTO selection on our business, but at this point don't have any further comments to make.

Brian Chin - Citigroup - Analyst

Okay, and then back to the industrial volume topic, when you guys say that you expect to see industrial recovery in 2011, is that a recovery to levels akin to what we saw in 2007, so that in 2010 you're expecting to see a gradual ramp up back to then after flat stabilization in the second half of this year? Or can you just help me define what you mean by recovery in 011?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Brian, I don't think we've gotten that specific in our analysis at this point, at what point we'll return to 2007 or 2006. I think we'll learn more each quarter in how quickly the rebound occurs. We still expect 2010 to be a bit sluggish.

Brian Chin - Citigroup - Analyst

And then lastly on the industrial question, are you getting that forecast or developing that view based on specific commentary that you're getting from your wholesale customer base or industrial customer base? And what anecdotes were they giving you or is that solely a top down macro forecast on your part?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

We're actually interviewing customers, Brian, in all of our jurisdictions, talking with them about production plans in 2009 and into 2010. And as I shared, the preponderance are expecting flat usage in the back half. There are some bright spots. I'm seeing some recovery and I think we'll just know more as we proceed through the rest of 2009.

Brian Chin - Citigroup - Analyst

Great. Thanks a lot.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thank you.

Operator

We'll take our next question from Paul Fremont with Jefferies.

Paul Fremont - Jefferies & Company - Analyst

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Thank you. Two questions. First of all, I think for Other, you had originally been guiding to negative \$250 million for the year and through the first half you're only at negative \$87 million. Does that mean that you're going to come in for the year materially better than your guidance in Other? And then the other question is with respect to the New Source Review lawsuit, the North Carolina court I guess is expected to issue a decision at some point after the case was remanded back to them. Can you give us a sense of what you think the timing of that might be?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Let me comment on Other just for a moment. We are running ahead due to lower governance costs and our cost management efforts, but haven't put a specific number on how much we would expect to underrun, but governance and shared service costs are certainly something we're very focused on controlling in 2009.

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

And Paul, with respect to the New Source Review case in the Carolinas, it's not clear to us when the court will rule.

Paul Fremont - Jefferies & Company - Analyst

In terms of Other, at least, is there anything you can tell us about the back half of the year?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Not at this point. Paul, I think I would really focus on the \$150 million of targeted O&M reductions across the business that I spoke about. I think that would be the best way to think about it.

Paul Fremont - Jefferies & Company - Analyst

And how much of that so far has shown up in Other?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

I'm not going to comment on how much. It's across the business in Other and FE&G and Commercial and International. I don't have a specific number for other.

Paul Fremont - Jefferies & Company - Analyst

Thank you.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Thank you.

Operator

We'll go next to Nathan Judge with Atlantic Equities.

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Good morning.

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Nathan Judge - Atlantic Equities - Analyst

Good morning. Wanted to ask on the Carolina rate case, and I apologize if you've addressed this already, but it appears that demand continues to be more sluggish than what you expected at the beginning of the year and perhaps when you filed your rate case in North Carolina. Do you plan to go back and update your demand forecast and potentially what could that be relative to what you expected?

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

I think in the course of the -- two ways to think about this, Nathan. One is we'll probably work hard to negotiate a settlement in the case and I think that's going to be our top priority. We work hard in every jurisdiction on every regulatory filing to resolve it through negotiations. Secondly, we'll have an opportunity to update the demand in the course of the proceeding if we find our way into a hearing with respect to this case.

Nathan Judge - Atlantic Equities - Analyst

And that type of settlement date would be around after the public hearings in September? Is that a way to think about it or is it later in the year?

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

I think it's after the public hearings.

Nathan Judge - Atlantic Equities - Analyst

Okay. Jim, on a broader, higher level, just with regard to the environmental legislation facing the Senate, what do you think needs to change in the current proposed bills in order for it to pass the Senate?

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

I think there's several things. I think that the first is I mentioned in my comments, I think there's going to be more emphasis on cost containment. I believe that the ramp down of allowances from 2025 to 2030 -- there will be a major push to extend that to 2040, to phase it out over a much longer period of time.

I also believe that there will be pressure with respect to the target in 2020. As you know, President Obama called for 14% below 2005, and the current legislation is 17% below 2005. So I think you will see pressure on that in the Senate. And finally, I believe for legislation to pass in the Senate, it needs to be more bipartisan than it was in the House. And what I mean by that is there's 15 to 17 senators that I would characterize as moderate Democrats who are significantly -- whose states are significantly affected because of their dependency on coal and their current carbon footprint. And so those senators are going to be very engaged, which in my judgment, to get a bill in the Senate is going to require picking up anywhere between seven to 10 Republicans. And to do that, that's going to require additional provisions with respect to the build out of nuclear in the United States. Such things as shortening the approval process time so we can bring these units online, addressing waste confidence related issues. I mean there are a variety of issues that need to be addressed to bring Republicans on.

And my last point is that virtually every major piece of legislation, environmental legislation that's ever been passed in the United States has been overwhelmingly bipartisan. So again, to get legislation that works for all of America, I believe that the Senate will have to build a solid base around the 15 to 17 moderate democrats as well as seven to 10 Republicans whose emphasis will primarily be on nuclear.

Nathan Judge - Atlantic Equities - Analyst

Thank you. And my final broad question, could you just update us on your view on mergers and acquisition? Is this the right time? Are you interested that, and given some of the recent developments, has that changed your view at all?

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

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I think that we're in a period where the PE band has always been narrow in our industry and it seems to be narrower today than historically, so that from a math standpoint makes it more complicated. And I think everybody in the industry seems really internally focused in terms of battening down the hatches, weathering the recession that we have, focused on the legislation in Washington. So based on things that I hear, it seems to be a lot more internal focused now than ever before, and because of the narrow PE bands, there seems to be less underlying fundamental economics to drive any consolidation.

But I do believe, Nathan, in the longer term, given the fact that our sector is going to fundamentally have to retire and replace every power plant between now and 2050, we're going to have huge capital expenditures with respect to smart grid, decarbonization, and meeting renewable portfolio standards, all of which translate into greater capital expenditure and higher prices. There is going to be a point where consolidation becomes the right answer. It just doesn't seem to be today.

Nathan Judge - Atlantic Equities - Analyst

Thank you very much.

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

Thank you.

Operator

Our final question comes from Hugh Wynne with Sanford Bernstein.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Hi. I had a question regarding the Carolinas rate cases. The Slide 15 points out that the test period is the year ending December 31, 2008, but that the rate increase probably would not go into effect until a full year later in early 2010. My question is to what extent will the rate case take into account capital expenditures in 2009 and 2010 and cost increases over that period in setting your rates? Or is this purely a backward looking rate setting where your rates probably would result in an 11.5% ROE based off 2008 cost, but may result in a lower ROE based on 2010 rate based cost?

Lynn Good - Duke Energy Corporation - Group Executive & CFO

Hi, Hugh, this is Lynn. It's a good question. We do have an opportunity to update the rate base additions through September 30 of 2009, so we will be making those adjustments as we move through the case.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Okay. How do you all feel about the reception of these proposed residential rate increases of 13.5% in North Carolina, 10.5% in South Carolina?

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

Well, I think they're a little more than that. But I will say that no one likes rate increases, and no one likes them during a period of -- economic period that we're currently experiencing. But I think the important point is that we've made significant investments in generation and environmental controls, and we're in a place where getting recovery of those investments is critical in terms of going forward and we're working hard with community outreach to the various stakeholders in the states and we're working hard to control our cost.

One of the things we did this year is there was no increase in compensation for our people other than those that were in unions. And so as a consequence of that, we've really worked hard to control our costs and to reach out to the various stakeholders. But at the end of the day, we've made -- and this is an important point that we make to all government officials -- we've made significant investments on behalf of consumers in

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this state to maintain the reliability of the system and to clean up the environment. So my belief is that at the end of the day, we'll succeed with respect to our proposals.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Thanks, Jim. Just real quick, could I get your view on the probability of CO2 regulation passing the Senate in this Congress? And if it fails, what you think would be the probability of it passing subsequently?

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

We have pushed hard for passage this year. I think with the way the -- I don't know how to say this exactly, but the way healthcare is going, I think that the probability of passage in the Senate is much lower than we anticipated several months ago and in all likelihood, the Senate is set -- September 28th is the date to get markup done. I suspect that gets pushed depending on how healthcare plays out. So my bet is that nothing happens until the first quarter of next year, maybe the second quarter. But if nothing happens by then, we're into the election cycle and the probability of passage of legislation then is very low.

So again, I think the goal line is to try to get legislation passed during this period of time. We've long believed that the passage of legislation during these tough economic times is the right time because Congress will be focused on the economics of the issues, and that is very important from our consumers' perspective. So we continue to push, but I would remind you that it's hard to think back over Congressional history where in any session of Congress two major pieces of legislation were passed. So to the extent healthcare gets passed, the probability of climate passing falls. So again, more work to do as things unfold.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Thanks, Jim. Appreciate it.

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

Thank you.

Operator

Ladies and gentlemen, that is all the time we have for questions today. I would like to turn the conference back over to Mr. Bill Currens for closing remarks.

Bill Currens - Duke Energy Corporation - General Manager of IR

Thank you, Miranda. Before we end today, let me point out that with both rate cases in the Carolinas likely to be decided later this year, rather than have an analyst meeting in November, we will have one in February in New York City. This meeting will be after we have announced our 2009 fourth quarter and year-end financial results. Look for the meeting details in the coming months. We also plan to be at the EEI Financial Conference this November.

Thank you for joining us today and as always our Investor Relations team is available to answer any follow-up questions that you may have. Have a great day.

Operator

Ladies and gentlemen, that does conclude today's conference call. We would like to thank you all for your participation.
