Duke Energy Kentucky
Case No. 2009-00202
Forecasted Test Period Filing Requirements
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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
1	1	KRS 278.180	30 days' notice of rates to PSC.	Julia S. Janson
1	2	807 KAR 5:001 Section 8 (1)	Full name and P.O. address of applicant and reference to the particular provision of law requiring PSC approval.	Julia S. Janson
1	3	807 KAR 5:001 Section 8 (2)	The original and 10 copies of application plus copy for anyone named as interested party.	Julia S. Janson
1	4	807 KAR 5:001 Section 10 (1)(b)(1)	Reason adjustment is required.	William Don Wathen
1	5	807 KAR 5:001 Section 10 (1)(b)(2)	Statement that utility's annual reports, including the most recent calendar year, are filed with PSC. 807 KAR 5:006, Section 3 (1).	Brenda R. Melendez
1	6	807 KAR 5:001 Section 10 (1)(b)(3) and (5)	If utility is incorporated, certified copy of articles of incorporation and amendments or out of state documents of similar import. If they have already been filed with PSC refer to the style and case number of the prior proceeding and file a certificate of good standing or authorization dated within 60 days of date application filed.	Julia S. Janson
1	7	807 KAR 5:001 Section 10 (1)(b)(4)	If applicant is limited partnership, certified copy of limited partnership agreement. If agreement filed with PSC refer to style and case number of prior proceeding and file a certificate of good standing or authorization dated within 60 days of date application filed.	Julia S. Janson
1	8	807 KAR 5:001 Section 10 (1)(b)(6)	Certified copy of certificate of assumed name required by KRS 365.015 or statement that certificate not necessary.	Julia S. Janson
1	9	807 KAR 5:001 Section 10 (1)(b)(7)	Proposed tariff in form complying with 807 KAR 5:011 effective not less than 30 days from date application filed.	James E. Ziolkowski
1	10	807 KAR 5:001 Section 10 (1)(b)(8)	Proposed tariff changes shown by present and proposed tariffs in comparative form or by indicating additions in italics or by underscoring and striking over deletions in current tariff.	James E. Ziolkowski
1	11	807 KAR 5:001 Section 10 (1)(b)(9)	Statement that notice given, see subsections (3) and (4) of 807 KAR 5:001, Section 10 with copy.	Julia S. Janson
1	12	807 KAR 5:001 Section 10 (2)	If gross annual revenues exceed $1,000,000, written notice of intent filed at least 4 weeks prior to application. Notice shall state whether application will be supported by historical or fully forecasted test period.	Julia S. Janson
1	13	807 KAR 5:001 Section 10 (4) (a)	Sewer utilities shall give the required typewritten notice by mail to all of their customers pursuant to KRS 278.185.	Julia S. Janson
1	14	807 KAR 5:001 Section 10 (4)(b)	Applicants with twenty (20) or fewer customers affected by the proposed general rate adjustment shall mail the required typewritten notice to each customer no later than the date the application is filed with the commission.	Julia S. Janson

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
1	15	807 KAR 5:001 Section 10 (4)(c)	Except for sewer utilities, applicants with more than twenty (20) customers affected by the proposed general rate adjustment shall give the required notice by one (1) of the following methods: 1. A typewritten notice mailed to all customers no later than the date the application is filed with the commission; 2. Publishing the notice in a trade publication or newsletter which is mailed to all customers no later than the date on which the application is filed with the commission; or 3. Publishing the notice once a week for three (3) consecutive weeks in a prominent manner in a newspaper of general circulation in the utility's service area, the first publication to be made within seven (7) days of the filing of the application with the commission.	Julia S. Janson
1	16	807 KAR 5:001 Section 10 (4)(d)	If notice is published, an affidavit from the publisher verifying that the notice was published, including the dates of the publication with an attached copy of the published notice, shall be filed with the Commission no later than forty-five (45) days of the filed date of the application.	Julia S. Janson
1	17	807 KAR 5:001 Section 10 (4)(e)	If notice is mailed, a written statement signed by the utility's chief officer in charge of Kentucky operations verifying the notice was mailed shall be filed with the Commission no later than thirty (30) days of the filed date of the application.	Julia S. Janson
1	18	807 KAR 5:001 Section 10 (4)(f)	All utilities, in addition to the above notification, shall post a sample copy of the required notification at their place of business no later than the date on which the application is filed which shall remain posted until the commission has finally determined the utility's rates.	Julia S. Janson
1	19	807 KAR 5:001 Section 10 (5)	Notice of hearing scheduled by the commission upon application by a utility for a general adjustment in rates shall be advertised by the utility by newspaper publication in the areas that will be affected in compliance with KRS 424.300.	Julia S. Janson
1	20	807 KAR 5:001 Section 10 (8)(a)	Financial data for forecasted period presented as pro forma adjustments to base period.	Robert M. Parsons, Jr.
1	21	807 KAR 5:001 Section 10 (8)(b)	Forecasted adjustments shall be limited to the 12 months immediately following the suspension period.	Robert M. Parsons, Jr.
1	22	807 KAR 5:001 Section 10 (8)(c)	Capitalization and net investment rate base shall be based on a 13 month average for the forecasted period.	Robert M. Parsons, Jr.

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
1	23	807 KAR 5:001 Section 10 (8)(d)	After an application based on a forecasted test period is filed, there shall be no revisions to the forecast, except for the correction of mathematical errors, unless such revisions reflect statutory or regulatory enactments that could not, with reasonable diligence, have been included in the forecast on the date it was filed. There shall be no revisions filed within thirty (30) days of a scheduled hearing on the rate application.	Robert M. Parsons, Jr.
1	24	807 KAR 5:001 Section 10 (8)(e)	The commission may require the utility to prepare an alternative forecast based on a reasonable number of changes in the variables, assumptions, and other factors used as the basis for the utility's forecast.	Robert M. Parsons, Jr.
1	25	807 KAR 5:001 Section 10 (8)(f)	Reconciliation of rate base and capital used to determine revenue requirements.	Robert M. Parsons, Jr.
1	26	807 KAR 5:001 Section 10 (9)(a)	Prepared testimony of each witness supporting its application including testimony from chief officer in charge of Kentucky operations on the existing programs to achieve improvements in efficiency and productivity, including an explanation of the purpose of the program.	All witnesses
1	27	807 KAR 5:001 Section 10 (9)(b)	Most recent capital construction budget containing at minimum 3 year forecast of construction expenditures.	Gary J. Hebbeler
1	28	807 KAR 5:001 Section 10 (9)(c)	Complete description, which may be in prefiled testimony form, of all factors used to prepare forecast period. All econometric models, variables, assumptions, escalation factors, contingency provisions, and changes in activity levels shall be quantified, explained, and properly supported.	Stephen R. Lee
1	29	807 KAR 5:001 Section 10 (9)(d)	Annual and monthly budget for the 12 months preceding filing date, base period and forecasted period.	Stephen R. Lee
1	30	807 KAR 5:001 Section 10 (9)(e)	Attestation signed by utility's chief officer in charge of Kentucky operations providing: 1. That forecast is reasonable, reliable, made in good faith and that all basic assumptions used have been identified and justified; and 2. That forecast contains same assumptions and methodologies used in forecast prepared for use by management, or an identification and explanation for any differences; and 3. That productivity and efficiency gains are included in the forecast.	Julia S. Janson
1	31	807 KAR 5:001 Section 10 (9)(f)	For each major construction project constituting 5% or more of annual construction budget within 3 year forecast, following information shall be filed: 1. Date project began or estimated starting date; 2. Estimated completion date; 3. Total estimated cost of construction by year	Gary J. Hebbeler

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
			exclusive and inclusive of Allowance for Funds Used During construction ("AFUDC") or Interest During construction Credit; and 4. Most recent available total costs incurred exclusive and inclusive of AFUDC or Interest During Construction Credit.	
1	32	807 KAR 5:001 Section 10 (9)(g)	For all construction projects constituting less than 5% of annual construction budget within 3 year forecast, file aggregate of information requested in paragraph (f) 3 and 4 of this subsection.	Gary J. Hebbeler
1	33	807 KAR 5:001 Section 10 (9)(h)	Financial forecast for each of 3 forecasted years included in capital construction budget supported by underlying assumptions made in projecting results of operations and including the following information: 1. Operating income statement (exclusive of dividends per share or earnings per share); 2. Balance sheet; 3. Statement of cash flows; 4. Revenue requirements necessary to support the forecasted rate of return; 5. Load forecast including energy and demand (electric); 6. Access line forecast (telephone); 7. Mix of generation (electric); 8. Mix of gas supply (gas); 9. Employee level; 10.Labor cost changes; 11.Capital structure requirements; 12.Rate base; 13.Gallons of water projected to be sold (water); 14.Customer forecast (gas, water); 15.MCF sales forecasts (gas); 16.Toll and access forecast of number of calls and number of minutes (telephone); and 17.A detailed explanation of any other information provided.	Stephen R. Lee Stephen G. De May #6, #13, #16 & #17 Not applicable
1	34	807 KAR 5:001 Section 10 (9)(i)	Most recent FERC or FCC audit reports.	Brenda R. Melendez
1	35	807 KAR 5:001 Section 10 (9)(j)	Prospectuses of most recent stock or bond offerings.	Stephen G. De May
1	36	807 KAR 5:001 Section 10 (9)(k)	Most recent FERC Form 1 (electric), FERC Form 2 (gas), or the Automated Reporting Management Information System Report (telephone) and PSC Form T (telephone).	Brenda R. Melendez
2	37	807 KAR 5:001 Section 10 (9)(l)	Annual report to shareholders or members and statistical supplements for the most recent 5 years prior to application filing date.	Stephen G. De May
3	38	807 KAR 5:001 Section 10 (9)(m)	Current chart of accounts if more detailed than Uniform System of Accounts charts.	Brenda R. Melendez

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
3	39	807 KAR 5:001 Section 10 (9)(n)	Latest 12 months of the monthly managerial reports providing financial results of operations in comparison to forecast.	Stephen R. Lee
3	40	807 KAR 5:001 Section 10 (9)(o)	Complete monthly budget variance reports, with narrative explanations, for the 12 months prior to base period, each month of base period, and subsequent months, as available.	Stephen R. Lee
4-7	41	807 KAR 5:001 Section 10 (9)(p)	SEC's annual report for most recent 2 years, Form 10-Ks and any Form 8-Ks issued during prior 2 years and any Form 10-Qs issued during past 6 quarters.	Stephen G. De May
8	42	807 KAR 5:001 Section 10 (9)(q)	Independent auditor's annual opinion report, with any written communication which indicates the existence of a material weakness in internal controls.	Stephen G. De May
8	43	807 KAR 5:001 Section 10 (9)(r)	Quarterly reports to the stockholders for the most recent 5 quarters.	David L. Doss
8	44	807 KAR 5:001 Section 10 (9)(s)	Summary of latest depreciation study with schedules itemized by major plant accounts, except that telecommunications utilities adopting PSC's average depreciation rates shall identify current and base period depreciation rates used by major plant accounts. If information has been filed in another PSC case, refer to that case's number and style.	John J. Spanos
8	45	807 KAR 5:001 Section 10 (9)(t)	List all commercial or in-house computer software, programs, and models used to develop schedules and work papers associated with application. Include each software, program, or model; its use; identify the supplier of each; briefly describe software, program, or model; specifications for computer hardware and operating system required to run program	Robert M. Parsons, Jr.
8	46	807 KAR 5:001 Section 10 (9)(u)	If utility had any amounts charged or allocated to it by affiliate or general or home office or paid any monies to affiliate or general or home office during the base period or during previous 3 calendar years, file: 1. Detailed description of method of calculation and amounts allocated or charged to utility by affiliate or general or home office for each allocation or payment; 2. method and amounts allocated during base period and method and estimated amounts to be allocated during forecasted test period; 3. Explain how allocator for both base and forecasted test period was determined; and 4. All facts relied upon, including other regulatory approval, to demonstrate that each amount charged, allocated or paid during base period is reasonable.	David L. Doss

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
9	47	807 KAR 5:001 Section 10 (9)(v)	If gas, electric or water utility with annual gross revenues greater than $5,000,000, cost of service study based on methodology generally accepted in industry and based on current and reliable data from single time period.	Donald L. Storck
10	48	807 KAR 5:001 Section 10 (9)(w)	Local exchange carriers with fewer than 50,000 access lines need not file cost of service studies, except as specifically directed by PSC. Local exchange carriers with more than 50,000 access lines shall file: 1. Jurisdictional separations study consistent with Part 36 of the FCC's rules and regulations; and 2. Service specific cost studies supporting pricing of services generating annual revenue greater than $1,000,000 except local exchange access: a. Based on current and reliable data from single time period; and b. Using generally recognized fully allocated, embedded, or incremental cost principles.	Not applicable
10	49	807 KAR 5:001 Section 10 (10)(a)	Jurisdictional financial summary for both base and forecasted periods detailing how utility derived amount of requested revenue increase.	Robert M. Parsons, Jr.
10	50	807 KAR 5:001 Section 10 (10)(b)	Jurisdictional rate base summary for both base and forecasted periods with supporting schedules which include detailed analyses of each component of the rate base.	Robert M. Parsons, Jr.
10	51	807 KAR 5:001 Section 10 (10)(c)	Jurisdictional operating income summary for both base and forecasted periods with supporting schedules which provide breakdowns by major account group and by individual account.	Robert M. Parsons, Jr.
10	52	807 KAR 5:001 Section 10 (10)(d)	Summary of jurisdictional adjustments to operating income by major account with supporting schedules for individual adjustments and jurisdictional factors.	Robert M. Parsons, Jr.
10	53	807 KAR 5:001 Section 10 (10)(e)	Jurisdictional federal and state income tax summary for both base and forecasted periods with all supporting schedules of the various components of jurisdictional income taxes.	Robert M. Parsons
10	54	807 KAR 5:001 Section 10 (10)(f)	Summary schedules for both base and forecasted periods (utility may also provide summary segregating items it proposes to recover in rates) of organization membership dues; initiation fees; expenditures for country club; charitable contributions; marketing, sales, and advertising; professional services; civic and political activities; employee parties and outings; employee gifts; and rate cases.	Robert M. Parsons, Jr.
10	55	807 KAR 5:001 Section 10 (10)(g)	Analyses of payroll costs including schedules for wages and salaries, employee benefits, payroll taxes, straight time and overtime hours, and executive compensation by title.	Jay R. Alvaro

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
10	56	807 KAR 5:001 Section 10 (10)(h)	Computation of gross revenue conversion factor for forecasted period.	Robert M. Parsons, Jr.
10	57	807 KAR 5:001 Section 10 (10)(i)	Comparative income statements (exclusive of dividends per share or earnings per share), revenue statistics and sales statistics for 5 calendar years prior to application filing date, base period, forecasted period, and 2 calendar years beyond forecast period.	Stephen R. Lee
10	58	807 KAR 5:001 Section 10 (10)(j)	Cost of capital summary for both base and forecasted periods with supporting schedules providing details on each component of the capital structure.	Stephen G. De May
10	59	807 KAR 5:001 Section 10 (10)(k)	Comparative financial data and earnings measures for the 10 most recent calendar years, base period, and forecast period.	Stephen R. Lee
10	60	807 KAR 5:001 Section 10 (10)(l)	Narrative description and explanation of all proposed tariff changes.	James E. Ziolkowski
10	61	807 KAR 5:001 Section 10 (10)(m)	Revenue summary for both base and forecasted periods with supporting schedules which provide detailed billing analyses for all customer classes.	James E. Ziolkowski
10	62	807 KAR 5:001 Section 10 (10)(n)	Typical bill comparison under present and proposed rates for all customer classes.	James E. Ziolkowski
10	63	807 KAR 5:001 Section (10)(3)	Amount of change requested in dollar amounts and percentage for each customer classification to which change will apply. a. Present and proposed rates for each customer class to which change would apply. b. Electric, gas, water and sewer utilities-the effect upon average bill for each customer class to which change would apply. c. Local exchange companies-include effect upon average bill for each customer class for change in basic local service.	James E. Ziolkowski
10	64	807 KAR 5:001 Section 10 (4)(c)(d)(e)(f)	If copy of public notice included, did it meet requirements?	Julia S. Janson
10	65	807 KAR 5:001 Section 6(1)	Amount and kinds of stock authorized.	Stephen G. De May
10	66	807 KAR 5:001 Section 6(2)	Amount and kinds of stock issued and outstanding.	Stephen G. De May
10	67	807 KAR 5:001 Section 6(3)	Terms of preference of preferred stock whether cumulative or participating, or on dividends or assets or otherwise.	Stephen G. De May
10	68	807 KAR 5:001 Section 6(4)	Brief description of each mortgage on property of applicant, giving date of execution, name of mortgagor, name of mortgagee, or trustee, amount of indebtedness authorized to be secured thereby, and the amount of indebtedness actually secured, together with any sinking fund provisions.	Stephen G. De May

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Vol. #	Tab #	Filing Requirement	Description	Sponsoring Witness
10	69	807 KAR 5:001 Section 6(5)	Amount of bonds authorized, and amount issued, giving the name of the public utility which issued the same, describing each class separately, and giving date of issue, face value, rate of interest, date of maturity and how secured, together with amount of interest paid thereon during the last fiscal year.	Stephen G. De May
10	70	807 KAR 5:001 Section 6(6)	Each note outstanding, giving date of issue, amount, date of maturity, rate of interest, in whose favor, together with amount of interest paid thereon during the last fiscal year.	Stephen G. De May
10	71	807 KAR 5:001 Section 6(7)	Other indebtedness, giving same by classes and describing security, if any, with a brief statement of the devolution or assumption of any portion of such indebtedness upon or by person or corporation if the original liability has been transferred, together with amount of interest paid thereon during the last fiscal year.	Stephen G. De May
10	72	807 KAR 5:001 Section 6(8)	Rate and amount of dividends paid during the five (5) previous fiscal years, and the amount of capital stock on which dividends were paid each year.	Stephen G. De May
10	73	807 KAR 5:001 Section 6(9)	Detailed income statement and balance sheet.	Robert M. Parsons, Jr.
11	-	807 KAR 5:001 Sction 10(10) (a) through (k)	Schedule Book (Schedules A-K)	Various
12	-	807 KAR 5:001 Sction 10(10) (l) through (n)	Schedule Book (Schedules L-N)	Various
13	-	-	Work papers	Various
14	-	807 KAR 5:001 Section 10(9)(a)	Testimony (Volume 1 of 2)	-
15	-	807 KAR 5:001 Section 10(9)(a)	Testimony (Volume 2 of 2)	-
16	-	KRS 278.2205(6)	Cost Allocation Manual	Brenda R. Melendez
17	-	807 KAR 5:056 Section 1(7)	Coal Contracts	Not Applicable-

STANDARD FILING REQUIREMENT SCHEDULES

KENTUCKY PUBLIC SERVICE COMMISSION

GAS CASE NO. 2009-00202

DATE: July 1, 2009

GENERAL APPLICATION FOR CHANGE IN
GAS RATES BEFORE KENTUCKY PUBLIC
SERVICE COMMISSION

NAME: DUKE ENERGY KENTUCKY
ADDRESS: 1697-A MONMOUTH STREET
NEWPORT, KENTUCKY 41071

MAILING
ADDRESS: P. O. BOX 960
CINCINNATI, OHIO 45201

TELEPHONE: AREA CODE 513 NUMBER 419-5908

COMPANY OFFICIAL TO BE CONTACTED
PERTAINING TO RATE CASE MATTERS William Don Wathen Jr.

FILING DATE: July 1, 2009

ATTORNEYS FOR APPLICANT:

NAME: Rocco D'Ascenzo

ADDRESS: P. O. Box 960
Cincinnati, Ohio 45202
TELEPHONE: (513) 419-1852

* * * FOR COMMISSION USE ONLY * * *

DATE RECEIVED BY COMMISSION ________________

DOCKET NUMBER ASSIGNED ____________________

RECEIVED BY ________________________________

DATE ACCEPTED ______________________________

ACCEPTED BY ________________________________

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE ADJUSTMENT
OF GAS RATES OF DUKE ENERGY KENTUCKY, INC.

CASE NO. 2009-00202

FILING REQUIREMENTS

VOLUME 3

DUKE ENERGY KENTUCKY
CASE NO. 2009-00202
FORECASTED TEST PERIOD FILING REQUIREMENTS
FR 10(9)(p)

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807 KAR 5:001, SECTION 10(9)(p)

Description of Filing Requirement:

Securities and Exchange Commission's annual report for the most recent two (2) years, Form 10-Ks and any Form 8-Ks issued within the past two (2) years, and Form 10-Qs issued during the past six (6) quarters updated as current information becomes available.

Response:

On May 8, 2006, the Union Light, Heat and Power Company provided certification and notice of termination of duty to file reports under Sections 13 and 15(d) of the Securities and Exchange Act of 1934. Since Duke Energy Kentucky has not filed reports with the Securities and Exchange Commission (SEC) within the past two (2) years, we are providing the filed reports of Duke Energy Ohio, Duke Energy Kentucky's parent. Additionally, we are providing Duke Energy Kentucky's quarterly and annual financial statements although they are not filed with the SEC. See attached Volume 3.

Sponsoring Witness: Brenda R. Melendez

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

March 31, 2009

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Year To Date March 31,	
	2009	2008
	(in thousands)	
Operating Revenues		
Electric	$ **81,871**	$ 76,681
Gas	**57,535**	72,601
Other	**5,639**	5,197
Total Operating Revenues	**145,045**	154,479
Operating Expenses		
Natural gas purchased	**40,054**	55,916
Operation, maintenance and other	**31,635**	31,280
Fuel used in electric generation and purchased power	**36,654**	33,357
Depreciation and amortization	**10,768**	8,044
Property and other taxes	**3,505**	3,113
Total Operating Expenses	**122,616**	131,710
Operating Income	**22,429**	22,769
Other Income and Expenses, net	**815**	1,416
Interest Expense	**4,588**	4,220
Income Before Income Taxes	**18,656**	19,965
Income Tax Expense	**6,866**	7,451
Net Income	$ **11,790**	$ 12,514

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

ASSETS	March 31, 2009	December 31, 2008
	(in thousands)	
Current Assets		
Cash and cash equivalents	$ 14,651	$ 11,768
Receivables (net of allowance for doubtful accounts of $466 at March 31, 2009 and $432 at December 31, 2008)	43,058	52,336
Inventory	35,455	33,045
Other	16,456	26,051
Total current assets	109,620	123,200
Investments and Other Assets		
Intangible assets	9,341	10,503
Other	3,960	4,392
Total investments and other assets	13,301	14,895
Property, Plant, and Equipment		
Cost	1,541,128	1,536,785
Less accumulated depreciation and amortization	628,183	625,727
Net property, plant, and equipment	912,945	911,058
Regulatory Assets and Deferred Debits		
Deferred debt expense	5,211	5,308
Regulatory Assets	49,688	47,742
Total regulatory assets and deferred debits	54,899	53,050
Total Assets	$ 1,090,765	$ 1,102,203

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	March 31, 2009	December 31, 2008
	(in thousands)	
Current Liabilities		
Accounts payable	**$ 45,387**	$ 51,936
Notes payable	**-**	3,241
Taxes accrued	**10,772**	11,212
Interest accrued	**1,306**	3,828
Current maturities of long-term debt	**22,374**	22,461
Other	**12,984**	14,274
Total current liabilities	**92,823**	106,952
Long-term Debt	**315,832**	316,168
Deferred Credits and Other Liabilities		
Deferred income taxes	**174,221**	171,851
Investment tax credit	**4,281**	4,519
Accrued pension and other postretirement benefit costs	**28,897**	39,180
Regulatory liabilities	**44,105**	40,482
Asset retirement obligations	**6,471**	6,390
Other	**18,320**	22,636
Total deferred credits and other liabilities	**276,295**	285,058
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at March 31, 2009 and December 31, 2008	**8,780**	8,780
Paid-in capital	**167,494**	167,494
Retained earnings	**229,541**	217,751
Total common stockholder's equity	**405,815**	394,025
Total Liabilities and Common Stockholder's Equity	**$ 1,090,765**	$ 1,102,203

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

				Accumulated Other Comprehensive Income (Loss)	
	Common Stock	Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			12,514		12,514
Other comprehensive income					
Cash flow hedges, net of tax expense of $628				998	998
Total comprehensive income					13,512
Balance at March 31, 2008	$ 8,780	$ 167,494	$ 222,784	$ -	$ 399,058
Balance at December 31, 2008	$ 8,780	$ 167,494	$ 217,751	$ -	$ 394,025
Net income and total comprehensive income			11,790		11,790
Balance at March 31, 2009	$ 8,780	$ 167,494	$ 229,541	$ -	$ 405,815

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **11,790**	$ 12,514
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**10,947**	8,192
Deferred income taxes	**4,433**	(2,735)
Regulatory asset/liability amortization	**435**	452
Contribution to company sponsored pension plan	**(13,554)**	-
Accrued pension and other postretirement benefit costs	**391**	584
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**2,072**	1,158
Receivables	**17,554**	3,900
Inventory	**(2,410)**	6,822
Other current assets	**7,518**	4,451
Increase (decrease) in:		
Accounts payable	**(3,302)**	(554)
Taxes accrued	**(441)**	6,818
Other current liabilities	**(4,070)**	(835)
Regulatory asset/liability deferrals	**(6,304)**	7,859
Other assets	**3,165**	1,169
Other liabilities	**(4,275)**	(2,133)
Net cash provided by operating activities	**23,949**	47,662
Cash Flows from Investing Activities		
Capital expenditures	**(12,404)**	(14,025)
Notes from affiliate, net	**(4,985)**	-
Other	**42**	-
Net cash used in investing activities	**(17,347)**	(14,025)
Cash Flows from Financing Activities		
Redemption of long-term debt	**(437)**	(440)
Other	**(3,282)**	(27,044)
Net cash used in financing activities	**(3,719)**	(27,484)
Net increase in cash and cash equivalents	**2,883**	6,153
Cash and cash equivalents at beginning of period	**11,768**	9,302
Cash and cash equivalents at end of period	$ **14,651**	$ 15,455

See Notes to Unaudited Financial Statements

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, Inc. (Duke Energy Kentucky), a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Unaudited Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim Unaudited 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 to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the Unaudited Financial Statements and Notes. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Unbilled Revenue. Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled retail 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 Mcfs delivered but not billed. Unbilled wholesale energy revenues are calculated by applying the contractual rate per megawatt hour (MWh) to the number of estimated MWh delivered, but not yet billed. Unbilled wholesale demand revenues are calculated by applying the contractual rate per megawatt (MW) to the MW volume not yet billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are primarily recorded as Receivables on the Balance Sheets, primarily relate to wholesale sales and were approximately $3 million and $1 million, at March 31, 2009 and December 31, 2008, respectively. Additionally, Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable and related collections to Cinergy Receivables Company, LLC (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 Financial Accounting Standards Board (FASB) 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" (SFAS No. 140), and, accordingly, the transfers of receivables are accounted for as sales. Receivables for unbilled revenues of approximately $15 million and $26 million at March 31, 2009 and December 31, 2008, respectively, related to retail accounts receivable at Duke Energy Kentucky were included in the sales of accounts receivable to Cinergy Receivables.

2. 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.

	March 31, 2009	December 31, 2008
	(in thousands)	
Coal held for electric generation	$ 20,789	$ 18,455
Materials and supplies	13,650	13,360
Natural gas	1,017	1,240
Total Inventory	$ 35,456	$ 33,055

Effective November 1, 2008, Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately $2 million and $10 million being held by a third party as of March 31, 2009 and December 31, 2008, respectively, has been classified as Other within Current Assets on the Consolidated Balance Sheets.

3. Debt and Credit Facilities

Money Pool. Duke Energy Kentucky 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 Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of the participating subsidiaries, as each entity independently participates in the money pool. As of March 31, 2009, Duke Energy Kentucky had a receivable balance of approximately $5 million, which is classified within Receivables in the accompanying Balance Sheets. As of December 31, 2008, Duke Energy Kentucky had amounts outstanding of approximately $3 million, which is classified within Notes Payable in the accompanying Balance Sheets. The $5 million increase in the money pool activity during the three months ended March 31, 2009 is reflected in Notes due from affiliate, net within Net cash used in investing activities on the Statements of Cash Flows. In addition, the $3 million decrease in the money pool activity during

the three months ended March 31, 2009 is reflected in Notes payable to affiliate, net within Net cash provided by (used in) financing activities on the Statements of Cash Flows.

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. The total credit facility capacity under Duke Energy's master credit facility is approximately $3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At March 31, 2009, Duke Energy Kentucky had a borrowing sub limit under Duke Energy's master credit facility of $100 million. The amount available to Duke Energy Kentucky under its sub limit to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility, of which Duke Energy Kentucky's portion is approximately $74 million. Duke Energy Kentucky's amount remained outstanding as of March 31, 2009. The loans, which are revolving credit loans, bear interest at one-month London Interbank Offered Rate (LIBOR) plus an applicable spread ranging from 19 to 24 basis points and are due in September 2009; however, Duke Energy Kentucky has the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Balance Sheets at March 31, 2009. This borrowing reduces Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At both March 31, 2009 and December 31, 2008, approximately $50 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Kentucky's intent and ability to utilize such borrowings as long-term financing. Duke Energy Kentucky's credit facility with non-cancelable terms in excess of one year as of the balance sheet date gives Duke Energy Kentucky the ability to refinance these short-term obligations on a long-term basis. This specific purpose credit facility backstopped the $50 million of pollution control bonds outstanding at March 31, 2009

Restrictive Debt Covenants. Duke Energy's debt and credit agreement contains various financial and other covenants. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2009, Duke Energy and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Kentucky's ability to borrow funds under the 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.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	(in thousands)	
Qualified Pension Benefits	$ 255	$ 266
Other Postretirement Benefits	$ 131	$ 318

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. In February 2009, Duke Energy Kentucky made a cash contribution of approximately $14 million, which represented its proportionate share of an approximate $500 million total contribution to Cinergy's and Duke Energy's qualified pension plans. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008. Duke Energy does not anticipate making additional contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2009. Cinergy also sponsors employee savings plans that cover substantially all employees. Duke Energy Kentucky expensed pre-tax employer matching contributions of approximately $279 thousand and $213 thousand for each of the three months ended March 31, 2009 and 2008, respectively.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of March 31, 2009 and December 31, 2008 is $9 million and $11 million, respectively.

During the three months ended March 31, 2009 and 2008, the carrying value of emission allowances sold or consumed was $1 million in each period.

6. Related Party Transactions

Duke Energy Kentucky 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 Balance Sheets as of March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009	December 31, 2008
	(in thousands)	
Accounts Receivable	$ 131	$10,765
Accounts Payable	$19,025	$13,478

Duke Energy Kentucky is charged its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also charged its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other shared service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations were $21 and $12 million for the three months ended March 31, 2009 and 2008, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and post-retirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Cinergy of approximately $26 million at March 31, 2009 and approximately $39 million at December 31, 2008. The above amounts have been classified in the Balance Sheet as follows:

	March 31, 2009	December 31, 2008
	(in thousands)	
Other current liabilities	$ **108**	$ 108
Accrued pension and other postretirement benefit costs	$ **25,815**	$ 39,195

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Kentucky 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 Balance Sheets and was approximately $25 million and $29 million as of March 31, 2009 and December 31, 2008, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Statements of Operations, was approximately $1 million for each of the three months ended March 31, 2009 and 2008.

As discussed further in Note 3, Duke Energy Kentucky participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2009, Duke Energy Kentucky was in a receivable position of approximately $5 million. As of December 31, 2008, Duke Energy Kentucky was in a payable position of approximately $3 million.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2009 and 2008.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. Regulatory Matters

Franchised Electric and Gas

Rate Related Information. The Kentucky Public Service Commission (KPSC) approves rates for retail electric and gas services within the Commonwealth of Kentucky.

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 June 2005, the Kentucky General Assembly enacted Kentucky Revised Statue 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. 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, which were approved prior to enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order, Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. 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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a save-a-watt energy efficiency plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. Intervenor testimony was filed on May 11, 2009. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

Application for the Establishment of a Regulatory Asset. On November 14, 2008, Duke Energy Kentucky petitioned the KPSC for permission to create a regulatory asset to defer, for future recovery, approximately $5 million for its expenses incurred to repair damage and restore service to its customers following extensive storm-related damage caused by Hurricane Ike on September 14, 2008. The KPSC approved the requested accounting order on January 7, 2009.

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 Federal Energy Regulatory Commission's (FERC) 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.

Midwest ISO's Establishment of an Ancillary Services Market (ASM). On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time 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 in the Midwest ISO area. The Midwest ISO launched the ASM on January 6, 2009.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable

and are reasonably estimable. During 2009, it is reasonably possible that Duke Energy Kentucky will incur costs associated with remediation activities at certain of its sites.

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. Coal-fired generating facilities in which Duke Energy Kentucky is either a whole or partial owner are affected sources under that rule. On April 1, 2009, the U.S. Supreme Court ruled in favor of the plaintiff that the EPA may consider costs when determining which technology option each site should implement. Depending on how the cost-benefit analysis is incorporated into the revised EPA rule, the analysis could narrow the range of technology options required for the affected facilities. Because of the wide range of potential outcomes, Duke Energy Kentucky is unable to estimate its costs to comply at this time.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO_2 emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. 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. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Kentucky is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $2 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

Comprehensive Environmental Response, Compensation, and Liability Act Matter. In August 2008, Duke Energy Kentucky 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 Kentucky does not have any further information regarding the scope of potential liability associated with this matter.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of March 31, 2009 and December 31, 2008. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

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 Kentucky, 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. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Kentucky cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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 arguments were heard on August 6, 2008. Due to the late recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of March 31, 2009 and December 31, 2008, Duke Energy Kentucky has recorded insignificant reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157. Through December 31, 2008, Duke Energy Kentucky's adoption of SFAS No. 157 was limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, *"Effective Date of FASB Statement No. 157,"* which delayed the effective date of SFAS No. 157 until January 1, 2009 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 Duke Energy Kentucky 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 in the U.S. 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 Duke Energy Kentucky 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.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Kentucky's Balance Sheets at fair value at March 31, 2009:

	Total Fair Value Amounts at March 31, 2009	Level 1	Level 2	Level 3
		(in thousands)		
Description				
Derivative Assets	$ —	$ —	$ —	$ —
Derivative Liabilities	(8,057)	(1,479)	(6,550)	(27)
Net Liabilities	$(8,057)	$(1,479)	$(6,550)	$(27)

	Total Fair Value Amounts at December 31, 2008	Level 1	Level 2	Level 3
		(in thousands)		
Description				
Derivative Assets	$ 178	$ —	$ —	$178

	Total Fair Value Amounts at March 31, 2009	Level 1	Level 2	Level 3
		(in thousands)		
Derivative Liabilities	(7,977)	—	(7,977)	—
Net (Liabilities) Assets	$(7,799)	$ —	$(7,977)	$178

The following table provides a reconciliation of beginning and ending balances of assets 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 thousands)
Balance at January 1, 2009	$178
Total gains included on balance sheet	(64)
Net purchases, sales, issuances and settlements	(141)
Balance at March 31, 2009	$(27)
Balance at January 1, 2008	$ —
Total gains included on balance sheet	318
Net purchases, sales, issuances and settlements	—
Balance at March 31, 2008	$318

Fair Value Disclosures Required Under FSP No. FAS 107-1 and Accounting Principles Board (APB) 28-1, "*Interim Disclosures About Fair Value of Financial Instruments.*" The fair value of financial instruments, excluding financial assets included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2009 and December 31, 2008 are not necessarily indicative of the amounts Duke Energy Kentucky could have realized in current markets.

	As of March 31, 2009		As of December 31, 2008	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
		(in thousands)		
Long-term debt, including current maturities	$338,206	$326,335	$338,629	$327,228

The fair value of cash and cash equivalents, accounts receivable, restricted funds held in trust, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

11. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Kentucky subsequent to March 31, 2008 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

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. Duke Energy Kentucky adopted SFAS No. 161 as of January 1, 2009. The adoption of SFAS No. 161 did not have any impact on Duke Energy Kentucky's results of operations, cash flows or financial position. See Note 10 for the disclosures required under SFAS No. 161.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

Duke Energy Kentucky has the following tax years open:

Jurisdiction	Tax Years
Federal	2005 and after
State	Closed through 2001, with the exception of any adjustments related to open federal years

The $585 thousand decrease in income tax expense for the comparative three-month periods ended March 31, 2009 and 2008 is due primarily to the $1.3 million decrease in pre-tax income.

13. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable and related collections to Cinergy Receivables. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140 and, accordingly, the transfers of receivables are accounted for as sales.

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 (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $25 million and $29 million at March 31, 2009 and December 31, 2008, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Balance Sheets at March 31, 2009 and March December 31, 2008.

In 2008, the governing purchase and sale agreement was amended to allow Cinergy Receivables to convey its bankrupt receivables to the applicable originator for consideration equal to the fair market value of such receivables as of the disposition date. The amount of bankrupt receivables sold is limited to 1% of aggregate sales of the originator during the most recently completed 12 month period. Cinergy Receivables and Duke Energy Kentucky completed a sale under this amendment in 2008.

Duke Energy Kentucky retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Kentucky exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Kentucky approximates a market rate.

The carrying value of the retained interest is determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions used in estimating the fair value for 2009 were an anticipated credit loss ratio of .9%, a discount rate of 2.8% and a receivable turnover rate of 12.2%. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Kentucky's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the three months ended March 31, 2009:

	Three Months Ended March 31, 2009
	(in thousands)
Receivables sold as of March 31,	$68,251
Less: Retained interests	24,853
Net receivables sold as of March 31,	$43,398
Sales	
Receivables sold	$152,160
Loss recognized on sale	1,248
Cash flows	
Cash proceeds from receivables sold	$154,588
Collection fees received	76
Return received on retained interests	804

14. Subsequent Events

For information on subsequent events related to regulatory matters, see Note 8.

Duke Energy Kentucky, Inc.

Financial Statements

and Auditor's Report

December 31, 2008

Deloitte & Touche LLP
1100 Carillon Building
227 West Trade Street
Charlotte, NC 28202
USA

Tel: +1 704 887 1500
Fax: +1 704 887 1570
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Duke Energy Kentucky, Inc.
Cincinnati, Ohio

We have audited the accompanying balance sheets of Duke Energy Kentucky, Inc. (the "Company") as of December 31, 2008 and 2007, and the related statements of operations, stockholder's equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 26, 2009

Member of
Deloitte Touche Tohmatsu

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Year To Date December 31, 2008	Year To Date December 31, 2007
	(in thousands)	
Operating Revenues		
Electric	$ **338,434**	$ 330,547
Gas	**143,678**	140,132
Other	**20,315**	22,005
Total Operating Revenues	**502,427**	492,684
Operating Expenses		
Fuel used in electric generation and purchased power	**156,952**	153,883
Operation, maintenance and other	**123,437**	127,079
Natural gas purchased	**106,913**	94,931
Depreciation and amortization	**37,392**	39,869
Property and other taxes	**7,475**	11,589
(Gain) Loss on sales of other assets, net	**(65)**	50
Total Operating Expenses	**432,104**	427,401
Operating Income	**70,323**	65,283
Other Income and Expenses, net	**4,853**	4,052
Interest Expense	**17,669**	17,414
Income Before Income Taxes	**57,507**	51,921
Income Tax Expense	**20,026**	18,452
Net Income	$ **37,481**	$ 33,469

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS	December 31, 2008	December 31, 2007
	(in thousands)	
Current Assets		
Cash and cash equivalents	**$ 11,768**	$ 9,302
Receivables (net of allowance for doubtful accounts of $432 at December 31, 2008 and $315 at December 31, 2007)	**52,336**	44,043
Inventory	**33,045**	27,391
Other	**26,051**	19,372
Total current assets	**123,200**	100,108
Investments and Other Assets		
Intangible assets	**10,503**	7,064
Other	**4,392**	3,430
Total investments and other assets	**14,895**	10,494
Property, Plant, and Equipment		
Cost	**1,536,785**	1,499,357
Less accumulated depreciation and amortization	**625,727**	617,530
Net property, plant, and equipment	**911,058**	881,827
Regulatory Assets and Deferred Debits		
Deferred debt expense	**5,308**	5,445
Regulatory assets related to income taxes	**460**	-
Other	**47,282**	17,093
Total regulatory assets and deferred debits	**53,050**	22,538
Total Assets	**$ 1,102,203**	$ 1,014,967

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	December 31, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Accounts payable	**$ 51,936**	$ 53,989
Notes payable	**3,241**	27,470
Taxes accrued	**11,212**	16,777
Interest accrued	**3,828**	3,553
Current maturities of long-term debt	**22,461**	21,678
Other	**14,274**	12,807
Total current liabilities	**106,952**	136,274
Long-term Debt	**316,168**	265,334
Deferred Credits and Other Liabilities		
Deferred income taxes	**171,851**	153,315
Investment tax credit	**4,519**	5,581
Accrued pension and other postretirement benefit costs	**39,180**	22,505
Regulatory liabilities	**40,482**	33,901
Asset retirement obligations	**6,390**	6,179
Other	**22,636**	6,332
Total deferred credits and other liabilities	**285,058**	227,813
Commitments and Contingencies (See Note 14)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at December 31, 2008 and December 31, 2007	**8,780**	8,780
Paid-in capital	**167,494**	167,494
Retained earnings	**217,751**	210,270
Accumulated other comprehensive loss	**-**	(998)
Total common stockholder's equity	**394,025**	385,546
Total Liabilities and Common Stockholder's Equity	**$ 1,102,203**	$ 1,014,967

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss) Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ 349,348
Net income			33,469		33,469
Other comprehensive loss					
Cash flow hedges, net of tax benefit of $146				(257)	(257)
Total comprehensive income					33,212
Capital contribution from parent		3,150			3,150
Adjustment due to SFAS No. 158 adoption			(164)		(164)
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			37,481		37,481
Other comprehensive income					
Cash flow hedges, net of tax expense of ($628)				998	998
Total comprehensive income					38,479
Dividends on common stock			(30,000)		(30,000)
Balance at December 31, 2008	$ 8,780	$ 167,494	$ 217,751	$ -	$ 394,025

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Twelve Months Ended December 31, 2008	2007
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **37,481**	$ 33,469
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**37,955**	40,475
(Gains) Losses on sales of other assets	**(65)**	50
Deferred income taxes	**6,920**	4,701
Regulatory asset/liability amortization	**1,792**	1,889
Contribution to company sponsored pension plan	-	(9,696)
Accrued pension and other post-retirement benefit costs	**2,240**	3,931
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**516**	(27)
Receivables	**(6,832)**	(9,057)
Inventory	**(4,158)**	1,611
Other current assets	**(5,787)**	(6,909)
Increase (decrease) in:		
Accounts payable	**(7,143)**	9,686
Taxes accrued	**(326)**	7,362
Other current liabilities	**440**	3,499
Regulatory asset/liability deferrals	**(6,363)**	(4,187)
Other assets	**(899)**	5,308
Other liabilities	**10,604**	(4,639)
Net cash provided by operating activities	**66,375**	77,466
Cash Flows from Investing Activities		
Capital expenditures	**(61,090)**	(64,199)
Purchases of emission allowances	-	(343)
Sale of emission allowances	**149**	343
Other	**55**	-
Net cash used in investing activities	**(60,886)**	(64,199)
Cash Flows from Financing Activities		
Issuance of long-term debt	**123,517**	3,067
Redemption of long-term debt	**(71,963)**	(1,492)
Notes payable to affiliate, net	**(24,229)**	(15,133)
Dividends paid	**(30,000)**	-
Contribution from parent	-	3,150
Other	**(348)**	(150)
Net cash used in financing activities	**(3,023)**	(10,558)
Net increase in cash and cash equivalents	**2,466**	2,709
Cash and cash equivalents at beginning of period	**9,302**	6,593
Cash and cash equivalents at end of period	$ **11,768**	$ 9,302
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Interest (net of amount capitalized)	$ **17,010**	$ 16,669
Income taxes	$ **14,143**	$ 6,912
Non-cash financing and investing activities:		
Allowance for funds used during construction (AFUDC) – equity component	$ **778**	$ 219
Accrued capital expenditures	$ **5,789**	$ 2,885

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC
Notes to Financial Statements
For the Years Ended December 31, 2008 and 2007

1. Summary of Significant Accounting Policies

Nature of Operations. Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy merged into wholly owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy or Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas LLC effective October 1, 2006). As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein. Duke Energy is a public registrant trading on the New York Stock Exchange under DUK.

The assets and liabilities of Duke Energy Kentucky were not adjusted to reflect their fair values as of the merger date since push-down accounting is not required by generally accepted accounting principles in the United States (GAAP).

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

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

Cash and Cash Equivalents. All highly liquid investments with remaining maturities of three months or less at the date of purchase are considered cash equivalents.

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.

Components of Inventory

	December 31, 2008	December 31, 2007
	(in thousands)	
Coal held for electric generation	$ 18,445	$ 9,010
Materials and supplies	13,360	9,241
Natural gas	1,240	9,140
Total Inventory	$ 33,045	$ 27,391

Effective November 1, 2008, Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the commitment from a third party to provide natural gas inventory of approximately $10 million as of December 31, 2008 has been classified as Other within Current Assets on the Balance Sheets. At December 31, 2008, this balance exceeded 5% of total current assets.

Cost-Based Regulation. Duke Energy Kentucky accounts for certain of its regulated operations under the provisions of SFAS No. 71, *"Accounting for the Effects of 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, Duke Energy Kentucky records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets and liabilities are amortized consistent with the treatment of the related costs in the ratemaking process. 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 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 Balance Sheets as Regulatory Assets and Deferred Debits, and Deferred Credits and Other Liabilities. Duke Energy Kentucky 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, Duke Energy Kentucky may have to reduce its asset balances to reflect a market basis less than cost and write off their associated regulatory assets and liabilities. For further information see Note 2.

In order to apply the accounting provisions of SFAS No. 71 and record regulatory assets and liabilities, the scope criteria in SFAS No. 71 must be met. Management makes significant judgments in determining whether the scope criteria of SFAS No. 71 are met for its operations, including determining whether revenue rates for services provided to customers are subject to approval by an independent, third-party regulator, whether the regulated rates are designed to recover specific costs of providing the regulated service, and a determination of whether, in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the operations' costs can be charged to and collected from customers. This final criterion requires consideration of anticipated changes in levels of demand or competition, direct and indirect, during the recovery period for any capitalized costs. If facts and circumstances change so that a portion of Duke Energy Kentucky's regulated operations meet all of the scope criteria set forth in SFAS No. 71 when such criteria had not been previously met, SFAS No. 71 would be reapplied to all or a separable portion of the operations. Such reapplication includes adjusting the balance sheet for amounts that meet the definition of a regulatory asset or regulatory liability of SFAS No. 71.

Accounting for Risk Management and Hedging Activities and Financial Instruments. All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" as amended (SFAS No. 133), are recorded on the Balance Sheet at their fair value.

Since Duke Energy Kentucky receives regulatory treatment for derivatives related to its native load, those mark-to-market gains and losses associated with those derivative contracts are reflected as regulatory assets or regulatory liabilities on the Balance Sheets.

Cash Flow and Fair Value Hedges. Changes in the fair value of a derivative designated and qualified as a cash flow hedge, to the extent effective, are included in the Statements of Common Stockholder's Equity and Comprehensive Income as Accumulated Other Comprehensive Income (Loss) (AOCI) until earnings are affected by the hedged item. Duke Energy Kentucky discontinues hedge accounting prospectively when it has determined that a derivative no longer qualifies as an effective hedge, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge, the derivative is subject to the Mark-to-Market model of accounting (MTM Model) prospectively. Gains and losses related to discontinued hedges that were previously accumulated in AOCI will remain in AOCI until the underlying contract is reflected in earnings, unless it is probable that the hedged forecasted transaction will not occur at which time associated deferred amounts in AOCI are immediately recognized in current earnings.

Valuation. Quoted market prices or prices obtained through external sources are used to measure a contract's fair value.

Property, Plant and Equipment. Property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Kentucky capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction. The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of property, plant and equipment, is expensed as incurred. Depreciation is generally computed over the asset's estimated useful life using the straight-line method. The composite weighted-average depreciation rate was 2.6% for both 2008 and 2007. Depreciation studies are conducted periodically to update the composite rates and are approved by the Kentucky Public Service Commission (KPSC). Also, see "Allowance for Funds Used During Construction (AFUDC)," discussed below.

When Duke Energy Kentucky retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation and amortization. When it sells entire regulated operating units, the cost is removed from the property account and the related accumulated depreciation and amortization accounts are reduced. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body (See Note 11).

Asset Retirement Obligations. Duke Energy Kentucky recognizes asset retirement obligations (ARO's) in accordance with SFAS No. 143, "*Accounting For Asset Retirement Obligations*" (SFAS No. 143), for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset and FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations*" (FIN 47), for conditional ARO's. The term conditional asset retirement obligation as used in SFAS No. 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Both SFAS No. 143 and FIN 47 require that the present value of the projected liability for an ARO be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 5 for further information.

Unamortized Debt Premium, Discount and Expense. Premiums, discounts and expenses incurred with the issuance of outstanding long-term debt are amortized over the terms of the debt issues. Any call premiums or unamortized expenses associated with refinancing higher-cost debt obligations to finance regulated assets and operations are amortized consistent with regulatory treatment of those items, where appropriate. The amortization expense is recorded as a component of interest expense in the Statements of Operations and is reflected as Depreciation and amortization within Net cash provided by operating activities on the Statements of Cash Flows.

Loss Contingencies. Duke Energy Kentucky is involved in certain legal and environmental matters that arise in the normal course of business. Loss contingencies are accounted for under SFAS No. 5, "*Accounting for Contingencies*" (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Kentucky records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred. See Note 14 for further information.

Environmental Expenditures. Duke Energy Kentucky expenses environmental expenditures related to conditions caused by past operations that do not generate current or future revenues. Environmental expenditures related to operations that generate current or future revenues are expensed or capitalized, as appropriate. Liabilities are recorded on an undiscounted basis when the necessity for environmental remediation becomes probable and the costs can be reasonably estimated, or when other potential environmental liabilities are reasonably estimable and probable.

Revenue Recognition and 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 from period to period as a result of factors, including seasonality, weather, customer usage patterns and customer mix. The receivables for unbilled revenues of approximately $26 million and $25 million at December 31, 2008 and 2007, respectively, related to retail accounts receivable at Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). See Note 10 for additional information.

Allowance for Funds Used During Construction (AFUDC). AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities, consists of two components, an equity component and an interest component. The equity component is a non-cash item. AFUDC is capitalized as a component of Property, Plant and Equipment cost, with offsetting credits to the Statements of Operations. After construction is completed, Duke Energy Kentucky is permitted to recover these costs through inclusion in the rate base and in the depreciation provision. The total amount of AFUDC included in the Statements of Operations was $1 million in 2008. The total amount of AFUDC included in the Statements of Operations was less than $500 thousand in 2007.

Accounting For Purchases and Sales of Emission Allowances. Emission allowances are issued by the Environmental Protection Agency (EPA) at zero cost and permit the holder of the allowance to emit certain gaseous by-products of fossil fuel combustion, including sulfur dioxide (SO_2) and nitrogen oxide (NO_x). Allowances may also be bought and sold via third party transactions or consumed as the emissions are generated. Allowances allocated to or acquired by Duke Energy Kentucky are held primarily for consumption. Duke Energy Kentucky records emission allowances as Intangible Assets on its Balance Sheets and recognizes the allowances in earnings as they are consumed or sold. Any gains or losses on sales of recoverable emission allowances are returned to customers via profit sharing mechanism riders included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Purchases and sales of emission allowances are presented gross as investing activities on the Statements of Cash Flows.

Income Taxes. The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own federal tax return as a C-Corporation.

Management evaluates and records contingent tax liabilities and related interest based on the probability of ultimately sustaining the tax deductions or income positions. Management assesses the probabilities of successfully defending the tax deductions or income positions based upon statutory, judicial or administrative authority.

Management evaluates and records uncertain tax positions in accordance with FIN 48, "*Accounting For Uncertainty in Income Taxes – an Interpretation of FASB Statement 109*" (FIN 48), which was adopted by Duke Energy Kentucky on January 1, 2007. Duke Energy Kentucky records unrecognized tax benefits for positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. In accordance with FIN 48, Duke Energy Kentucky records the largest amount of the unrecognized tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Kentucky does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 4 for further information.

Duke Energy Kentucky records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net, in the Statements of Operations.

New Accounting Standards. The following new accounting standards were adopted by Duke Energy Kentucky during the year ended December 31, 2008 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). Refer to Note 7 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 157.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities- including an amendment of FASB Statement No. 115" (SFAS No. 159). Refer to Note 7 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 159.

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). The impact of adopting FSP FIN 39-1 was not significant in 2008.

The following new accounting standards were adopted by Duke Energy Kentucky during the year ended December 31, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke Energy Kentucky for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that have been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140. SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 was effective for Duke Energy Kentucky as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Kentucky recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in regulatory assets of approximately

$22 million and an increase in liabilities of approximately $22 million as of December 31, 2006. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Kentucky has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Kentucky adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. In the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of accumulated other comprehensive income (loss) (AOCI) and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Kentucky completed these calculations. The finalization of these actuarial calculations resulted in an insignificant adjustment to AOCI and regulatory assets.

The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows.

FIN 48. In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Kentucky has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Kentucky's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Kentucky adopted FIN 48 effective January 1, 2007. See Note 4 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No. FIN 48-1). In May 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Kentucky's adoption of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

2. Regulatory Matters

Regulatory Assets and Liabilities. Duke Energy Kentucky's regulated operations apply the provisions of SFAS No. 71. Accordingly, Duke Energy Kentucky records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.

Duke Energy Kentucky's Regulatory Assets and Liabilities:

	As of December 31,		Recovery/Refund
	2008	2007	Period Ends
	(in thousands)		
Regulatory Assets[(a)(b)]			
Accrued pension and post retirement	$ 29,149	$ 12,517	(g)
Merger Costs	2,319	3,278	(e)
Vacation accrual[(h)]	2,349	1,624	2009
Storm cost deferrals	4,913	-	(g)
Hedge Costs and Other Deferrals	10,236	-	2009
Unamortized costs of reacquiring debt[(j)]	3,663	3,676	2025
Other	4,706	3,415	(g)
Total Regulatory Assets	$ 57,335	$ 24,510	
Regulatory Liabilities[(a)]			
Removal costs[(d)(k)]	$ 33,208	$ 31,372	(f)
Amounts due from Customers – Income Taxes[(e)(k)]	1,554	1,756	(g)
Over-recovery of fuel costs[(c)]	7,696	-	2009
Other[(i)(k)]	117	680	(g)
Total Regulatory Liabilities	$ 42,575	$ 33,808	

(a) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.
(b) Included in Regulatory Assets and Deferred Debits on the Balance Sheet unless otherwise noted.
(c) Included in Accounts payable on the Balance Sheet.
(d) Included in rate base.
(e) Recovery/refund is over the life of the associated asset or liability.
(f) Liability is extinguished over the lives of the associated assets.
(g) Recovery/Refund period currently unknown.
(h) Included in Other within Current Assets on the Balance Sheet.
(i) The current portion of the amounts in the other category are included in accounts payable on the balance sheet.
(j) Included in Deferred Debt Expense on the Balance Sheets.
(k) Included in Regulatory Liabilities within Deferred Credits and Other Liabilities on the Balance Sheets.

Regulatory Merger Approvals. As discussed in Note 1, 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 Kentucky Public Service Commission (KPSC) required that certain

merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 $2 million of the rate reduction was passed through to customers during each of the years ended December 31, 2008 and 2007.
- The FERC approved the merger without conditions.

Restrictions on the Ability of Duke Energy Kentucky to Make Dividends, Advances and Loans to Duke Energy Corporation. As a condition of the Duke Energy and Cinergy merger approval, the state utility commissions imposed conditions (the Merger Conditions) on the ability of Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Pursuant to the Merger Conditions, Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure.

Franchised Electric and Gas.

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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 June 2005, the Kentucky General Assembly enacted Kentucky Revised Statue 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. 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, which were approved prior to the enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order, Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC. The plan provided for Duke Energy Kentucky to purchase back-up power through bilateral contracts for unscheduled outages. Duke Energy Kentucky will recover these costs through base rates. The plan provided for Duke Energy Kentucky to purchase back-up power through the Midwest Independent System Operator, Inc. (Midwest ISO) energy markets for unscheduled outages. The KPSC issued an order in March 2007 approving Duke Energy Kentucky's back-up power supply plan.

Energy Efficiency. 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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a new save-a-watt Energy Efficiency Plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

Other Franchised Electric and Gas Matters

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.

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 to January 6, 2009.

Other Matters.

Application for the Establishment of a Regulatory Asset. On November 14, 2008, Duke Energy Kentucky petitioned the KPSC for permission to create a regulatory asset to defer, for future recovery, approximately $5 million for its expenses incurred to repair damage and restore service to its customers following extensive storm-related damage caused by Hurricane Ike on September 14, 2008. The KPSC approved the requested accounting order on January 7, 2009.

3. Joint Ownership of Generating Facilities

Duke Energy Kentucky and Dayton Power & Light jointly own an electric generating unit.

Duke Energy Kentucky's share in the jointly-owned plant included on the December 31, 2008 Balance Sheet was as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
		(in thousands)		
Duke Energy Kentucky				
Production:				
East Bend Station	69.0	$ 422,532	$ 219,411	$ 4,652

Duke Energy Kentucky's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line on the Statements of Operations. Each participant in the jointly owned facilities must provide its own financing.

4. Income Taxes

The following details the components of income tax expense:

Income Tax Expense

	Year Ended December 31, 2008	Year Ended December 31, 2007
	(in thousands)	
Current income taxes		
Federal	**$ 10,889**	$ 11,387
State	**2,217**	2,364
Total current income taxes[(a)]	**13,106**	13,751
Deferred income taxes		
Federal	**6,634**	4,559
State	**1,063**	927
Total deferred income taxes	**7,697**	5,486
Investment tax credit amortization	**(777)**	(785)
Total income tax expense presented in Statements of Operations	**$ 20,026**	$ 18,452

(a) Included are FIN 48 benefits relating primarily to certain temporary differences of approximately $95 thousand for 2008 and no amount for 2007.

Reconciliation of Income Tax Expense at the U.S. Federal Statutory Tax Rate to the Actual Tax Expense (Statutory Rate Reconciliation)

	Year Ended December 31, 2008	Year Ended December 31, 2007
	(in thousands)	
Income tax expense, computed at the statutory rate of 35%	**$ 20,128**	$ 18,173
State income tax, net of federal income tax effect	**2,132**	2,139
Depreciation and other PP&E related differences	**51**	173
ITC amortization	**(777)**	(785)
Manufacturing Deduction	**(1,305)**	(477)
Other items, net	**(203)**	(771)
Total income tax expense from continuing operations	**$ 20,026**	$ 18,452
Effective Tax Rates	**34.8%**	35.5%

The manufacturing deduction was created by the American Job Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities. During the years ended December 31, 2008 and 2007, the Act provided for a 6% deduction on qualified production activities.

Net Deferred Income Tax Liability Components

	As of December 31, 2008	2007
	(in thousands)	
Deferred credits and other liabilities	**$ 696**	$ 6,273
Other	**8,741**	3,250
Total deferred income tax assets	**9,437**	9,523
Investments and other assets	**9,178**	6,164
Accelerated depreciation rates	**164,930**	159,444
Regulatory assets and deferred debits	**(315)**	(1,144)
Total deferred income tax liabilities	**173,793**	164,464
Total net deferred income tax liabilities	**$ (164,356)**	$ (154,941)

The above amounts have been classified in the Balance Sheets as follows:

Net Deferred Income Tax Liabilities

	As of December 31, 2008	2007
	(in thousands)	
Current deferred tax assets/(liabilities), included in other current assets/(liabilities)	**$ 7,495**	$ 1,626
Non-current deferred tax liabilities	**(171,851)**	(153,315)
Total net deferred income tax liabilities	**$ (164,356)**	$ (154,941)

Changes to Unrecognized Tax Benefits

	2008 Increase/(Decrease) (in thousands)	2007 Increase/(Decrease) (in thousands)
Unrecognized Tax Benefits – January 1	**$ 252**	$ 420
Unrecognized Tax Benefits Changes		
Gross increases – tax positions in prior periods	**0**	0
Gross decreases—tax positions in prior periods	**(252)**	(10)
Gross increases – current period tax positions	**0**	0
Settlements	**0**	(158)
Total Changes	**(252)**	(168)

Unrecognized Tax Benefits – December 31	$ 0	$ 252

At December 31, 2008, and December 31, 2007, no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate.

During the years ended December 31, 2008 and December 31, 2007, Duke Energy Kentucky recognized net interest income of approximately $224 thousand and net interest expense of approximately $215 thousand, respectively. At December 31, 2008 and December 31, 2007, Duke Energy Kentucky had approximately $529 thousand and $305 thousand, respectively, of interest receivable which reflects all interest related to income taxes, and no amount has been accrued for the payment of penalties in the Balance Sheets.

Duke Energy Kentucky 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

5. Asset Retirement Obligations

Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected costs for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred. This additional carrying amount is then depreciated over the life of the asset. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation (with corresponding adjustments to property, plant and equipment), which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired and changes in federal, state or local regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset.

Asset retirement obligations at Duke Energy Kentucky relate primarily to the retirement of gas mains, asbestos abatement at certain generating stations and closure and post-closure activities of landfills. In accordance with SFAS No.143, Duke Energy Kentucky identified certain assets that have an indeterminate life, and thus the fair value of the retirement obligation is not reasonably estimable. These assets include transmission pipelines. A liability for these asset retirement obligations will be recorded when a fair value is determinable.

The following table presents the changes to liability associated with asset retirement obligations during the years ended December 31, 2008 and 2007:

Reconciliation of Asset Retirement Obligation Liability

	Years Ended December 31,	
	2008	**2007**
	(in thousands)	
Balance as of January 1,	**$ 6,179**	$ 8,266
Accretion expense	**345**	466
Liabilities settled[(a)]	**(134)**	(2,553)
Balance as of December 31,	**$ 6,390**	$ 6,179

(a) Liabilities settled are related to the retirement of gas mains.

Upon adoption of SFAS No. 143, Duke Energy Kentucky's regulated electric and regulated natural gas operations classifies removal costs for property that does not have an associated legal retirement obligation as a regulatory liability, in accordance with regulatory treatment under SFAS No. 71. The total amount of removal costs included in Regulatory Liabilities within Deferred Credits and Other Liabilities on the Balance Sheets was $33 million and $31 million as of December 31, 2008 and 2007, respectively.

6. Risk Management and Hedging Activities and Credit Risk

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load (off-system, wholesale power sales). Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into financial derivative instruments, including, but not limited to, interest rate swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. Duke Energy Kentucky's existing interest rate derivative instruments and related ineffectiveness were insignificant to its results of operations, cash flows and financial position in 2008 and 2007.

Credit Risk. Where exposed to credit risk, Duke Energy Kentucky analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis.

Duke Energy Kentucky's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Kentucky may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Kentucky also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

7. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157. Duke Energy Kentucky'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 until January 1, 2009 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 Duke Energy Kentucky 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 in the U.S. 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 Duke Energy Kentucky 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. In October 2008, the FASB issued FSP No. FAS 157-3, which illustrated key considerations in determining the fair value of a financial asset when the market for that asset is not active. The application of FSP FAS 157-3 did not change the way Duke Energy Kentucky determined fair value of its financial assets and liabilities.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 Other in both Current Assets and Current Liabilities and Other within Deferred Credits and Other Liabilities on Duke Energy Kentucky's Balance Sheets at fair value at December 31, 2008:

Description	Total Fair Value Amounts at December 31, 2008	Level 1	Level 2	Level 3
		(in thousands)		
Derivatives Assets	$ 178	$ —	$ —	$ 178
Derivatives Liabilities	$ (7,977)	$ —	$ (7,977)	$ —

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

	Derivatives (net)
	(in thousands)
Balance at January 1, 2008	$ 0
Total gains included on balance sheet	841
Net purchases, sales, issuances and settlements	(663)
Balance at December 31, 2008	$ 178

The valuation method of the primary fair value measurements disclosed above is as follows:

Fair Value Disclosures Required Under SFAS No. 107, "*Disclosures About Fair Value of Financial Instruments.*" The fair value of financial instruments, excluding financial assets included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value.

Accordingly, the estimates determined as of December 31, 2008 and 2007, are not necessarily indicative of the amounts Duke Energy Kentucky could have realized in current markets.

Financial Instruments

	As of December 31,			
	2008		2007	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in thousands)			
Long-term debt, including current maturities	**$ 338,629**	**$ 327,228**	$ 287,012	$ 283,183

The fair value of cash and cash equivalents, accounts receivable, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

8. Intangibles

The carrying amount of emission allowances in intangible assets as of December 31, 2008 and December 31, 2007 were $11 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed were $5 million and $6 million as of December 31, 2008 and December 31, 2007, respectively.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2007. The expected amortization expense includes estimates of emission allowances consumption. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2009	2010-2012
	(in thousands)	
Expected Amortization expense	$ 10,503	—

9. Related Party Transactions

Duke Energy Kentucky engages in related party transactions. These transactions 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 Balance Sheets as of December 31, 2008 and December 31, 2007 are as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Accounts Receivable	**$ 10,765**	$ 3,660
Accounts Payable	**$ 13,478**	$ 26,429

Duke Energy Kentucky is charged its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also charged its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations were as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Corporate governance and shared services expenses	**$ 56,979**	$ 47,495

Duke Energy Kentucky incurs expenses from Duke Energy Ohio related to purchasing network integration transmission service from the Midwest Independent Transmission System Operator (MISO) and ancillary services. These expenses, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations, were approximately $16 million and $17 million for the years ended December 31, 2008 and 2007, respectively.

See Note 15 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and post-retirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Cinergy of approximately $39 million at December 31, 2008 and approximately $23 million at December 31, 2007. The above amounts have been classified in the Balance Sheet as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Other current liabilities	$ **108**	$ 101
Accrued pension and other postretirement benefit costs	$ **39,195**	$ 22,505

Additionally, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 by Duke Energy Kentucky as Receivables in the Balance Sheets and was approximately $29 million as of December 31, 2008 and 2007. See Note 10 for additional information. See Note 12 for information on money pool.

10. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Kentucky sells, on a revolving basis, nearly all of its 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 SFAS No. 140, and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

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 (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $29 million at December 31, 2008 and 2007, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Balance Sheets at December 31, 2008 and 2007.

The carrying values of the retained interests are determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions in estimating fair value are the anticipated credit losses, the selection of discount rates, and expected receivables turnover rate. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Kentucky's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. Interest accrues to Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred (which is unlikely unless credit losses on the receivables far exceed the anticipated level).

The key assumptions used in estimating the fair value are as follows:

	Years Ended December 31, 2008	2007
Anticipated credit loss rate	**0.9%**	0.9%
Discount rate on expected cash flows	**5.3%**	7.7%
Receivables turnover rate	**12.1%**	11.9%

The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history.

Duke Energy Kentucky retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Kentucky exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Kentucky approximates a market rate.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the periods ending:

	December 31, 2008	December 31, 2007
	(in thousands)	
Receivables sold as of period end	$ **71,340**	$ 63,936
Less: Retained interests	**28,530**	29,165
Net receivables sold as of period end	$ **42,810**	$ 34,771
Sales during period		
Receivables sold	$ **486,988**	$ 468,617
Loss recognized on sale	**5,350**	6,583
Cash flows during period		
Cash proceeds from receivables sold	$ **484,916**	$ 453,052
Return received on retained interests	**3,214**	3,694

11. Property, Plant and Equipment

	Estimated Useful Life	December 31, 2008	December 31, 2007
	(Years)	(in thousands)	
Land	—	$ **17,755**	$ 17,894
Plant			
Electric generation, distribution and transmission[a]	8 – 100	**1,083,826**	1,085,286
Natural gas transmission and distribution[a]	12 – 50	**341,547**	315,763
Other buildings and improvements[a]	15 – 100	**29,063**	29,064
Equipment	11 – 25	**7,599**	7,097
Vehicles	9 – 15	**314**	314
Construction in process	—	**36,504**	24,572
Other	5 – 10	**20,177**	19,367
Total property, plant and equipment		**1,536,785**	1,499,357
Total accumulated depreciation[b]		**(625,727)**	(617,530)
Total net property, plant and equipment		$ **911,058**	$ 881,827

(a) Includes capitalized leases, for which the totals were $29 million for 2008 and $24 million for 2007.
(b) Includes accumulated amortization of capitalized leases: $3 million for 2008 and $2 million for 2007.

Capitalized interest, which includes the interest expense component of AFUDC, was less than $500 thousand for the years ended December 31, 2008 and 2007.

12. Debt and Credit Facilities

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	December 31, 2008	December 31, 2007
			(in thousands)	
Unsecured debt	6.0%	2009 – 2036	$ **175,000**	$ 195,000
Capital leases	5.6%	2009 – 2020	**13,126**	15,089
Other debt[a]	1.5%	2009 – 2027	**77,572**	77,571
Notes payable	2.3%	2012	**73,517**	—
Money Pool	.5%		**3,241**	27,470
Unamortized debt discount and premium, net			**(586)**	(648)
Total debt			**341,870**	314,482
Current maturities of long-term debt			**(22,461)**	(21,678)
Short-term notes payable			**(3,241)**	(27,470)
Total long-term debt			$ **316,168**	$ 265,334

(a) Includes $77 million of Duke Energy Kentucky pollution control bonds as of December 31, 2008 and 2007.

Unsecured and Other Debt. In December 2008, Duke Energy Kentucky refunded $50 million of tax-exempt auction rate bonds through the issuance of $50 million of tax-exempt variable-rate demand bonds, which are supported by a direct-pay letter of credit. The variable-rate demand bonds, which are due August 1, 2027, had an initial interest rate of 0.65% which is reset on a weekly basis.

Money Pool. Duke Energy Kentucky 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 Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of the participating subsidiaries, as each entity independently participates in the money pool. As of December 31, 2008 and December 31, 2007, Duke Energy Kentucky had amounts outstanding of approximately $3 million and $27 million, respectively, classified within Notes payable in the Balance Sheets. During the years ended December 31, 2008 and 2007, the $24 million and $15 million decrease, respectively, in the money pool activity is reflected as a cash outflow in Notes payable and commercial paper within Net cash (used in) provided by financing activities on the Statements of Cash Flows.

Floating Rate Debt. Unsecured debt and other debt included approximately $150 million and $77 million of floating-rate debt as of December 31, 2008 and 2007, respectively. Floating-rate debt is primarily based on commercial paper rates or a spread relative to an index such as a London Interbank Offered Rate (LIBOR). As of December 31, 2008 and 2007, the weighted-average interest rate associated with floating-rate debt was approximately 1.9% and 4.4%, respectively.

Auction Rate Debt. As of December 31, 2008 and 2007, Duke Energy Kentucky had approximately $27 million and $77 million, respectively, of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Kentucky prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Kentucky began to experience failed auctions. When failed auctions occur on a series of this debt, Duke Energy Kentucky is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 2.0 times one-month LIBOR. Payment of the failed-

auction interest rates will continue until Duke Energy Kentucky is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. As noted above, Duke Energy Kentucky refunded $50 million of these auction rate bonds in December 2008. While Duke Energy Kentucky intends to refund and refinance the remaining tax exempt auction rate bond, the timing of such refinancing transaction is uncertain and subject to market conditions. However, even if Duke Energy Kentucky is unable to successfully refund and refinance this debt instrument, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially effect Duke Energy Kentucky's results of operations, cash flows or financial position. The weighted-average interest rate associated with Duke Energy Kentucky's auction rate pollution control bonds, was .94% as of December 31, 2008 and 4.39% as of December 31, 2007.

Maturities, Call Options and Acceleration Clauses.
Annual Maturities as of December 31, 2008

	(in thousands)
2009	$ 22,461
2010	1,628
2011	1,439
2012	75,126
2013	1,408
Thereafter	236,567
Total long-term debt (including current maturities)	$ 338,629

Duke Energy Kentucky has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than the above as a result of Duke Energy Kentucky's ability to repay these obligations prior to their scheduled maturity.

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. In June 2007, Duke Energy closed the syndication of an amended and restated credit facility, which replaced existing credit facilities, with a 5-year, $2.65 billion master credit facility. 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. In October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately $63 million of credit commitment under its master credit facility. The total credit facility capacity under the master credit facility subsequent to this termination is approximately $3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At December 31, 2008, Duke Energy Kentucky had borrowing sub limit under Duke Energy's master credit facility of $100 million. The amount available to Duke Energy Kentucky under their sub limit to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility. As of December 31, 2008, outstanding borrowings totaled approximately $750 million under Duke Energy's master credit facility, of which Duke Energy Kentucky's portion is approximately $74 million. The loan, which is a revolving credit loan, bears interest at one-month LIBOR plus an applicable spread of 24 basis points and is due in September 2009; however, Duke Energy Kentucky has the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Balance Sheets at December 31, 2008. This borrowing reduces Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At December 31, 2008 and December 31, 2007, approximately $50 million and $0 million, respectively, of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Kentucky's intent and ability to utilize such borrowings as long-term financing. Duke Energy Kentucky's credit facility with non-cancelable terms in excess of one year as of the balance sheet date give Duke Energy Kentucky the ability to refinance these short-term obligations on a long-term basis. The specific credit facility discussed below backstopped the $50 million of pollution control bonds outstanding at December 31, 2008.

In September 2008, Duke Energy Kentucky and Duke Energy Indiana, Inc., a wholly-owned subsidiary of Duke Energy, collectively entered into a $330 million letter of credit agreement with a syndicate of banks. Under this letter of credit agreement, Duke Energy Kentucky may request the issuance of letters of credit up to approximately $51 million on its behalf to support various series of variable rate demand bonds issued or to be issued on behalf of Duke Energy Kentucky. This credit facility, which is not part of Duke Energy's master credit facility, may not be used for any purpose other than to support variable rate demand bonds issued by Duke Energy Kentucky and Duke Energy Indiana, Inc.

Restrictive Debt Covenants. Duke Energy's debt and 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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2008, Duke Energy and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Kentucky's ability to borrow funds under the 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.

13. Common Stock

Common Stock. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio. See Note 1 for additional information.

During the year ended December 31, 2008, Duke Energy Kentucky paid dividends of $30 million. Duke Energy Kentucky did not pay dividends during the year ended December 31, 2007.

14. Commitments and Contingencies

General Insurance

Effective with the date of the merger between Duke Energy and Cinergy, Duke Energy Kentucky carries, either directly or through Duke Energy's captive insurance company, Bison Insurance Company Limited, insurance and reinsurance coverages consistent with companies engaged in similar commercial operations with similar type properties. Duke Energy Kentucky's insurance coverage includes (1) commercial general public liability insurance for liabilities arising to third parties for bodily injury and property damage resulting from Duke Energy Kentucky's operations; (2) workers' compensation liability coverage to required statutory limits; (3) automobile liability insurance for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage; (4) insurance policies in support of the indemnification provisions of Duke Energy Kentucky's by-laws and (5) property insurance covering the replacement value of all real and personal property damage, excluding electric transmission and distribution lines, including damages arising from boiler and machinery breakdowns, earthquake, flood damage and extra expense. All coverages are subject to certain deductibles, terms and conditions common for companies with similar types of operations.

Duke Energy Kentucky also maintains excess liability insurance coverage above the established primary limits for commercial general liability and automobile liability insurance. Limits, terms, conditions and deductibles are comparable to those carried by other companies with similar types of operations.

The cost of Duke Energy Kentucky's general insurance coverages continued to fluctuate over the past year reflecting the changing conditions of the insurance markets.

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Clean Water Act 316(b). The 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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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 was filed on July 14, 2008. Oral argument occurred on December 2, 2008. A decision is expected in 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; however, Duke Energy Kentucky is unable to estimate at this time its costs to comply.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO_2 emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. 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. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Kentucky is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above.

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. The U.S. EPA and the Utility Air Regulatory Group have requested that the U.S. Supreme Court review the D.C. Circuit's 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. On January 29, 2009, the EPA requested the U.S. Department of Justice withdraw its Petition for Writ of Certiorari filed on October 17, 2008. On February 23, 2009, the Supreme Court denied the Utility Air Regulatory Group's petition. The EPA will not develop emission standards for utility units under section 112 of the Clean Air

Act, thus abiding by the D.C. Circuit's decision. At this point, Duke Energy Kentucky 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. Duke Energy Kentucky currently estimates that it will spend approximately $2 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

Comprehensive Environmental Response, Compensation, and Liability Act Matter. In August 2008, Duke Energy Kentucky 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 Kentucky 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 Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of both December 31, 2008 and 2007. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

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 Kentucky, 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. Briefing in that case is under way. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, North Carolina v. EPA No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Kentucky cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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 arguments were heard on August 6, 2008. Due to the late recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy will incur any liability or to estimate the damages, if any, that Duke Energy might incur in connection with this matter.

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

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

Other Commitments and Contingencies

General. Duke Energy Kentucky enters into various commitments to purchase or sell power or capacity that may or may not be recognized on the Balance Sheets.

Operating and Capital Lease Commitments

Duke Energy Kentucky leases assets in several areas of its operations. Rental expense for operating leases was $6 million for the year ended December 31, 2008 and $4 million for the year ended December 31, 2007, which is included in Operation, Maintenance and Other on the Statements of Operations. Capitalized lease obligations are classified as debt on the Balance Sheets (see Note 12). Amortization of assets recorded under capital leases was included in Depreciation and Amortization on the Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2008:

	Operating Leases	Capital Leases
	(in thousands)	
2009	$ **2,909**	$ 2,519
2010	**2,464**	1,680
2011	**2,135**	1,492
2012	**1,721**	1,662
2013	**1,550**	1,461
Thereafter	**4,044**	4,311
Total future minimum lease payments	$ **14,823**	$ 13,125

15. Employee Benefit Obligations

Cinergy Retirement Plans. Duke Energy Kentucky participates in qualified and non-qualified defined benefit pension plans as well as other post-retirement benefit plans sponsored by Cinergy. Cinergy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Kentucky.

Upon consummation of the merger with Duke Energy, Cinergy's benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit/post-retirement costs to be allocated to Duke Energy Kentucky.

Cinergy adopted the change in measurement date transition requirements of SFAS No. 158 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date. Previously, Cinergy used a September 30 measurement date for its defined benefit and other post-retirement plans. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows. See Note 1 for additional information related to the adoption of SFAS No. 158.

Qualified Pension Plans

Cinergy's qualified defined benefit pension plans cover substantially all employees meeting certain minimum age and service requirements. The plans cover most employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of the their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years.

Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities.

Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the retirement plan is 11 years. Cinergy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets over five years.

Duke Energy Kentucky's Qualified Pension Plan Pre-Tax Net Periodic Pension Benefit costs as allocated by Cinergy were as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Qualified Pension Benefits	$ **1,674**	$ 2,353

The fair value of Cinergy's plan assets was approximately $1,110 million and $1,701 million as of December 31, 2008 and 2007, respectively. The projected benefit obligation for the plans was approximately $1,992 million and $1,941 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the plans was approximately $1,729 million as of December 31, 2008 and approximately $1,753 million at December 31, 2007. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Balance Sheets at December 31, 2008 and 2007 was approximately $32 million and approximately $9 million, respectively. Regulatory assets, as allocated by Cinergy to Duke Energy Kentucky, and recognized in Other within Regulatory Assets and Deferred Debits on the Balance Sheets was approximately $28 million and $7 million as of December 31, 2008 and 2007, respectively.

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan participants. Duke Energy did not make any contributions to its defined benefit retirement plans in 2008. Duke Energy made qualified pension benefit contributions of approximately $350 million to the legacy Cinergy qualified pension benefit plans during the year ended December 31, 2007, of which approximately $9 million represents contributions made by Duke Energy Kentucky. In February 2009, Duke Energy Kentucky made a cash contribution of approximately $14 million, which represented its proportionate share of an approximate $500 million total contribution to Cinergy's and Duke Energy's qualified pension plans.

Qualified Plans - Assumptions Used for Cinergy's Pension Benefits Accounting

	2008	2007
	Percentages	
Benefit Obligations		
Discount rate	6.50	6.00
Salary increase	5.00	5.00
Net Periodic Benefit Cost		

	2008	2007
	Percentages	
Discount rate	6.00	5.75
Salary increase	5.00	5.00
Expected long-term rate of return on plan assets	8.50	8.50

Non-Qualified Pension Plans

In addition, Cinergy also maintains, and Duke Energy Kentucky participates in, non-qualified, non-contributory defined benefit retirement plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. There are no plan assets. The projected benefit obligation for the plans was approximately $113 million as of December 31, 2008 and approximately $105 million as of December 31, 2007. The accumulated benefit obligation for the plans was approximately $104 million as of December 31, 2008 and approximately $102 million at December 31, 2007. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Balance Sheets at December 31, 2008 and 2007 was approximately $155 thousand and $131 thousand, respectively, and as recognized in Other within Current Liabilities on the Balance Sheets at December 31, 2008 and 2007 was approximately $11 thousand and $10 thousand, respectively.

Duke Energy Kentucky's Non-Qualified Pension Plan pre-tax Net Periodic Pension Benefit Costs as allocated by Cinergy were as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Non-Qualified Pension	$ 19	$ 19

Non-Qualified Plans—Assumptions Used for Cinergy's Pension Benefits Accounting

	2008	2007
	Percentages	
Benefit Obligations		
Discount rate	6.50	6.00
Salary increase	5.00	5.00
Net Periodic Benefit Cost		
Discount rate	6.00	5.75
Salary increase	5.00	5.00

Other Post-Retirement Benefit Plans

Duke Energy Kentucky participates in other postretirement benefit plans sponsored by Cinergy. Cinergy provides certain health care and life insurance benefits to retired employees and their eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over approximately 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 13 years. Duke Energy Kentucky's Other Post-Retirement Plan pre-tax Net Periodic Benefit costs as allocated by Cinergy were as follows:

	December 31, *2008*	December 31, *2007*
	(in thousands)	
Other Postretirement	$ 547	$ 1,559

The fair value of Cinergy's plans assets was approximately $23 million as of December 31, 2008 and $32 million as of December 31, 2007. The accumulated other post-retirement benefit obligation for the plans was approximately $330 million as of December 31, 2008 and $464 million as of December 31, 2007. The accrued other post-retirement liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued Pension and Other Postretirement Benefit Costs within the Balance Sheets at December 31, 2008 and 2007 was $7 million and $13 million, respectively. The accrued other post-retirement liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Other within Current Liabilities on the Balance Sheets at December 31, 2008 and 2007 was $97 thousand and $86 thousand, respectively. Regulatory assets, as allocated by Cinergy to Duke Energy Kentucky, and recognized in Regulatory Assets and Deferred Debits within the Balance Sheets was approximately $1 million as of December 31, 2008 and $5 million as of December 31, 2007.

Duke Energy did not make any contributions to its other post-retirement plans in 2008. Duke Energy made other post-retirement plan contributions during 2007 of approximately $32 to the legacy Cinergy other post-retirement plans, of which approximately $1 million represents contribution made by Duke Energy Kentucky.

Duke Energy Kentucky recognized regulatory assets related to its other post-retirement benefit plans of approximately a credit of $4 million and approximately zero as of December 31, 2008 and 2007, respectively, within the Balance Sheets.

Assumptions Used in Cinergy's Other Post-retirement Benefits Accounting

Determined Benefit Obligations	2008	2007
Discount rate	6.50	6.00

Determined Expense	2008	2007
Discount rate	6.00	5.75
Expected long-term rate of return on plan assets	8.50	8.50

Assumed Health Care Cost Trend Rates

	Medicare Trend Rate		Prescription Drug Trend Rate	
	2008	2007	2008	2007
Health care cost trend rate assumed for next year	8.50%	8.00%	11.00%	12.50%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2013	2013	2022	2022

16. Other Income and Expenses, net

The components of Other Income and Expenses, net on the Statements of Operations for the years ended December 31, 2008 and 2007 are as follows:

	December 31, 2008	December 31, 2007
	(in thousands)	
Income/(Expense):		
Interest Income	$ **4,020**	$ 3,656
AFUDC Equity	**778**	219
Other	**55**	177
Total	$ **4,853**	$ 4,052

17. Subsequent Events

For information on subsequent events related to regulatory matters, and commitments and contingencies, and employee benefit obligations, see Notes 2, 14 and 15, respectively.

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

September 30, 2008

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Year To Date September 30,	
	2008	2007
	(in thousands)	
Operating Revenues		
Electric	$ 250,080	$ 250,632
Gas	107,807	100,010
Other	16,805	16,488
Total Operating Revenues	374,692	367,130
Operating Expenses		
Natural gas purchased	77,014	67,022
Operation, maintenance and other	94,422	94,108
Fuel used in electric generation and purchased power	115,969	115,877
Depreciation and amortization	28,600	31,102
Property and other taxes	9,146	10,734
Loss on sales of other assets, net	-	50
Total Operating Expenses	325,151	318,893
Operating Income	49,541	48,237
Other Income and Expenses, net	3,626	3,402
Interest Expense	12,096	13,161
Income Before Income Taxes	41,071	38,478
Income Tax Expense	14,401	14,263
Net Income	$ 26,670	$ 24,215

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

ASSETS		September 30, 2008		December 31, 2007
		(in thousands)		
Current Assets				
Cash and cash equivalents	$	**82,807**	$	9,302
Receivables (net of allowance for doubtful accounts of $399 at September 30, 2008 and $315 at December 31, 2007)		**32,760**		17,613
Inventory		**41,790**		27,391
Other		**11,641**		19,372
Total current assets		**168,998**		73,678
Investments and Other Assets				
Intangible assets		**11,852**		7,064
Other		**2,886**		3,430
Total investments and other assets		**14,738**		10,494
Property, Plant, and Equipment				
Cost		**1,535,987**		1,499,357
Less accumulated depreciation and amortization		**637,950**		617,530
Net property, plant, and equipment		**898,037**		881,827
Regulatory Assets and Deferred Debits				
Deferred debt expense		**5,154**		5,445
Regulatory Assets		**19,324**		17,093
Total regulatory assets and deferred debits		**24,478**		22,538
Total Assets	**$**	**1,106,251**	$	988,537

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	September 30, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Accounts payable	$ **85,622**	$ 27,560
Notes payable	**-**	27,470
Taxes accrued	**15,047**	16,777
Interest accrued	**1,826**	3,553
Current maturities of long-term debt	**22,547**	21,678
Other	**10,410**	12,806
Total current liabilities	**135,452**	109,844
Long-term Debt	**315,638**	265,334
Deferred Credits and Other Liabilities		
Deferred income taxes	**161,150**	153,315
Investment tax credit	**4,780**	5,581
Accrued pension and other postretirement benefit costs	**22,553**	22,505
Regulatory liabilities	**40,053**	33,901
Asset retirement obligations	**6,483**	6,179
Other	**6,928**	6,332
Total deferred credits and other liabilities	**241,947**	227,813
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at September 30, 2008 and December 31, 2007	**8,780**	8,780
Paid-in capital	**167,494**	167,494
Retained earnings	**236,940**	210,270
Accumulated other comprehensive loss	**-**	(998)
Total common stockholder's equity	**413,214**	385,546
Total Liabilities and Common Stockholder's Equity	**$ 1,106,251**	$ 988,537

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ 349,348
Net income			24,215		24,215
Other comprehensive income, net of tax effect of $579					
Cash flow hedges				387	387
Total comprehensive income					24,602
Contribution from parent company for purchase of generating assets		3,150			3,150
Pension- FAS 158 change in measurement date			(164)		(164)
Balance at September 30, 2007	$ 8,780	$ 167,494	$ 201,016	$ (354)	$ 376,936
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			26,670		26,270
Other comprehensive income, net of tax effect of $628					
Cash flow hedges				998	998
Total comprehensive income					27,668
Balance at September 30, 2008	$ 8,780	$ 167,494	$ 236,940	$ -	$ 413,214

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2008	2007
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **26,670**	$ 24,215
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**29,029**	31,102
Losses on sales of equity investments and other assets	-	50
Deferred income taxes	**1,166**	3,920
Regulatory asset/liability amortization	**1,354**	2,972
Contribution to company sponsored pension plan	-	(9,696)
Accrued pension and other postretirement benefit costs	**1,680**	2,870
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**(141)**	(1,075)
Receivables	**18,347**	9,540
Inventory	**(12,903)**	(1,308)
Other current assets	**12,301**	(16,800)
Increase (decrease) in:		
Accounts payable	**24,827**	(5,501)
Taxes accrued	**(1,729)**	3,536
Other current liabilities	**(8,875)**	2,197
Regulatory asset/liability deferrals	**(164)**	(7,362)
Other assets	**718**	4,824
Other liabilities	**1,171**	(2,701)
Net cash provided by operating activities	**93,451**	40,783
Cash Flows from Investing Activities		
Capital expenditures	**(41,150)**	(51,555)
Purchases of emission allowances	-	(342)
Notes from affiliate, net	**(2,559)**	-
Sale of emission allowances	**149**	523
Other	**58**	-
Net cash used in investing activities	**(43,502)**	(51,374)
Cash Flows from Financing Activities		
Redemption of long-term debt	**(21,531)**	(1,099)
Issuance of long-term debt	**72,656**	-
Notes payable and commercial paper	**(27,470)**	10,205
Contribution from parent	-	3,150
Other	**(99)**	(30)
Net cash provided by financing activities	**23,556**	12,226
Net increase in cash and cash equivalents	**73,505**	1,635
Cash and cash equivalents at beginning of period	**9,302**	6,593
Cash and cash equivalents at end of period	$ **82,807**	$ 8,228
Supplemental Disclosure of Cash Flow Information		
Non-cash financing and investing activities:		
Allowance for funds used during construction (AFUDC) – equity component	**627**	199

See Notes to Unaudited Financial Statements

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Unaudited Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim Unaudited 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, changing commodity prices, and other factors.

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the Unaudited 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 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, the effects of which require retrospective application to the Balance Sheets.

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. The receivables for unbilled revenues for Duke Energy Kentucky ($17 million and $25 million at September 30, 2008 and December 31, 2007, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Kentucky sells, on a revolving basis, nearly all of their 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.

2. 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.

	September 30, 2008	December 31, 2007
	(in thousands)	
Coal held for electric generation	$ 14,235	$ 9,010
Materials and supplies	13,333	9,241
Natural gas	14,221	9,140
Total Inventory	$ 41,789	$ 27,391

3. Debt and Credit Facilities

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. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limit of Duke Energy Kentucky, subject to maximum cap limitation, at any time. At September 30, 2008, Duke Energy Kentucky had a borrowing sub limit under Duke Energy's master credit facility of $100 million. In October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately $63 million of credit commitment under its master credit facility which reduced the total credit facility capacity under Duke Energy's master credit facility to approximately $3.14 billion. This termination reduced Duke Energy Kentucky's borrowing sub limit by approximately $2 million. The amount available to Duke Energy Kentucky under its sub limit to Duke Energy's master credit facility has been reduced by drawdowns of cash and borrowings through the money pool arrangement, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility. Of the approximate $1 billion, Duke Energy Kentucky borrowed approximately $73 million. The loan, which is a revolving credit loan, bears interest at the bank prime rate and is due in September 2009; however, Duke Energy Kentucky has the ability under the master credit facility to renew the loan up through the date the master credit facility matures which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Balance Sheets at September 30, 2008. These borrowings reduce Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

Duke Energy Kentucky 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 Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Kentucky as it independently participates in the money pool. As of September 30,

2008, Duke Energy Kentucky had net receivables of approximately $1 million, which are classified within Receivables in the accompanying Balance Sheets. As of December 31, 2007, Duke Energy Kentucky had net borrowings of approximately $27 million, which are classified within Notes Payable in the accompanying Balance Sheets. The $27 million outflow and $11 million inflow in the money pool borrowings during the nine months ended September 30, 2008 and 2007, respectively, are reflected in Notes Payable to Affiliate within Net cash provided by (used in) financing activities on the Statement of Cash Flows. The $1 million increase in the money pool receivables during the nine months ended September 30, 2008 is reflected in Other within Net cash used in investing activities on the Statements of Cash Flows.

In September 2008, Duke Energy Kentucky and Duke Energy Indiana, Inc., a wholly owned subsidiary of Duke Energy, collectively entered into a $330 million letter of credit agreement with a syndicate of banks. Under this letter of credit agreement, Duke Energy Kentucky may request the issuance of letters of credit up to approximately $51 million on its behalf to support various series of variable rate demand bonds issued or to be issued on behalf of Duke Energy Kentucky. This credit facility, which is not part of Duke Energy's master credit facility, may not be used for any purpose other than to support variable rate demand bonds issued by Duke Energy Kentucky and Duke Energy Indiana, Inc.

Restrictive Debt Covenants. 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 and Duke Energy Kentucky to not exceed 65%. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of September 30, 2008, Duke Energy and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Kentucky's ability to borrow funds under the 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.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Nine Months Ended September 30, *2008*	Nine Months Ended September 30, *2007*
	(in thousands)	
Qualified Pension Benefits	$ 1,256	$ 1,704
Other Postretirement Benefits	$ 410	$ 1,150

Duke Energy's policy is to fund amounts for its U.S. qualified and non-qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the nine months ended September 30, 2008 and Duke Energy does not anticipate making contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the nine months ended September 30, 2007, Duke Energy made qualified pension benefit contributions of approximately $350 million to the legacy Cinergy qualified pension plans, of which approximately $10 million of contributions were made by Duke Energy Kentucky. Additionally, Duke Energy Kentucky participates in Cinergy sponsored employee savings plans that cover substantially all Duke Energy Kentucky employees. Duke Energy Kentucky made its proportionate share of pre-tax employer matching contributions of approximately $708 thousand during the nine months ended September 30, 2008. Duke Energy Kentucky made its proportionate share of pre-tax employer matching contributions of approximately $322 thousand during the nine months ended September 30, 2007.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of September 30, 2008 and December 31, 2007 is $12 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed during the nine months ended September 30, 2008 and 2007 were $4 million and $5 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 9 for further discussion of the decision.

6. Related Party Transactions

Duke Energy Kentucky 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 Balance Sheets as of September 30, 2008 and December 31, 2007 are as follows:

	September 30, 2008	December 31, 2007
	(in thousands)	
Current assets due from affiliated companies[a]	$ 50	$ 3,660
Current liabilities due to affiliate companies[a]	$58,713	$26,429

(a) Balances exclude assets or liabilities associated with accrued pension and other postretirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. 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. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, maintenance and other within Operating Expenses on the Statements of Operations were $40 million and $36 million for the nine months ended September 30, 2008 and 2007, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $23 million at September 30, 2008 and December 31, 2007. These amounts have been classified in the Balance Sheets as follows:

	September 30, 2008	December 31, 2007
	(in thousands)	
Other current liabilities	$ 101	$ 101
Accrued pension and other postretirement benefit costs	$ 22,553	$ 22,505
Other deferred credits and other liabilities	$ –	$ 456
Net deferred tax liabilities to Duke Energy[a][b]	$ (142,600)	$(128,770)

(a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements.

(b) Of the balance at September 30, 2008, approximately $(141) million is classified as Deferred Income Taxes, approximately $(5) million is classified as Investment Tax credit, and approximately $3 million is classified as Other within Current Assets on the Balance Sheets. Of the balance at December 31, 2007, approximately $(134) million is classified as Deferred Income Taxes, approximately $(6) million is classified as Investment Tax Credit, and approximately $1 million is classified as Other within Current Assets on the Balance Sheets.

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Kentucky 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 Balance Sheets and was approximately $15 million and $29 million as of September 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 Statements of Operations, was approximately $3 million and $4 million for the nine months ended September 30, 2008 and 2007.

As discussed further in Note 3, Duke Energy Kentucky 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 Statements of Operations, were insignificant for the nine months ended September 30, 2008 and $551 thousand for the nine months ended September 30, 2007.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2008 and 2007.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 $2 million of the rate reduction was passed through to customers during both the nine months ended September 30, 2008 and 2007.
- The FERC approved the merger without conditions.

Restrictions on the Ability of Duke Energy Kentucky to Make Dividends, Advances and Loans to Duke Energy Corporation. As a condition of approving the merger of Duke Energy and Cinergy, the state utility commission imposed conditions (the Merger Conditions) on the ability of Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure.

Franchised Electric and Gas

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky.

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 and continues to utilize tracking mechanisms in its billed sales to customers. Duke Energy Kentucky and the KPSC appealed these cases to the Kentucky Court of Appeals. In November 2008, the Kentucky Court of Appeals ruled that the KPSC had no legal authority to approve tracker recovery of gas main replacement costs prior to legislation enacted in 2005. Duke Energy Kentucky is evaluating this ruling and cannot predict the outcome of these proceedings.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. 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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On November 17, 2008 Duke Energy Kentucky filed its annual report on its energy efficiency programs and application to true- up its gas and electric tracking mechanism for recovery of lost revenues, program costs, and shared savings. The matter is under evaluation by the KPSC. Duke Energy Kentucky cannot predict the outcome of this filing.

Application for the Establishment of a Regulatory Asset. On November 14, 2008, Duke Energy Kentucky petitioned the KPSC for permission to create a regulatory asset to defer for future recovery $4.9 million for its expenses incurred to repair damage and restore service to its customers following extensive storm-related damage caused by Hurricane Ike on September 14, 2008. This requested accounting order is currently under evaluation by the KPSC. Duke Energy Kentucky cannot predict the outcome of this filing.

Other Matters

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 that Midwest ISO file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal establishes 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 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 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. Duke Energy Kentucky does not believe the resource adequacy requirement will have a material impact on its results of operations, cash flows, or financial position.

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 to January 6, 2009. At this time, Duke Energy Kentucky does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its results of operations, cash flows, or financial position.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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 was filed on July 14, 2008. Oral argument is scheduled for December 2, 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 Duke Energy Kentucky 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 NO_x emissions and annual SO_2 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 SO_2. Phase 2 was to begin in 2015 for both NO_x and SO_2. 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. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. A decision is pending on that petition. Subsequent to the filing of the rehearing petitions, the D.C. Circuit ordered all Petitioners (including Duke Energy) to file briefs on the petition for rehearing. The D.C. Circuit directed the parties to address whether any party is seeking vacatur of CAIR, and whether the Court should stay its mandate until the EPA promulgates a revised rule. Duke Energy has responded to the request accordingly. The D.C. Circuit's decision creates uncertainty regarding future NO_x and SO_2 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 it decides whether to grant rehearing. Duke Energy Kentucky's plan had been to spend approximately $10 million between 2008 and 2012 to comply with Phase 1 of CAIR. It has not been determined how the court's decision will affect these planned expenditures. Duke Energy Kentucky did not expect to incur any significant costs for complying with Phase 2 of CAIR.

Duke Energy Kentucky is unable to estimate the costs to comply with any new rule the EPA or states may issue as a result of this decision. As discussed in Note 5, at September 30, 2008, Duke Energy Kentucky had emission allowances with a carrying amount of $12 million which could be impacted by the D.C. Circuit Court's decision to vacate CAIR.

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 U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. The EPA and utilities have requested rehearing of the D.C. Circuit Court decision by the entire D.C. Circuit panel (en banc review). The court has ordered briefing on whether it should accept the case for en banc review. Thus, the matter remains unsettled until the court decides whether to rehear the case. Barring reversal of the decision if reheard, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Kentucky is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $19 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of September 30, 2008 and December 31, 2007. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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. Briefing in that case is under way. At this time, Duke Energy Kentucky cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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 arguments were heard on August 6, 2008. The second oral arguments were heard on November 3, 2008. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

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

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157, "*Fair Value Measurements*," (SFAS No. 157). Duke Energy Kentucky'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 nonfinancial 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 Duke Energy Kentucky 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 in the U.S. 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 Duke Energy Kentucky 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.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Kentucky's Balance Sheets at fair value at September 30, 2008:

Description	Total Fair Value Amounts at September 30, 2008	Level 1	Level 2	Level 3
		(in thousands)		
Derivatives Assets	$ 364	$ —	$ —	$ 364
Derivatives Liabilities	$ (2,668)	$ —	$ (2,317)	$ (351)

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

	Derivatives (net)
	(in thousands)
Balance at January 1, 2008	$ 0
Total gains included on balance sheet	575
Net purchases, sales, issuances and settlements	(562)
Balance at September 30, 2008	$ 13

11. New Accounting Standards

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

SFAS No. 157. Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 157.

SFAS No. 159. Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 159.

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

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Kentucky as of September 30, 2008:

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. Duke Energy Kentucky 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 Duke Energy Kentucky's results of operations, cash flows or financial position.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

At September 30, 2008, Duke Energy Kentucky has approximately $229 thousand recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. It is reasonably possible that Duke Energy Kentucky will reflect an approximate $250 thousand reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

Duke Energy Kentucky 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

13. Subsequent Events

For information on subsequent events related to intangibles, regulatory matters and commitments and contingencies, see Notes 5, 8 and 9, respectively.

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

June 30, 2008

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Year To Date June 30,	
	2008	2007
	(in thousands)	
Operating Revenues		
Electric	$ 162,668	$ 162,619
Gas	94,093	88,312
Total Operating Revenues	256,761	250,931
Operating Expenses		
Natural gas purchased	69,660	61,241
Operation, maintenance and other	62,002	63,463
Fuel used in electric generation and purchased power	67,314	66,969
Depreciation and amortization	18,070	18,988
Property and other taxes	6,064	6,847
Loss on sales of other assets, other net	-	50
Total Operating Expenses	223,110	217,558
Operating Income	33,651	33,373
Other Income and Expenses, net	2,557	2,363
Interest Expense	8,198	8,611
Income Before Income Taxes	28,010	27,125
Income Tax Expense	10,475	10,514
Net Income	$ 17,535	$ 16,611

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS		June 30, 2008		December 31, 2007
		(in thousands)		
Current Assets				
Cash and cash equivalents	$	12,334	$	9,302
Receivables (net of allowance for doubtful accounts of $358 at June 30, 2008 and $315 at December 31, 2007)		29,671		44,043
Inventory		39,224		27,391
Other		8,773		19,372
Total current assets		90,002		100,108
Investments and Other Assets				
Intangible assets		13,357		7,064
Other		2,457		3,430
Total investments and other assets		15,814		10,494
Property, Plant, and Equipment				
Cost		1,521,607		1,499,357
Less accumulated depreciation and amortization		629,487		617,530
Net property, plant, and equipment		892,120		881,827
Regulatory Assets and Deferred Debits				
Deferred debt expense		5,251		5,445
Regulatory Assets		18,549		17,093
Total regulatory assets and deferred debits		23,800		22,538
Total Assets	$	1,021,736	$	1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	June 30, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Accounts payable	$ 79,914	$ 53,989
Notes payable	7,663	27,470
Taxes accrued	13,373	16,777
Interest accrued	3,357	3,553
Current maturities of long-term debt	1,905	21,678
Other	13,488	12,807
Total current liabilities	119,700	136,274
Long-term Debt	264,254	265,334
Deferred Credits and Other Liabilities		
Deferred income taxes	152,300	153,315
Investment tax credit	5,059	5,581
Accrued pension and other postretirement benefit costs	23,231	22,505
Regulatory liabilities	40,735	33,901
Asset retirement obligations	6,395	6,179
Other	5,983	6,332
Total deferred credits and other liabilities	233,703	227,813
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at June 30, 2008 and December 31, 2007	8,780	8,780
Paid-in capital	167,494	167,494
Retained earnings	227,805	210,270
Accumulated other comprehensive loss	-	(998)
Total common stockholder's equity	404,079	385,546
Total Liabilities and Common Stockholder's Equity	$ 1,021,736	$ 1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss) Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ 349,348
Net income			16,611		16,611
Other comprehensive income, net of tax effect of $579					
Cash flow hedges				897	897
Total comprehensive income					17,508
Contribution from parent company for purchase of generating assets		3,150			3,150
Pension- FAS 158 change in measurement date			(164)		(164)
Balance at June 30, 2007	$ 8,780	$ 167,494	$ 193,412	$ 156	$ 369,842
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			17,535		17,535
Other comprehensive income, net of tax effect of $628					
Cash flow hedges				998	998
Total comprehensive income					18,533
Balance at June 30, 2008	$ 8,780	$ 167,494	$ 227,805	$ -	$ 404,079

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ 17,535	$ 16,611
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,369	18,987
Losses on sales of equity investments and other assets	-	50
Deferred income taxes	(1,938)	1,332
Regulatory asset/liability amortization	903	3,523
Contribution to company sponsored pension plan	-	(8,793)
Accrued pension and other postretirement benefit costs	1,483	1,996
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(423)	(1,907)
Receivables	18,451	10,969
Inventory	(10,337)	1,683
Other current assets	10,700	(21,435)
(Increase) decrease in:		
Accounts payable	20,394	8,972
Taxes accrued	(3,404)	6,415
Other current liabilities	484	721
Regulatory asset/liability deferrals	3,416	(9,236)
Other assets	914	2,311
Other liabilities	(2,465)	867
Net cash provided by operating activities	74,082	33,066
Cash Flows from Investing Activities		
Capital expenditures	(30,532)	(30,900)
Purchases of Emission Allowances	-	(342)
Sale of Emission Allowances	190	523
Other	65	-
Net cash used in investing activities	(30,277)	(30,719)
Cash Flows from Financing Activities		
Redemption of long-term debt	(20,886)	(732)
Notes payable and commercial paper	(19,807)	(5,177)
Contribution from parent	-	3,150
Other	(80)	(30)
Net cash used in financing activities	(40,773)	(2,789)
Net increase (decrease) in cash and cash equivalents	3,032	(442)
Cash and cash equivalents at beginning of period	9,302	6,593
Cash and cash equivalents at end of period	$ 12,334	$ 6,151

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC
Notes to Unaudited Financial Statements

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim 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`, changing commodity prices, and other factors.

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the 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 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, the effects of which require retrospective application to the Balance Sheets.

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. The receivables for unbilled revenues for Duke Energy Kentucky ($15 million and $25 million at June 30, 2008 and December 31, 2007, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Kentucky sells, on a revolving basis, nearly all of their 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.

2. 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 thousands)	
Gas held in storage	$ 9,311	$ 9,140
Fuel for use in electric generation	20,316	9,010
Materials and supplies	9,597	9,241
Total Inventory	$ 39,224	$ 27,391

3. Debt and Credit Facilities

Money Pool Arrangement Duke Energy Kentucky 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. As of June 30, 2008 and December 31, 2007, Duke Energy Kentucky had net borrowings of approximately $8 million and $27 million, respectively, which are classified within Notes payable in the accompanying Balance Sheets. During the six months ended June 30, 2008 and 2007, the $19 million and $5 million change in the money pool, respectively, is reflected as a cash outflow in Notes payable and commercial paper, net within Net cash used in financing activities on the Statements of Cash Flows.

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 borrowing sub limit of Duke Energy Kentucky did not change. Duke Energy Kentucky has a borrowing sub limit of $100 million under the master credit facility.

The amount available to Duke Energy Ohio 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 and Duke Energy Kentucky to not exceed 65%. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of June 30, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with those covenants. 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.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in thousands)	
Qualified Pension Benefits	$ 837	$ 1,305
Other Postretirement Benefits	$ 636	$ 691

Duke Energy's policy is to fund amounts for its U.S. qualified plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the six months ended June 30, 2008 and Duke Energy does not anticipate making contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the six months ended June 30, 2007, Duke Energy made qualified pension benefit contributions of approximately $350 million to the legacy Cinergy qualified pension plans, of which approximately $9 million represents contributions made by Duke Energy Kentucky. Duke Energy Kentucky expensed pre-tax employer matching contributions of less than $1 million for each of the six months ended June 30, 2008 and 2007.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of June 30, 2008 and December 31, 2007 is $13 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed during the six months ended June 30, 2008 and 2007 were $2 million and $4 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 9 for a discussion of the decision. Duke Energy Kentucky is currently evaluating the effect of the decision on the carrying value of its emission allowances.

6. Related Party Transactions

Duke Energy Kentucky 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 Balance Sheets as of June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(in thousands)	
Accounts Receivable[(a)]	$ 1,420	$ 3,660
Accounts Payable[(a)]	$47,594	$26,429

(a) Balances exclude assets or liabilities associated with accrued pension and other postretirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. 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. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, maintenance and other within Operating Expenses on the Statements of Operations were $24 million and $23 million for the six months ended June 30, 2008 and 2007, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $23 million at June 30, 2008 and December 31, 2007. These amounts have been classified in the Balance Sheets as follows:

	June 30, 2008	December 31, 2007
	(in thousands)	
Other current liabilities	$ 101	$ 101
Accrued pension and other postretirement benefit costs	$ 23,231	$ 22,505
Other deferred credits and other liabilities	$ –	$ 456

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Kentucky 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 Balance Sheets and was approximately $14 million and $29 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 Statements of Operations, was approximately $2 million for each of the six months ended June 30, 2008 and 2007.

As discussed further in Note 3, Duke Energy Kentucky 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 Statements of Operations, were insignificant for the six months ended June 30, 2008 and 2007.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2008 and 2007.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 both the six months ended June 30, 2008 and 2007.
- The FERC approved the merger without conditions.

Franchised Electric and Gas

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky.

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.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. 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.

Other Matters

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 that Midwest ISO file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal establishes 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 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 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. Duke Energy Kentucky does not believe the resource adequacy requirement will have a material impact on its results of operations, cash flows, or financial position.

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. At this time, Duke Energy Kentucky does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its results of operations, cash flows, or financial position.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Duke Energy Kentucky believes that completion or resolution of these matters will have no material adverse effect on its 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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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 was 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 Duke Energy Kentucky 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 SO_2 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 SO_2. Phase 2 was to begin in 2015 for both NO_x and SO_2. 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 SO_2 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 August 25, 2008 to appeal the decision. The D.C. Circuit's decision creates uncertainty regarding future NO_x and SO_2 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. Duke Energy Kentucky's plan had been to spend approximately $10 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Kentucky owns or partially owns but does not operate. It has not been determined how the court's decision will affect these planned expenditures. Duke Energy Kentucky did not expect to incur any significant costs for complying with Phase 2 of CAIR.

Duke Energy Kentucky is unable to estimate the costs to comply with any new rule EPA may issue as a result of this decision. See Note 5 for a discussion of 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 U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. The EPA and utilities have requested rehearing of the D.C. Circuit Court decision by the entire D.C. Circuit panel (en banc review). The court has ordered briefing on whether it should accept the case for en banc review. Thus, the matter remains unsettled until the court decides whether to rehear the case. Barring reversal of the decision if reheard, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Kentucky is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $19 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of June 30, 2008 and December 31, 2007. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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 arguments were heard on August 6, 2008. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

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

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157, "*Fair Value Measurements*," (SFAS No. 157). Duke Energy Kentucky'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 nonfinancial 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 Duke Energy Kentucky 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 Duke Energy Kentucky 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.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Kentucky's Balance Sheets at fair value at June 30, 2008:

Description	Total Fair Value Amounts at June 30, 2008	Level 1	Level 2	Level 3
		(in thousands)		
Derivatives Assets	$ 646	$ —	$ —	$ 646
Derivatives Liabilities	$ 1,740	$ —	$ 1,740	$ —

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

	Derivatives (net)
	(in thousands)
Balance at January 1, 2008	$ 0
Total gains included on balance sheet	646
Balance at June 30, 2008	$ 646

11. New Accounting Standards

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

SFAS No. 157 Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 157.

SFAS No. 159 Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 159.

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

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

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. Duke Energy Kentucky 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 Duke Energy Kentucky's results of operations, cash flows or financial position.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

At June 30, 2008, Duke Energy Kentucky has approximately $233 thousand recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. It is reasonably possible that Duke Energy Kentucky will reflect an approximate $250 thousand reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the six months ended June 30, 2008, Duke Energy Kentucky recognized net interest income of approximately $158 thousand. At June 30, 2008, Duke Energy Kentucky had approximately $464 thousand of interest receivable, which reflects all interest related to income taxes, and no accrued penalties in the Balance Sheets.

Duke Energy Kentucky 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

13. Subsequent Events

For information on subsequent events related to intangibles, regulatory matters and commitments and contingencies, see Notes 5, 8 and 9, respectively.

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

March 31, 2008

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Quarters Ended March 31,	
	2008	2007
	(in thousands)	
Operating Revenues		
Electric	$ **81,721**	$ 79,646
Gas	**72,758**	67,161
Total Operating Revenues	**154,479**	146,807
Operating Expenses		
Natural gas purchased	**55,916**	48,776
Operation, maintenance and other	**31,280**	30,604
Fuel used in electric generation and purchased power	**33,357**	30,707
Depreciation and amortization	**8,044**	9,361
Property and other taxes	**3,113**	3,439
Total Operating Expenses	**131,710**	122,887
Operating Income	**22,769**	23,920
Other Income and Expenses, net	**1,416**	1,249
Interest Expense	**4,220**	4,250
Income Before Income Taxes	**19,965**	20,919
Income Tax Expense	**7,451**	8,010
Net Income	$ **12,514**	$ 12,909

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS		March 31, 2008		December 31, 2007
		(in thousands)		
Current Assets				
Cash and cash equivalents	$	**15,455**	$	9,302
Receivables (net of allowance for doubtful accounts of $318 at March 31, 2008 and $315 at December 31, 2007)		**38,223**		44,043
Inventory		**24,820**		27,391
Other		**11,986**		19,372
Total current assets		**90,484**		100,108
Investments and Other Assets				
Intangible assets		**6,046**		7,064
Other		**2,172**		3,430
Total investments and other assets		**8,218**		10,494
Property, Plant, and Equipment				
Cost		**1,506,822**		1,499,357
Less accumulated depreciation and amortization		**621,350**		617,530
Net property, plant, and equipment		**885,472**		881,827
Regulatory Assets and Deferred Debits				
Deferred debt expense		**5,368**		5,445
Regulatory Assets		**20,108**		17,093
Total regulatory assets and deferred debits		**25,476**		22,538
Total Assets	**$**	**1,009,650**	$	1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	March 31, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Accounts payable	**$ 58,278**	$ 53,989
Notes payable	**485**	27,470
Taxes accrued	**23,595**	16,777
Interest accrued	**1,884**	3,553
Current maturities of long-term debt	**21,907**	21,678
Other	**13,887**	12,807
Total current liabilities	**120,036**	136,274
Long-term Debt	**264,683**	265,334
Deferred Credits and Other Liabilities		
Deferred income taxes	**151,293**	153,315
Investment tax credit	**5,320**	5,581
Accrued pension and other postretirement benefit costs	**22,702**	22,505
Regulatory liabilities	**33,093**	33,901
Asset retirement obligations	**6,309**	6,179
Other	**7,156**	6,332
Total deferred credits and other liabilities	**225,873**	227,813
Common Stockholder's Equity		
Common stock – $15 00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at March 31, 2008 and December 31, 2007	**8,780**	8,780
Paid-in capital	**167,494**	167,494
Retained earnings	**222,784**	210,270
Accumulated other comprehensive loss	**-**	(998)
Total common stockholder's equity	**399,058**	385,546
Total Liabilities and Common Stockholder's Equity	**$ 1,009,650**	$ 1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss) Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ 349,348
Net income			12,909		12,909
Other comprehensive income, net of tax effect of $179					
Cash flow hedges				276	276
Total comprehensive income					13,185
Adoption of SFAS No. 158 - measurement			(416)		(416)
Balance at March 31, 2007	$ 8,780	$ 164,344	$ 189,458	$ (465)	$ 362,117
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			12,514		12,514
Other comprehensive income, net of tax effect of $628					
Cash flow hedges				998	998
Total comprehensive income					13,512
Balance at March 31, 2008	$ 8,780	$ 167,494	$ 222,784	$ -	$ 399,058

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Three Months Ended March 31, 2008	2007
	(in thousands)	
Cash Flows from Operating Activities		
Net income	**$ 12,514**	$ 12,909
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**8,192**	9,361
Losses on sales of equity investments and other assets	**-**	50
Deferred income taxes	**(2,735)**	371
Regulatory asset/liability amortization	**452**	1,762
Accrued pension and other postretirement benefit costs	**584**	1,081
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**1,158**	(1,784)
Receivables	**3,900**	2,970
Inventory	**6,822**	6,004
Other current assets	**4,451**	2,448
(Increase) decrease in:		
Accounts payable	**(554)**	(4,120)
Taxes accrued	**6,818**	7,160
Other current liabilities	**(835)**	(1,160)
Regulatory asset/liability deferrals	**7,859**	3,270
Other assets	**1,169**	1,054
Other liabilities	**(2,133)**	(91)
Net cash provided by operating activities	**47,662**	41,285
Cash Flows from Investing Activities		
Capital expenditures	**(14,025)**	(12,178)
Net cash used in investing activities	**(14,025)**	(12,178)
Cash Flows from Financing Activities		
Redemption of long-term debt	**(440)**	(371)
Notes payable and commercial paper	**(26,985)**	(24,992)
Other	**(59)**	-
Net cash used in financing activities	**(27,484)**	(25,363)
Net increase in cash and cash equivalents	**6,153**	3,744
Cash and cash equivalents at beginning of period	**9,302**	6,593
Cash and cash equivalents at end of period	**$ 15,455**	$ 10,337

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY
Notes to Unaudited Financial Statements

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim 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 to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the 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 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, the effects of which require retrospective application to the Balance Sheets.

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. The receivables for unbilled revenues for Duke Energy Kentucky ($21 million and $25 million at March 31, 2008 and December 31, 2007, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables).

2. 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.

	March 31, 2008	December 31, 2007
	(in thousands)	
Gas held in storage	$ 3,442	$ 9,140
Fuel for use in electric generation	11,936	9,010
Materials and supplies	9,442	9,241
Total Inventory	$ 24,820	$ 27,391

3. Debt and Credit Facilities

Duke Energy Kentucky receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Kentucky to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. As of March 31, 2008 and December 31, 2007, Duke Energy Kentucky was in a payable position of less than $500 thousand and $27 million, respectively, classified within Notes payable in the accompanying Balance Sheets. During the three months ended March 31, 2008 and 2007, the $27 million and $25 million change in the money pool, respectively, is reflected as a cash outflow in Notes payable and commercial paper, net within Net cash used in financing activities on the Statements of Cash Flows.

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 borrowing sub limit of Duke Energy Kentucky did not change. Duke Energy Kentucky has a borrowing sub limit of $100 million under the master credit facility.

The issuance of commercial paper, letters of credit and other borrowings reduces the amount available under the credit facility.

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 and Duke Energy Kentucky to not exceed 65%. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2008, Duke Energy Kentucky was in compliance with those covenants. 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.

While Duke Energy Kentucky has plans to refund and refinance its tax exempt auction rate bonds, which had an outstanding balance of $77 million at March 31, 2008, the timing of such refinancing transactions is uncertain and subject to market conditions.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
	(in thousands)	
Qualified Pension Benefits	$ 266	$ 747
Other Postretirement Benefits	$ 318	$ 346

Duke Energy's policy is to fund amounts for its U.S. qualified and non-qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008 or 2007. Duke Energy does not anticipate making contributions to the legacy Cinergy qualified or non-qualified pension plans during 2008. Duke Energy Kentucky expensed pre-tax employer matching contributions of less than $1 million for each of the three months ended March 31, 2008 and 2007.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of March 31, 2008 and December 31, 2007 is $6 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed during the three months ended March 31, 2008 and 2007 were $1 million and $3 million, respectively.

6. Related Party Transactions

Duke Energy Kentucky engages in related party transactions. These transactions 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 Balance Sheets as of March 31, 2008 and December 31, 2007 are as follows:

	March 31, 2008	December 31, 2007
	(in thousands)	
Accounts Receivable[(a)]	$ 1,019	$ 3,660
Accounts Payable[(a)]	$30,933	$26,429

(a) Balances exclude assets or liabilities associated with accrued pension and other postretirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. 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. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, maintenance and other within Operating Expenses on the Statements of Operations were $12 million and $11 million for the three months ended March 31, 2008 and 2007, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $23 million at March 31, 2008 and December 31, 2007. These amounts have been classified in the Balance Sheets as follows:

	March 31, 2008	December 31, 2007
	(in thousands)	
Other current liabilities	$ 101	$ 101
Accrued pension and other postretirement benefit costs	$ 22,702	$ 22,505
Other deferred credits and other liabilities	$ 492	$ 456

Additionally, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 by Duke Energy Kentucky as Receivables in the Balance Sheets and was approximately $27 million and $29 million as of March 31, 2008 and December 31, 2007, respectively. The interest income associated with Cinergy Receivables for Duke Energy Kentucky, which is recorded in Other Income and Expenses, net on the Statements of Operations, was approximately $1 million for the three months ended March 31, 2008 and 2007.

Duke Energy Kentucky participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2008 and December 31, 2007, Duke Energy Kentucky was in a payable position of less than $500 thousand and $27 million, respectively, classified within Notes payable in the accompanying Balance Sheets. See Note 3 for further discussion of the money pool arrangement.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load (off-system, wholesale power sales). Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2008 and 2007.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commissions also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 both the three months ended March 31, 2008 and 2007.
- The FERC approved the merger without conditions.

Franchised Electric and Gas. *Rate Related Information.* The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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 requested increase is attributable to recovery of the current cost of the accelerated 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.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. 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. By Order dated May 14, 2008, the KPSC approved Duke Energy Kentucky's application to continue its energy efficiency program offerings. The Home Energy Assistance Program matter remains pending.

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 that Midwest ISO file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal establishes 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 tariff be effective March 27, 2008. This action established a Midwest ISO-wide resource adequacy requirement for the first Planning Year. In the Order, the FERC clarified that States have the authority to set their own planning reserve margins, as long as they are consistent with any FERC-approved reliability standard. The FERC also rejected the use of power purchase agreements or seller's choice contracts as capacity resources if the contracts do not specify resources. Duke Energy Kentucky does not believe the Midwest ISO resource adequacy requirement will have a material impact on its results of operations, cash flows, or financial position.

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. The FERC's conditional approval is based upon the "cost benefits" verification. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation Balancing Authority responsibility in the Midwest ISO so that it will become the North American Electric Reliability Council-certified Balancing Authority for the entire Midwest ISO Balancing Authority Area. This transfer 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 FERC also approved the adoption of conduct and impact mitigation tests that are the same as those now used in the Midwest ISO's energy market. These tests, along with a comprehensive package of market mitigation measures, will ensure that ancillary services market rates are just and reasonable as the region moves from cost-based rates to market-based rates. The Order also maintained the proposed ASM launch date of June 1, 2008. On March 21, 2008, MISO informed the FERC that it was delaying the ASM launch date until September 9, 2008. At this time, Duke Energy Kentucky does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its results of operations, cash flows, or financial position.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could

potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Duke Energy Kentucky believes that completion or resolution of these matters will have no material adverse effect on its 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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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. Duke Energy Kentucky is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time. On April 14, 2008, the U.S. Supreme Court issued an order granting review of the case. A decision is not likely until 2009 after briefs are submitted and oral argument occurs.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime nitrogen oxides (NO_x) emissions and annual sulfur dioxide (SO_2) emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. Duke Energy Kentucky currently estimates that it will spend approximately $10 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Kentucky currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR.

On March 25, 2008, the U.S. Court of Appeals for the District of Columbia heard oral arguments 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 sulfur dioxide allowance allocations. A decision is expected in the summer of 2008. The outcome and any resulting consequences cannot be estimated at this time.

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 U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. The EPA and utilities have requested rehearing of the D.C. Circuit Court decision by the entire D.C. Circuit panel (en banc review). The court has ordered briefing on whether it should accept the case for en banc review. Thus, the matter remains unsettled until the court decides whether to rehear the case. Barring reversal of the decision if reheard, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Kentucky is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision.

Coal Combustion Product (CCP) Management. Duke Energy Ohio currently estimates that it will spend approximately $14 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of March 31, 2008 and December 31, 2007. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their notice of appeal to the Fifth Circuit Court of Appeals. Briefing is ongoing in the Fifth Circuit. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of March 31, 2008 and December 31, 2007, Duke Energy Kentucky has recorded immaterial reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

Other. Duke Energy Kentucky enters into various commitments to purchase or sell power or capacity that may or may not be recognized on the Balance Sheets.

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157, "*Fair Value Measurements*," (SFAS No. 157). Duke Energy Kentucky'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 nonfinancial 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 Duke Energy Kentucky 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 Duke Energy Kentucky 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.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 on Duke Energy Kentucky's Balance Sheets at fair value at March 31, 2008:

Description	Total Fair Value Amounts at March 31, 2008	Level 1	Level 2	Level 3
	(in thousands)			
Derivatives Assets	$ 290	$ —	$ (28)	$ 318
Derivatives Liabilities	$ 3,074	$ —	$ 3,074	$ —

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

	Derivatives (net)
	(in thousands)
Balance at January 1, 2008	$ —
Total pre-tax gain included in other comprehensive Income	318
Balance at March 31, 2008	$ 318

11. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Kentucky subsequent to March 31, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

SFAS No. 157. Refer to Note 10 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

SFAS No. 159. Refer to Note 10 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

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

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of March 31, 2008:

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. Duke Energy Kentucky 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 Duke Energy Kentucky's results of operations, cash flows or financial position.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

At March 31, 2008, Duke Energy Kentucky has approximately $238 thousand recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. It is reasonably possible that Duke Energy Kentucky will reflect an approximate $250 thousand reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the three months ended March 31, 2008, Duke Energy Kentucky recognized net interest income of approximately $16 thousand. At March 31, 2008, Duke Energy Kentucky had approximately $321 thousand of interest receivable, which reflects all interest related to income taxes, and no accrued penalties.

Duke Energy Kentucky 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

13. Subsequent Events

For information on subsequent events related to regulatory matters and commitments and contingencies, see Notes 8 and 9, respectively.

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

June 30, 2008

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Year To Date June 30, 2008	Year To Date June 30, 2007
	(in thousands)	
Operating Revenues		
Electric	$ 162,668	$ 162,619
Gas	94,093	88,312
Total Operating Revenues	256,761	250,931
Operating Expenses		
Natural gas purchased	69,660	61,241
Operation, maintenance and other	62,002	63,463
Fuel used in electric generation and purchased power	67,314	66,969
Depreciation and amortization	18,070	18,988
Property and other taxes	6,064	6,847
Loss on sales of other assets, other net	-	50
Total Operating Expenses	223,110	217,558
Operating Income	33,651	33,373
Other Income and Expenses, net	2,557	2,363
Interest Expense	8,198	8,611
Income Before Income Taxes	28,010	27,125
Income Tax Expense	10,475	10,514
Net Income	$ 17,535	$ 16,611

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS		June 30, 2008		December 31, 2007
		(in thousands)		
Current Assets				
Cash and cash equivalents	$	12,334	$	9,302
Receivables (net of allowance for doubtful accounts of $358 at June 30, 2008 and $315 at December 31, 2007)		29,671		44,043
Inventory		39,224		27,391
Other		8,773		19,372
Total current assets		90,002		100,108
Investments and Other Assets				
Intangible assets		13,357		7,064
Other		2,457		3,430
Total investments and other assets		15,814		10,494
Property, Plant, and Equipment				
Cost		1,521,607		1,499,357
Less accumulated depreciation and amortization		629,487		617,530
Net property, plant, and equipment		892,120		881,827
Regulatory Assets and Deferred Debits				
Deferred debt expense		5,251		5,445
Regulatory Assets		18,549		17,093
Total regulatory assets and deferred debits		23,800		22,538
Total Assets	$	1,021,736	$	1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	June 30, 2008	December 31, 2007
	(in thousands)	
Current Liabilities		
Accounts payable	$ 79,914	$ 53,989
Notes payable	7,663	27,470
Taxes accrued	13,373	16,777
Interest accrued	3,357	3,553
Current maturities of long-term debt	1,905	21,678
Other	13,488	12,807
Total current liabilities	119,700	136,274
Long-term Debt	264,254	265,334
Deferred Credits and Other Liabilities		
Deferred income taxes	152,300	153,315
Investment tax credit	5,059	5,581
Accrued pension and other postretirement benefit costs	23,231	22,505
Regulatory liabilities	40,735	33,901
Asset retirement obligations	6,395	6,179
Other	5,983	6,332
Total deferred credits and other liabilities	233,703	227,813
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at June 30, 2008 and December 31, 2007	8,780	8,780
Paid-in capital	167,494	167,494
Retained earnings	227,805	210,270
Accumulated other comprehensive loss	-	(998)
Total common stockholder's equity	404,079	385,546
Total Liabilities and Common Stockholder's Equity	$ 1,021,736	$ 1,014,967

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ 349,348
Net income			16,611		16,611
Other comprehensive income, net of tax effect of $579					
Cash flow hedges				897	897
Total comprehensive income					17,508
Contribution from parent company for purchase of generating assets		3,150			3,150
Pension- FAS 158 change in measurement date			(164)		(164)
Balance at June 30, 2007	$ 8,780	$ 167,494	$ 193,412	$ 156	$ 369,842
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			17,535		17,535
Other comprehensive income, net of tax effect of $628					
Cash flow hedges				998	998
Total comprehensive income					18,533
Balance at June 30, 2008	$ 8,780	$ 167,494	$ 227,805	$ -	$ 404,079

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ 17,535	$ 16,611
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,369	18,987
Losses on sales of equity investments and other assets	-	50
Deferred income taxes	(1,938)	1,332
Regulatory asset/liability amortization	903	3,523
Contribution to company sponsored pension plan	-	(8,793)
Accrued pension and other postretirement benefit costs	1,483	1,996
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(423)	(1,907)
Receivables	18,451	10,969
Inventory	(10,337)	1,683
Other current assets	10,700	(21,435)
(Increase) decrease in:		
Accounts payable	20,394	8,972
Taxes accrued	(3,404)	6,415
Other current liabilities	484	721
Regulatory asset/liability deferrals	3,416	(9,236)
Other assets	914	2,311
Other liabilities	(2,465)	867
Net cash provided by operating activities	74,082	33,066
Cash Flows from Investing Activities		
Capital expenditures	(30,532)	(30,900)
Purchases of Emission Allowances	-	(342)
Sale of Emission Allowances	190	523
Other	65	-
Net cash used in investing activities	(30,277)	(30,719)
Cash Flows from Financing Activities		
Redemption of long-term debt	(20,886)	(732)
Notes payable and commercial paper	(19,807)	(5,177)
Contribution from parent	-	3,150
Other	(80)	(30)
Net cash used in financing activities	(40,773)	(2,789)
Net increase (decrease) in cash and cash equivalents	3,032	(442)
Cash and cash equivalents at beginning of period	9,302	6,593
Cash and cash equivalents at end of period	$ 12,334	$ 6,151

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC
Notes to Unaudited Financial Statements

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim 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, changing commodity prices, and other factors.

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the 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 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, the effects of which require retrospective application to the Balance Sheets.

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. The receivables for unbilled revenues for Duke Energy Kentucky ($15 million and $25 million at June 30, 2008 and December 31, 2007, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Kentucky sells, on a revolving basis, nearly all of their 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.

2. 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 thousands)	
Gas held in storage	$ 9,311	$ 9,140
Fuel for use in electric generation	20,316	9,010
Materials and supplies	9,597	9,241
Total Inventory	$ 39,224	$ 27,391

3. Debt and Credit Facilities

Money Pool Arrangement. Duke Energy Kentucky 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. As of June 30, 2008 and December 31, 2007, Duke Energy Kentucky had net borrowings of approximately $8 million and $27 million, respectively, which are classified within Notes payable in the accompanying Balance Sheets. During the six months ended June 30, 2008 and 2007, the $19 million and $5 million change in the money pool, respectively, is reflected as a cash outflow in Notes payable and commercial paper, net within Net cash used in financing activities on the Statements of Cash Flows.

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 borrowing sub limit of Duke Energy Kentucky did not change. Duke Energy Kentucky has a borrowing sub limit of $100 million under the master credit facility.

The amount available to Duke Energy Ohio 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 and Duke Energy Kentucky to not exceed 65%. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of June 30, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with those covenants. 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.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
	(in thousands)	
Qualified Pension Benefits	$ 837	$ 1,305
Other Postretirement Benefits	$ 636	$ 691

Duke Energy's policy is to fund amounts for its U.S. qualified plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the six months ended June 30, 2008 and Duke Energy does not anticipate making contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the six months ended June 30, 2007, Duke Energy made qualified pension benefit contributions of approximately $350 million to the legacy Cinergy qualified pension plans, of which approximately $9 million represents contributions made by Duke Energy Kentucky. Duke Energy Kentucky expensed pre-tax employer matching contributions of less than $1 million for each of the six months ended June 30, 2008 and 2007.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of June 30, 2008 and December 31, 2007 is $13 million and $7 million, respectively.

The carrying values of emission allowances sold or consumed during the six months ended June 30, 2008 and 2007 were $2 million and $4 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 9 for a discussion of the decision. Duke Energy Kentucky is currently evaluating the effect of the decision on the carrying value of its emission allowances.

6. Related Party Transactions

Duke Energy Kentucky 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 Balance Sheets as of June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(in thousands)	
Accounts Receivable[a]	$ 1,420	$ 3,660
Accounts Payable[a]	$47,594	$26,429

(a) Balances exclude assets or liabilities associated with accrued pension and other postretirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. 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. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, maintenance and other within Operating Expenses on the Statements of Operations were $24 million and $23 million for the six months ended June 30, 2008 and 2007, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $23 million at June 30, 2008 and December 31, 2007. These amounts have been classified in the Balance Sheets as follows:

	June 30, 2008	December 31, 2007
	(in thousands)	
Other current liabilities	$ 101	$ 101
Accrued pension and other postretirement benefit costs	$ 23,231	$ 22,505
Other deferred credits and other liabilities	$ –	$ 456

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Kentucky 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 Balance Sheets and was approximately $14 million and $29 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 Statements of Operations, was approximately $2 million for each of the six months ended June 30, 2008 and 2007.

As discussed further in Note 3, Duke Energy Kentucky 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 Statements of Operations, were insignificant for the six months ended June 30, 2008 and 2007.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2008 and 2007.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 both the six months ended June 30, 2008 and 2007.
- The FERC approved the merger without conditions.

Franchised Electric and Gas

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky.

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.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. 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.

Other Matters

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 that Midwest ISO file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal establishes 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 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 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. Duke Energy Kentucky does not believe the resource adequacy requirement will have a material impact on its results of operations, cash flows, or financial position.

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. At this time, Duke Energy Kentucky does not believe the establishment of the Midwest Ancillary Services Market will have a material impact on its results of operations, cash flows, or financial position.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Duke Energy Kentucky believes that completion or resolution of these matters will have no material adverse effect on its 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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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 was 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 Duke Energy Kentucky 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 SO_2 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 SO_2. Phase 2 was to begin in 2015 for both NO_x and SO_2. 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 SO_2 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 August 25, 2008 to appeal the decision. The D.C. Circuit's decision creates uncertainty regarding future NO_x and SO_2 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. Duke Energy Kentucky's plan had been to spend approximately $10 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Kentucky owns or partially owns but does not operate. It has not been determined how the court's decision will affect these planned expenditures. Duke Energy Kentucky did not expect to incur any significant costs for complying with Phase 2 of CAIR.

Duke Energy Kentucky is unable to estimate the costs to comply with any new rule EPA may issue as a result of this decision. See Note 5 for a discussion of 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 U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. The EPA and utilities have requested rehearing of the D.C. Circuit Court decision by the entire D.C. Circuit panel (en banc review). The court has ordered briefing on whether it should accept the case for en banc review. Thus, the matter remains unsettled until the court decides whether to rehear the case. Barring reversal of the decision if reheard, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Kentucky is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $19 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of June 30, 2008 and December 31, 2007. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection 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 arguments were heard on August 6, 2008. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

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

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157, "*Fair Value Measurements*," (SFAS No. 157). Duke Energy Kentucky'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 nonfinancial 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 Duke Energy Kentucky 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 Duke Energy Kentucky 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.

Duke Energy Kentucky 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:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky 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. Duke Energy Kentucky 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 Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky 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 Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Kentucky's Balance Sheets at fair value at June 30, 2008:

Description	Total Fair Value Amounts at June 30, 2008	Level 1	Level 2	Level 3
	(in thousands)			
Derivatives Assets	$ 646	$ —	$ —	$ 646
Derivatives Liabilities	$ 1,740	$ —	$ 1,740	$ —

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

	Derivatives (net)
	(in thousands)
Balance at January 1, 2008	$ 0
Total gains included on balance sheet	646
Balance at June 30, 2008	$ 646

11. New Accounting Standards

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

SFAS No. 157. Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 157.

SFAS No. 159 Refer to Note 10 for a discussion of Duke Energy Kentucky's adoption of SFAS No. 159.

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

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

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. Duke Energy Kentucky 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 Duke Energy Kentucky's results of operations, cash flows or financial position.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

At June 30, 2008, Duke Energy Kentucky has approximately $233 thousand recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. It is reasonably possible that Duke Energy Kentucky will reflect an approximate $250 thousand reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the six months ended June 30, 2008, Duke Energy Kentucky recognized net interest income of approximately $158 thousand. At June 30, 2008, Duke Energy Kentucky had approximately $464 thousand of interest receivable, which reflects all interest related to income taxes, and no accrued penalties in the Balance Sheets.

Duke Energy Kentucky 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

13. Subsequent Events

For information on subsequent events related to intangibles, regulatory matters and commitments and contingencies, see Notes 5, 8 and 9, respectively.

Duke Energy Kentucky, Inc.

Financial Statements

and Auditor's Report

December 31, 2007

Deloitte.

Deloitte & Touche LLP
1100 Carillon Building
227 West Trade Street
Charlotte, NC 28202
USA

Tel: +1 704 887 1500
Fax: +1 704 887 1570
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Duke Energy Kentucky, Inc.
Cincinnati, Ohio

We have audited the accompanying balance sheets of Duke Energy Kentucky, Inc. (the "Company") as of December 31, 2007 and 2006, and the related statements of operations, stockholder's equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

March 27, 2008

Member of
Deloitte Touche Tohmatsu

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Year To Date December 31, 2007	Year To Date December 31, 2006
	(in thousands)	
Operating Revenues		
Electric	**$ 351,846**	$ 267,917
Gas	**140,838**	136,535
Total Operating Revenues	**492,684**	404,452
Operating Expenses		
Fuel used in electric generation and purchased power	**153,883**	116,314
Operation, maintenance and other	**127,129**	115,806
Natural gas purchased	**94,931**	92,105
Depreciation and amortization	**39,869**	37,750
Property and other taxes	**11,589**	10,067
Total Operating Expenses	**427,401**	372,042
Operating Income	**65,283**	32,410
Other Income and Expenses, net	**4,052**	2,104
Interest Expense	**17,414**	15,776
Income Before Income Taxes	**51,921**	18,738
Income Tax Expense	**18,452**	8,015
Net Income	**$ 33,469**	$ 10,723

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS		December 31, 2007		December 31, 2006
		(in thousands)		
Current Assets				
Cash and cash equivalents	$	**9,302**	$	6,593
Receivables (net of allowance for doubtful accounts of $315 at December 31, 2007 and $242 at December 31, 2006)		**44,043**		32,768
Inventory		**27,391**		29,002
Other		**19,372**		11,127
Total current assets		**100,108**		79,490
Investments and Other Assets				
Intangible assets		**7,064**		12,470
Other		**3,430**		1,541
Total investments and other assets		**10,494**		14,011
Property, Plant, and Equipment				
Cost		**1,499,357**		1,451,463
Less accumulated depreciation and amortization		**617,530**		599,625
Net property, plant, and equipment		**881,827**		851,838
Regulatory Assets and Deferred Debits				
Deferred debt expense		**5,445**		5,827
Regulatory Assets		**17,093**		29,167
Total regulatory assets and deferred debits		**22,538**		34,994
Total Assets	**$**	**1,014,967**	$	980,333

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	December 31, 2007	December 31, 2006
	(in thousands)	
Current Liabilities		
Accounts payable	**$ 53,989**	$ 45,122
Notes payable	**27,470**	42,603
Taxes accrued	**16,777**	6,603
Interest accrued	**3,553**	2,808
Current maturities of long-term debt	**21,678**	1,318
Other	**12,807**	11,128
Total current liabilities	**136,274**	109,582
Long-term Debt	**265,334**	283,192
Deferred Credits and Other Liabilities		
Deferred income taxes	**153,315**	149,016
Investment tax credit	**5,581**	6,634
Accrued pension and other postretirement benefit costs	**22,505**	36,497
Regulatory liabilities	**33,901**	29,432
Asset retirement obligations	**6,179**	8,266
Other	**6,332**	8,366
Total deferred credits and other liabilities	**227,813**	238,211
Commitments and Contingencies (Note 14)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at December 31, 2007 and December 31, 2006	**8,780**	8,780
Paid-in capital	**167,494**	164,344
Retained earnings	**210,270**	176,965
Accumulated other comprehensive loss	**(998)**	(741)
Total common stockholder's equity	**385,546**	349,348
Total Liabilities and Common Stockholder's Equity	**$ 1,014,967**	$ 980,333

See Notes to Financial Statements

DUKE ENERGY KENTUCKY
STATEMENT OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Net (Losses) on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss): Minimum Pension Liability Adjustment	Total Common Stockholder's Equity
Balance at December 31, 2005	$ 8,780	$ 23,760	$ 166,242	$ -	$ (2,323)	$ 196,459
Net income			10,723			10,723
Other comprehensive income, net of tax effect of ($1,011)						
Minimum pension liability adjustment					(767)	(767)
Cash flow hedges				(741)		(741)
Total comprehensive income						9,215
Contribution from parent company for reallocation of taxes		523				523
Adjustment due to SFAS No. 158 adoption					3,090	3,090
Contribution from parent company for purchase of generating assets		140,061				140,061
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ -	$ 349,348
Net income			33,469			33,469
Other comprehensive income, net of tax effect of ($146)						
Cash flow hedges				(257)		(257)
Total comprehensive income						33,212
Capital contribution from parent		3,150				3,150
Adjustment due to SFAS No. 158 adoption			(164)			(164)
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ -	$ 385,546

See Notes to Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Twelve Months Ended December 31, 2007	2006
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **33,469**	$ 10,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**40,475**	37,750
Losses (gains) on sales of other assets	**50**	(104)
Deferred income taxes	**4,701**	8,481
Regulatory asset/liability amortization	**1,889**	3,969
Contribution to company sponsored pension plan	**(9,696)**	(2,330)
Accrued pension and postretirement benefit costs	**3,931**	4,113
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**(27)**	1,653
Receivables	**(9,057)**	4,684
Inventory	**1,611**	(1,556)
Other current assets	**(6,909)**	2,849
Increase (decrease) in:		
Accounts payable	**9,686**	(8,817)
Taxes accrued	**7,362**	(166)
Other current liabilities	**3,499**	2,513
Regulatory asset/liability deferrals	**(4,187)**	(4,016)
Other assets	**5,308**	8,466
Other liabilities	**(4,639)**	(7,327)
Net cash provided by operating activities	**77,466**	60,885
Cash Flows from Investing Activities		
Capital expenditures	**(64,199)**	(65,096)
Purchases of emission allowances	**(343)**	(23,289)
Sale of emission allowances	**343**	4,748
Net cash used in investing activities	**(64,199)**	(83,637)
Cash Flows from Financing Activities		
Issuance of long-term debt	**3,067**	194,126
Redemption of long-term debt	**(1,492)**	(76,939)
Notes payable and commercial paper	**(15,133)**	(93,454)
Contribution from parent	**3,150**	523
Other	**(150)**	(4,787)
Net cash (used in) provided by financing activities	**(10,558)**	19,469
Net increase (decrease) in cash and cash equivalents	**2,709**	(3,283)
Cash and cash equivalents at beginning of period	**6,593**	9,876
Cash and cash equivalents at end of period	$ **9,302**	$ 6,593
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Interest (net of amount capitalized)	$ **16,669**	$ 13,913
Income taxes	$ **(515)**	$ 5,950
Non-cash financing and investing activities:		
Equity contribution from parent company for acquisition of net generating assets	$ -	$ 140,061
Allowance for funds used during construction (AFUDC) – equity component	$ **219**	$ 626
Accrued capital expenditures	$ **2,885**	$ 3,001

See Notes to Financial Statements

Notes to Financial Statements

1. Summary of Significant Accounting Policies

Nature of Operations

Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy merged into wholly owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas LLC effective October 1, 2006). As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 2 for additional information regarding the merger. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein. Duke Energy is a public registrant trading on the New York Stock Exchange under DUK.

The assets and liabilities of Duke Energy Kentucky were not adjusted to reflect their fair values as of the merger date since push-down accounting is not required by generally accepted accounting principles in the United States (GAAP).

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

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

Cash and Cash Equivalents. All highly liquid investments with remaining maturities of three months or less at the date of purchase are considered cash equivalents.

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.

Components of Inventory

	December 31, 2007	December 31, 2006
	(in thousands)	
Inventory		
Gas held in storage	$ 9,140	$ 10,988
Fuel for use in electric generation	9,010	9,074
Materials and supplies	9,241	8,940
Total Inventory	$ 27,391	$ 29,002

Cost-Based Regulation. Duke Energy Kentucky accounts for certain of its regulated operations under the provisions of SFAS No. 71, *"Accounting for the Effects of 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, Duke Energy Kentucky 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 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 Balance Sheets as Regulatory Assets and Deferred Debits, and Deferred Credits and Other Liabilities Duke Energy Kentucky 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, Duke Energy Kentucky may have to reduce its asset balances to reflect a market basis less than cost and write-off their associated regulatory assets and liabilities. (For further information see Note 3.)

Accounting for Risk Management and Hedging Activities and Financial Instruments. All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities"* as amended, (SFAS No. 133), are recorded on the Balance Sheet at their fair value.

For each of Duke Energy Kentucky's contracts that are derivatives, the accounting model and presentation of gains and losses, or revenue and expense in the Statements of Operations is shown below.

Classification of Contract	Duke Energy Kentucky Accounting Model	Presentation of Gains & Losses or Revenue & Expense
Non-trading derivatives:		
Undesignated	*Mark-to-market*[(a)]	Net basis in the related Statement of Operations category for interest rate and commodity derivatives

(a) An accounting term used by Duke Energy Kentucky to refer to derivative contracts for which an asset or liability is recognized at fair value and the change in the fair value of that asset or liability is recognized in the Statements of Operations. As this term is not explicitly defined within GAAP, Duke Energy Kentucky's application of this term could differ from that of other companies.

Changes in the fair value of a derivative, to the extent effective, are included in the Statements of Common Stockholder's Equity and Comprehensive Income as Accumulated Other Comprehensive Loss (AOCI) until earnings are affected by the hedged item. Duke Energy Kentucky discontinues hedge accounting prospectively when it has determined that a derivative no longer qualifies as an effective hedge, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge, the derivative is subject to the Mark-to-Market model of accounting (MTM Model) prospectively. Gains and losses related to discontinued hedges that were previously accumulated in AOCI will remain in AOCI until the underlying contract is reflected in earnings; unless it is probable that the hedged forecasted transaction will not occur at which time associated deferred amounts in AOCI are immediately recognized in current earnings.

Valuation. Quoted market prices or prices obtained through external sources are used to measure a contract's fair value.

Property, Plant and Equipment. Property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Kentucky capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction. The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of property, plant and equipment, is expensed as incurred. Depreciation is generally computed over the asset's estimated useful life using the straight-line method. The composite weighted-average depreciation rate was 2.6% for 2007 and 2006. Also, see "Allowance for Funds Used During Construction (AFUDC)," discussed below.

When Duke Energy Kentucky retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation and amortization. When it sells entire regulated operating units, the cost is removed from the property account and the related accumulated depreciation and amortization accounts are reduced. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

Duke Energy Kentucky recognizes asset retirement obligations (ARO's) in accordance with SFAS No. 143, "*Accounting For Asset Retirement Obligations*" (SFAS No. 143), for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset and FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations*" (FIN 47), for conditional ARO's. The term conditional asset retirement obligation as used in SFAS No. 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Both SFAS No. 143 and FIN 47 require that the fair value of a liability for an ARO be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 6 for further information.

Loss Contingencies. Duke Energy Kentucky is involved in certain legal and environmental matters that arise in the normal course of business. Loss contingencies are accounted for under SFAS No. 5, "*Accounting for Contingencies*," (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Kentucky records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred. See Note 14 for further information.

Environmental Expenditures. Duke Energy Kentucky expenses environmental expenditures related to conditions caused by past operations that do not generate current or future revenues. Environmental expenditures related to operations that generate current or future revenues are expensed or capitalized, as appropriate. Liabilities are recorded on an undiscounted basis when the necessity for environmental remediation becomes probable and the costs can be reasonably estimated, or when other potential environmental liabilities are reasonably estimable and probable.

Revenue Recognition and 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. The receivables for unbilled revenues for Duke Energy Kentucky ($25 million and $22 million at December 31, 2007 and 2006, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). See Note 10 for additional information.

Allowance for Funds Used During Construction (AFUDC). AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities, consists of two components, an equity component and an interest component. The equity component is a non-cash item. AFUDC is capitalized as a component of Property, Plant and Equipment cost, with offsetting credits to the Statements of Operations. After construction is completed, Duke Energy Kentucky is permitted to recover these costs through inclusion in the rate base and in the depreciation provision. The total amount of AFUDC included within income from continuing operations in the Statements of Operations was less than $500 thousand in 2007. The total amount of AFUDC included within income from continuing operations in the Statements of Operations for 2006 was $1 million.

Accounting For Purchases and Sales of Emission Allowances. Duke Energy Kentucky recognizes emission allowances in earnings as they are consumed or sold. Any gains or losses on sales of recoverable emission allowances are returned to customers via Profit Sharing Mechanism riders included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Purchases and sales of emission allowances are presented gross as investing activities on the Statements of Cash Flows.

Income Taxes. As a result of Duke Energy's merger with Cinergy in 2006, Duke Energy Kentucky entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses or benefits to the subsidiaries whose investments or results of operations provide these tax expenses or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Kentucky has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Kentucky and Cinergy prior to the merger.

Management evaluates and records contingent tax liabilities and related interest based on the probability of ultimately sustaining the tax deductions or income positions. Management assesses the probabilities of successfully defending the tax deductions or income positions based upon statutory, judicial or administrative authority.

Management evaluates and records uncertain tax positions in accordance with FIN 48, *"Accounting For Uncertainty in Income Taxes – an Interpretation of FASB Statement 109,"* (FIN 48), which was adopted by Duke Energy Kentucky on January 1, 2007. Duke Energy Kentucky records unrecognized tax benefits for positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. In accordance with FIN 48, Duke Energy Kentucky records the largest amount of the unrecognized tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Kentucky does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 5 for further information.

Duke Energy Kentucky records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net, in the Statements of Operations.

Reclassifications and Revisions. Certain prior period amounts have been reclassified to conform to the presentation for the current period.

New Accounting Standards. The following new accounting standards were adopted by Duke Energy Kentucky during the year ended December 31, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke Energy Kentucky for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that have been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140. SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 was effective for Duke Energy Kentucky as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Kentucky recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in regulatory assets of approximately $22 million and an increase in liabilities of approximately $22 million as of December 31, 2006. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Kentucky has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Kentucky adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. In the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of accumulated other comprehensive income (loss)

(AOCI) and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Kentucky completed these calculations. The finalization of these actuarial calculations resulted in an immaterial adjustment to AOCI and regulatory assets.

The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows.

FIN 48. In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Kentucky has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Kentucky's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Kentucky adopted FIN 48 effective January 1, 2007. See Note 5 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No FIN 48-1). In May, 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Kentucky's adoption of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

The following new accounting standard was adopted by Duke Energy Kentucky during the year ended December 31, 2006 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). In September 2006, the SEC issued SAB No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Traditionally, there have been two widely-recognized approaches for quantifying the effects of financial statement misstatements. The income statement approach focuses primarily on the impact of a misstatement on the income statement—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The balance sheet approach, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (a "dual approach") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material.

SAB No. 108 was effective for Duke Energy Kentucky's year ending December 31, 2006. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii), under certain circumstances, recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Duke Energy Kentucky has historically used a dual approach for quantifying identified financial statement misstatements. Therefore, the adoption of SAB No. 108 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Kentucky as of December 31, 2007:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. The application of SFAS No. 157 may change Duke Energy Kentucky's current practice for measuring and disclosing fair values under other accounting pronouncements that require fair value measurements. For Duke Energy Kentucky, SFAS No. 157 is effective as of January 1, 2008 and must be applied prospectively except in certain cases. To date, no matters have been identified regarding implementation of SFAS 157 that would have any material impact on Duke Energy Kentucky's results of operations or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Kentucky, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky 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, Duke Energy Kentucky may elect to measure certain financial instruments at the fair value in accordance with the standard.

2. Duke Energy/Cinergy Merger

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated (see Note 1 for additional information on the merger). For accounting purposes, the effective date of the merger was April 1, 2006. The merger combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the midwestern United States (Midwest).

Based on the market price of Duke Energy common stock during the period, including the two trading days before, through the two trading days after, May 9, 2005, the date Duke Energy and Cinergy announced the merger, the transaction was valued at approximately $9,115 million and resulted in goodwill recorded at Duke Energy Ohio of approximately $2,348 million.

Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the Federal Energy Regulatory Commission (FERC). See Note 3 for a discussion of the regulatory impacts of the merger.

3. Regulatory Matters

Regulatory Assets and Liabilities. Duke Energy Kentucky's regulated operations are subject to SFAS No. 71. Accordingly, Duke Energy Kentucky records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.

Duke Energy Kentucky's Regulatory Assets and Liabilities:

	As of December 31,		Recovery/Refund
	2007	2006	Period Ends
	(in thousands)		
Regulatory Assets[a][b]			
Accrued pension and post retirement	$ 12,517	$ 21,560	[g]
Merger Costs	3,278	4,453	[e]
Vacation accrual[h]	1,624	2,572	2008
Other	3,415	3,154	[g]
Total Regulatory Assets	$ 20,834	$ 31,739	
Regulatory Liabilities[a]			
Removal costs[d]	$ 31,372	$ 26,937	[f]
Amounts due from Customers – Income Taxes[e]	1,756	0	[g]
Other[c][i]	680	2,495	[g]
Total Regulatory Liabilities	$ 33,808	$ 29,432	

(a) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.
(b) Included in Regulatory Assets and Deferred Debits on the Balance Sheet unless otherwise noted.
(c) Included in Accounts payable or Other deferred credits and other liabilities on the Balance Sheets.
(d) Included in rate base.
(e) Recovery/refund is over the life of the associated asset or liability.
(f) Liability is extinguished over the lives of the associated assets.
(g) Recovery/Refund period currently unknown.
(h) Included in Other current assets on the Balance Sheet.
(i) The current portion of the amounts in the other category are included in accounts payable on the balance sheet.

Regulatory Merger Approvals. As discussed in Note 1 and Note 2, 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 $2 million of the rate reduction was passed through to customers during each of the years ended December 31, 2007 and 2006.
- The FERC approved the merger without conditions.

Franchised Electric and Gas. Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

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 requested increase was attributable to recovery of the current cost of the accelerated 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 continues to utilize tracking mechanisms in its billed rates to customers. At this time, Duke Energy Kentucky cannot predict the outcome of these proceedings.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base

electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC. The plan provided for Duke Energy Kentucky to purchase back-up power through bilateral contracts for unscheduled outages. Duke Energy Kentucky will recover these costs through base rates. The plan provided for Duke Energy Kentucky to purchase back-up power through the Midwest Independent System Operator, Inc. (Midwest ISO) energy markets for unscheduled outages. The KPSC issued an order in March 2007 approving Duke Energy Kentucky's back-up power supply plan.

Energy Efficiency 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. An order on the application is expected in the first quarter of 2008.

FERC Issues Electric Reliability Standards. Consistent with reliability provisions of the Energy Policy Act of 2005, on July 20, 2006, FERC issued its Final Rule certifying the North American Electric Reliability Council (NERC) as the Electric Reliability Organization. NERC has filed over 100 proposed reliability standards with FERC. On March 16, 2007, FERC issued a final rule establishing mandatory, enforceable reliability standards for the nation's bulk power system. In the final rule, FERC approved 83 of the 107 mandatory reliability standards submitted by the NERC and compliance with these standards became mandatory on June 18, 2007. FERC will consider the remaining 24 proposed standards for approval once the necessary criteria and procedures are submitted. In the interim, compliance with these 24 standards is expected to continue on a voluntary basis as good utility practice. Duke Energy Kentucky does not believe that the issuance of these standards will have a material impact on its results of operations, cash flows, or financial position.

Midwest ISO Resource Adequacy Filing. On December 28, 2007, the Midwest Independent Transmission System Operator, Inc. (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. While the proposal has been filed for approval from the FERC, it currently lacks enforcement and financial settlement mechanisms. Given that the proposal has not yet been approved by the FERC, it is difficult to estimate its impact on Duke Energy Kentucky, but at this time Duke Energy Kentucky does not believe the resource adequacy requirement will have a material impact on its consolidated results of operations, cash flows, or financial position.

4. Joint Ownership of Generating Facilities

Duke Energy Kentucky and Dayton Power & Light jointly own an electric generating station.

As of December 31, 2007, Duke Energy Kentucky's share in the jointly-owned plant was as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
		(in thousands)		
Duke Energy Kentucky				
Production:				
East Bend Station	69.0	$ 428,628	$ 219,731	$ 1,235

Duke Energy Kentucky's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line on the Statements of Operations. Each participant in the jointly owned facilities must provide its own financing.

5. Income Taxes

Prior to the merger of Cinergy and Duke Energy on April 3, 2006, the taxable income of Duke Energy Kentucky was reflected in Cinergy's U.S. federal and state income tax returns. After the merger, the taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. As a result of Duke Energy's merger with Cinergy, Duke Energy Kentucky entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses or benefits to the subsidiaries whose investments or results of operations provide these tax expenses or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Kentucky has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Kentucky and Cinergy prior to the merger.

The following details the components of income tax expense:

Income Tax Expense

	Twelve Months Ended December 31, 2007	Twelve Months Ended December 31, 2006
	(in thousands)	
Current income taxes		
Federal	$ **11,387**	$ (292)
State	**2,364**	(174)
Total current income taxes	**13,751**	(466)
Deferred income taxes		
Federal	**4,559**	7,565
State	**927**	1,728
Total deferred income taxes	**5,486**	9,293
Investment tax credit amortization	**(785)**	(812)
Total income tax expense presented in Statements of Operations	$ **18,452**	$ 8,015

Reconciliation of Income Tax Expense at the U.S. Federal Statutory Tax Rate to the Actual Tax Expense (Statutory Rate Reconciliation)

	Twelve Months Ended December 31, 2007	Twelve Months Ended December 31, 2006
	(in thousands)	
Income tax expense, computed at the statutory rate of 35%	$ **18,173**	$ 6,558
State income tax, net of federal income tax effect	**2,139**	1,010
Depreciation and other PP&E related differences	**173**	(336)
ITC amortization	**(785)**	(812)
Manufacturing Deduction	**(477)**	—
Other items, net	**(771)**	1,594
Total income tax expense	$ **18,452**	$ 8,015
Effective Tax Rates	**35.5%**	42.8%

The manufacturing deduction was created by the American Job Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities. During the year ended December 31, 2006, the Act provided for a 3% deduction on qualified production activities. During the year ended December 31, 2007, the deduction increased to 6% on qualified production activities.

Net Deferred Income Tax Liability Components

	As of December 31, 2007	2006
	(in thousands)	
Deferred credits and other liabilities	$ **6,273**	$ 7,905
Other	**3,250**	1,614
Total deferred income tax assets	**9,523**	9,519
Investments and other assets	**6,164**	3,342
Accelerated depreciation rates	**159,444**	153,834
Regulatory assets and deferred debits	**(1,144)**	359
Total deferred income tax liabilities	**164,464**	157,535
Total net deferred income tax liabilities	$ **(154,941)**	$ (148,016)

The above amounts have been classified in the Balance Sheets as follows:

Net Deferred Income Tax Liabilities

	As of December 31,	
	2007	**2006**
	(in thousands)	
Current deferred tax assets/(liabilities), included in other current assets/(liabilities)	$ **(1,626)**	$ 1,000
Non-current deferred tax liabilities	**(153,315)**	(149,016)
Total net deferred income tax liabilities	$ **(154,941)**	$ (148,016)

On January 1, 2007, Duke Energy Kentucky adopted FIN 48.

As a result of the adoption of FIN 48, Duke Energy Kentucky had no cumulative effect adjustment to retained earnings, which reflects all adoption provisions of FIN 48, including those provisions related to unrecognized income tax benefits net of gain contingencies, and interest expense and penalties.

Effective with the adoption of FIN 48 on January 1, 2007, Duke Energy Kentucky recognized approximately $623 thousand of accrued interest receivable, which reflects all interest related to income taxes, and no accrued penalties.

The following table details the changes in Duke Energy Kentucky's unrecognized tax benefits from January 1, 2007 to December 31, 2007.

	Increase/(Decrease) (in thousands)
Unrecognized Tax Benefits – January 1, 2007	**$ 420**
Unrecognized Tax Benefits Changes	
Gross decreases – tax positions in prior periods	**(10)**
Settlements	**(158)**
Total Changes	**$ (168)**
Unrecognized Tax Benefits – December 31, 2007	**$ 252**

At December 31, 2007, no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. It is reasonably possible that Duke Energy Kentucky will reflect an approximate $250 thousand reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the year ended December 31, 2007, Duke Energy Kentucky recognized net interest expense of approximately $215 thousand. At December 31, 2007, Duke Energy Kentucky had approximately $305 thousand of interest receivable, which reflects all interest related to income taxes, and no accrued penalties.

Duke Energy Kentucky 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

6. Asset Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, which was adopted by Duke Energy Kentucky on January 1, 2003. SFAS No. 143 addresses financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and the related asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the life of the asset. The liability increases due to the passage of time based on the time value of money until the obligation is settled. Subsequent to the initial recognition, the liability is adjusted for any revisions to the expected value of the retirement obligation (with corresponding adjustments to property, plant, and equipment), and for accretion of the liability due to the passage of time. Additional depreciation expense is recorded prospectively for any increases to the carrying amount of the associated asset.

Asset retirement obligations at Duke Energy Kentucky relate primarily to the retirement of gas mains. In accordance with SFAS No.143, Duke Energy Kentucky identified certain assets that have an indeterminate life, and thus the fair value of the retirement obligation is not reasonably estimable. These assets include transmission pipelines. A liability for these asset retirement obligations will be recorded when a fair value is determinable.

The adoption of SFAS No. 143 had no impact on the income of the regulated electric and gas operations, as the effects were offset by the establishment of regulatory assets and liabilities pursuant to SFAS No. 71. While Duke Energy Kentucky was granted approval to recover gas main retirements and other obligations, it was not granted approval by the KPSC to defer all cumulative and future income statement impacts related to SFAS No. 143.

The asset retirement obligation is adjusted each period for any liabilities incurred or settled during the period, accretion expense and any revisions made to the estimated cash flows.

Reconciliation of Asset Retirement Obligation Liability

	Years Ended December 31,	
	2007	2006
	(in thousands)	
Balance as of January 1,	$ 8,266	$ 6,306
Liabilities incurred due to new acquisitions	—	1,736
Accretion expense	466	481
Revisions in estimated cash flows	—	(257)
Liabilities settled[a]	(2,553)	—
Balance as of December 31,	$ 6,179	$ 8,266

(a) Liabilities settled during 2007 were related to the retirement of gas mains.

Upon adoption of SFAS No. 143, Duke Energy Kentucky's regulated electric and regulated natural gas operations classifies removal costs for property that does not have an associated legal retirement obligation as a regulatory liability, in accordance with regulatory treatment under SFAS No. 71. The total amount of removal costs included in Other Deferred Credits and Other Liabilities on the Balance Sheets was $31 million and $27 million as of December 31, 2007 and 2006, respectively.

7. Risk Management and Hedging Activities, Credit Risk, and Financial Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load (off-system, wholesale power sales). Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2007 and 2006.

Credit Risk. Where exposed to credit risk, Duke Energy Kentucky analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis.

Duke Energy Kentucky's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Kentucky may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Kentucky also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

Financial Instruments. The fair value of financial instruments, excluding derivatives included elsewhere in this Note, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of December 31, 2007 and 2006, are not necessarily indicative of the amounts Duke Energy Kentucky could have realized in current markets.

Financial Instruments

	As of December 31,			
	2007		2006	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in thousands)			
Long-term debt[a]	$ 287,012	$ 283,183	$ 284,510	$ 284,487

(a) Includes current maturities.

The fair value of cash and cash equivalents, accounts receivable, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

8. Intangibles

The carrying amount of emission allowances in intangible assets as of December 31, 2007 and December 31, 2006 were $7 million and $12 million, respectively.

The carrying values of emission allowances sold or consumed were $6 million and $11 million as of December 31, 2007 and December 31, 2006, respectively.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2007. The expected amortization expense includes estimates of emission allowances consumption. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2008	2009	2010-2012
	(in thousands)		
Expected Amortization expense	$ 4,541	$ 2,523	—

9. Related Party Transactions

Duke Energy Kentucky engages in related party transactions. These transactions 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 Balance Sheets as of December 31, 2007 and December 31, 2006 are as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Accounts Receivable	$ **3,660**	$ 4,825
Accounts Payable	$ **26,429**	$ 20,303

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. 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.

The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations were as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Corporate governance and shared services expenses	$ **47,495**	$ 51,072

See Note 15 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $23 million at December 31, 2007 and approximately $37 million at December 31, 2006. The above amounts have been classified in the Balance Sheet as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Other current liabilities	$ **101**	$ 624
Accrued pension and other postretirement benefit costs	$ **22,505**	$ 36,497

Additionally, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 by Duke Energy Kentucky as Receivables in the Balance Sheets and was approximately $29 million and $20 million as of December 31, 2007 and December 31, 2006, respectively. See Note 10 for additional information. See Note 12 for information on money pool.

10. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Kentucky sells certain of its accounts receivable and related collections through Cinergy Receivables a bankruptcy remote, special purpose entity. Cinergy Receivables is a wholly owned non-consolidated limited liability company of Cinergy. As a result of the securitization, Duke Energy Kentucky sells, on a revolving basis, its retail accounts receivable, including estimated unbilled revenues, and related collections. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140.

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 (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $189 million and $133 million at December 31, 2007 and 2006, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows

from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Balance Sheets at December 31, 2007 and 2006.

The carrying values of the retained interests are determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions in estimating fair value are the anticipated credit losses, the selection of discount rates, and expected receivables turnover rate. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Kentucky's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. Interest accrues to Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred (which is unlikely unless credit losses on the receivables far exceed the anticipated level).

The key assumptions used in estimating the fair value are as follows:

	Years Ended December 31,	
	2007	2006
Anticipated credit loss rate	0.9%	1.0%
Discount rate on expected cash flows	7.7%	7.4%
Receivables turnover rate	11.9%	12.1%

The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history.

Duke Energy Kentucky retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Kentucky exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Kentucky approximates a market rate.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the periods ending:

	December 31, 2007	December 31, 2006
	(in thousands)	
Receivables sold as of period end	$ **63,936**	$ 51,748
Less: Retained interests	**29,165**	20,183
Net receivables sold as of period end	$ **34,771**	$ 31,565
Sales during period		
Receivables sold	$ **468,617**	$ 383,713
Loss recognized on sale	**6,583**	5,721
Cash flows during period		
Cash proceeds from sold receivables[(a)]	$ **453,052**	$ 387,040
Return received on retained interests	**3,694**	2,784

(a) Cash flows from the sale of receivables are reflected within Operating Activities on the Statements of Cash Flows.

11. Property, Plant and Equipment

	Estimated Useful Life	December 31, 2007	December 31, 2006
	(Years)	(in thousands)	
Land	—	$ **17,894**	$ 17,165
Plant			
Electric generation, distribution and transmission[(a)]	8 – 100	**1,085,286**	1,062,496
Natural gas transmission and distribution[(a)]	12 – 50	**315,763**	294,241
Other buildings and improvements[(a)]	15 – 100	**29,064**	26,970
Equipment	11 – 25	**7,097**	4,579
Vehicles	9 – 15	**314**	222
Construction in process	—	**24,572**	26,680
Other	5 – 10	**19,367**	19,110
Total property, plant and equipment		**1,499,357**	1,451,463
Total accumulated depreciation[(b)]		**(617,530)**	(599,625)
Total net property, plant and equipment		$ **881,827**	$ 851,838

(a) Includes capitalized leases, for which the totals were $24 million for 2007 and $18 million for 2006.
(b) Includes accumulated amortization of capitalized leases: $2 million for 2007 and $1 million for 2006.

Capitalized interest, which includes the interest expense component of AFUDC, amounted to less than $1 million for the year ended December 31, 2007, and $1 million for the year ended December 31, 2006.

12. Debt and Credit Facilities

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	December 31, 2007	December 31, 2006
			(in thousands)	
Unsecured debt	5.8%	2008 – 2036	**$ 195,000**	$ 195,000
Capital leases	5.2%	2008 – 2020	**15,089**	13,513
Other debt[(a)]	4.5%	2011 – 2041	**77,571**	76,720
Money Pool	5.4%		**27,470**	42,603
Unamortized debt discount and premium, net			**(648)**	(723)
Total debt			**314,482**	327,113
Current maturities of long-term debt			**(21,678)**	(1,318)
Short-term notes payable			**(27,470)**	(42,603)
Total long-term debt			**$ 265,334**	$ 283,192

(a) Includes $77 million of Duke Energy Kentucky pollution control bonds as of December 31, 2007 and 2006.

Unsecured Debt. In August 2006, Duke Energy Kentucky issued approximately $77 million principal amount of floating rate tax-exempt notes due August 1, 2027. Proceeds from the issuance were used to refund a like amount of debt on September 1, 2006 then outstanding at Duke Energy Ohio. Approximately $27 million of floating rate debt was swapped to a fixed rate concurrent with closing.

Money Pool. Duke Energy Kentucky participates with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement to better manage cash and working capital requirements. Under this arrangement, those companies with short-term funds provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Kentucky participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. The amounts outstanding under this money pool arrangement are shown as a component of Notes payable and commercial paper on the Balance Sheets. The amounts outstanding were $27 million as of December 31, 2007 and $43 million as of December 31, 2006. The change in the money pool from December 31, 2006 to December 31, 2007 is reflected as a $15 million cash outflow in Notes payable and commercial paper within Net cash provided by (used in) financing activities on the Statements of Cash Flows.

Floating Rate Debt. As of December 31, 2007 and March 27, 2008 Duke Energy Kentucky had approximately $77 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Kentucky prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Kentucky experienced failed auctions on a portion of these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Kentucky is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the majority of the auction rate debt is 1.75 times one-month LIBOR. Payment of the failed-auction interest rates will continue until Duke Energy Kentucky is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. Duke Energy Kentucky is currently pursuing a refunding and refinancing plan, which is subject to approval by applicable state or county financing authorities and utility regulators. If Duke Energy Kentucky is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially effect Duke Energy Kentucky's overall financial position, results of operations or cash flows. The weighted-average interest rate, associated with Duke Energy Kentucky's auction rate pollution control bonds, was 4.39% as of December 31, 2007 and 4.56% as of March 27, 2008.

Maturities, Call Options and Acceleration Clauses.

Annual Maturities as of December 31, 2007

	(in thousands)
2008	$ 21,678
2009	22,458
2010	1,628
2011	1,439
2012	1,609
Thereafter	238,200
Total long-term debt (including current maturities)	$ 287,012

Duke Energy Kentucky has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than the above as a result of Duke Energy Kentucky's ability to repay these obligations prior to their scheduled maturity.

Available Credit Facilities and Restrictive Debt Covenants. In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling $2.65 billion with a 5-year, $2.65 billion master credit facility. In March 2008, Duke Energy increased its capacity under its master credit facility by $550 million. The borrowing sub limit of Duke Energy Kentucky did not change. Duke Energy Kentucky has a borrowing sub limit of $100 million under the master credit facility. Concurrent with the syndication of the master credit facility, Duke Energy established a new $1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

The issuance of commercial paper, letters of credit and other borrowings reduces the amount available under the credit facility.

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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2007, Duke Energy and Duke Energy Kentucky were in compliance with those covenants. 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.

13. Subsequent Events

For information related to subsequent events related to regulatory matters and commitments and contingencies, see Notes 3 and 14, respectively.

14. Commitments and Contingencies

General Insurance

Effective with the date of the merger between Duke Energy and Cinergy, Duke Energy Kentucky carries, either directly or through Duke Energy's captive insurance company, Bison Insurance Company Limited, insurance and reinsurance coverages consistent with companies engaged in similar commercial operations with similar type properties. Duke Energy Kentucky's insurance coverage includes (1) commercial general public liability insurance for liabilities arising to third parties for bodily injury and property damage resulting from Duke Energy Kentucky's operations; (2) workers' compensation liability coverage to required statutory limits; (3) automobile liability insurance for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage; (4) insurance policies in support of the indemnification provisions of Duke Energy Kentucky's by-laws and (5) property insurance covering the replacement value of all real and personal property damage, excluding electric transmission and distribution lines, including damages arising from boiler and machinery breakdowns, earthquake, flood damage and extra expense. All coverages are subject to certain deductibles, terms and conditions common for companies with similar types of operations.

Duke Energy Kentucky also maintains excess liability insurance coverage above the established primary limits for commercial general liability and automobile liability insurance. Limits, terms, conditions and deductibles are comparable to those carried by other companies with similar types of operations.

The cost of Duke Energy Kentucky's general insurance coverages continued to fluctuate over the past year reflecting the changing conditions of the insurance markets.

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky is responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Duke Energy Kentucky believes that completion or resolution of these matters will have no material adverse effect on its 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. Coal-fired generating facilities in which Duke Energy Kentucky 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 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. Duke Energy Kentucky is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR). The EPA finalized its CAMR and CAIR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program beginning in 2010. The CAIR limits total annual and summertime nitrogen oxides (NO_x) emissions and annual sulfur dioxide (SO_2) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2.

Duke Energy Kentucky currently estimates that it will spend approximately $10 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Kentucky owns or partially owns but does not operate. Duke Energy Kentucky currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR.

On February 8, 2008 the U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. Barring reversal of the decision if appealed, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Kentucky is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Manufactured Gas Plant (MGP) Sites. Duke Energy Kentucky has performed site assessments on certain of its sites where MGP activities are believed to have occurred at some point in the past and have found no imminent risk to the environment. At this time, Duke Energy Kentucky cannot predict whether investigation and/or remediation will be required in the future at any of these sites.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $25 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million for each year ending December 31, 2007 and 2006, respectively. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide (CO_2) 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 United States 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 United States 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

Ontario, Canada Lawsuit. Duke Energy Kentucky understands that a class action lawsuit was filed in Superior Court in Ontario, Canada on July 3, 2005 against Duke Energy Ohio and approximately 20 other utility and power generation companies alleging various claims relating to environmental emissions from coal-fired power generation facilities in the United States and Canada and damages of approximately $50 billion, with continuing damages in the amount of approximately $4 billion annually. Duke Energy Kentucky understands that the lawsuit also claims entitlement to punitive and exemplary damages in the amount of $1 billion. Duke Energy Kentucky understands that Duke Energy Ohio had not yet been served in this lawsuit by the deadline of July 3, 2007. However, if served, Duke Energy Kentucky understands that Duke Energy Ohio intends to defend this lawsuit vigorously in court. At this time, Duke Energy Kentucky is not able to predict whether resolution of this matter would have a material effect on its financial position, cash flows or results of operations.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States 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. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their notice of appeal to the Fifth Circuit Court of Appeals. Briefing is ongoing in the Fifth Circuit. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Other Litigation and Legal Proceedings. Duke Energy Kentucky 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. Duke Energy Kentucky believes that the final disposition of these proceedings will not have a material adverse effect on its results of operations, cash flows or financial position.

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of December 31, 2007 and 2006, Duke Energy Kentucky has recorded reserves where such amounts are probable of payment and the amounts are reasonably estimable. Such accruals are immaterial for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

Other. Duke Energy Kentucky enters into various commitments to purchase or sell power or capacity that may or may not be recognized on the Balance Sheets.

Operating and Capital Lease Commitments

Duke Energy Kentucky leases assets in several areas of its operations. Rental expense for operating leases was $4 million for the year ended December 31, 2007 and $4 million for the year ended December 31, 2006, which is included in Operation, Maintenance and Other on the Statements of Operations. Capitalized lease obligations are classified as debt on the Balance

Sheets (see Note 12). Amortization of assets recorded under capital leases was included in Depreciation and Amortization on the Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2007:

	Operating Leases	Capital Leases
	(in thousands)	
2008	$ 1,312	$ 1,966
2009	1,246	2,515
2010	952	1,681
2011	790	1,492
2012	453	1,662
Thereafter	4,058	5,773
Total future minimum lease payments	$ 8,811	$ 15,089

15. Employee Benefit Obligations

Cinergy Retirement Plans. Duke Energy Kentucky participates in qualified and non-qualified defined benefit pension plans as well as other post-retirement benefit plans sponsored by Cinergy. Cinergy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Kentucky.

Upon consummation of the merger with Duke Energy, Cinergy's benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit/post-retirement costs to be allocated to Duke Energy Kentucky. As a result, the discount rate used to determine net periodic benefit cost to be allocated to Duke Energy Ohio by Cinergy changed from 5.50% to 6.00% in 2006.

Cinergy adopted the funded status disclosure and recognition provisions of SFAS No. 158, effective December 31, 2006. Cinergy adopted the change in measurement date transition requirements of SFAS No. 158 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date. Previously, Cinergy used a September 30 measurement date for its defined benefit and other post-retirement plans.

Qualified Pension Plans

Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. The plans cover most U.S. employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy U.S. employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of the their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years.

Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities.

Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the retirement plan is 11 years. Cinergy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets over five years.

Duke Energy Kentucky's Qualified Pension Plan Pre-Tax Net Periodic Pension Benefit costs as allocated by Cinergy were as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Qualified Pension Benefits	$ 2,353	$ 2,900

The fair value of Cinergy's plan assets was approximately $1,701 million as of December 31, 2007 and approximately $1,302 million as of September 30, 2006. The projected benefit obligation for the plans was approximately $1,941 million as of December 31, 2007 and approximately $1,976 million as of September 30, 2006. The accumulated benefit obligation for the plans was approximately $1,753 million as of December 31, 2007 and approximately $1,688 million at September 30, 2006. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Balance Sheets at December 31, 2007 and 2006 was approximately $9 million and approximately $24 million, respectively. Regulatory assets, as allocated by Cinergy to Duke Energy Kentucky, and recognized in Regulatory Assets and Deferred Debits within the Balance Sheets was approximately $7 million and $15 million as of December 31, 2007 and 2006, respectively.

Duke Energy made qualified pension benefit contributions of approximately $350 million and $124 million to the legacy Cinergy qualified pension benefit plans, of which approximately $9 million and $2 million represent contributions made by Duke Energy Kentucky for the years ended December 31, 2007 and December 31, 2006, respectively.

Assumptions Used for Cinergy's Pension Benefits Accounting

	2007	2006
	Percentages	
Benefit Obligations		
Discount rate	**6.00**	5.75
Salary increase	**5.00**	5.00
Net Periodic Benefit Cost		
Discount rate[(a)]	**5.75**	5.50 -6.00
Salary increase	**5.00**	5.00
Expected long-term rate of return on plan assets	**8.50**	8.50

(a) Discount rate was 5.75 % and 6.00% for the year ended December 31, 2007 and for the nine months ended December 31, 2006, respectively. Discount rate was 5.50% for the three months ended March 31, 2006.

Non-Qualified Pension Plans

In addition, Cinergy also maintains, and Duke Energy Kentucky participates in, non-qualified, non-contributory defined benefit retirement plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. There are no plan assets. The projected benefit obligation for the plans was approximately $105 million as of December 31, 2007 and approximately $114 million as of September 30, 2006. The accumulated benefit obligation for the plans was approximately $102 million as of December 31, 2007 and approximately $109 million at September 30, 2006. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Balance Sheets at December 31, 2007 and 2006 was approximately $131 thousand and $134 thousand, respectively. Regulatory assets, as allocated by Cinergy to Duke Energy Kentucky, and recognized in Regulatory Assets and Deferred Debits within the Balance Sheets was approximately $82 thousand and $95 thousand as of December 31, 2007 and 2006, respectively.

Duke Energy Kentucky's Non-Qualified Pension Plan pre-tax Net Periodic Pension Benefit Costs as allocated by Cinergy were as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Non-Qualified Pension[(a)]	**$ 19**	$ 16

Non-Qualified Plans—Assumptions Used for Cinergy's Pension Benefits Accounting

	2007	2006
Benefit Obligations		
Discount rate	**6.00**	5.75
Salary increase	**5.00**	5.00
Net Periodic Benefit Cost		
Discount rate	**5.75**	5.50-6.00
Salary increase	**5.00**	5.00

(a) Discount rate was 5.75% and 6.00% for the year ended December 31, 2007 and the nine months ended December 31, 2006, respectively. Discount rate was 5.50% for the three months ended March 31, 2006.

Other Post-Retirement Benefit Plans

Duke Energy Kentucky participates in other postretirement benefit plans sponsored by Cinergy. Cinergy provides certain health care and life insurance benefits to retired United States employees and their eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over approximately 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 13 years. Duke Energy Kentucky's Other Post-Retirement Plan pre-tax Net Periodic Benefit costs as allocated by Cinergy were as follows:

	December 31, 2007	December 31, 2006
	(in thousands)	
Other Postretirement	**$ 1,559**	$ 1,200

The fair value of Cinergy's plans assets was approximately $32 million as of December 31, 2007 and zero as of September 30, 2006. The accumulated other post-retirement benefit obligation for the plans was approximately $36 million as of December 31, 2007 and $497 million as of September 30, 2006. The accrued other post-retirement liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Balance Sheets at December 31, 2007 and 2006 was approximately $13 million and as recognized in Other Current Liabilities within the Balance Sheet at December 31, 2007 and 2006 was approximately $91 thousand and $613 thousand, respectively.

Duke Energy made other postretirement plan contributions of approximately $32 million to the legacy Cinergy other postretirement plans, of which approximately $1 million represents contribution made by Duke Energy Kentucky. No amounts

were contributed to the legacy Cinergy other postretirement plans for the nine months ended December 31, 2006 and three months ended March 31, 2006.

Regulatory assets, as allocated by Cinergy to Duke Energy Kentucky, and recognized in Regulatory Assets and Deferred Debits within the Balance Sheets was approximately $5 million and $6 million as of December 31, 2007 and 2006, respectively.

Assumptions Used in Cinergy's Other Postretirement Benefits Accounting

	2007	2006
	Percentages	
Benefit Obligations		
Discount rate	**6.00**	5.75
Net Periodic Benefit Cost		
Discount rate[a]	**5.75**	5.50-6.00
Expected long-term rate of return on plan assets	**5.53-8.50**	N/A

(a) Discount rate was 5.75% and 6.00% for the year ended December 31, 2007 and the nine months ended December 31, 2006, respectively. Discount rate was 5.50% for the three months ended March 31, 2006.

Assumed Health Care Cost Trend Rates

	Medicare Trend Rate		Prescription Drug Trend Rate	
	2007	2006	2007	2006
Health care cost trend rate assumed for next year	8.00%	8.50%	12.50%	13.00%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	4.75%	5.00%	4.75%
Year that the rate reaches the ultimate trend rate	2013	2013	2022	2022

16. Transfer of Generating Assets from Duke Energy Ohio to Duke Energy Kentucky

In January 2006, Duke Energy Ohio contributed to Duke Energy Kentucky 100 percent of its ownership interest in one generating unit and one peaking plant with a combined capacity of 727 megawatts (MWs) and its 69 percent interest in another generating station with an owned capacity of 414 MWs, as follows:

Generating Plant	Location	Ownership Interest	Fuel Type	Owned MW Capacity
East Bend	Boone County, Kentucky	69 %	Coal	414
Miami Fort	Hamilton County, Ohio	100 (1)	Coal	163
Woodsdale	Butler County, Ohio	100	Gas	564
				1,141

(1) Consists of 100 percent ownership in one generating unit at Miami Fort.

The transaction was effective as of January 1, 2006 at net book value. The final required regulatory approval for the plant transfer was received in November 2005 from the SEC under the Public Utility Holding Company Act of 1935. KPSC and the FERC had earlier issued orders approving aspects of the transaction. See Note 3 for details on Duke Energy Kentucky rate proceedings.

In connection with the transfer of these assets, Duke Energy Kentucky accepted a capital contribution from Duke Energy Ohio and assumed certain liabilities of Duke Energy Ohio. In particular, Duke Energy Kentucky agreed to assume from Duke Energy Ohio all payment, performance, and other obligations of Duke Energy Ohio, with respect to (i) certain tax-exempt pollution control debt currently shown on the balance sheet of Duke Energy Ohio, (ii) certain of Duke Energy Ohio's outstanding *Accounts payable to affiliated companies*, and (iii) certain deferred tax liabilities related to the assets. Duke Energy Kentucky has repaid the tax-exempt obligations with the proceeds from an issuance of tax-exempt debt by Duke Energy Kentucky. The accounts payable obligations were repaid initially with the proceeds from short-term borrowings and eventually through the issuance of long-term senior unsecured debentures. The following table summarizes this transaction for Duke Energy Kentucky:

		(in thousands)
Assets Received		
Generating Assets	$	375,811
Inventory		23,579
Total Assets Received	$	399,390
Liabilities Assumed		
Debt	$	76,720
Accounts payable to affiliated companies		90,280
Deferred tax liabilities		90,369
Other		1,960
Total Liabilities Assumed	$	259,329
Contributed Capital from Duke Energy Ohio	$	140,061

Duke Energy Kentucky, Inc.

Condensed Financial Statements

(Unaudited)

September 30, 2007

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS
(Unaudited)

	Year To Date September 30, 2007	Year To Date September 30, 2006
	(in thousands)	
Operating Revenues		
Electric	$ 266,537	$ 202,617
Gas	100,593	93,305
Total Operating Revenues	367,130	295,922
Operating Expenses		
Natural gas and petroleum products purchased	67,022	62,303
Operation, maintenance, and other	94,108	88,252
Fuel used in electric generation and purchased power	115,877	88,300
Depreciation and amortization	31,102	28,190
Property and other taxes	10,734	7,655
Loss (gain) on sales of other assets and other, net	50	(104)
Total Operating Expenses	318,893	274,596
Operating Income	48,237	21,326
Other Income and Expenses, net	3,402	2,807
Interest Expense	13,161	12,314
Income Before Income Taxes	38,478	11,819
Income Tax Expense	14,263	3,475
Net Income	$ 24,215	$ 8,344

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(Unaudited)

ASSETS	September 30, 2007	December 31, 2006
	(in thousands)	
Current Assets		
Cash and cash equivalents	**$ 8,228**	$ 6,593
Receivables (net of allowance for doubtful accounts of $310 at September 30, 2007 and $242 at December 31, 2006)	**28,920**	32,768
Inventory	**30,310**	29,002
Other	**29,228**	11,127
Total current assets	**96,686**	79,490
Investments and Other Assets		
Intangible assets	**8,390**	12,470
Other	**2,368**	1,541
Total investments and other assets	**10,758**	14,011
Property, Plant, and Equipment		
Cost	**1,499,046**	1,451,463
Less accumulated depreciation and amortization	**622,081**	599,625
Net property, plant, and equipment	**876,965**	851,838
Regulatory Assets and Deferred Debits		
Deferred debt expense	**5,579**	5,827
Other	**24,460**	29,167
Total regulatory assets and deferred debits	**30,039**	34,994
Total Assets	**$ 1,014,448**	$ 980,333

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(Unaudited)

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	September 30, 2007	December 31, 2006
	(in thousands)	
Current Liabilities		
Accounts payable	$ 37,648	$ 45,122
Notes payable and commercial paper	52,808	42,603
Taxes accrued	12,362	6,603
Interest accrued	2,045	2,808
Current maturities of long-term debt	21,761	1,318
Other	12,825	11,128
Total current liabilities	139,449	109,582
Long-term Debt	262,558	283,192
Deferred Credits and Other Liabilities		
Deferred income taxes	153,651	149,016
Investment tax credit	5,844	6,634
Accrued pension and other postretirement benefit costs	29,255	36,497
Regulatory liabilities	33,037	29,432
Asset retirement obligations	8,634	8,266
Other	5,084	8,366
Total deferred credits and other liabilities	235,505	238,211
Commitments and Contingencies		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at September 30, 2007 and December 31, 2006	8,780	8,780
Paid-in capital	167,494	164,344
Retained earnings	201,016	176,965
Accumulated other comprehensive loss	(354)	(741)
Total Common Stockholder's Equity	376,936	349,348
Total Liabilities and Stockholder's Equity	$ 1,014,448	$ 980,333

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **24,215**	$ 8,344
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**31,102**	28,190
Losses (gains) on sales of equity investments and other assets	**50**	(104)
Deferred income taxes	**3,920**	6,450
Regulatory asset/liability amortization	**2,972**	2,687
Contribution to company sponsored pension plan	**(9,696)**	(2,330)
Accrued pension and postretirement benefit costs	**2,870**	3,131
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**(1,075)**	965
Receivables	**9,540**	27,249
Inventory	**(1,308)**	7,434
Other current assets	**(16,800)**	4,830
Increase (decrease) in:		
Accounts payable	**(5,501)**	(29,124)
Taxes accrued	**3,536**	2,500
Other current liabilities	**2,197**	(2,143)
Regulatory asset/liability deferrals	**(7,362)**	(5,404)
Other assets	**4,824**	3,710
Other liabilities	**(2,701)**	(1,897)
Net cash provided by operating activities	**40,783**	54,488
Cash Flows from Investing Activities		
Capital expenditures	**(51,555)**	(44,646)
Purchases of emission allowances	**(342)**	(21,704)
Sale of emission allowances	**523**	4,748
Net cash used in investing activities	**(51,374)**	(61,602)
Cash Flows from Financing Activities		
Issuance of long-term debt	**-**	191,994
Redemption of long-term debt	**(1,099)**	(76,590)
Notes payable and commercial paper	**10,205**	(108,876)
Contribution from parent	**3,150**	-
Other	**(30)**	(3,740)
Net cash provided by financing activities	**12,226**	2,788
Net increase (decrease) in cash and cash equivalents	**1,635**	(4,326)
Cash and cash equivalents at beginning of period	**6,593**	9,876
Cash and cash equivalents at end of period	$ **8,228**	$ 5,550

Supplemental Disclosure of Cash Flow Information

Non-cash financing and investing activities:		
Equity contribution from parent company for acquisition of net generating assets	**-**	139,855
Allowance for funds used during construction (AFUDC) – equity component	**199**	510

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

Nature of Operations

Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp., a Delaware corporation organized in 1993.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy Corp. merged into wholly owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy or Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas LLC effective October 1, 2006). As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 2 for additional information regarding the merger. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein.

Use of Estimates

To conform to generally accepted accounting principles (GAAP) in the United States, management makes estimates and assumptions that affect the amounts reported in the Financial Statements and Notes. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Reclassifications

The financial statements for the periods prior to the merger have been reclassified to conform with Duke Energy's format. Certain other prior period amounts have been reclassified to conform to the presentation for the current period.

Unbilled Revenue

Revenues on sales of electricity and gas are recognized when the service is provided. Unbilled revenues are estimated by applying an average revenue per kilowatt hour or per 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 pattern and customer mix. Unbilled revenues, which are recorded as Receivables in Duke Energy Kentucky's Balance Sheets at September 30, 2007 and December 31, 2006 were approximately $15 million and $21 million, respectively.

2. Duke Energy/Cinergy Merger

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated (see Note 1 for additional information on the merger). For accounting purposes, the effective date of the merger was April 1, 2006. The merger combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States (Midwest).

3. 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.

	September 30, 2007	December 31, 2006
	(in thousands)	
Inventory		
Fuel for use in electric generation	$ 9,491	$ 9,074
Materials and supplies	8,945	8,940
Gas held in storage	11,874	10,988
Total Inventory	$ 30,310	$ 29,002

4. Debt and Credit Facilities

Duke Energy Kentucky receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Kentucky to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Kentucky participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. As of September 30, 2007 and December 31, 2006, Duke Energy Kentucky was in a payable position of $53 million and $43 million, respectively. The change in the money pool from December 31, 2006 to September 30, 2007 is reflected as a $11 million cash inflow in Notes payable and commercial paper within Net cash provided by financing activities on the Statement of Cash Flows.

In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling $2.65 billion with a 5-year, $2.65 billion master credit facility. Duke Energy Kentucky has a borrowing sub limit under the master credit facility of $100 million. Concurrent with the syndication of the master credit facility, Duke Energy established a new $1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

The issuance of commercial paper, letters of credit and other borrowings reduces the amount available under the credit facility.

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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of September 30, 2007, Duke Energy and Duke Energy Kentucky were in compliance with these covenants. 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.

5. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities. In addition, Cinergy sponsors non-qualified pension plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. Cinergy also provides certain health care and life insurance benefits to retired United States employees and their eligible dependents. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments.

Duke Energy's policy is to fund amounts for its U.S. retirement plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. During the nine months ended September 30, 2007, Duke Energy made qualified pension benefit contributions of $350 million to the legacy Cinergy qualified pension benefit plans, of which, approximately $9 million represents contributions made by Duke Energy Kentucky. During the nine months ended September 30, 2006, Duke Energy made qualified pension benefit contributions of approximately $124 million to the legacy Cinergy qualified pension benefit plans, of which, approximately $2 million represents contributions made by Duke Energy Kentucky. During the three and nine months ended September 30, 2007, Duke Energy contributed approximately $32 million to the legacy Cinergy other post-retirement plans, of which, approximately $1 million represents contributions by Duke Energy Kentucky. Duke Energy does not anticipate making any additional contributions to its legacy Cinergy retirement plans during the remainder of 2007.

Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands)	
Qualified Pension Benefits	$ 1,704	$ 2,219
Other Postretirement	$ 1,150	$ 912

Upon consummation of the merger with Duke Energy, all defined benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit cost to be allocated to Duke Energy Kentucky.

See Note 10 for a discussion of the effect of adoption of *SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158).*

6. Intangible Assets

The carrying amount of emission allowances were $8 million and $12 million as of September 30, 2007 and December 31, 2006 respectively. Emission allowances sold or consumed during the nine months ended September 30, 2007 and September 30, 2006 were $5 million and $10 million, respectively.

7. Regulatory Matters

Regulatory Merger Approvals

As discussed in Note 1 and Note 2, 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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 and $2 million of the rate reduction was passed through to customers during the three and nine months ended September 30, 2007, respectively. Approximately $1 million was passed through to customers during the three and nine months ended September 30, 2006, respectively.
- The FERC approved the merger without conditions.

Rate Related Information

The KPSC approves rates for retail electric and gas sales within the Commonwealth of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

Duke Energy Kentucky Electric Rate Case

In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC. The plan provided for Duke Energy Kentucky to purchase back-up power through bilateral contracts for scheduled outages. Duke Energy Kentucky will recover these costs through base rates. The plan provided for Duke Energy Kentucky to purchase back-up power through the Midwest Independent System Operator, Inc. (Midwest ISO) energy markets for unscheduled outages. Duke Energy Kentucky will recover these costs through its fuel adjustment clause. The KPSC issued an order in March 2007 approving Duke Energy Kentucky's back-up power supply plan

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 requested increase was attributable to recovery of the current cost of the accelerated 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 any tracking mechanism unless the KPSC has specific statutory authority to approve the tracking mechanism.. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the gas main replacement tracking mechanism. Duke Energy Kentucky and the KPSC have appealed these cases to the Kentucky Court of Appeals. Duke Energy Kentucky and the KPSC entered into an agreed order with the Kentucky Attorney General that allows Duke Energy Kentucky to continue utilizing other types of tracking mechanisms in its billed rates to customers pending the outcome of the appeals. At this time, Duke Energy Kentucky cannot predict the outcome of these proceedings.

FERC Issues Electric Reliability Standards.

Consistent with reliability provisions of the Energy Policy Act of 2005, on July 20, 2006, FERC issued its Final Rule certifying the North American Electric Reliability Council (NERC) as the Electric Reliability Organization. NERC has filed over 100 proposed reliability standards with FERC. On March 16, 2007, FERC issued a final rule establishing mandatory, enforceable reliability standards for the nation's bulk power system. In the final rule, FERC approved 83 of the 107 mandatory reliability standards submitted by the NERC and compliance with these standards became mandatory on June 18, 2007. FERC will consider the remaining 24 proposed standards for approval once the necessary criteria and procedures are submitted. In the interim, compliance with these 24 standards is expected to continue on a voluntary basis as good utility practice. Duke Energy Kentucky does not believe that the issuance of these standards will have a material impact on its results of operations, cash flows, or financial position.

8. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Duke Energy Kentucky

believes that completion or resolution of these matters will have no material adverse effect on its 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. Three of six coal-fired generating facilities in which Duke Energy Kentucky 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 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. Duke Energy Kentucky is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR). The EPA finalized its CAMR and CAIR in May 2005. The CAMR limits total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program. Phase 1 begins in 2010 and Phase 2 begins in 2018. The CAIR limits total annual and summertime nitrogen oxides (NO_x) emissions and annual sulfur dioxide (SO_2) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2.

Duke Energy Kentucky currently estimates that it will spend approximately $13 million between 2007 and 2011 to comply with Phase 1 of CAMR and CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Kentucky currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR and is currently unable to estimate the cost of complying with Phase 2 of CAMR.

Manufactured Gas Plant (MGP) Sites. Duke Energy Kentucky has performed site assessments on certain of its sites where MGP activities are believed to have occurred at some point in the past and have found no imminent risk to the environment. At this time, Duke Energy Kentucky cannot predict whether investigation and/or remediation will be required in the future at any of these sites.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of September 30, 2007 and December 31, 2006. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Kentucky believes that completion or resolution of these matters will have no material impact on its results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide (CO_2) 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 United States 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 United States 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Ontario, Canada Lawsuit. Duke Energy Kentucky understands that a class action lawsuit was filed in Superior Court in Ontario, Canada on July 3, 2005 against Duke Energy Ohio and approximately 20 other utility and power generation companies alleging various claims relating to environmental emissions from coal-fired power generation facilities in the United States and Canada and damages of approximately $50 billion, with continuing damages in the amount of approximately $4 billion annually. Duke Energy Ohio understands that the lawsuit also claims entitlement to punitive and exemplary damages in the amount of $1 billion. Duke Energy Ohio had not yet been served in this lawsuit by the deadline of July 3, 2007. However, if served, Duke Energy Ohio intends to defend this lawsuit vigorously in court. At this time, Duke Energy Ohio is not able to predict whether resolution of this matter would have a material effect on its financial position, cash flows or results of operations.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States 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. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their notice of appeal to the Fifth Circuit Court of Appeals. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

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

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of September 30, 2007 and December 31, 2006, Duke Energy Kentucky has recorded immaterial reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

9. Related Party Transactions

Duke Energy Kentucky engages in related party transactions. These transactions 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 Balance Sheets as of September 30, 2007 and December 31, 2006 are as follows:

	September 30, 2007	December 31, 2006
	(in thousands)	
Accounts Receivable	$ 250	$ 4,825
Accounts Payable	$ 25,394	$ 20,303

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. 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.

The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations for the nine months ended September 30, 2007 and September 30, 2006 were as follows:

	September 30,	
	2007	2006
	(in thousands)	
Corporate Governance and shared service expenses	$ 35,628	$ 40,137

See Note 5 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and health care and postretirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $30 million at September 30, 2007 and approximately $37 million at December 31, 2006. The amounts have been classified on the Balance Sheets as follows:

	September 30, 2007	December 31, 2006
	(in thousands)	
Other Current Liabilities	$ 948	$ 948
Accrued pension and other postretirement benefit costs	$29,255	$36,497

Additionally, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables Company, LLC (Cinergy Receivables), an unconsolidated entity formed by Cinergy. 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 by Duke Energy Kentucky as Receivables in the Balance Sheets and was approximately $16 million and $20 million as of September 30, 2007 and December 31, 2006, respectively.

During the second quarter of 2007, Duke Energy Kentucky received a $3 million capital contribution from its parent, Cinergy.

Duke Energy Kentucky participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of September 30, 2007 and December 31, 2006, Duke Energy Kentucky was in a payable position of $53 million and $43 million, respectively, classified within Notes payable and commercial paper in the accompanying Balance Sheets. See Note 4 for further discussion of the money pool arrangement.

10. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Kentucky subsequent to September 30, 2006 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke Energy Kentucky for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that have been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140. SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 was effective for Duke Energy Kentucky as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Kentucky recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately $22 million (consisting solely of an increase in regulatory assets of $22 million) and an increase in total liabilities of approximately $22 million as of December 31, 2006. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Kentucky's results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Kentucky has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Kentucky adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. In the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of accumulated other comprehensive income (loss) (AOCI) and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Kentucky completed these calculations. The finalization of these actuarial calculations resulted in an immaterial adjustment to AOCI and regulatory assets.

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). In September 2006, the SEC issued SAB No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Traditionally, there have been two widely-recognized approaches for quantifying the effects of financial statement misstatements. The income statement approach focuses primarily on the impact of a misstatement on the income statement—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The balance sheet approach, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (a "dual approach") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material.

SAB No. 108 was effective for Duke Energy Kentucky's year ending December 31, 2006. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii), under certain circumstances, recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Duke Energy Kentucky has historically used a dual approach for quantifying identified financial statement misstatements. Therefore, the adoption of SAB No. 108 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

FASB Interpretation No (FIN) 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" (FIN 48). In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Kentucky has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Kentucky's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Kentucky adopted FIN 48 effective January 1, 2007. See Note 11 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No. FIN 48-1) In May, 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Kentucky's adoption of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

FSP No. AUG AIR-1, "Accounting for Planned Major Maintenance Activities," (FSP No. AUG AIR-1). In September 2006, the FASB Staff issued FSP No. AUG AIR-1. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods, if no liability is required to be recorded for an asset retirement obligation based on a legal obligation for which the event obligating the entity has occurred. The FSP also requires disclosures regarding the method of accounting for planned major maintenance activities and the effects of implementing the FSP. The guidance in this FSP was effective for Duke Energy Kentucky as of January 1, 2007. The adoption of FSP No. AUG AIR-1 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

Emerging Issues Task Force (EITF) Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" (EITF No. 06-3). In June 2006, the EITF reached a consensus on EITF No. 06-3 to address any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales, use, value added, and some excise taxes. For taxes within the issue's scope, the consensus requires that entities present such taxes on either a gross (i.e., included in revenues and costs) or net (i.e., exclude from revenues) basis according to their accounting policies, which should be disclosed. If such taxes are reported gross and are significant, entities should disclose the amounts of those taxes. Disclosures may be made on an aggregate basis. The consensus was effective for Duke Energy Kentucky beginning January 1, 2007. The adoption of EITF No. 06-3 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4" (EITF No. 06-5). In June 2006, the EITF reached a consensus on the accounting for corporate-owned and bank-owned life insurance policies. EITF No. 06-5 requires that a policyholder consider the cash surrender value and any additional amounts to be received under the contractual terms of the policy in determining the amount that could be realized under the insurance contract. Amounts that are recoverable by the policyholder at the discretion of the insurance company must be excluded from the amount that could be realized. Fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy must be recognized at their present value. EITF No. 06-5 was effective for Duke Energy Kentucky as of January 1, 2007 and must be applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings or other components of equity as of January 1, 2007. The adoption of EITF No. 06-5 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Kentucky as of September 30, 2007:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, in some cases, the application of SFAS No. 157 may change Duke Energy Kentucky's current practice for measuring and disclosing fair values under other accounting pronouncements that require or permit fair value measurements. For Duke Energy Kentucky, SFAS No. 157 is effective as of January 1, 2008 and must be applied prospectively except in certain cases. Duke Energy Kentucky is currently evaluating the impact of adopting SFAS No. 157, and cannot currently estimate the impact of SFAS No. 157 on its results of operations, cash flows or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Kentucky, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky cannot currently estimate the impact of SFAS No. 159 on its results of operations, cash flows or financial position and has not yet determined whether or not it will choose to measure items subject to SFAS No. 159 at fair value.

11. Income Taxes

Prior to the merger of Cinergy and Duke Energy on April 3, 2006, the taxable income of Duke Energy Kentucky was reflected in Cinergy's U.S. federal and state income tax returns. After the merger, the taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. As a result of Duke Energy's merger with Cinergy, Duke Energy Kentucky entered into 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 Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Kentucky has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Kentucky and Cinergy prior to the merger.

On January 1, 2007, Duke Energy Kentucky adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes— an interpretation of FASB Statement No. 109" (FIN 48).

As a result of the adoption of FIN 48, Duke Energy Kentucky had no cumulative effect adjustment to retained earnings, which reflects all adoption provisions of FIN 48, including those provisions related to unrecognized income tax benefits net of gain contingencies, and interest expense and penalties.

The following table shows the accounting for the adoption of FIN 48 on January 1, 2007 and the increase/(decrease) in Duke Energy Kentucky's unrecognized tax benefits from January 1, 2007 to September 30, 2007.

	January 1, 2007	Changes in Balances	September 30, 2007
		(in thousands)	
Unrecognized Tax Benefits (a)	$ 420	$ (168)	$ 252
Interest Payable/(Receivable) (b)	$ (623)	$ 264	$ (359)

(a) Decrease in the liability primarily related to a settlement.
(b) Reflects all interest related to income taxes. The change was primarily a decrease to pre-tax income of $148 thousand and $264 thousand for the three and nine months ended September 30, 2007

It is reasonably possible that the total unrecognized tax benefits balance will be settled in the next twelve months.

Duke Energy Kentucky 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

Effective with the adoption of FIN 48, Duke Energy Kentucky records, as it relates to taxes, interest expense as Interest Expense, and interest income and penalties in Other Income and Expenses, net in the Statements of Operations.

The $4 million increase in income tax expense from continuing operations for the comparative three-month periods ended September 30, 2007 and 2006 is primarily due to the $11 million increase in income from continuing operations before income taxes.

12. Subsequent Events

For information on subsequent events related to debt and credit facilities, regulatory matters and commitments and contingencies, see Notes 4, 7 and 8, respectively.

Duke Energy Kentucky, Inc.

Condensed Financial Statements

(Unaudited)

June 30, 2007

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS

	Year To Date June 30, 2007	Year To Date June 30, 2006
	(in thousands)	
Operating Revenues		
Electric	**$ 162,619**	$ 129,786
Gas	**88,312**	79,391
Total Operating Revenues	**250,931**	209,177
Operating Expenses		
Natural gas and petroleum products purchased	**61,241**	55,635
Operation, maintenance, and other	**63,463**	59,465
Fuel used in electric generation and purchased power	**66,969**	53,337
Depreciation and amortization	**18,988**	18,637
Property and other taxes	**6,847**	4,925
Loss on sales of other assets and other, net	**50**	-
Total Operating Expenses	**217,558**	191,999
Operating Income	**33,373**	17,178
Other Income and Expenses, net	**2,363**	2,097
Interest Expense	**8,611**	7,854
Income Before Income Taxes	**27,125**	11,421
Income Tax Expense	**10,514**	3,510
Net Income	**$ 16,611**	$ 7,911

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

ASSETS	June 30, 2007	December 31, 2006
	(in thousands)	
Current Assets		
Cash and cash equivalents	**$ 6,151**	$ 6,593
Receivables (net of allowance for doubtful accounts of $303 at June 30, 2007 and $242 at December 31, 2006)	**31,804**	32,768
Inventory	**27,319**	29,002
Other	**33,145**	11,127
Total current assets	**98,419**	79,490
Investments and Other Assets		
Intangible assets	**10,228**	12,470
Other	**1,980**	1,541
Total investments and other assets	**12,208**	14,011
Property, Plant, and Equipment		
Cost	**1,479,947**	1,451,463
Less accumulated depreciation and amortization	**615,332**	599,625
Net property, plant, and equipment	**864,615**	851,838
Regulatory Assets and Deferred Debits		
Deferred debt expense	**5,648**	5,827
Other	**25,670**	29,167
Total regulatory assets and deferred debits	**31,318**	34,994
Total Assets	**$ 1,006,560**	$ 980,333

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	June 30, 2007	December 31, 2006
	(in thousands)	
Current Liabilities		
Accounts payable	**$ 54,228**	$ 45,122
Notes payable and commercial paper	**37,426**	42,603
Taxes accrued	**15,241**	6,603
Interest accrued	**3,118**	2,808
Current maturities of long-term debt	**21,541**	1,318
Other	**9,888**	11,128
Total current liabilities	**141,442**	109,582
Long-term Debt	**262,275**	283,192
Deferred Credits and Other Liabilities		
Deferred income taxes	**152,216**	149,016
Investment tax credit	**6,107**	6,634
Accrued pension and other postretirement benefit costs	**29,749**	36,497
Regulatory liabilities	**32,343**	29,432
Asset retirement obligations	**8,509**	8,266
Other	**4,077**	8,366
Total deferred credits and other liabilities	**233,001**	238,211
Commitments and Contingencies		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at June 30, 2007 and December 31, 2006	**8,780**	8,780
Paid-in capital	**167,494**	164,344
Retained earnings	**193,412**	176,965
Accumulated other comprehensive income (loss)	**156**	(741)
Total Common Stockholder's Equity	**369,842**	349,348
Total Liabilities and Stockholder's Equity	**$ 1,006,560**	$ 980,333

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ **16,611**	$ 7,911
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**18,988**	18,637
Losses on sales of equity investments and other assets	**50**	-
Deferred income taxes	**1,332**	2,576
Regulatory asset/liability amortization	**3,523**	2,131
Contribution to company sponsored pension plan	**(8,793)**	-
Accrued pension and postretirement benefit costs	**1,996**	2,048
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	**(1,907)**	319
Receivables	**10,969**	27,800
Inventory	**1,683**	7,353
Other current assets	**(21,435)**	4,169
Increase (decrease) in:		
Accounts payable	**8,972**	(23,221)
Taxes accrued	**6,415**	4,236
Other current liabilities	**721**	(90)
Regulatory asset/liability deferrals	**(9,236)**	(3,979)
Other assets	**2,310**	909
Other liabilities	**867**	267
Net cash provided by operating activities	**33,066**	51,066
Cash Flows from Investing Activities		
Capital expenditures	**(30,900)**	(30,666)
Purchases of emission allowances	**(342)**	(13,902)
Sale of emission allowances	**523**	3,312
Net cash used in investing activities	**(30,719)**	(41,256)
Cash Flows from Financing Activities		
Issuance of long-term debt	**-**	114,602
Redemption of long-term debt	**(732)**	(15,591)
Notes payable and commercial paper	**(5,177)**	(110,553)
Contribution from parent	**3,150**	-
Other	**(30)**	(1,690)
Net cash used in financing activities	**(2,789)**	(13,232)
Net decrease in cash and cash equivalents	**(442)**	(3,422)
Cash and cash equivalents at beginning of period	**6,593**	9,876
Cash and cash equivalents at end of period	**$ 6,151**	$ 6,454

Supplemental Disclosure of Cash Flow Information

	2007	2006
Non-cash financing and investing activities:		
Equity contribution from parent company for acquisition of net generating assets	**-**	139,855
Allowance for funds used during construction (AFUDC) – equity component	**162**	369

See Notes to Unaudited Financial Statements

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

Nature of Operations

Duke Energy Kentucky, a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp., a Delaware corporation organized in 1993.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy Corp. merged into wholly owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transaction, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy or Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas LLC effective October 1, 2006). As a result of the merger transaction, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, and each share of common stock of Old Duke Energy was converted into one share of Duke Energy common stock, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 2 for additional information regarding the merger. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein.

Use of Estimates

To conform to generally accepted accounting principles (GAAP) in the United States, management makes estimates and assumptions that affect the amounts reported in the Financial Statements and Notes. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Reclassifications

The financial statements for the periods prior to the merger have been reclassified to conform with Duke Energy's format. Certain other prior period amounts have been reclassified to conform to current year presentation.

2. Duke Energy/Cinergy Merger

On April 3, 2006, the merger between Duke Energy and Cinergy was consummated (see Note 1 for additional information on the merger). For accounting purposes, the effective date of the merger was April 1, 2006. The merger combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States (Midwest).

3. 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 at the lower of cost or market value using the average cost method.

	June 30, 2007	December 31, 2006
	(in thousands)	
Inventory		
Fuel for use in electric generation	$ 9,477	$ 9,074
Materials and supplies	9,073	8,940
Gas stored for current use	8,769	10,988
Total Inventory	$ 27,319	$ 29,002

4. Debt and Credit Facilities

Duke Energy Kentucky receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Kentucky to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Kentucky participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. As of June 30, 2007 and December 31, 2006, Duke Energy Kentucky was in a payable position of $37.4 million and $42.6 million, respectively. The change in the money pool from December 31, 2006 to June 30, 2007 is reflected as a $5.2 million cash outflow in Notes payable and commercial paper within Net cash used in financing activities on the Statement of Cash Flows.

In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling $2.65 billion with a 5-year, $2.65 billion master credit facility. Duke Energy Kentucky has a borrowing sub limit under the master credit facility of $100 million. Concurrent with the syndication of the master credit facility, Duke Energy established a new $1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

The issuance of commercial paper, letters of credit and other borrowings reduces the amount available under the credit facility.

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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of June 30, 2007, Duke Energy and Duke Energy Kentucky were in compliance with these covenants. 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.

5. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities. In addition, Cinergy sponsors non-qualified pension plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. Cinergy also provides certain health care and life insurance benefits to retired United States employees and their eligible dependents. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments.

During the six months ended June 30, 2007, Duke Energy made qualified pension benefit contributions of $350 million to the legacy Cinergy qualified pension benefit plans, of which, approximately $9 million represents contributions made by Duke Energy Kentucky. There were no qualified pension benefit contributions for the six months ended June 30, 2006. Duke Energy does not anticipate making any additional contributions to its legacy Cinergy qualified pension benefit plans during the remainder of 2007.

Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
	(in thousands)	
Qualified Pension Benefits	$ 1,305	$ 1,467
Other Postretirement	$ 691	$ 581

Upon consummation of the merger with Duke Energy, all defined benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit cost to be allocated to Duke Energy Kentucky.

See Note 10 for a discussion of the effect of adoption of *SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158).*

6. Intangible Assets

The carrying amount of emission allowances was $10 million and $12 million as June 30, 2007 and December 31, 2006 respectively. Emission allowances of $4 million were sold or consumed during both the six months ended June 30, 2007 and 2006.

7. Regulatory Matters

Regulatory Merger Approvals

As discussed in Note1 and Note 2, 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 Kentucky Public Service Commission (KPSC) required that certain merger related savings be shared with consumers in Kentucky. The commission also required Duke Energy Kentucky to meet additional conditions. Key elements of these conditions include:

- 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. Less than $1 million of the rate reduction was passed through to customers during the six months ended June 30, 2007. During the six months ended June 30, 2006, $1 million was returned to customers on this rate credit.

The KPSC approves rates for retail electric and gas sales within the state of Kentucky. The FERC approves rates for electric sales to wholesale customers served under cost-based rates. The FERC approved the merger without conditions.

Duke Energy Kentucky Electric Rate Case

In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC. The plan provided for Duke Energy Kentucky to purchase back-up power through bilateral contracts for scheduled outages. Duke Energy Kentucky will recover these costs through base rates. The plan provided for Duke Energy Kentucky to purchase back-up power through the Midwest Independent System Operator, Inc. (Midwest ISO) energy markets for unscheduled outages. Duke Energy Kentucky will recover these costs through its fuel adjustment clause. The KPSC issued an order in March 2007 approving Duke Energy Kentucky's back-up power supply plan.

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 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 tracking mechanisms other than in the context of a general base rate review. This could result in customers owing Duke Energy Kentucky certain credits that were provided and Duke Energy Kentucky reimbursing revenue collected under such trackers, approximately $9 million in annual rate adjustments under the gain main replacement tracking mechanism. Duke Energy Kentucky has appealed these cases to the Kentucky Court of Appeals. At this time, Duke Energy Kentucky cannot predict the outcome of this litigation.

FERC To Issue Electric Reliability Standards.

Consistent with reliability provisions of the Energy Policy Act of 2005, on July 20, 2006, FERC issued its Final Rule certifying North American Electric Reliability Corporation (NERC) as the Electric Reliability Organization. NERC has filed over 100 proposed reliability standards with FERC. On March 16, 2007, FERC issued a final rule establishing mandatory, enforceable reliability standards for the nation's bulk power system. In the final rule, FERC approved 83 of the 107 mandatory reliability standards submitted by the NERC. FERC will consider the remaining 24 proposed standards for approval once the necessary criteria and procedures are submitted. In the interim, compliance with these 24 standards is expected to continue on a voluntary basis as good utility practice. Duke Energy Kentucky does not believe that the issuance of these standards will have a material impact on its results of operations, cash flows, or financial position.

8. Commitments and Contingencies

Environmental

Duke Energy Kentucky 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 Duke Energy Kentucky.

Remediation activities. Like others in the energy industry, Duke Energy Kentucky and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky 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, Duke Energy Kentucky or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky 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. Management believes that completion or resolution of these matters will have no material adverse effect on Duke Energy Kentucky's results of operations, cash flows or financial position.

Clean Water Act. The U.S. Environmental Protection Agency's (EPA's) final Clean Water Act Section 316(b) rule became effective July 9, 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. Three of six coal-fired generating facilities in which Duke Energy Kentucky 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 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. Although Duke Energy Kentucky is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR). The EPA finalized its CAMR and CAIR in May 2005. The CAMR limits total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program. Phase 1 begins in 2010 and Phase 2 begins in 2018. The CAIR limits total annual and summertime nitrogen oxides (NOx) emissions and annual sulfur dioxide (SO2) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NOx and in 2010 for SO2. Phase 2 begins in 2015 for both NOx and SO2.

Duke Energy Kentucky currently estimates that it will spend approximately $13 million between 2007 and 2011 to comply with Phase 1 of CAMR and CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Kentucky currently estimates that any additional costs it might incur to comply with Phase 1 of CAMR or CAIR above the $13 million will have no material adverse effect on its results of operations, cash flows or financial position. Duke Energy Kentucky currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR and is currently unable to estimate the cost of complying with Phase 2 of CAMR.

Extended Environmental Activities, Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of June 30, 2007 and December 31, 2006. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management believes that completion or resolution of these matters will have no material adverse effect on Duke Energy Kentucky's results of operations, cash flows or financial position.

Litigation

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 Kentucky, 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.

Carbon Dioxide 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 United States 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 United States 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 carbon dioxide (CO2) from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to à 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006.

It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Ontario, Canada Lawsuit. Duke Energy Kentucky understands that a class action lawsuit was filed in Superior Court in Ontario, Canada against Duke Energy Ohio and approximately 20 other utility and power generation companies alleging various claims relating to environmental emissions from coal-fired power generation facilities in the United States and Canada and damages of approximately $50 billion, with continuing damages in the amount of approximately $4 billion annually. Duke Energy Ohio understands that the lawsuit also claims entitlement to punitive and exemplary damages in the amount of $1 billion. Duke Energy Ohio has not yet been served in this lawsuit; however, if served, Duke Energy Ohio intends to defend this lawsuit vigorously in court. At this time, Duke Energy Ohio is not able to predict whether resolution of this matter would have a material effect on its financial position, cash flows or results of operations.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States 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. In October 2006, Cinergy was served with this lawsuit and subsequently filed a motion to dismiss. Prior to a ruling on that motion, in December 2006 plaintiffs filed a motion for leave to file a fourth amended complaint to set forth additional claims, add additional parties and to substitute proper parties for improperly named defendants. Specifically, plaintiffs seek to replace holding companies, such as Cinergy, with their operating company subsidiaries, such as Duke Energy Kentucky. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Other Litigation and Legal Proceedings. Duke Energy Kentucky is involved in other legal, tax and regulatory proceedings arising in the ordinary course of business, some of which involve substantial amounts. Management believes that the final disposition of these proceedings will not have a material adverse effect on Duke Energy Kentucky's results of operations, cash flows or financial position.

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of June 30, 2007, Duke Energy Kentucky has recorded immaterial reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

9. Related Party Transactions

Duke Energy Kentucky engages in related party transactions. These transactions 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 Balance Sheets as of June 30, 2007 and December 31, 2006 are as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Accounts Receivable	$ 584	$ 4,825
Accounts Payable	$ 29,898	$ 20,303

Duke Energy Kentucky is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. 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.

The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations for the six months ended June 30, 2007 and six months ended June 30, 2006 were as follows:

	June 30,	
	2007	2006
	(in thousands)	
Corporate Governance and shared service expenses	$ 22,566	$ 27,518

See Note 5 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $31 million at June 30, 2007 and approximately $37 million at December 31, 2006. The above amounts have been classified on the Balance Sheets as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Other Current Liabilities	$ 948	$ 948
Accrued pension and other postretirement benefit costs	$29,749	$36,497

Additionally, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables Company, LLC (Cinergy Receivables), an unconsolidated entity formed by Cinergy. 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 by Duke Energy Kentucky as Receivables in the Balance Sheets and was approximately $13 million and $20 million as of June 30, 2007 and December 31, 2006, respectively.

During the second quarter of 2007 Duke Energy Kentucky received a $3 million capital contribution from its parent, Duke Energy.

Duke Energy Kentucky participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of June 30, 2007 and December 31, 2006, Duke Energy Kentucky was in a payable position of $37.4 million and $42.6

million, respectively, classified within Notes payable and commercial paper in the accompanying Balance Sheets. See Note 4 for further discussion of the money pool arrangement.

10. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Kentucky subsequent to June 30, 2006 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

FSP No. FIN 46(R)-6, "Determining the Variability to Be Considered In Applying FASB Interpretation No. 46(R) (FSP No. FIN 46(R)-6)." In April 2006, the FASB staff issued FSP No. FIN 46(R)-6 to address how to determine the variability to be considered in applying FIN 46(R), "Consolidation of Variable Interest Entities." The variability that is considered in applying FIN 46(R) affects the determination of whether the entity is a variable interest entity (VIE), which interests are variable interests in the entity, and which party, if any, is the primary beneficiary of the VIE. The variability affects the calculation of expected losses and expected residual returns. This guidance was effective for all entities with which Duke Energy Kentucky first becomes involved or existing entities for which a reconsideration event occurs after July 1, 2006. The adoption of FSP No. FIN 46(R)-6 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 is effective for Duke Energy Kentucky for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that have been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 is effective for Duke Energy Kentucky as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of OCI, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Kentucky recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. Retrospective application was not permitted. The adoption of SFAS No. 158's funded status requirements resulted in an increase in total assets of approximately $22 million (consisting solely of an increase in regulatory assets of $22 million) and an increase in total liabilities of approximately $22 million as of December 31, 2006. The adoption of SFAS No. 158 did not have any material impact on Duke Energy Kentucky's results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Kentucky has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Kentucky adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately $416 thousand for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost is required to be recognized, net of tax, as a separate adjustment of the opening balance of accumulated other comprehensive income (AOCI) and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Kentucky completed these calculations. The finalization of these actuarial calculations resulted in an immaterial adjustment to AOCI and regulatory assets.

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). In September 2006 the SEC issued SAB No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Traditionally, there have been two widely-recognized approaches for quantifying the effects of financial statement misstatements. The income statement approach focuses primarily on the impact of a misstatement on the income statement—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The balance sheet approach, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (a "dual approach") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material.

SAB No. 108 was effective for Duke Energy Kentucky's year ending December 31, 2006. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii), under certain circumstances, recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Duke Energy Kentucky has historically used a dual approach for quantifying identified financial statement misstatements. Therefore, the adoption of SAB No. 108 did not have any material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

FASB Interpretation No (FIN) 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" (FIN 48). In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Kentucky has concluded there is a level of uncertainty with respect to the recognition in Duke Energy Kentucky's financial statements. FIN 48 prescribes a minimum recognition

threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Kentucky implemented FIN 48 effective January 1, 2007. The implementation resulted in no cumulative effect adjustment to retained earnings. Entries impacted Deferred income taxes and Other Liabilities. Upon implementation of FIN 48, Duke Energy Kentucky reflects interest expense related to taxes as Interest Expense in the Statements of Operations. In addition, subsequent accounting for FIN 48 (after January 1, 2007) involves an evaluation to determine if any changes have occurred that would impact the existing uncertain tax positions as well as determining whether any new tax positions are uncertain. Any impacts resulting from the evaluation of existing uncertain tax positions or from the recognition of new uncertain tax positions impacts income tax expense and interest expense in the Statement of Operations, with offsetting impacts to the balance sheet line items described above and Taxes accrued. See Note 11 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No. FIN 48-1) In May, 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Kentucky's implementation of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

FSP No. AUG AIR-1, "Accounting for Planned Major Maintenance Activities," (FSP No. AUG AIR-1). In September 2006, the FASB Staff issued FSP No. AUG AIR-1. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods, if no liability is required to be recorded for an asset retirement obligation based on a legal obligation for which the event obligating the entity has occurred. The FSP also requires disclosures regarding the method of accounting for planned major maintenance activities and the effects of implementing the FSP. The guidance in this FSP was effective for Duke Energy Kentucky as of January 1, 2007 and is required to be applied retrospectively for all financial statements presented. The adoption of FSP No. AUG AIR-1 did not have any material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

E*merging Issues Task Force (EITF) Issue No. 06-3*, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" (EITF No. 06-3). In June 2006, the EITF reached a consensus on EITF No. 06-3 to address any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales, use, value added, and some excise taxes. For taxes within the issue's scope, the consensus requires that entities present such taxes on either a gross (i.e., included in revenues and costs) or net (i.e., exclude from revenues) basis according to their accounting policies, which should be disclosed. If such taxes are reported gross and are significant, entities should disclose the amounts of those taxes. Disclosures may be made on an aggregate basis. The consensus was effective for Duke Energy Kentucky beginning January 1, 2007. The adoption of EITF No. 06-3 did not have any material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4" (EITF No. 06-5). In June 2006, the EITF reached a consensus on the accounting for corporate-owned and bank-owned life insurance policies. EITF No. 06-5 requires that a policyholder consider the cash surrender value and any additional amounts to be received under the contractual terms of the policy in determining the amount that could be realized under the insurance contract. Amounts that are recoverable by the policyholder at the discretion of the insurance company must be excluded from the amount that could be realized. Fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy must be recognized at their present value. EITF No. 06-5 was effective for Duke Energy Kentucky as of January 1, 2007 and must be applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings or other components of equity as of January 1, 2007. The adoption of EITF No. 06-5 did not have any material impact on Duke Energy Kentucky's results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Kentucky as June 30, 2007:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. However, in some cases, the application of SFAS No. 157 may change Duke Energy Kentucky's current practice for measuring and disclosing fair values under other accounting pronouncements that require or permit fair value measurements. For Duke Energy, SFAS No. 157 is effective as of January 1, 2008 and must be applied prospectively except in certain cases. Duke Energy Kentucky is currently evaluating the impact of adopting SFAS No. 157, and cannot currently estimate the impact of SFAS No. 157 on its results of operations, cash flows or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Kentucky, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky cannot currently estimate the impact of SFAS No. 159 on its results of operations, cash flows or financial position and has not yet determined whether or not it will choose to measure items subject to SFAS No. 159 at fair value.

11. Income Taxes

Prior to the merger of Cinergy and Duke Energy on April 3, 2006, the taxable income of Duke Energy Kentucky was reflected in Cinergy's U.S. federal and state income tax returns. After the merger, the taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. As a result of Duke Energy's merger with Cinergy, Duke Energy Kentucky entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses or benefits to the subsidiaries whose investments or results of operations provide these tax expenses or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Kentucky has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Kentucky and Cinergy prior to the merger.

On January 1, 2007, Duke Energy Kentucky adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes— an interpretation of FASB Statement No. 109" (FIN 48).

As a result of the adoption of FIN 48, Duke Energy Kentucky had no cumulative effect adjustment to retained earnings, which reflects all adoption provisions of FIN 48, including those provisions related to unrecognized income tax benefits net of gain contingencies, and interest expense and penalties.

The following table shows the accounting for the adoption of FIN 48 on January 1, 2007 and the increase/(decrease) in Duke Energy Kentucky's unrecognized tax benefits from January 1, 2007 to June 30, 2007.

	January 1, 2007	Changes in Balances	June 30, 2007
	(in thousands)		
Unrecognized Tax Benefits (a)	$ 420	$ (168)	**$ 252**
Interest Payable/(Receivable) (b)	$ (623)	$ 116	**$ (507)**

(a) Decrease in the liability primarily related to a settlement.
(b) Reflects all interest related to income taxes. The change was primarily a decrease to pre-tax income for the three and six months ended June 30, 2007.

It is reasonably possible that the total unrecognized tax benefits balance will be settled in the next twelve months.

Duke Energy Kentucky 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

Effective with the adoption of FIN 48, Duke Energy Kentucky records, as it relates to taxes, interest expense as Interest Expense, and interest income and penalties in Other Income and Expenses, net in the Statements of Operations.

The $7 million increase in income tax expense for the comparative periods June 30, 2007 and 2006 is primarily due to $16 million increase in pre-tax income for the comparative period.

12. Subsequent Events

For information on subsequent events relating to regulatory matters and commitments and contingencies, see Notes 7 and 8, respectively.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008 or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_________ to _________

Commission file number 1-1232

DUKE ENERGY OHIO, INC.

(Exact name of registrant as specified in its charter)

Ohio	31-0240030
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
139 East Fourth Street, Cincinnati, Ohio	45202
(Address of principal executive offices)	(Zip Code)

704-594-6200
(Registrant's telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☒ (Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes ☐ No ☒

The registrant meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K and is therefore filing this Form 10-K with the reduced disclosure format. Part II Items 4 and 6 and Part III Items 10, 11, 12 and 13 have been omitted in accordance with Instruction (I)(2)(a) and (c).

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853), which files reports and proxy material pursuant to the Securities Exchange Act of 1934, as amended.

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DUKE ENERGY OHIO, INC.
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2008

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, droughts and tornados;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

Item 1. Business.

GENERAL

Overview. Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania through Duke Energy Ohio's Commercial Power business segment operations, which are discussed further below. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity, as well as the sale of and/or transportation of natural gas in northern Kentucky. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky.

In the second quarter of 2006, Duke Energy and Cinergy consummated a merger which combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States (U.S.).

Business Segments. At December 31, 2008, Duke Energy Ohio operated two business segments, both of which are considered reportable segments under the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 131, "*Disclosures about Segments of an Enterprise and Related Information*": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. For additional information on each of these business segments, including financial information about each reportable business segment, see Note 2 to the Consolidated Financial Statements, "Business Segments."

The following is a brief description of the nature of operations of each of Duke Energy Ohio's reportable business segments, as well as Other.

Franchised Electric and Gas. Franchised Electric and Gas consists of Duke Energy Ohio's regulated electric and gas transmission and distribution systems, including its regulated electric generation in Kentucky. Franchised Electric and Gas plans, constructs, operates and maintains Duke Energy Ohio's transmission and distribution systems, which generate, transmit and distribute electric energy to consumers in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. These electric and gas operations are subject to the rules and regulations of the Federal Energy Regulatory Commission (FERC), the Public Utilities Commission of Ohio (PUCO) and the Kentucky Public Service Commission (KPSC). Substantially all of Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*" (SFAS No. 71).

Franchised Electric and Gas' service area covers about 3,000 square miles with an estimated population of 2.1 million in southern Ohio and northern Kentucky. Franchised Electric and Gas supplies electric service to approximately 820,000 residential, commercial and industrial customers over approximately 19,500 miles of distribution lines and an approximate 2,500-mile transmission system in Ohio and Kentucky. Franchised Electric and Gas provides regulated transmission and distribution services for natural gas to approximately 500,000 customers via approximately 7,100 miles of gas mains (gas distribution lines that serve as a common source of supply for more than one service line) and service lines. See Item 2. "Properties" for further discussion of Franchised Electric and Gas' generating facilities.

Commercial Power. Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net megawatts (MW) and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle (CC) and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. See Item 2. "Properties" for further discussion of Commercial Power's generating facilities. Most of the generation asset output in Ohio has been contracted through the Rate Stabilization Plan (RSP), which expired on December 31, 2008. Effective January 1, 2009, Commercial Power began operating under an Electric Security Plan (ESP), which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 4, "Summary of Significant Accounting Policies," and "Regulatory Matters," to the Consolidated Financial Statements, respectively, for a discussion of the reapplication of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

Other. The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other for Duke Energy Ohio includes certain allocated governance costs.

General. Duke Energy Ohio is an Ohio corporation. Duke Energy Ohio's principal executive offices are located at 139 East Fourth Street, Cincinnati, Ohio 45202. The telephone number is 704-594-6200. Duke Energy Ohio electronically files reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports. The public may read and copy any materials that Duke Energy Ohio files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at *http://www.sec.gov*. Additionally, information about Duke Energy Ohio, including its reports filed with the SEC, is available through Duke Energy's web site at *http://www.duke-energy.com*. Such reports are accessible at no charge through Duke Energy's web site and are made available as soon as reasonably practicable after such material is filed with or furnished to the SEC.

GLOSSARY OF TERMS

The following terms or acronyms used in this Form 10-K are defined below:

Term or Acronym	Definition
AAC	Annually Adjusted Component
AFUDC	Allowance for Funds Used During Construction
APB	Accounting Principles Board
CC	Combined Cycle
Cinergy	Cinergy Corp. (collectively with its subsidiaries)
CO_2	Carbon dioxide
CT	Combustion Turbine
DOE	Department of Energy
DOJ	Department of Justice
Duke Energy	Duke Energy Corporation (collectively with its subsidiaries)
Duke Energy Kentucky	Duke Energy Kentucky, Inc.
Duke Energy Ohio	Duke Energy Ohio, Inc.
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
ESP	Electric Security Plan
EWG	Exempt Wholesale Generator
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FIN	Financial Accounting Standards Board Interpretation
FPP	Fuel and Purchased Power
FSP	Financial Accounting Standards Board Staff Position
FTC	United States Federal Trade Commission
GAAP	United States Generally Accepted Accounting Principles
KPSC	Kentucky Public Service Commission
LIBOR	London Interbank Offered Rate
Midwest ISO	Midwest Independent Transmission System Operator
MMBtu	Million British thermal units
MW	Megawatt

Term or Acronym	Definition
NO_x	Nitrogen oxide
OCC	Office of the Ohio Consumers' Counsel
PUCO	Public Utilities Commission of Ohio
RSP	Rate Stabilization Plan
RTC	Regulatory Transition Charges
SAB	Securities and Exchange Commission Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SO_2	Sulfur dioxide

ENVIRONMENTAL MATTERS

Duke Energy Ohio is subject to federal, state and local laws and regulations with regard to air and water quality, hazardous and solid waste disposal and other environmental matters. Environmental laws and regulations affecting Duke Energy Ohio include, but are not limited to:

- The Clean Air Act, as well as state laws and regulations impacting air emissions, including State Implementation Plans related to existing and new national ambient air quality standards for ozone and particulate matter. Owners and/or operators of air emission sources are responsible for obtaining permits and for annual compliance and reporting.
- The Clean Water Act which requires permits for facilities that discharge wastewaters into the environment.
- The Comprehensive Environmental Response, Compensation and Liability Act, which can require any individual or entity that currently owns or in the past may have owned or operated a disposal site, as well as transporters or generators of hazardous substances sent to a disposal site, to share in remediation costs.
- The Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act, which requires certain solid wastes, including hazardous wastes, to be managed pursuant to a comprehensive regulatory regime.
- The National Environmental Policy Act, which requires federal agencies to consider potential environmental impacts in their decisions, including siting approvals.

(For more information on environmental matters involving Duke Energy Ohio, including possible liability and capital costs, see Notes 4 and 18 to the Consolidated Financial Statements, "Regulatory Matters," and "Commitments and Contingencies," respectively.)

Except to the extent discussed in Note 4 to the Consolidated Financial Statements, "Regulatory Matters," and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies," compliance with current federal, state and local provisions regulating the discharge of materials into the environment, or otherwise protecting the environment, is incorporated into the routine cost structure of our various business segments and is not expected to have a material adverse effect on the competitive position, consolidated results of operations, cash flows or financial position of Duke Energy Ohio.

Item 1A. Risk Factors.

The risk factors discussed herein relate specifically to risks associated with Duke Energy Ohio.

Duke Energy Ohio's electric revenues, earnings and results are dependent on federal and state legislation and regulation that affect electric generation, transmission, distribution and related activities, which may limit Duke Energy Ohio's ability to recover costs.

Duke Energy Ohio's franchised electric businesses are regulated on a cost-of-service/rate-of-return basis subject to the statutes and regulatory commission rules and procedures of Ohio and Kentucky. If Duke Energy Ohio's franchised electric earnings exceed the returns established by the state regulatory commissions, Duke Energy Ohio's retail electric rates may be subject to review by the commissions and possible reduction, which may decrease Duke Energy Ohio's future earnings. Additionally, if regulatory bodies do not allow recovery of costs incurred in providing service on a timely basis, Duke Energy Ohio's future earnings could be negatively impacted. Additionally, certain portions of Duke Energy Ohio's Commercial Power operations are regulated on a partial cost-of-service/rate-of-return basis under the ESP.

Duke Energy Ohio's business is subject to extensive regulation that will affect Duke Energy Ohio's operations and costs.

Duke Energy Ohio is subject to regulation by FERC and by federal, state and local authorities under environmental laws and by state public utility commissions under laws regulating Duke Energy Ohio's businesses. Regulation affects almost every aspect of Duke Energy Ohio's businesses, including, among other things, Duke Energy Ohio's ability to: take fundamental business management actions; determine the terms and rates of Duke Energy Ohio's transmission and distribution businesses' services as well as its regulated generation business; make acquisitions; issue debt securities; engage in transactions between Duke Energy Ohio's utilities and other subsidiaries and affiliates; and pay dividends to its ultimate parent, Duke Energy. Changes to these regulations are ongoing, and Duke Energy Ohio cannot predict the future course of changes in this regulatory environment or the ultimate effect that this changing regulatory environment will have on Duke Energy Ohio's businesses. However, changes in regulation (including re-regulating previously deregulated markets) can cause delays in or affect business planning and transactions and can substantially increase Duke Energy Ohio's costs.

New laws or regulations could have a negative impact on Duke Energy Ohio's results of operations, cash flows or financial position.

Changes in laws and regulations affecting Duke Energy Ohio, including new accounting standards could change the way Duke Energy Ohio is required to record revenues, expenses, assets and liabilities. These types of regulations could have a negative impact on Duke Energy Ohio's results of operations, cash flows or financial position or access to capital.

Deregulation or restructuring in the electric industry may result in increased competition and unrecovered costs that could adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position and its utilities' businesses.

Increased competition resulting from deregulation or restructuring efforts could have a significant adverse financial impact on Duke Energy Ohio and consequently on its consolidated results of operations, cash flows or financial position. Increased competition could also result in increased pressure to lower costs, including the cost of electricity. Duke Energy Ohio cannot predict the extent and timing of entry by additional competitors into the electric markets. Duke Energy Ohio cannot predict when it will be subject to changes in legislation or regulation, nor can it predict the impact of these changes on its consolidated results of operations, cash flows or financial position.

Duke Energy Ohio may be unable to secure long-term power sales agreements or transmission agreements, which could expose Duke Energy Ohio's sales to increased volatility.

In the future, Duke Energy Ohio may not be able to secure long-term power sales agreements for Duke Energy Ohio's unregulated power generation facilities. If Duke Energy Ohio is unable to secure these types of agreements, Duke Energy Ohio's sales volumes would be exposed to increased volatility. Without the benefit of long-term customer power purchase agreements, Duke Energy Ohio cannot assure that it will be able to operate profitably. The inability to secure these agreements could materially adversely affect Duke Energy Ohio's results and business.

Competition in the unregulated markets in which Duke Energy Ohio operates may adversely affect the growth and profitability of Duke Energy Ohio's business.

Duke Energy Ohio may not be able to respond in a timely or effective manner to the many changes designed to increase competition in the electricity industry. To the extent competitive pressures increase, the economics of Duke Energy Ohio's business may come under long-term pressure.

Duke Energy Ohio may also face competition from new competitors that have greater financial resources than Duke Energy Ohio does, seeking attractive opportunities to acquire or develop energy assets or energy trading operations both in the United States and abroad. These new competitors may include sophisticated financial institutions, some of which are already entering the energy trading and marketing sector, and international energy players, which may enter regulated or unregulated energy businesses. This competition in generation assets in non-regulated competitive markets may adversely affect Duke Energy Ohio's ability to make investments or acquisitions.

Duke Energy Ohio must meet credit quality standards and there is no assurance that Duke Energy Ohio will maintain investment grade credit ratings. If Duke Energy Ohio or its rated subsidiary is unable to maintain an investment grade credit rating, it would be required under credit agreements to provide collateral in the form of letters of credit or cash, which may materially adversely affect its liquidity.

Both Duke Energy Ohio's and its rated subsidiary's senior unsecured long-term debt is rated investment grade by various rating agencies. Duke Energy Ohio cannot be sure that its or its rated subsidiary's senior unsecured long-term debt will continue to be rated investment grade.

If the rating agencies were to rate Duke Energy Ohio or its rated subsidiary below investment grade, Duke Energy Ohio's borrowing costs would increase, perhaps significantly. In addition, Duke Energy Ohio would likely be required to pay a higher interest rate in future financings, and its potential pool of investors and funding sources would likely decrease. Any downgrade or other event negatively affecting the credit ratings of Duke Energy Ohio or its rated subsidiary could also increase Cinergy's or Duke Energy's need to provide liquidity in the form of capital contributions or loans, thus reducing the liquidity and borrowing availability of the consolidated group.

A downgrade below investment grade could also trigger termination clauses in some interest rate and foreign exchange derivative agreements, which would require cash payments. All of these events would likely reduce Duke Energy Ohio's liquidity and profitability and could have a material adverse effect on its consolidated results of operations, cash flows or financial position.

Duke Energy Ohio relies on access to short-term intercompany borrowings and longer-term capital markets to finance its capital requirements and support its liquidity needs, and Duke Energy Ohio's access to those markets can be adversely affected by a number of conditions, many of which are beyond its control.

Duke Energy Ohio's business is financed to a large degree through debt and the maturity and repayment profile of debt used to finance investments often does not correlate to cash flows from its assets. Accordingly, Duke Energy Ohio relies on access to short-term borrowings via Duke Energy's money pool arrangement and financings from longer-term capital markets as a source of liquidity for capital requirements not satisfied by the cash flow from its operations and to fund investments originally financed through debt instruments with disparate maturities. If Duke Energy Ohio is not able to access capital at competitive rates or Duke Energy Ohio cannot obtain short-term borrowings via the money pool arrangement, its ability to finance its operations and implement its strategy could be adversely affected.

Market disruptions may increase Duke Energy Ohio's cost of borrowing or adversely affect its ability to access one or more financial markets. Such disruptions could include: economic downturns; the bankruptcy of an unrelated energy company; capital market conditions generally; market prices for electricity and gas; terrorist attacks or threatened attacks on Duke Energy Ohio's facilities or unrelated energy companies; or the overall health of the energy industry. Restrictions on Duke Energy Ohio's ability to access financial markets may also affect its ability to execute its business plan as scheduled. An inability to access capital may limit Duke Energy Ohio's ability to pursue improvements or acquisitions that it may otherwise rely on for future growth.

Duke Energy Ohio's ultimate parent, Duke Energy, maintains revolving credit facilities to provide back-up for commercial paper programs and/or letters of credit at various entities. These facilities typically include financial covenants which limit the amount of debt that can be outstanding as a percentage of the total capital for the specific entity. Failure to maintain these covenants at a particular entity could preclude that entity from issuing commercial paper or letters of credit or borrowing under the revolving credit facility and could require other of Duke Energy Ohio's affiliates to immediately pay down any outstanding drawn amounts under other revolving credit agreements.

Current levels of market volatility are unprecedented.

The capital and credit markets have been experiencing extreme volatility and disruption. In recent months, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on credit capacity for certain issuers. If current levels of market disruption and volatility continue or worsen, Duke Energy Ohio may be forced to meet its other liquidity needs by further drawing upon contractually committed lending agreements primarily provided by global banks, although there is no assurance that the commitments made by lenders under Duke Energy's master credit facility will be available if needed due to the recent turmoil throughout the financial services industry. This could require Duke Energy Ohio to seek other funding sources. However, under such extreme market conditions, there can be no assurance other funding sources would be available or sufficient.

Duke Energy Ohio is exposed to credit risk of customers and counterparties with whom it does business.

Adverse economic conditions affecting, or financial difficulties of customers and counterparties with whom Duke Energy Ohio does business could impair the ability of these customers and counterparties to pay for Duke Energy Ohio's services or fulfill their contractual

obligations, including loss recovery payments under insurance contracts or cause them to delay such payments or obligations. Duke Energy Ohio depends on these customers and counterparties to remit payments on a timely basis. Any delay or default in payment could adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

Poor investment performance of Cinergy's pension plan holdings and other factors impacting pension plan costs could unfavorably impact Duke Energy Ohio's liquidity and results of operations.

Duke Energy Ohio participates in certain employee benefit plans sponsored by its parent, Cinergy. Duke Energy Ohio is allocated costs and obligations related to these plans. Cinergy's costs of providing non-contributory defined benefit pension plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation and required or voluntary contributions made to the plans. While Cinergy has complied with the minimum funding requirements as of December 31, 2008, Cinergy's qualified pension plans had obligations which exceeded the value of plan assets by approximately $882 million. Without sustained growth in the pension investments over time to increase the value of plan assets and depending upon the other factors impacting Cinergy's costs as listed above, Duke Energy Ohio could be required to fund its parent's plans with significant amounts of cash. Such cash funding obligations could have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

Duke Energy Ohio is subject to numerous environmental laws and regulations that require significant capital expenditures, can increase its cost of operations, and which may impact or limit its business plans, or expose it to environmental liabilities.

Duke Energy Ohio is subject to numerous environmental laws and regulations affecting many aspects of its present and future operations, including air emissions (such as reducing nitrogen oxide, sulfur dioxide and mercury emissions or potential future control of greenhouse gas emissions), water quality, wastewater discharges, solid waste and hazardous waste. These laws and regulations can result in increased capital, operating and other costs. These laws and regulations generally require Duke Energy Ohio to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Compliance with environmental laws and regulations can require significant expenditures, including expenditures for clean up costs and damages arising out of contaminated properties, and failure to comply with environmental regulations may result in the imposition of fines, penalties and injunctive measures affecting operating assets. The steps Duke Energy Ohio takes to ensure that its facilities are in compliance could be prohibitively expensive. As a result, Duke Energy Ohio may be required to shut down or alter the operation of its facilities, which may cause it to incur losses. Further, Duke Energy Ohio's regulatory rate structure and its contracts with customers may not necessarily allow it to recover capital costs Duke Energy Ohio incurs to comply with new environmental regulations. Also, Duke Energy Ohio may not be able to obtain or maintain from time to time all required environmental regulatory approvals for its operating assets or development projects. If there is a delay in obtaining any required environmental regulatory approvals, if Duke Energy Ohio fails to obtain and comply with them or if environmental laws or regulations change and become more stringent, then the operation of Duke Energy Ohio's facilities or the development of new facilities could be prevented, delayed or become subject to additional costs. Although it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position, no assurance can be made that the costs of complying with environmental regulations in the future will not have such an effect.

There is growing consensus that some form of regulation will be forthcoming at the federal level with respect to greenhouse gas emissions, including carbon dioxide (CO_2), and such regulation could result in the creation of substantial compliance costs.

In addition, Duke Energy Ohio is generally responsible for on-site liabilities, and in some cases off-site liabilities, associated with the environmental condition of Duke Energy Ohio's power generation facilities and natural gas assets which it has acquired or developed, regardless of when the liabilities arose and whether they are known or unknown. In connection with some acquisitions and sales of assets, Duke Energy Ohio may obtain, or be required to provide, indemnification against some environmental liabilities. If Duke Energy Ohio incurs a material liability, or the other party to a transaction fails to meet its indemnification obligations to Duke Energy Ohio, Duke Energy Ohio could suffer material losses.

Duke Energy Ohio is involved in numerous legal proceedings, the outcomes of which are uncertain, and resolution adverse to Duke Energy Ohio could negatively affect its consolidated results of operations, cash flows or financial position.

Duke Energy Ohio is subject to numerous legal proceedings. Litigation is subject to many uncertainties and Duke Energy Ohio cannot predict the outcome of individual matters with assurance. It is reasonably possible that the final resolution of some of the matters in which Duke Energy Ohio is involved could require it to make additional expenditures, in excess of established reserves, over an extended period

of time and in a range of amounts that could have a material effect on its consolidated results of operations and cash flows. Similarly, it is reasonably possible that the terms of resolution could require Duke Energy Ohio to change its business practices and procedures, which could also have a material effect on its consolidated results of operations, cash flows or financial position.

Duke Energy Ohio's consolidated results of operations may be negatively affected by sustained downturns or sluggishness in the economy, including low levels in the market prices of commodities, all of which are beyond Duke Energy Ohio's control.

Sustained downturns or sluggishness in the economy generally affect the markets in which Duke Energy Ohio operates and negatively influence its operations. Declines in demand for electricity as a result of economic downturns in Duke Energy Ohio's franchised electric service territories will reduce overall electricity sales and lessen Duke Energy Ohio's cash flows, especially as its industrial customers reduce production and, therefore, consumption of electricity and gas. Although Duke Energy Ohio's franchised electric business is subject to regulated allowable rates of return and recovery of fuel costs under a fuel adjustment clause, overall declines in electricity sold as a result of economic downturn or recession could reduce revenues and cash flows, thus diminishing results of operations. Additionally, prolonged economic downturns that negatively impact Duke Energy Ohio's result of operations and cash flows could result in future material impairment charges being recorded to write down the carrying value of certain assets, including goodwill, to their respective fair values.

Duke Energy Ohio also sells electricity into the spot market or other competitive power markets on a contractual basis. With respect to such transactions, Duke Energy Ohio is not guaranteed any rate of return on Duke Energy Ohio's capital investments through mandated rates, and Duke Energy Ohio's revenues and results of operations are likely to depend, in large part, upon prevailing market prices in Duke Energy Ohio's regional markets and other competitive markets. These market prices may fluctuate substantially over relatively short periods of time and could reduce Duke Energy Ohio's revenues and margins and thereby diminish its consolidated results of operations.

Factors that could impact sales volumes, generation of electricity and market prices at which Duke Energy Ohio is able to sell electricity are as follows:

- weather conditions, including abnormally mild winter or summer weather that cause lower energy usage for heating or cooling purposes, respectively, and periods of low rainfall that decrease Duke Energy Ohio's ability to operate its facilities in an economic manner;
- supply of and demand for energy commodities;
- illiquid markets including reductions in trading volumes which result in lower revenues and earnings;
- general economic conditions, including downturns in the U.S. or other economies which impact energy consumption particularly in which sales to industrial or large commercial customers comprise a significant portion of total sales;
- transmission or transportation constraints or inefficiencies which impact Duke Energy Ohio's non-regulated energy operations;
- availability of competitively priced alternative energy sources, which are preferred by some customers over electricity produced from coal, or gas plants, and of energy-efficient equipment which reduces energy demand;
- natural gas prices;
- ability to procure satisfactory levels of fuel supplies and inventory, such as coal and natural gas;
- electric generation capacity surpluses which cause Duke Energy Ohio's non-regulated energy plants to generate and sell less electricity at lower prices and may cause some plants to become non-economical to operate;
- capacity and transmission service into, or out of, Duke Energy Ohio's markets;
- natural disasters, acts of terrorism, wars, embargoes and other catastrophic events to the extent they affect Duke Energy Ohio's operations and markets, as well as the cost and availability of insurance covering such risks; and
- federal, and state energy and environmental regulation and legislation.

Duke Energy Ohio's operating results may fluctuate on a seasonal and quarterly basis.

Electric power generation is generally a seasonal business. In most parts of the United States and in markets in which Duke Energy Ohio operates, demand for electricity peaks during the warmer summer months and demand for natural gas peaks during the cold winter months, with market prices also peaking during the warmer summer months for electricity and cold winter months for natural gas. Further, extreme weather conditions such as heat waves or winter storms could cause these seasonal fluctuations to be more pronounced. As a result, in the future, the overall operating results of Duke Energy Ohio's businesses may fluctuate substantially on a seasonal and quarterly basis and thus make period comparison less relevant.

Potential terrorist activities or military or other actions could adversely affect Duke Energy Ohio's business.

The continued threat of terrorism and the impact of retaliatory military and other action by the United States and its allies may lead to increased political, economic and financial market instability and volatility in prices for natural gas and oil which may materially adversely affect Duke Energy Ohio in ways it cannot predict at this time. In addition, future acts of terrorism and any possible reprisals as a consequence of action by the United States and its allies could be directed against companies operating in the United States. Infrastructure and generation facilities could be potential targets of terrorist activities. The potential for terrorism has subjected Duke Energy Ohio's operations to increased risks and could have a material adverse effect on Duke Energy Ohio's business. In particular, Duke Energy Ohio may experience increased capital and operating costs to implement increased security for its plants, such as additional physical plant security, additional security personnel or additional capability following a terrorist incident.

The insurance industry has also been disrupted by these events. As a result, the availability of insurance covering risks that Duke Energy Ohio and its competitors typically insure against may decrease. In addition, the insurance Duke Energy Ohio is able to obtain may have higher deductibles, higher premiums and more restrictive policy terms.

Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be insignificant also may adversely affect Duke Energy Ohio's consolidated results of operations, cash flows or financial condition.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

FRANCHISED ELECTRIC AND GAS

As of December 31, 2008, Franchised Electric and Gas operated two coal-fired stations with a combined net capacity of 577 MW and one combustion turbine (CT) station with a net capacity of 501 MW. Franchised Electric and Gas also owns two underground caverns with a total storage capacity of approximately 16 million gallons of liquid propane. The stations and caverns are located in Ohio and Kentucky.

In addition, as of December 31, 2008, Duke Energy Ohio owned approximately 2,500 conductor miles of electric transmission lines, including 1,000 miles of 345 kilovolts, 700 miles of 100 to 161 kilovolts, and 800 miles of 13 to 69 kilovolts. Duke Energy Ohio also owned approximately 19,500 conductor miles of electric distribution lines, including 14,000 miles of overhead lines and 5,500 miles of underground lines, as of December 31, 2008 and approximately 7,100 miles of gas mains and service lines. As of December 31, 2008, the electric transmission and distribution systems had approximately 280 substations. In addition, Duke Energy Ohio has access to 5.5 million gallons of liquid propane storage and product loaned through a commercial services agreement with a third party. This liquid propane is used in the three propane/air peak shaving plants located in Ohio and Kentucky. Propane/air peak shaving plants vaporize the propane and mix with natural gas to supplement the natural gas supply during peak demand periods and emergencies.

Substantially all of Franchised Electric and Gas' electric plant in service is mortgaged under the mortgage bond indenture of Duke Energy Ohio.

COMMERCIAL POWER

As of December 31, 2008, Commercial Power jointly owns six coal-fired stations with a combined net capacity of 3,529 MW, of which Duke Energy Ohio operates three. Commercial Power also owns and operates five CT stations, one of which is jointly owned, with a combined net capacity of 1,544 MW and three CC stations with a combined net capacity of 2,480 MW. The stations are located in Ohio, Illinois, Indiana and Pennsylvania.

Item 3. Legal Proceedings.

For information regarding legal proceedings, including regulatory and environmental matters, see Note 4 to the Consolidated Financial Statements, "Regulatory Matters" and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies—Litigation" and "Commitments and Contingencies—Environmental."

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Cinergy owns all of the common stock of Duke Energy Ohio. Duke Energy owns all of the common stock of Cinergy. Duke Energy Ohio anticipates making periodic dividends to provide funding support for Duke Energy's dividend. During the years ended December 31, 2008, 2007 and 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of $200 million, $135 million and $102 million, respectively.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

Management's Discussion and Analysis should be read in conjunction with the accompanying Consolidated Financial Statements and Notes for the years ended December 31, 2008, 2007 and 2006.

BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instruction (I)(2)(a) of Form 10-K.

RESULTS OF OPERATIONS

Results of Operations and Variances

Summary of Results (in millions)

	Years Ended December 31,		
	2008	2007	Increase (Decrease)
Operating revenues	$3,424	$3,455	$(31)
Operating expenses	2,965	2,964	1
Gains (losses) on sales of other assets and other, net	59	(8)	67
Operating income	518	483	35
Other income and expenses, net	34	32	2
Interest expense	94	100	(6)
Income before income taxes	458	415	43
Income tax expense	171	151	20
Income before extraordinary items	287	264	23
Extraordinary items, net of tax	67	—	67
Net income	$ 354	$ 264	$ 90

Net Income

The $90 million increase in Duke Energy Ohio's net income was primarily due to the following factors:

Operating Revenues. The decrease was due primarily to:

- A $38 million decrease from coal sales due to the expiration of contracts,
- A $30 million decrease in retail electric revenues resulting from lower retail volumes due to the weakening economy,
- A $21 million decrease in wholesale electric revenues due to lower hedge realization and lower generation volumes primarily resulting from increased plant outages in 2008 compared to 2007,
- A $21 million decrease in net mark-to-market revenues on non-qualifying hedge accounting power and capacity contracts, consisting of $74 million of net mark-to-market losses in 2008, as compared to net mark-to-market losses of $53 million in 2007,
- A $17 million decrease in revenues due to lower generation volumes from the Midwest gas-fired assets resulting from milder weather net of increased PJM capacity revenues in 2008 compared to 2007, and
- An $11 million decrease related to native load due to milder weather in 2008 compared to 2007.

Partially offsetting these decreases were:

- A $45 million increase in regulated fuel revenues driven primarily by higher natural gas costs,
- A $21 million increase in retail electric revenues resulting from higher retail pricing primarily related to environmental and capacity riders that were approved in the fourth quarter of 2007 by the PUCO and increased amortization of purchase accounting valuation liability of the Rate Stabilization Plan (RSP) in 2008 compared to 2007,

- A $19 million increase due to implementation of new gas rates in Ohio,
- A $9 million increase related to the Ohio electric Demand Side Management (DSM) rider implemented in the third quarter of 2007, and
- A $9 million increase in Ohio electric base transmission due to a change in the Transmission Cost Recovery rider.

Operating Expenses. The increase was due primarily to:

- An $82 million impairment of emission allowances due to the invalidation of the Clean Air Interstate Rule (CAIR) in July 2008,
- A $69 million increase in fuel expense due to mark-to-market losses on non-qualifying fuel hedge contracts, consisting of mark-to-market losses of $3 million in 2008, as compared to gains of $66 million in 2007,
- A $40 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A $16 million increase in regulatory amortization of the Ohio and Kentucky DSM costs and Ohio regulatory transition charge.

Partially offsetting these increases were:

- A $63 million decrease in emission allowance expenses due to lower cost basis emission allowances consumed and lower overall emission allowance consumption due to installation of flue gas desulfurization equipment and lower generation volumes due to increased plant outages in 2008 compared to 2007,
- A $46 million decrease in net fuel and purchased power expense for retail load due to realized gains on fuel hedges, partially offset by higher purchased power as a result of increased plant outages in 2008 compared to 2007,
- A $31 million decrease in expenses associated with coal sales due to the expiration of contracts,
- A $24 million decrease in fuel and operating expenses for the Midwest gas-fired assets primarily due to lower generation volumes and lower amortization of locked-in hedge losses in 2008 compared to 2007, net of an approximate $15 million bad debt reserve related to the Lehman Bros. bankruptcy and higher plant maintenance expenses,
- A $21 million decrease in other post-employment benefits due to an adjustment to the liability recorded for these benefits, and
- An $18 million decrease in short-term incentive costs.

Gains (Losses) on Sales of Other Assets and Other, net. The increase in 2008 as compared to 2007 was attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007. Gains in 2008 were a result of sales of zero cost basis emission allowances, while losses in 2007 were as a result of sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in 2006 which were written up to fair value as part of purchase accounting.

Income Tax Expense. The increase was primarily the result of higher pre-tax income.

Extraordinary Items, net of tax. The reapplication of SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*" (SFAS No. 71), on December 17, 2008 resulted in an approximate $67 million after-tax (approximately $103 million pre-tax) extraordinary gain related to total mark-to-market losses previously recorded in earnings associated with open forward native load economic hedge contracts for fuel, purchased power and emission allowances, which the Electric Security Plan (ESP) allows to be recovered through a fuel and purchased power rider. See further discussion under the "Matters Impacting Future Results" below.

Matters Impacting Future Results

Sales, especially in the industrial sector, were impacted by the economic downturn in 2008. Duke Energy Ohio expects this trend to continue for some period into 2009, and perhaps beyond, until the economy begins to recover. Duke Energy Ohio's current strategy is focused on maximizing the returns and cash flows from its current portfolio. Results for Duke Energy Ohio are sensitive to changes in power supply, power demand and weather.

On December 17, 2008, the PUCO approved Duke Energy Ohio's ESP price structure, which establishes generation rates for 2009 through 2011. The base cost for generation service will increase by approximately 2 percent annually in 2009 and 2010 for residential customers, and each year from 2009 through 2011 for non-residential customers. Additionally, the ESP provides for a new Infrastructure Modernization rider to maintain distribution system reliability and to purchase and deploy SmartGrid technology. As discussed further below, the approval of the ESP also resulted in the reapplication of SFAS No. 71 to portions of generation within Duke Energy Ohio's Commercial Power business segment. As a result of the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's operations, Duke Energy Ohio's future results will be subject to less volatility than had been caused by the timing of under-and-over collections of certain costs, as well as the impacts of mark-to-market activity on certain coal and power derivatives.

The outcome of the pending Duke Energy Ohio electric distribution rate case could impact future results through the increase of base rates.

Duke Energy Ohio's generation operations within its Commercial Power business segment include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the Public Utilities Commission of Ohio (PUCO) approved Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a RSP, which was a market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 4 to the Consolidated Financial Statements, "Regulatory Matters," in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio will bill for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a fuel and purchased power (FPP) rider and certain portions of a cost of environmental compliance (AAC) rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "Goodwill and Intangible Assets." As of the date of the 2008 annual impairment analysis, the estimated fair value of Duke Energy Ohio's reporting units exceeded their respective carrying value, thus no goodwill impairment charges were recorded. However, management is continuing to monitor the impact of recent market and economic events to determine if it is more likely than not that the carrying value of any of Duke Energy Ohio's reporting units have been impaired. Should any such triggering events or circumstances occur in 2009 that would more likely than not reduce the fair value of a reporting unit below its carrying value, management would perform an impairment assessment of Duke Energy Ohio's goodwill and it is possible that goodwill impairment charges could be recorded as a result of any such assessments. At December 31, 2008, Duke Energy Ohio had total goodwill of approximately $2,360 million.

Other Matters

General. Duke Energy Ohio's fixed charges coverage ratio, as calculated using SEC guidelines, was 4.6 times for the year ended December 31, 2008, 3.8 times for the year ended December 31, 2007, 1.9 times for the nine months ended December 31, 2006 and 6.2 times for the three months ended March 31, 2006.

As of December 31, 2008, Duke Energy Ohio had approximately $390 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Ohio began to experience failed auctions on these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 2.0 times one-month London Interbank Offered Rate. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position. The weighted-average interest rate, associated with Duke Energy Ohio's auction rate pollution control bonds, was 1.58% as of December 31, 2008 and 4.56% as of December 31, 2007.

Global Climate Change. A body of scientific evidence now accepted by a growing majority of the public and policymakers suggests that the Earth's climate is changing, caused in part by greenhouse gases emitted into the atmosphere from human activities. Although there is still much to learn about the causes and long-term effects of climate change, many, including Duke Energy Ohio, advocate taking steps now to begin reducing emissions with the aim of stabilizing the atmospheric concentration of greenhouse gases at a level that avoids the potentially worst-case effects of climate change.

Greenhouse gas (GHG) emissions are produced from a wide variety of human activities. The U.S. EPA publishes an inventory of these emissions annually. Carbon dioxide (CO_2), an essential trace gas, is a by product of fossil fuel combustion and currently accounts for about 85% of U.S. greenhouse gas emissions. Duke Energy Ohio currently accounts for about 0.30% of total U.S. CO_2 emissions, and about 0.26% of total U.S. GHG emissions.

Duke Energy Ohio's long-term strategies for how best to meet its customers' growing demand for electricity are impacted by the issues surrounding global warming. These strategies include significant commitments to customer energy efficiency and renewable energy. Each of these actions will or has the potential to reduce Duke Energy Ohio's CO_2 emissions and therefore its exposure to the costs of future GHG regulation.

Duke Energy Ohio's cost of complying with any federal GHG emissions law that may be enacted will depend on the design details of the program. If potential future GHG legislation adopts a cap-and-trade approach, the design elements of such a program that will have the greatest influence on Duke Energy Ohio's compliance costs include (1) the required levels and timing of the cap, which will drive emission allowance prices, (2) the emission sources covered under the cap, (3) the number of allowances that Duke Energy Ohio might be allocated at no cost on a year-to-year basis, (4) the type and effectiveness of any cost control mechanisms included in the program, (5) the role of emission offsets, which will also influence allowance prices, and (6) the availability and cost of technologies that Duke Energy Ohio can deploy to lower its emissions. While Duke Energy Ohio believes it is very likely that Congress will adopt mandatory GHG emission reduction legislation at some point, the timing and design details of any such legislation are highly uncertain.

While there were many bills introduced in both houses of Congress during the 110th Congress that proposed mandatory limits on GHG emissions, S. 2191—America's Climate Security Act of 2007 (commonly referred to as the Lieberman-Warner bill after the sponsors Senators Joseph Lieberman of Connecticut and John Warner of Virginia) became the primary climate change related legislative vehicle. The bill was approved by the Senate Environment and Public Works Committee in December 2007, but failed to advance on the Senate floor in June 2008 when the bill fell considerably short of the 60 votes necessary to invoke cloture and cut off debate. No subsequent action was taken in the 110th Congress related to mandatory federal GHG legislation.

Numerous bills mandating reductions in GHG emissions are expected to be introduced in both houses of Congress in 2009. The leadership in both the House and Senate has publicly stated it is their intent to proceed with climate legislation. President Obama, in his presidential campaign and after the election, indicated passage of climate change legislation is a priority. Still, as the Senate debate in 2008 revealed, there are wide-ranging views in Congress regarding what constitutes acceptable GHG legislation. The current condition of the U.S. economy could add a degree of uncertainty, and there are indications that, in the 111th Congress multiple committees will be involved in crafting GHG legislation, which will make the process of developing GHG legislation potentially more challenging.

Duke Energy Ohio supports the enactment of federal GHG cap-and-trade legislation. Due to Duke Energy Ohio's concern about patchwork policies focused on a single industrial sector or particular region of the country, Duke Energy Ohio believes this legislation should establish a program that applies to all parts of the economy, including power generation, industrial and commercial sources and motor vehicles. To permit the economy to adjust rationally to the policy, legislation should establish a long-term program that first slows the growth of emissions, stops them and then transitions to a gradually declining emissions cap as new lower-and non-emitting technologies are developed and become available for wide-scale deployment. Legislation should also include adequate cost-containment measures to protect the U.S. economy from grave and unintended impacts of the policy.

Duke Energy Ohio is unable to estimate the potential cost of complying with currently unspecified and unknowable future GHG legislation or any indirect costs that might result. Compliance costs are sensitive to numerous policy design details, allowance prices, and technology availability and cost. During the Senate debate on the Lieberman-Warner legislation in 2007 and 2008, Duke Energy Ohio attempted to estimate its cost of complying with that legislation over a range of potential allowance prices. Duke Energy Ohio estimated its compliance costs under the Lieberman-Warner model to be between approximately $230 million to $680 million in the first year of the program (2012), which represented the cost to purchase emission allowances needed for compliance over and above what might be allocated to Duke Energy Ohio at zero cost. Duke Energy Ohio would have continued to incur similar or greater annual compliance costs in subsequent years for continued allowance purchases until such time as new lower-and zero-emitting technologies could be deployed to reduce emissions. Duke Energy Ohio's compliance costs at that time would then include the cost of purchasing and deploying new generation technologies. Duke Energy Ohio would only be able to reduce its allowance purchase costs after new technologies were actually deployed.

There is no way to know how similar or different the requirements of the Lieberman-Warner legislation might be to any future GHG legislation that Congress may eventually adopt, so it is uncertain whether these costs are at all representative of compliance costs that Duke Energy Ohio might incur as a result of any potential future GHG legislation. Under any future scenario involving mandatory GHG limitations, Duke Energy Ohio would plan to seek to recover its compliance costs through appropriate regulatory mechanisms in the jurisdictions in which it operates.

At the state level, the Midwestern Governors Association has an initiative under way called the Midwestern Greenhouse Gas Reduction Accord. One of the ongoing activities of the initiative is the design of a regional GHG cap-and-trade system, with the anticipated end product to be a Model Rule for implementing a GHG cap-and-trade system. Once complete, the Model Rule would go to participating states for their consideration and possible adoption. The state of Ohio is currently only an observer to the accord process. The outcome of this initiative is highly uncertain and Duke Energy Ohio is unable to determine at this time whether there might be direct or indirect cost impacts from any new regulations that might result from the initiative.

While Duke Energy Ohio's near-term compliance strategy associated with any potential future GHG legislation that incorporates a cap-and-trade mechanism will likely be focused on allowance purchases, it is expected that at some point in the future Duke Energy Ohio would begin reducing emissions by replacing existing coal-fired generation with new lower-and zero-emitting generation technologies, and/or installing new carbon capture and sequestration technology on existing coal-fired generating plants when the technologies become available and cost-effective. It is not possible at this time, however, to predict with certainty what new technologies might be developed, when they will be ready to be deployed, or what their costs will be. There is also uncertainty as to how or when certain non-technical issues, such as legal and liability questions, that could affect the cost and availability of new technologies might be resolved by regulators. Duke Energy Ohio currently is focused on integrated gasification combined cycle generation with carbon capture and sequestration, and capture and storage retrofit technology for existing pulverized coal-fired generation as promising new technologies for generating electricity with lower or no CO_2 emissions.

Duke Energy Ohio has regulatory requirements in Ohio to meet increasing percentages of customer demand for electricity with renewable energy. The requirement reaches a minimum of 12.5% in 2024. Duke Energy Ohio also anticipates the Congress will consider a federal renewable portfolio standard in 2009. Previous attempts have passed in the U.S. House of Representatives but fallen short in the Senate. Duke Energy Ohio believes, however, chances of passage in the 111th Congress have increased.

In addition to relying on new technologies to reduce its CO_2 emissions, Duke Energy Ohio has received regulatory approval in Ohio for a first-of-its-kind innovative approach in the utility industry to help meet growing customer demand with new and creative ways to increase energy efficiency, thereby reducing demand (Save-A-Watt) instead of relying almost exclusively on new power plants to generate electricity.

Each of these activities has the potential to reduce Duke Energy Ohio's future CO_2 emissions which will reduce Duke Energy Ohio's exposure to future GHG regulation.

Duke Energy Ohio recognizes the potential for more frequent and severe extreme weather events as a result of climate change and the possibility that these weather events could have a material impact on its future results of operations should these events occur. However, the uncertain nature of potential changes in extreme weather events (such as increased frequency, duration, and severity) and the long period of time over which any changes might take place make estimating any potential future financial risk to Duke Energy Ohio's operations that may be caused by the physical risks of climate change extremely challenging. Currently, Duke Energy Ohio plans and prepares for extreme weather events that it experiences from time to time, such as ice storms, tornados, severe thunderstorms, high winds and droughts. Duke Energy Ohio's past experiences preparing for and responding to the impacts of these types of weather-related events would reasonably be expected to help management plan and prepare for future climate change-related severe weather events to reduce, but not eliminate, the operational, economic and financial impacts of such events.

For additional information on other issues related to Duke Energy Ohio, see Note 4 to the Consolidated Financial Statements, "Regulatory Matters" and Note 18 to the Consolidated Financial Statements, "Commitments and Contingencies."

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Risk Management Policies

Duke Energy Ohio is exposed to market risks associated with commodity prices, credit exposure and interest rates. Management has established comprehensive risk management policies to monitor and manage these market risks. The Treasurer of Duke Energy, the ultimate parent entity of Duke Energy Ohio, is responsible for the overall governance of managing credit risk and commodity price risk, including monitoring exposure limits for Duke Energy Ohio.

Commodity Price Risk

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased within its non-regulated operations, as well as within its regulated operations, to the extent there is excess capacity from generation assets that are dedicated to serve Ohio native load customers. Price risk represents the potential risk of loss from adverse changes in the market price of electricity or other energy commodities, such as gas and coal. For Duke Energy Ohio, this price risk has been somewhat reduced by the December 17, 2008 PUCO approval of Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's Commercial Power business segment operations as of that date. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity derivatives, such as swaps, futures, forwards and options. See Note 1 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies" and Note 8 to the Consolidated Financial Statements, "Risk Management and Hedging Activities and Credit Risk," for additional information.

Validation of a contract's fair value is performed by an internal group separate from Duke Energy Ohio's deal origination areas. Duke Energy Ohio's derivative contract portfolio is predominantly valued using observable market inputs with little internally developed assumptions. However, for contracts valued beyond the observable market period, Duke Energy Ohio uses common industry practices to develop its valuation techniques and changes in its pricing methodologies or the underlying assumptions could result in significantly different fair values and income recognition.

Hedging Strategies. Duke Energy Ohio closely monitors the risks associated with commodity price changes on its future operations and, where appropriate, uses various commodity instruments such as electricity, coal and natural gas forward contracts to mitigate the effect of such fluctuations on operations. Duke Energy Ohio's primary use of energy commodity derivatives is to hedge the generation portfolio against exposure to changes in the prices of power and fuel.

Certain derivatives used to manage Duke Energy Ohio's commodity price exposure are accounted for as either cash flow hedges or fair value hedges. To the extent that instruments accounted for as hedges are effective in offsetting the transaction being hedged, there is no impact to the Consolidated Statements of Operations until delivery or settlement occurs. Accordingly, assumptions and valuation techniques for these contracts have no impact on reported earnings prior to settlement. Several factors influence the effectiveness of a hedge contract, including the use of contracts with different commodities or unmatched terms and counterparty credit risk. Hedge effectiveness is monitored regularly and measured at least quarterly.

In addition to the hedge contracts described above and recorded on the Consolidated Balance Sheets, Duke Energy Ohio enters into other contracts that qualify for the normal purchases and sales exception described in paragraph 10 of SFAS No. 133, as amended and interpreted by Derivatives Implementation Group Issue C15, *"Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity,"* and SFAS No. 149, *"Amendment of Statement 133 on Derivative Instruments*

and Hedging Activities." On a limited basis, Franchised Electric and Gas and Commercial Power apply the normal purchase and normal sales exception to certain contracts. Income recognition and realization related to normal purchases and normal sales contracts generally coincide with the physical delivery of power. For contracts qualifying for the scope exception, no recognition of the contract's fair value in the Consolidated Financial Statements is required until settlement of the contract unless the contract ceases to qualify for the normal purchase and normal sale exception at some point during the contract period. Recognition of the contracts in the Consolidated Statements of Operations will be the same regardless of whether the contracts are accounted for as cash flow hedges or as normal purchases and sales assuming no hedge ineffectiveness.

Other derivatives used to manage Duke Energy Ohio's commodity price exposure are either not designated as a hedge or do not qualify for hedge accounting. Derivatives related to regulated businesses reflect changes in the fair value of the derivative instruments as a regulatory asset or liability on the Consolidated Balance Sheets. Derivatives related to unregulated businesses are marked-to-market each period, with changes in the fair value of the derivative instruments reflected in earnings.

Generation Portfolio Risks for 2009. Duke Energy Ohio is primarily exposed to market price fluctuations of wholesale power, coal, natural gas and emission allowance prices associated with its excess capacity from generation assets that are dedicated to serve Ohio native load customers and its non-regulated operations. Duke Energy Ohio closely monitors the risks associated with these commodity price changes on its future generation operations and, where appropriate, uses various commodity instruments such as electricity, coal and natural gas forward contracts to mitigate the effect of such fluctuations on operations, in addition to optimizing the value of its non-regulated generation portfolio. The portfolio includes generation assets (power and capacity), fuel, and emission allowances. Modeled forecasts of future generation output, fuel requirements, and emission allowance requirements are based on forward power, fuel and emission allowance markets. The component pieces of the portfolio are bought and sold based on this model in order to manage the economic value of the portfolio, where such market transparency exists. The generation portfolio not utilized to serve native load or committed load is subject to commodity price fluctuations. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change per megawatt hour in forward wholesale power prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $5 million in 2009 and $13 million in 2008, respectively, excluding the impact of mark-to-market changes on non-qualifying or undesignated hedges relating to periods in excess of one year from the respective date, which are discussed further below. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent change in the forward price per ton of coal would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $10 million in 2009 and $4 million in 2008, respectively, excluding the impact of mark-to-market changes on non-qualifying or undesignated hedges relating to periods in excess of one year from the respective date, which are discussed further below. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change per MMBtu (one million British thermal units) in natural gas prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $5 million in 2009 and $9 million in 2008 respectively, excluding the impact of mark-to-market changes on undesignated hedges relating to periods in excess of one year from the respective date.

Sensitivities for derivatives beyond 2009. Derivative contracts executed to manage generation portfolio risks for delivery periods beyond 2009 are also exposed to changes in fair value due to market price fluctuations of wholesale power and coal. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent price change in the forward price per megawatt hour of wholesale power would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $11 million in 2009 and $16 million in 2008, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated power contracts pertaining to periods in excess of one year from the respective date. Based on a sensitivity analysis as of December 31, 2008 and 2007, it was estimated that a ten percent change in the forward price per ton of coal would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $10 million in 2009 and $14 million in 2008, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated coal contracts pertaining to periods in excess of one year from the respective date.

Comparability of sensitivity analysis. As Commercial Power began reapplying the provisions of SFAS No. 71 on December 17, 2008 to portions of its operations, certain derivative contracts that historically resulted in earnings volatility receive regulatory deferral of gains and losses. Accordingly, the mark-to-market associated with these contracts will not impact earnings until recovered in revenues. However, to achieve comparability of sensitivity information between periods, the portion of the derivative contracts that receive regulatory treatment has been included in the sensitivity amounts for both periods presented. Since certain derivative contracts included in the sensitivity analysis for 2009 will not result in earnings impacts, the forecasted sensitivities for 2009 are less than the pre-tax income amounts disclosed above.

The commodity price sensitivity calculations above consider existing hedge positions and estimated production levels, but do not consider other potential effects that might result from such changes in commodity prices.

Credit Risk

Credit risk represents the loss that Duke Energy Ohio would incur if a counterparty fails to perform under its contractual obligations.

Retail. Credit risk associated with Duke Energy Ohio's service to residential, commercial and industrial customers is generally limited to outstanding accounts receivable. Duke Energy Ohio mitigates this credit risk by requiring customers to provide a cash deposit or letter of credit until a satisfactory payment history is established, at which time the deposit is typically refunded. Charge-offs for the retail customers have historically been insignificant to the operations of Duke Energy Ohio and are typically recovered through the retail rates. However, in light of current overall economic conditions, management continues to monitor customer charge-offs and payment patterns to ensure the adequacy of bad debt reserves. Duke Energy Ohio sells certain of their accounts receivable and related collections through Cinergy Receivables Company, LLC a bankruptcy remote, special purpose entity. While no direct recourse to Duke Energy Ohio exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests or in the event the level of charge-offs in future periods increases. See Note 13 to the Consolidated Financial Statements, "Sales of Accounts Receivable."

Wholesale and Non-native Sales. To reduce credit exposure related to non-native sales, Duke Energy Ohio seeks to enter into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties. Duke Energy Ohio attempts to further reduce credit risk with certain counterparties by entering into agreements that enable it to obtain collateral or to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events. Where exposed to credit risk, Duke Energy Ohio analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis. Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Ohio also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

Based on Duke Energy Ohio's policies for managing credit risk, its exposures and its credit and other reserves, Duke Energy Ohio does not anticipate a materially adverse effect on its consolidated results of operations, cash flows or financial position as a result of non-performance by any counterparty.

Interest Rate Risk

Duke Energy Ohio is exposed to risk resulting from changes in interest rates as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters into financial derivative instruments, including interest rate swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. See Notes 1, 8, and 16 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies," "Risk Management and Hedging Activities and Credit Risk" and "Debt and Credit Facilities," respectively.

Based on a sensitivity analysis as of December 31, 2008, it was estimated that if market interest rates average 1% higher (lower) in 2009 than in 2008, interest expense, net of offsetting impacts in interest income, would increase (decrease) by approximately $11 million. Comparatively, based on a sensitivity analysis as of December 31, 2007, had interest rates averaged 1% higher (lower) in 2008 than in 2007, it was estimated that interest expense, net of offsetting impacts in interest income, would have increased (decreased) by approximately $8 million. These amounts were estimated by considering the impact of the hypothetical interest rates on variable-rate securities outstanding, including money pool balances, adjusted for interest rate hedges and cash and cash equivalents outstanding as of December 31, 2008 and 2007. If interest rates changed significantly, management would likely take actions to manage its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in Duke Energy Ohio's financial structure.

Item 8. Financial Statements and Supplementary Data.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Duke Energy Ohio, Inc.
Charlotte, North Carolina

We have audited the accompanying consolidated balance sheets of Duke Energy Ohio, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, common stockholder's equity and comprehensive income, and cash flows for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 (successor period), and the three months ended March 31, 2006 (predecessor period). Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Duke Energy Ohio, Inc. and subsidiaries at December 31, 2008 and 2007, and the results of their operations their cash flows for the periods stated above, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP
Charlotte, North Carolina
March 13, 2009

DUKE ENERGY OHIO, INC.

Consolidated Statements of Operations
(In millions)

	Successor			Predecessor
	Year Ended December 31, 2008	Year Ended December 31, 2007	*Nine Months Ended* December 31, 2006	*Three Months Ended* March 31, 2006
Operating Revenues				
Non-regulated electric and other	$1,646	$1,751	$1,236	$421
Regulated electric	988	984	638	220
Regulated natural gas	790	720	387	322
Total operating revenue	3,424	3,455	2,261	963
Operating Expenses				
Fuel used in electric generation and purchased power—non-regulated	847	916	712	172
Fuel used in electric generation and purchased power—regulated	157	154	92	24
Cost of natural gas and coal sold	486	496	313	276
Operation, maintenance and other	743	756	505	173
Depreciation and amortization	409	392	280	68
Property and other taxes	241	250	165	68
Impairment charges	82	—	—	—
Total operating expenses	2,965	2,964	2,067	781
Gains (Losses) on Sales of Other Assets and Other, net	59	(8)	(28)	26
Operating Income	518	483	166	208
Other Income and Expenses, net	34	32	17	8
Interest Expense	94	100	81	30
Income From Continuing Operations Before Income Taxes	458	415	102	186
Income Tax Expense from Continuing Operations	171	151	41	68
Income From Continuing Operations	287	264	61	118
Loss From Discontinued Operations, net of tax	—	—	(6)	(2)
Income Before Extraordinary Items	287	264	55	116
Extraordinary Items, net of tax	67	—	—	—
Net Income	$ 354	$ 264	$ 55	$116

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

Consolidated Balance Sheets
(In millions)

	December 31,	
	2008	2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 27	$ 33
Receivables (net of allowance for doubtful accounts of $18 at December 31, 2008 and $3 at December 31, 2007)	303	334
Inventory	180	212
Unrealized gains on mark-to-market and hedging transactions	51	22
Other	336	94
Total current assets	897	695
Investments and Other Assets		
Restricted funds held in trust	10	62
Goodwill	2,360	2,325
Intangibles, net	403	551
Unrealized gains on mark-to-market and hedging transactions	17	17
Other	55	33
Total investments and other assets	2,845	2,988
Property, Plant and Equipment		
Cost	10,047	9,577
Less accumulated depreciation and amortization	2,277	2,097
Net property, plant and equipment	7,770	7,480
Regulatory Assets and Deferred Debits		
Deferred debt expense	23	23
Regulatory assets related to income taxes	103	90
Other	451	401
Total regulatory assets and deferred debits	577	514
Total Assets	$12,089	$11,677

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

Consolidated Balance Sheets—(Continued)
(In millions, except share and per-share amounts)

	December 31,	
	2008	2007
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	$ 511	$ 602
Notes payable	343	189
Taxes accrued	134	172
Interest accrued	24	24
Current maturities of long-term debt	27	126
Unrealized losses on mark-to-market and hedging transactions	47	24
Other	93	86
Total current liabilities	1,179	1,223
Long-term Debt	1,856	1,810
Deferred Credits and Other Liabilities		
Deferred income taxes	1,619	1,436
Investment tax credit	14	16
Accrued pension and other post-retirement benefit costs	406	259
Unrealized losses on mark-to-market and hedging transactions	15	25
Asset retirement obligations	33	31
Other	297	343
Total deferred credits and other liabilities	2,384	2,110
Commitments and Contingencies		
Common Stockholder's Equity		
Common Stock, $8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at December 31, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	381	227
Accumulated other comprehensive loss	(43)	(25)
Total common stockholder's equity	6,670	6,534
Total Liabilities and Common Stockholder's Equity	$12,089	$11,677

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

Consolidated Statements of Cash Flows
(In millions)

	Successor			Predecessor
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	$ 354	$ 264	$ 55	$ 116
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	412	395	280	68
Extraordinary items, net of taxes	(67)	—	—	—
(Gains) losses on sales of other assets and other, net	(59)	8	31	(26)
Impairment charges	82	—	—	—
Deferred income taxes	53	18	(120)	7
Accrued pension and other post-retirement benefit costs	4	37	40	9
Contribution to company-sponsored pension and other post-retirement benefit plans	—	(92)	(22)	—
(Increase) decrease in:				
Net realized and unrealized mark-to-market and hedging transactions	10	21	(6)	(30)
Receivables	47	(25)	132	10
Inventory	(70)	5	(84)	56
Other current assets	(28)	22	25	68
Increase (decrease) in:				
Accounts payable	(130)	181	(86)	(157)
Taxes accrued	(43)	(144)	54	50
Other current liabilities	9	1	(63)	(78)
Regulatory asset/liability deferrals	(50)	(19)	(7)	(1)
Other assets	19	165	184	24
Other liabilities	4	(89)	(50)	—
Net cash provided by operating activities	547	748	363	116
CASH FLOWS FROM INVESTING ACTIVITIES				
Capital expenditures	(565)	(593)	(391)	(135)
Purchases of emission allowances	(17)	(23)	(167)	(162)
Sales of emission allowances	74	29	138	105
Net proceeds from the sales of other assets	4	—	32	—
Change in restricted funds held in trust	52	(31)	22	8
Other	1	—	—	—
Net cash used in investing activities	(451)	(618)	(366)	(184)
CASH FLOWS FROM FINANCING ACTIVITIES				
Issuance of long-term debt	136	205	88	141
Redemption of long-term debt	(191)	(153)	(80)	(1)
Redemption of preferred stock of subsidiaries	—	—	—	(21)
Notes payable and commercial paper	279	—	—	—
Notes payable to affiliate, net	(126)	(85)	36	50
Dividends to parent	(200)	(135)	—	(102)
Capital contribution from parent	—	29	—	—
Other	—	(3)	(4)	(1)
Net cash (used in) provided by financing activities	(102)	(142)	40	66
Net (decrease) increase in cash and cash equivalents	(6)	(12)	37	(2)
Cash and cash equivalents at beginning of period	33	45	8	10
Cash and cash equivalents at end of period	$ 27	$ 33	$ 45	$ 8
Supplemental Disclosures:				
Cash paid for interest, net of amount capitalized	$ 91	$ 91	$ 103	$ 21
Cash paid for income taxes	$ 187	$ 159	$ 77	$ —
Significant non-cash transactions:				
Purchase accounting adjustments	$ —	$ (14)	$2,894	$ —
Accrued capital expenditures	$ 81	$ 62	$ 49	$ —
Transfer of generating assets from Duke Energy	$ —	$ —	$1,462	$ —

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

Consolidated Statements of Common Stockholder's Equity and Comprehensive Income (In millions)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Net Gains (Losses) on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss): Minimum Pension Liability Adjustment	Accumulated Other Comprehensive Income (Loss): Pension and OPEB Related Adjustments to AOCI	Total
Successor							
Nine Months Ended December 31, 2006							
Balance at April 1, 2006	**$762**	**$4,123**	**$ —**	**$ —**	**$ —**	**$ —**	**$4,885(b)**
Net income	—	—	55	—	—	—	55
Other comprehensive income							
Cash flow hedges (d)	—	—	—	3	—	—	3
Total comprehensive income							58
Transfer of generating assets from Duke Energy (a)	—	1,462	—	(39)	—	—	1,423
Contribution from parent company for reallocation of taxes	—	16	—	—	—	—	16
SFAS No. 158 funded status provision	—	—	—	—	—	(2)	(2)
Balance at December 31, 2006	**$762**	**$5,601**	**$ 55**	**$(36)**	**$ —**	**$ (2)**	**$6,380**
Year Ended December 31, 2007							
Balance at December 31, 2006	**$762**	**$5,601**	**$ 55**	**$(36)**	**$ —**	**$ (2)**	**$6,380**
Net income	—	—	264	—	—	—	264
Other comprehensive income							
Cash flow hedges (d)	—	—	—	4	—	—	4
SFAS 158 net actuarial gain (c), (e)	—	—	—	—	—	11	11
Total comprehensive income							279
Capital contribution from parent	—	29	—	—	—	—	29
Push-down accounting adjustments	—	(14)	—	—	—	—	(14)
Adoption of SFAS No. 158 —measurement date provision	—	—	(3)	—	—	(2)	(5)
Dividends to Cinergy Corp.	—	(46)	(89)	—	—	—	(135)
Balance at December 31, 2007	**$762**	**$5,570**	**$227**	**$(32)**	**$ —**	**$ 7**	**$6,534**
Year Ended December 31, 2008							
Balance at December 31, 2007	**$762**	**$5,570**	**$227**	**$(32)**	**$ —**	**$ 7**	**$6,534**
Net income	—	—	354	—	—	—	354
Other comprehensive income							
Cash flow hedges (d)	—	—	—	17	—	—	17
Pension and OPEB related adjustments to AOCI (f)	—	—	—	—	—	(35)	(35)
Total comprehensive income							336
Dividends to Cinergy Corp.	—	—	(200)	—	—	—	(200)
Balance at December 31, 2008	**$762**	**$5,570**	**$381**	**$(15)**	**$ —**	**$(28)**	**$6,670**
Predecessor							
Three Months Ended March 31, 2006							
Balance at December 31, 2005	**$762**	**$ 603**	**$657**	**$(14)**	**$(33)**	**$ —**	**$1,975**
Net income	—	—	116	—	—	—	116
Other comprehensive income							
Minimum pension liability adjustment	—	—	—	—	1	—	1
Cash flow hedges	—	—	—	1	—	—	1
Total comprehensive income							118
Dividends to Cinergy Corp.	—	—	(102)	—	—	—	(102)
Balance at March 31, 2006	**$762**	**$ 603**	**$671**	**$(13)**	**$(32)**	**$ —**	**$1,991(b)**

(a) Includes $39 (net of tax benefit of $24) related to deferred losses on terminated cash flow hedges included in Accumulated Other Comprehensive Income (Loss).
(b) Difference in equity balances at March 31, 2006 and April 1, 2006 is due to the application of push-down accounting reflecting Duke Energy's merger with Cinergy (see Notes 1 and 3 to the *Consolidated Financial Statements*).
(c) Excludes $50 reflected as regulatory assets.
(d) Net of $10 tax expense in 2008, $3 tax expense in 2007 and $2 tax expense for the nine months ended December 31, 2006.
(e) Net of $5 tax expense in 2007.
(f) Net of $19 tax benefit in 2008.

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements
For the Years Ended December 31, 2008, 2007 and 2006

1. Summary of Significant Accounting Policies

Nature of Operations and Basis of Consolidation. Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania through Duke Energy Ohio's Commercial Power business segment operations, which are discussed further below. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity, as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy merged into wholly-owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy or Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas, LLC effective October 1, 2006). As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 3 for additional information regarding the merger. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein.

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

Predecessor and Successor Reporting. In connection with the merger between Duke Energy and Cinergy, Duke Energy acquired all of the outstanding common stock of Cinergy. The merger was accounted for under the purchase method of accounting with Duke Energy treated as the acquirer for accounting purposes. As a result, the assets and liabilities of Cinergy were recorded at their respective fair values as of the merger consummation date. Purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006 (see Note 3). Except for an adjustment related to pension and other post-retirement benefit obligations, as mandated by the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 87, *"Employers' Accounting for Pensions,"* and SFAS No. 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions,"* the accompanying consolidated financial statements do not reflect any adjustments related to Duke Energy Ohio's regulated operations that were accounted for pursuant to SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation"* (SFAS No. 71) at the time of the merger, which are comprised of Duke Energy Ohio's regulated transmission and distribution operations and Duke Energy Kentucky. Under the rate setting and recovery provisions currently in place for these regulated operations which provide revenues derived from cost, the fair values of the individual tangible and intangible assets and liabilities are considered to approximate their carrying values.

Duke Energy Ohio's Consolidated Statements of Operations subsequent to the merger include amortization expense relating to purchase accounting adjustments and depreciation of fixed assets based upon their fair value as of the merger date. Therefore, the Duke Energy Ohio financial data prior to the merger will not generally be comparable to its financial data subsequent to the merger. See Note 3 for additional information.

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States (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 information at the time, actual results could differ.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Reapplication of SFAS No. 71 to Portions of Generation in Ohio. Duke Energy Ohio's generation operations within its Commercial Power business segment (see Note 2) include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the Public Utilities Commission of Ohio (PUCO) approved Duke Energy Ohio's Electric Security Plan (ESP), which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a rate stabilization plan (RSP), which was a market-based standard service offer. See "Cost-Based Regulation" section below for further information on the RSP and the market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 4, in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio will bill for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a fuel and purchased power (FPP) rider and certain portions of a cost of environmental compliance (AAC) rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Despite certain portions of the Ohio native load operations not being subject to the accounting provisions of SFAS No. 71, all of Duke Energy Ohio's native load operations' rates are subject to approval by the PUCO, and thus these operations are referred to herein as Duke Energy Ohio's regulated operations.

Extraordinary item. The reapplication of SFAS No. 71 to certain portions of generation in Ohio on December 17, 2008, as discussed above, resulted in an approximate $67 million after-tax (approximately $103 million pre-tax) extraordinary gain related to mark-to-market losses previously recorded in earnings associated with open forward native load economic hedge contracts for fuel, purchased power and emission allowances, which the RSP and ESP allow to be recovered through a FPP rider. There were no other immediate income statement impacts on the date of reapplication of SFAS No. 71. A corresponding regulatory asset was established for the value of these contracts.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Cash and Cash Equivalents. All highly liquid investments with maturities of three months or less at the date of acquisition are considered cash equivalents.

Restricted Funds Held in Trust. At December 31, 2008 and 2007, Duke Energy Ohio had approximately $10 million and $62 million, respectively, of restricted cash related primarily to proceeds from debt issuances that are held in trust, primarily for the purpose of funding future environmental expenditures.

Inventory. Inventory consists primarily of coal held for electric generation, materials and supplies and natural gas held in storage for transmission and sales commitments, and is recorded primarily using the average cost method. Inventory related to Duke Energy Ohio's regulated operations is valued at historical cost consistent with ratemaking treatment. Materials and supplies are recorded as inventory when purchased and subsequently charged to expense or capitalized to plant when installed. Inventory related to Duke Energy Ohio's non-regulated operations is valued at the lower of cost or market.

Components of Inventory

	December 31,	
	2008	2007
	(in millions)	
Inventory		
Fuel for use in electric generation	$ 89	$ 77
Materials and supplies	88	66
Gas held in storage	3	69
Total Inventory	$180	$212

Effective November 1, 2008, Duke Energy Ohio and Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Ohio and Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Ohio and Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately $81 million being held by a third party as of December 31, 2008 has been classified as Other within Current Assets on the Consolidated Balance Sheets. At December 31, 2008, this balance exceeded 5% of total current assets.

Cost-Based Regulation. Duke Energy Ohio accounts for certain of its regulated operations under the provisions of 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, Duke Energy Ohio records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets and liabilities are amortized consistent with the treatment of the related costs in the ratemaking process. 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 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. Duke Energy Ohio 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, Duke Energy Ohio may have to reduce its asset balances to reflect a market basis less than cost and write off the associated regulatory assets and liabilities. For further information see Note 4.

In order to apply the accounting provisions of SFAS No. 71 and record regulatory assets and liabilities, the scope criteria in SFAS No. 71 must be met. Management makes significant judgments in determining whether the scope criteria of SFAS No. 71 are met for its operations, including determining whether revenue rates for services provided to customers are subject to approval by an independent, third-party regulator, whether the regulated rates are designed to recover specific costs of providing the regulated service, and a determination of whether, in view of the demand for the regulated services and the level of competition, it is reasonable to assume that

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Notes To Consolidated Financial Statements—(Continued)

rates set at levels that will recover the operations' costs can be charged to and collected from customers. This final criterion requires consideration of anticipated changes in levels of demand or competition, direct and indirect, during the recovery period for any capitalized costs. If facts and circumstances change so that a portion of Duke Energy Ohio's regulated operations meet all of the scope criteria set forth in SFAS No. 71 when such criteria had not been previously met, SFAS No. 71 would be reapplied to all or a separable portion of the operations. Such reapplication includes adjusting the balance sheet for amounts that meet the definition of a regulatory asset or regulatory liability of SFAS No. 71. Refer to the above section titled, "Reapplication of SFAS No. 71 to Portions of Generation in Ohio."

From January 1, 2005 through December 31, 2008, Duke Energy Ohio operated under a RSP, a market-based standard service offer which was approved by the PUCO in November 2004, and which provided price certainty through December 31, 2008. See Note 4 for additional information. The RSP consisted of the following discrete charges:

- Annually Adjusted Component—intended to provide cost recovery primarily for environmental compliance expenditures. This component was avoidable (or by-passable) for the first 25% of residential load and 50% of non-residential load to switch to an alternative electric service provider.
- Infrastructure Maintenance Fund Charge—intended to compensate Duke Energy Ohio for committing its physical capacity. This charge was unavoidable (or non-by-passable).
- System Reliability Tracker—intended to provide actual cost recovery for capacity purchases, purchased power, reserve capacity, and related market costs for purchases to meet capacity needs. This charge was non-by-passable for residential load and by-passable for non-residential load under certain circumstances.
- Rate Stabilization Charge—intended to compensate Duke Energy Ohio for maintaining a fixed price through 2008. This charge was by-passable by the first 25% of residential load and 50% of non-residential load to switch.
- Generation Prices and Fuel Recovery—A market price has been established for generation service. A component of the market price was a fuel cost recovery mechanism that was adjusted quarterly for fuel, emission allowances, and certain purchased power costs, that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. These new prices were applied to non-residential customers beginning January 1, 2005 and to residential customers beginning January 1, 2006.
- Transmission Cost Recovery—A transmission cost recovery mechanism was established beginning January 1, 2005 for non-residential customers and beginning January 1, 2006 for residential customers. The transmission cost recovery mechanism was designed to permit Duke Energy Ohio to recover certain Midwest Independent Transition System Operator, Inc. (Midwest ISO) charges, all Federal Energy Regulatory Commission (FERC) approved transmission costs, and all congestion costs allocable to retail ratepayers that are provided service by Duke Energy Ohio.

Energy Purchases and Fuel Costs. A cost tracking recovery mechanism is used to recover costs of retail fuel and emission allowances that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. Also, Duke Energy Ohio began utilizing a tracking mechanism approved by the PUCO for the recovery of system reliability capacity costs related to certain specified purchases of power.

Accounting for Risk Management and Hedging Activities and Financial Instruments. Duke Energy Ohio may use a number of different derivative and non-derivative instruments in connection with its commodity price and interest rate risk management activities, including swaps, futures, forwards and options. All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities,"* as amended (SFAS No. 133), are recorded on the Consolidated Balance Sheets at their fair value. Cash inflows and outflows related to derivative instruments, except those that contain financing elements and those related to other investing activities, are presented as a component of operating cash flows in the accompanying Consolidated Statements of Cash Flows. Cash inflows and outflows related to derivative instruments containing financing elements are presented as a component of financing cash flows in the accompanying Consolidated Statements of Cash Flows while cash inflows and outflows from derivatives related to investing activities are presented as a component of investing cash flows in the accompanying Consolidated Statements of Cash Flows.

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Duke Energy Ohio has designated all energy commodity derivatives as non-trading subsequent to the October 2006 sale of Cinergy Marketing and Trading, LP, and Cinergy Canada, Inc. (collectively CMT), which is discussed further in Note 14. Gains and losses for all derivative contracts that do not represent physical delivery contracts are reported on a net basis in the Consolidated Statements of Operations. For each of Duke Energy Ohio's physical delivery contracts that are derivatives, the accounting model and presentation of gains and losses, or revenue and expense in the Consolidated Statements of Operations is shown below.

Classification of Contract	Duke Energy Ohio Accounting Model	Presentation of Gains & Losses or Revenue & Expense
Trading derivatives	Mark-to-market[(a)]	Net basis in Non-regulated electric and other
Non-trading derivatives:		
Cash flow hedge	Accrual[(b)]	Gross basis in the same Statement of Operations category as the related hedged item
Fair value hedge	Accrual[(b)]	Gross basis in the same Statement of Operations category as the related hedged item
Normal purchase or sale	Accrual[(b)]	Gross basis upon settlement in the corresponding Statement of Operations category based on commodity type
Undesignated	Mark-to-market[(a)]	Net basis in the related Statement of Operations category for interest rate and commodity derivatives in the non-regulated business. For derivatives related to the regulated business, gains and losses are deferred as regulatory liabilities and assets, respectively.

(a) An accounting term used by Duke Energy Ohio to refer to derivative contracts for which an asset or liability is recognized at fair value and the change in the fair value of that asset or liability is generally recognized in the Consolidated Statements of Operations for the non-regulated business and the Consolidated Balance Sheets within regulatory assets or regulatory liabilities for the regulated business. This term is applied to trading and undesignated non-trading derivative contracts. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.
(b) An accounting term used by Duke Energy Ohio to refer to contracts for which there is generally no recognition in the Consolidated Statements of Operations for any changes in fair value until the service is provided, the associated delivery period occurs or there is hedge ineffectiveness. As discussed further below, this term is applied to derivative contracts that are accounted for as cash flow hedges, fair value hedges, and normal purchases or sales, as well as to non-derivative contracts used for commodity risk management purposes. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.

On January 1, 2008, Duke Energy Ohio adopted FASB Staff Position (FSP) No. FIN 39-1, "*Amendment of FASB Interpretation No. (FIN) 39, Offsetting of Amounts Related to Certain Contracts*" (FSP No. FIN 39-1). In accordance with FSP No. FIN 39-1, Duke Energy Ohio 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, Duke Energy Ohio 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 December 31, 2008 and 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately $85 million and $5 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount at each balance sheet date that have been offset against net derivative positions in the Consolidated Balance Sheets. Additionally, Duke Energy Ohio had cash collateral receivables of approximately $53 million and $15 million under master netting arrangements that have not been offset against net derivative positions at December 31, 2008 and 2007, respectively, as these amounts primarily represent initial margin deposits related to New York Mercantile Exchange (NYMEX) futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at December 31, 2008 and December 31, 2007.

Cash Flow and Fair Value Hedges. Qualifying energy commodity and other derivatives may be designated as either a hedge of a forecasted transaction or future cash flows (cash flow hedge) or a hedge of a recognized asset, liability or firm commitment (fair value hedge). For all contracts accounted for as a hedge, Duke Energy Ohio prepares formal documentation of the hedge in accordance with SFAS No. 133. In addition, at inception and at least every three months thereafter, Duke Energy Ohio formally assesses whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. Duke Energy Ohio documents hedging activity by transaction type (futures/swaps) and risk management strategy (commodity price risk/interest rate risk).

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Notes To Consolidated Financial Statements—(Continued)

Changes in the fair value of a derivative designated and qualified as a cash flow hedge, to the extent effective, are included in the Consolidated Statements of Common Stockholder's Equity and Comprehensive Income as Accumulated Other Comprehensive Income (Loss) (AOCI) until earnings are affected by the hedged item. Duke Energy Ohio discontinues hedge accounting prospectively when it has determined that a derivative no longer qualifies as an effective hedge, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge, the derivative is subject to the Mark-to-Market model of accounting (MTM Model) prospectively. Gains and losses related to discontinued hedges that were previously accumulated in AOCI will remain in AOCI until the underlying contract is reflected in earnings, unless it is probable that the hedged forecasted transaction will not occur, at which time associated deferred amounts in AOCI are immediately recognized in earnings.

For derivatives designated as fair value hedges, Duke Energy Ohio recognizes the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item in earnings, to the extent effective, in the current period. All derivatives designated and accounted for as hedges are classified in the same category as the item being hedged in the Consolidated Statements of Cash Flows. In addition, all components of each derivative gain or loss are included in the assessment of hedge effectiveness.

Normal Purchases and Normal Sales (NPNS). On a limited basis, Duke Energy Ohio applies the NPNS exception to certain contracts. If contracts cease to meet this exception, the fair value of the contracts is recognized on the Consolidated Balance Sheets and the contracts are accounted for prospectively using the MTM Model unless immediately designated as a cash flow or fair value hedge.

Valuation. When available, quoted market prices or prices obtained through external sources are used to measure a contract's fair value. For contracts with a delivery location or duration for which quoted market prices are not available, fair value is determined based on internally developed valuation techniques or models. For derivatives recognized under the MTM Model, valuation adjustments are also recognized in the Consolidated Statements of Operations.

Goodwill. Duke Energy Ohio evaluates goodwill for potential impairment under the guidance of SFAS No. 142, "*Goodwill and Other Intangible Assets*" (SFAS No. 142). Under this provision, goodwill is subject to an annual test for impairment. Duke Energy Ohio has designated August 31 as the date it performs the annual review for goodwill impairment for its reporting units. Under the provisions of SFAS No. 142, Duke Energy Ohio performs the annual review for goodwill impairment at the reporting unit level, which Duke Energy Ohio has determined to be an operating segment.

Impairment testing of goodwill consists of a two-step process. The first step involves a comparison of the determined fair value of a reporting unit with its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Additional impairment tests are performed between the annual reviews if events or changes in circumstances make it more likely than not that the fair value of a reporting unit is below its carrying amount.

Duke Energy Ohio primarily uses a discounted cash flow analysis to determine fair value. Key assumptions in the determination of fair value include the use of an appropriate discount rate, estimated future cash flows and estimated run rates of operation, maintenance, and general and administrative costs. In estimating cash flows, Duke Energy Ohio incorporates expected growth rates, regulatory stability and ability to renew contracts as well as other factors into its revenue and expense forecasts. See Note 10 for further information.

Property, Plant and Equipment. As discussed under "Predecessor and Successor Reporting" above, recorded balances for property, plant and equipment existing as of April 3, 2006 were adjusted to reflect fair values as of that date. Due to rate-setting and recovery provisions currently in place for regulated operations, the fair values of property plant and equipment of the regulated operations were considered to approximate their carrying values as of the date of Duke Energy's merger with Cinergy. Accumulated depreciation was not reset to zero as of the merger date for the regulated property, plant and equipment due primarily to regulatory reporting implications. Unregulated property, plant and equipment were recorded at respective fair values and accumulated deprecation was reset to zero as of the merger date. Otherwise, property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Ohio capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction (see "Allowance for Funds Used During Construction (AFUDC)," discussed below). The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, is expensed as incurred. Depreciation is generally computed over the asset's estimated useful life using the composite straight-line method. The composite weighted-average depreciation rates were 2.6% for 2008, 2.6% for 2007

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

and 2.7% for 2006. Depreciation studies are conducted periodically to update the composite rates and are approved by the PUCO and the Kentucky Public Service Commission (KPSC).

When Duke Energy Ohio retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation. When it sells entire regulated operating units, or retires or sells non-regulated properties, the cost is removed from the property account and the related accumulated depreciation and amortization accounts are reduced. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

See Note 15 for further information on the components and estimated useful lives of Duke Energy Ohio's property, plant and equipment balance.

Asset Retirement Obligations. Duke Energy Ohio recognizes asset retirement obligations in accordance with SFAS No. 143, "*Accounting For Asset Retirement Obligations*" (SFAS No. 143), for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset and FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations*" (FIN 47), for conditional asset retirement obligations. The term conditional asset retirement obligation as used in SFAS No. 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Both SFAS No. 143 and FIN 47 require that the present value of the projected liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 7 for further information regarding Duke Energy Ohio's asset retirement obligations.

Long-Lived Asset Impairments, Assets Held For Sale and Discontinued Operations. Duke Energy Ohio evaluates whether long-lived assets, excluding goodwill, have been impaired when circumstances indicate the carrying value of those assets may not be recoverable. For such long-lived assets, an impairment exists when its carrying value exceeds the sum of estimates of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used for developing estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on these estimated future undiscounted cash flows, the impairment loss is measured as the excess of the asset's carrying value over its fair value, such that the asset's carrying value is adjusted to its estimated fair value.

Management assesses the fair value of long-lived assets using commonly accepted techniques, and may use more than one source. Sources to determine fair value include, but are not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. Significant changes in market conditions resulting from events such as changes in commodity prices or the condition of an asset, or a change in management's intent to utilize the asset may generally require management to re-assess the cash flows related to the long-lived assets.

Duke Energy Ohio uses the criteria in SFAS No. 144 "*Accounting for the Impairment or Disposal of Long-Lived Assets*" (SFAS No. 144), to determine when an asset is classified as "held for sale." Upon classification as "held for sale," the long-lived asset or asset group is measured at the lower of its carrying amount or fair value less cost to sell, depreciation is ceased and the asset or asset group is separately presented on the Consolidated Balance Sheets. When an asset or asset group meets the SFAS No. 144 criteria for classification as held for sale within the Consolidated Balance Sheets, Duke Energy Ohio does not retrospectively adjust prior period balance sheets to conform to current year presentation.

Duke Energy Ohio uses the criteria in SFAS No. 144 and Emerging Issues Task Force (EITF) Issue No. 03-13, "*Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*" (EITF 03-13), to determine whether components of Duke Energy Ohio that are being disposed of, are classified as held for sale or have been wound down are required to be reported as discontinued operations in the Consolidated Statements of Operations. To qualify as a discontinued operation under SFAS No. 144, the component being disposed of must have clearly distinguishable operations and cash flows. Additionally, pursuant to EITF 03-13, Duke Energy Ohio must not have significant continuing involvement in the operations after the disposal (i.e., Duke Energy Ohio must not have the ability to influence the operating or financial policies of the disposed component) and cash flows of the operations being disposed of must have been eliminated from Duke Energy Ohio's ongoing operations (i.e., Duke Energy Ohio does not

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expect to generate significant direct cash flows from activities involving the disposed component after the disposal transaction is completed). Assuming both preceding conditions are met, the related results of operations for the current and prior periods, including any related impairments, are reflected within discontinued operations, net of tax, in the Consolidated Statements of Operations. If an asset held for sale does not meet the requirements for discontinued operations classification, any impairments and gains or losses on sales are recorded as a component of continuing operations in the Consolidated Statements of Operations. Impairments for all other long-lived assets are recorded in Operating Expenses in the Consolidated Statements of Operations.

Unamortized Debt Premium, Discount and Expense. Premiums, discounts and expenses incurred with the issuance of outstanding long-term debt are amortized over the terms of the debt issues. Any call premiums or unamortized expenses associated with refinancing higher-cost debt obligations to finance regulated assets and operations are amortized consistent with regulatory treatment of those items, where appropriate. The amortization expense is recorded as a component of interest expense in the Consolidated Statements of Operations and is reflected as Depreciation and amortization within Net cash provided by operating activities on the Consolidated Statements of Cash Flows.

Loss Contingencies. Duke Energy Ohio is involved in certain legal and environmental matters that arise in the normal course of business. Loss contingencies are accounted for under SFAS No. 5, "*Accounting for Contingencies*" (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Ohio records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred. See Note 18 for further information.

Environmental Expenditures. Duke Energy Ohio expenses environmental expenditures related to conditions caused by past operations that do not generate current or future revenues. Environmental expenditures related to operations that generate current or future revenues are expensed or capitalized, as appropriate. Liabilities are recorded on an undiscounted basis when the necessity for environmental remediation becomes probable and the costs can be reasonably estimated, or when other potential environmental liabilities are reasonably estimable and probable.

Revenue Recognition and 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 Mcfs delivered but not billed. The amount of unbilled revenues can vary significantly from 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 at Commercial Power and were approximately $40 million and $38 million, at December 31, 2008 and 2007, respectively. Additionally, receivables for unbilled revenues of approximately $149 million and $145 million at December 31, 2008 and 2007, respectively, related to retail accounts receivable at Duke Energy Ohio and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). See Note 13 for additional information.

Fuel Cost Deferrals. Fuel expense includes fuel costs or other recoveries that are deferred through fuel clauses established by Duke Energy Ohio's regulators. These clauses allow Duke Energy Ohio to recover fuel costs, fuel-related costs and portions of purchased power costs through surcharges on customer rates. These deferred fuel costs are recognized in revenues and fuel expenses as they are billable to customers.

AFUDC. In accordance with regulatory treatment, Duke Energy Ohio records AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities. Both the debt and equity components of AFUDC are non-cash amounts within the Consolidated Statements of Operations. AFUDC is capitalized as a component of the cost of Property, Plant and Equipment, with an offsetting credit to Other Income and Expenses, net on the Consolidated Statements of Operations for the equity component and as an offset to Interest Expense on the Consolidated Statements of Operations for the debt component. After construction is completed, Duke Energy Ohio is permitted to recover these costs through inclusion in the rate base and the corresponding depreciation expense. The total amount of AFUDC included in the Consolidated Statements of Operations was $26 million in 2008, which consisted of an after-tax equity component of $7 million and a before-tax interest expense component of $19 million. The total amount of AFUDC included in the Consolidated Statements of Operations was $34 million in 2007, which consisted of an after-tax equity component of $4 million and a before-tax interest expense component of $30 million. The total amount of AFUDC included in the Consolidated Statements of Operations for the nine months ended December 31, 2006 was $16 million, which consisted of an after-tax

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

equity component of $2 million and a before-tax interest expense component of $14 million. The total amount of AFUDC included in the Consolidated Statements of Operations for the three months ended March 31, 2006 was $4 million, which consisted of an after-tax equity component of $1 million and a before-tax interest expense component of $3 million.

AFUDC equity is recorded in the Consolidated Statements of Operations on an after-tax basis and is a permanent difference item for income tax purposes (i.e., a permanent difference between financial statement and income tax reporting), thus reducing Duke Energy Ohio's income tax expense and effective tax rate during the construction phase in which AFUDC equity is being recorded. The effective tax rate is subsequently increased in future periods when the completed property, plant and equipment is placed in service and depreciation of the AFUDC equity commences.

Accounting For Purchases and Sales of Emission Allowances. Emission allowances are issued by the Environmental Protection Agency (EPA) at zero cost and permit the holder of the allowance to emit certain gaseous by-products of fossil fuel combustion, including sulfur dioxide (SO_2) and nitrogen oxide (NO_x). Allowances may also be bought and sold via third party transactions or consumed as the emissions are generated. Allowances allocated to or acquired by Duke Energy Ohio are held primarily for consumption. Duke Energy Ohio records emission allowances as Intangibles, net on its Consolidated Balance Sheets and recognizes the allowances in earnings as they are consumed or sold. Gains or losses on sales of emission allowances for non-regulated businesses are presented on a net basis in Gains (Losses) on Sales of Other Assets and Other, net, in the accompanying Consolidated Statements of Operations. For regulated businesses that provide for direct recovery of emission allowances, any gain or loss on sales of recoverable emission allowances are included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Future rates charged to retail customers are impacted by any gain or loss on sales of recoverable emission allowances and, therefore, as the recovery of the gain or loss is recognized in operating revenues, the regulatory asset or liability related to the emission allowance activity is recognized as a component of Fuel Used in Electric Generation and Purchased Power—Regulated in the Consolidated Statements of Operations. Purchases and sales of emission allowances are presented gross as investing activities on the Consolidated Statements of Cash Flows. See Note 11 for discussion regarding the impairment of the carrying value of certain emission allowances in 2008.

Income Taxes. As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into 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 or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own federal tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger. Deferred income taxes have been provided for temporary differences between the GAAP and tax carrying amounts of assets and liabilities. These differences create taxable or tax-deductible amounts for future periods. Investment tax credits have been deferred and are being amortized over the estimated useful lives of the related properties in Duke Energy Ohio's regulated operations.

Management evaluates and records uncertain tax positions in accordance with FIN 48, "*Accounting For Uncertainty in Income Taxes—an Interpretation of FASB Statement 109*" (FIN 48), which was adopted by Duke Energy Ohio on January 1, 2007. Duke Energy Ohio records tax benefits for uncertain positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. In accordance with FIN 48, Duke Energy Ohio records the largest amount of the uncertain tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Ohio does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 6 for further information.

Duke Energy Ohio records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net, in the Consolidated Statements of Operations.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Excise Taxes. Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio 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. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as revenues in the accompanying Consolidated Statements of Operations were as follows:

Successor[(a)]			Predecessor[(a)]
Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
(in millions)			
$121	**$119**	**$77**	$38

(a) See "Predecessor and Successor Reporting" section above for additional information on Predecessor and Successor reporting.

Segment Reporting. SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*" (SFAS No. 131), establishes standards for a public company to report financial and descriptive information about its reportable operating segments in annual and interim financial reports. Operating segments are components of an enterprise about which separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. Two or more operating segments may be aggregated into a single reportable segment provided aggregation is consistent with the objective and basic principles of SFAS No. 131, if the segments have similar economic characteristics, and the segments are considered similar under criteria provided by SFAS No. 131. There is no aggregation within Duke Energy Ohio's reportable business segments. SFAS No. 131 also establishes standards and related disclosures about the way the operating segments were determined, including products and services, geographic areas and major customers, differences between the measurements used in reporting segment information and those used in the general-purpose financial statements, and changes in the measurement of segment amounts from period to period. The description of Duke Energy Ohio's reportable segments, consistent with how business results are reported internally to management and the disclosure of segment information in accordance with SFAS No. 131, are presented in Note 2.

Statements of Consolidated Cash Flows. Duke Energy Ohio has made certain classification elections within its Consolidated Statements of Cash Flows related to discontinued operations and debt restricted for qualified capital and maintenance expenditures. Cash flows from discontinued operations are combined with cash flows from continuing operations within operating, investing and financing cash flows within the Consolidated Statements of Cash Flows. Proceeds from debt issued with restrictions to fund future capital and maintenance expenditures are presented on a gross basis, with the debt proceeds classified as a financing cash inflow and the changes in the restricted funds held in trust presented as a component of investing activities.

New Accounting Standards. The following new accounting standards were adopted by Duke Energy Ohio during the year ended December 31, 2008 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). Refer to Note 9 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities- including an amendment of FASB Statement No. 115" (SFAS No. 159). Refer to Note 9 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

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). Refer to "Accounting for Risk Management and Hedging Activities and Financial Instruments" above for a discussion of Duke Energy Ohio's adoption of FSP No. FIN 39-1.

The following new accounting standards were adopted by Duke Energy Ohio during the year ended December 31, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" and SFAS No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*" (SFAS No. 140). SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Energy Ohio for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that had been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140. SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 was effective for Duke Energy Ohio as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other post-retirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Ohio recognized the funded status of its defined benefit pension and other post-retirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately $33 million (consisting of an increase in regulatory assets of $31 million and an increase in deferred tax assets of $2 million), an increase in total liabilities of approximately $35 million and a decrease in AOCI, net of tax, of approximately $2 million as of December 31, 2006. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Ohio's consolidated results of operations or cash flows.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Ohio has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Ohio adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately $3 million for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, in the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of AOCI and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Ohio completed these calculations. The finalization of these actuarial calculations resulted in a $2 million adjustment to AOCI and an insignificant adjustment to regulatory assets.

FIN 48. In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Ohio has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Ohio's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Ohio adopted FIN 48 effective January 1, 2007. See Note 6 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No. FIN 48-1). In May, 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Ohio's adoption of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

The following new accounting standard was adopted by Duke Energy Ohio during the year ended December 31, 2006 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). In September 2006 the Securities and Exchange Commission (SEC) issued SAB No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Traditionally, there have been two widely-recognized approaches for quantifying the effects of financial statement misstatements. The income statement approach focuses primarily on the impact of a misstatement on the income statement—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The balance sheet approach, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (a "dual approach") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material.

SAB No. 108 was effective for Duke Energy Ohio's year ending December 31, 2006. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii), under certain circumstances, recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Duke Energy Ohio has historically used a dual approach for quantifying identified financial statement misstatements. Therefore, the adoption of SAB No. 108 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of December 31, 2008:

SFAS No. 141 (revised 2007), "Business Combinations" (SFAS No. 141(R)). In December 2007, the FASB issued SFAS No. 141(R), which replaces SFAS No. 141, "*Business Combinations.*" SFAS No. 141(R) 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 Duke Energy Ohio, SFAS No. 141(R) must be applied prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. The impact to Duke Energy Ohio of applying SFAS No. 141(R) for periods subsequent to implementation will be dependent upon the nature of any transactions within the scope of SFAS No. 141(R). SFAS No. 141(R) 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. 141(R), 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. 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. Duke Energy Ohio 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 Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

2. Business Segments

Duke Energy Ohio operates the following business segments, which are all considered reportable business segments under SFAS No. 131: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's management believes these reportable business segments properly align the various operations of Duke Energy Ohio with how the chief operating decision maker views the business.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these reportable business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky. These electric and gas operations are subject to the rules and regulations of the FERC, the PUCO and the KPSC. Substantially all of Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71.

Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net megawatts (MW) and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. Most of the generation asset output in Ohio has been contracted through the RSP, which expired on December 31, 2008 (see Note 4). Effective January 1, 2009, Commercial Power began operating under an ESP, which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 4 for a discussion of the reapplication of the provisions of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 12).

Duke Energy Ohio's reportable business segments offer different products and services or operate under different competitive environments and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in Note 1. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents and short-term investments, if any, are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT. Transactions between reportable business segments, if any, are accounted for on the same basis as revenues and expenses in the accompanying Consolidated Financial Statements.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Business Segment Data[a]

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT/ Consolidated Income from Continuing Operations before Income Taxes	Depreciation and Amortization	Capital Expenditures	Segment Assets[b][d]
				(in millions)			
Successor[c]							
Year Ended December 31, 2008							
Franchised Electric and Gas	$1,778	$—	$1,778	$ 291	$243	$305	$ 5,857
Commercial Power	1,646	—	1,646	301	166	260	6,249
Total reportable segments	3,424	—	3,424	592	409	565	12,106
Other	—	—	—	(67)	—	—	17
Eliminations and reclassifications	—	—	—	—	—	—	(34)
Interest expense	—	—	—	(94)	—	—	—
Interest income and other	—	—	—	27	—	—	—
Total consolidated	$3,424	$—	$3,424	$ 458	$409	$565	$12,089
Successor[c]							
Year Ended December 31, 2007							
Franchised Electric and Gas	$1,707	$—	$1,707	$ 257	$228	$275	$ 5,530
Commercial Power	1,748	—	1,748	304	164	318	6,147
Total reportable segments	3,455	—	3,455	561	392	593	11,677
Other	—	—	—	(75)	—	—	—
Eliminations and reclassifications	—	—	—	—	—	—	—
Interest expense	—	—	—	(100)	—	—	—
Interest income and other	—	—	—	29	—	—	—
Total consolidated	$3,455	$—	$3,455	$ 415	$392	$593	$11,677
Successor[c]							
Nine Months Ended December 31, 2006							
Franchised Electric and Gas	$1,027	$—	$1,027	$ 130	$160	$198	$ 5,381
Commercial Power	1,234	1	1,235	93	120	193	6,349
Total reportable segments	2,261	1	2,262	223	280	391	11,730
Other	—	—	—	(56)	—	—	—
Eliminations and reclassifications	—	(1)	(1)	—	—	—	—
Interest expense	—	—	—	(81)	—	—	—
Interest income and other	—	—	—	16	—	—	—
Total consolidated	$2,261	$—	$2,261	$ 102	$280	$391	$11,730
Predecessor[c]							
Three Months Ended March 31, 2006							
Franchised Electric and Gas	$ 543	$—	$ 543	$ 80	$ 50	$ 75	
Commercial Power	420	1	421	166	18	60	
Total reportable segments	963	1	964	246	68	135	
Other	—	—	—	(39)	—	—	
Eliminations and reclassifications	—	(1)	(1)	—	—	—	
Interest expense	—	—	—	(30)	—	—	
Interest income and other	—	—	—	9	—	—	
Total consolidated	$ 963	$—	$ 963	$ 186	$ 68	$135	

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

(a) Segment results exclude results of entities classified as discontinued operations.
(b) Segment assets at December 31, 2006 include assets held for sale.
(c) See Note 1 for additional information on Predecessor and Successor reporting.
(d) Amounts include goodwill recorded as of December 31, 2008 and December 31, 2007 resulting from Duke Energy's merger with Cinergy in the amount of $2,360 million and $2,325 million, respectively. Franchised Electric and Gas' allocated amount as of December 31, 2008 and December 31, 2007 was $1,154 million and $1,137 million, respectively. Commercial Power's allocated amount as of December 31, 2008 and December 31, 2007 was $1,206 million and $1,188 million, respectively.

All of Duke Energy Ohio's revenues are generated domestically and its long-lived assets are all in the U.S.

3. Merger, Transfer of Generating Assets and Sales of Other Assets

Acquisitions. Duke Energy Ohio 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 date of acquisition. The purchase price minus the estimated fair value of the acquired assets and liabilities meeting the definition of a business as defined in EITF Issue No. 98-3, "*Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*" (EITF 98-3), 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. As discussed in Note 1, effective January 1, 2009, Duke Energy Ohio adopted SFAS No. 141(R) and will apply the provisions of this standard to any future acquisitions.

Cinergy Merger. On April 3, 2006, the merger between Duke Energy and Cinergy was consummated (see Note 1 for additional information on the merger, purchase accounting and Predecessor and Successor reporting). For accounting purposes, the effective date of the merger was April 1, 2006. The merger combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States.

Based on the market price of Duke Energy common stock during the period, including the two trading days before, through the two trading days after, May 9, 2005, the date Duke Energy and Cinergy announced the merger, the transaction was valued at approximately $9,115 million and resulted in goodwill recorded at Duke Energy Ohio at the time of the merger of approximately $2,348 million.

As discussed in Note 1, purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006. The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the merger with Duke Energy had occurred at the beginning of 2006:

Unaudited Consolidated Pro Forma Results (Predecessor)

	Three Months Ended March 31, 2006
	(in millions)
Operating revenues	$966
Income from continuing operations	88
Net income	86
Earnings available for common stockholder	86

Pro forma results for the nine months ended December 31, 2006 are not presented since the merger occurred at the beginning of such period. Additionally, pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of Cinergy's merger with Duke Energy.

Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the FERC. See Note 4 for a discussion of the regulatory impacts of the merger.

Transfer of Certain Duke Energy Generating Assets to Duke Energy Ohio. In April 2006, Duke Energy contributed to Duke Energy Ohio its ownership interest in five plants, representing a mix of combined cycle and peaking plants, with a combined capacity of 3,600 MW. The transaction was effective in April 2006 and was accounted for at Duke Energy's net book value for these assets. The entities holding these generating plants, which were indirect subsidiaries of Duke Energy, were first distributed to Duke Energy, which then contributed them to Cinergy which, in turn, contributed them to Duke Energy Ohio. In the final step, the entities were then merged into Duke Energy Ohio.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the contribution of the Duke Energy generating assets to Duke Energy Ohio had occurred at the beginning of the periods presented:

Unaudited Consolidated Pro Forma Results (Predecessor)

	Three Months Ended March 31, 2006
	(in millions)
Operating revenues	$971
Income from continuing operations	106
Net income	104
Earnings available for common stockholder	104

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of the transfer of the ownership interest in the five plants as discussed above. As part of this transaction, Duke Energy agreed to reimburse Duke Energy Ohio, on a quarterly basis, through April 2016 in the event of certain cash shortfalls related to the performance of the five plants. Based on the assessment of the performance of the five plants on a quarterly basis during 2008 and 2007, Duke Energy Ohio did not incur any qualifying shortfalls related to the performance of the five plants and thus no cash reimbursement was required from Duke Energy. During the third quarter of 2006, Duke Energy reimbursed Duke Energy Ohio $1.9 million for certain cash shortfalls that occurred during the second quarter of 2006. However, as a result of the calculation pertaining to the third quarter 2006 performance of the five plants, the $1.9 million received by Duke Energy Ohio from Duke Energy was returned to Duke Energy during the fourth quarter of 2006. Duke Energy Ohio accounts for any payments from or return of payments to Duke Energy in Common Stockholder's Equity as an adjustment to Additional paid-in capital.

Other Asset Sales. For the year ended December 31, 2008, the sale of other assets resulted in approximately $77 million in proceeds and net pre-tax gains of approximately $59 million, which is recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of zero cost basis emission allowances.

For the year ended December 31, 2007 and the nine months ended December 31, 2006, the sale of other assets resulted in proceeds of approximately $29 million and $138 million, respectively, and net pre-tax losses of approximately $8 million and $28 million, respectively, recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These losses primarily relate to Commercial Power's sales of emission allowances that were written up to fair value in purchase accounting in connection with Duke Energy's merger with Cinergy in April 2006.

See Note 14 for dispositions related to discontinued operations.

For the three months ended March 31, 2006, the sale of other assets resulted in approximately $105 million in proceeds and net pre-tax gains of approximately $26 million recorded in Gains (Losses) on Sales of Other Assets and Other, net in the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of emission allowances.

4. Regulatory Matters

Regulatory Assets and Liabilities. Substantially all of Franchised Electric and Gas' operations and certain portions of Commercial Power's operations apply the provisions of SFAS No. 71. Accordingly, these businesses record assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio's Regulatory Assets and Liabilities:

	As of December 31,		Recovery/Refund Period Ends
	2008	2007	
	(in millions)		
Regulatory Assets[a]			
Regulatory Transition Charges (RTC)[d][e]	$138	$239	2011
Accrued pension and post-retirement[e]	191	120	[b]
Net regulatory asset related to income taxes	103	90	[i]
Capital-related distribution costs[e]	15	22	[m]
Unamortized costs of reacquiring debt[f]	10	11	2025
Vacation accrual[g]	12	10	2009
Deferred operating expense[e][c]	8	7	2067
Hedge costs and other deferrals[h][n]	106	5	2009
Storm cost deferrals[e]	36	—	[b]
Other[h]	15	9	[b]
Total Regulatory Assets	$634	$513	
Regulatory Liabilities[a]			
Removal costs[c][k]	$189	$181	[j]
Accrued pension and post-retirement[k]	—	27	[b]
Over-recovery of fuel costs[l]	36	1	2009
Other[l]	29	7	[b]
Total Regulatory Liabilities	$254	$216	

(a) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.
(b) Recovery/Refund period currently unknown.
(c) Included in rate base.
(d) The state of Ohio passed comprehensive electric deregulation legislation in 1999, and in 2000, the PUCO approved a stipulation agreement relating to Duke Energy Ohio's transition plan creating a RTC designed to recover Duke Energy Ohio's generation-related regulatory assets and transition costs over a ten-year period beginning January 1, 2001.
(e) Included in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.
(f) Included in Deferred Debt Expense on the Consolidated Balance Sheets.
(g) Included in Other within Current Assets on the Consolidated Balance Sheets.
(h) Included in Other within Current Assets and Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheet.
(i) Recovery/refund is over the life of the associated asset or liability.
(j) Liability is extinguished over the lives of the associated assets.
(k) Included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
(l) Included in Accounts Payable or Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
(m) Recovered via revenue rider.
(n) Approximately $95 million of the balance at December 31, 2008 relates to mark-to-market deferrals associated with open hedge positions at Commercial Power as a result of the reapplication of SFAS No. 71.

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 Duke Energy Ohio and Duke Energy Kentucky to meet additional 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 and $34 million of the rate reductions was passed through to customers during the year ended December 31, 2007 and 2006, respectively.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

- 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 $2 million of the rate reduction was passed through to customers during the years ended December 31, 2008, 2007 and 2006, respectively.
- The FERC approved the merger without conditions.

Restrictions on the Ability of Duke Energy Ohio to Make Dividends, Advances and Loans to Duke Energy Corporation. As discussed above, on April 3, 2006, the merger between Duke Energy and Cinergy was consummated. As a condition of the merger approval the state utility commissions imposed conditions (the Merger Conditions) on the ability of Duke Energy Ohio and Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Pursuant to the Merger Conditions, Duke Energy Ohio will not declare and pay dividends out of capital or unearned surplus without the prior authorization of the PUCO and Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure. At December 31, 2008, Duke Energy Ohio had restricted net assets of approximately $6.3 billion that may not be transferred to Duke Energy without appropriate approval based on the aforementioned Merger Conditions.

Franchised Electric and Gas.

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. 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 (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based rates.

Duke Energy Ohio Electric Rate Filings. Duke Energy Ohio operated under a RSP, a market-based standard service approved by the PUCO in November 2004, from January 1, 2005 through December 31, 2008. In March 2005, the Office of the Ohio Consumers' Counsel (OCC) appealed the PUCO's approval of the RSP to the Supreme Court of Ohio which issued its decision in November 2006. It upheld the RSP 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.

In October 2007, the PUCO issued its ruling affirming the RSP, with certain modifications, and maintained the then 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 non-residential 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 non-residential 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 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 RSP riders. Duke Energy

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Ohio 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. Oral arguments were conducted on November 18, 2008. On January 2, 2009, the PUCO filed a motion to dismiss the action as moot. The PUCO argued that the rates at issue in this matter expired on January 1, 2009, with the implementation of Duke Energy Ohio's ESP. On February 19, 2009, the Ohio Supreme Court issued its decision on OCC's appeal. The Ohio Supreme Court granted the PUCO's motion to dismiss ruling that because the challenged rate structure is no longer in effect, it can neither order lower prospective rates nor order a refund.

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 ESP, which would allow for pricing structures similar to the current RSP. Electric utilities are required to file an ESP and may also file an application for a market rate option (MRO) at the same time. The MRO is a price determined through a competitive bidding process. If a MRO price is approved, the utility would blend in the RSP or ESP price with the MRO 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 a 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 designated generating assets to an EWG absent PUCO approval.

On July 31, 2008, Duke Energy Ohio filed a new generation pricing formula to be effective January 1, 2009, when the current RSP expired. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, renewables and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and was filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit will be presented to the PUCO for a ruling. Parties to this proceeding who do not support the Stipulation were free to litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately $36 million, $74 million and $98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as Save-A-Watt, to achieve the energy efficiency mandate pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program will also presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to $50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO issued its finding and order resolving the two litigated issues and adopting a modified Stipulation. Specifically, the PUCO modified the Stipulation to permit certain non-residential customers to opt out of utility-sponsored energy efficiency initiatives and to allow residential governmental aggregation customers who leave Duke Energy Ohio's system to avoid some charges. Applications for rehearing of the PUCO's decision have been filed by environmental groups and a residential customer advocate group. On February 11, 2009 the PUCO issued an Entry denying the rehearing requests.

As discussed further below within "Commercial Power" and in Note 1, as a result of the approval of the ESP, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

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. On September 16 and 19, 2008 respectively, OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue. Merit briefs were filed with the Ohio Supreme Court on February 2, 2009. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision of May 28, 2008.

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. On December 22, 2008, Duke Energy Ohio filed an application requesting deferral of approximately $31 million related to damage to its distribution system from a September 14, 2008 windstorm. On January 14, 2009, the PUCO granted Duke Energy Ohio's deferral request. Accordingly, a regulatory asset was recorded as of December 31, 2008 for $31 million. The staff of the PUCO issued a Staff Report in January 2009 recommending an increase of approximately $54 million to $62 million associated with the Ohio distribution rate case. The staff report did not recommend approval of the distribution modernization tracker. The report also recommended approval of a rider to recover the deferred storm costs from the September 14, 2008 windstorm and recommended a future hearing be established to evaluate the windstorm related costs and implement a rider. An evidentiary hearing with the PUCO is scheduled to begin March 31, 2009.

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 June 2005, the Kentucky General Assembly enacted Kentucky Revised Statue 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. 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, which were approved prior to the enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order,

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

Energy Efficiency. On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). The DSM 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 program costs are 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. Duke Energy Ohio filed the Save-A-Watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of Save-A-Watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO approved the ESP, including allowing for the implementation of a new Save-A-Watt energy efficiency compensation model. However, the PUCO determined that certain non-residential customers may opt out of Duke Energy Ohio's energy efficiency initiative. Applications for rehearing of this decision have been filed by environmental groups and a residential customer advocate group.

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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a Save-A-Watt Energy Efficiency Plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

Other Franchised Electric and Gas Matters.

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. As of January 1, 2008, Duke Energy Ohio had 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 expected to be completed at the end of 2012.

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.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

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 launched the ASM on January 6, 2009.

Commercial Power.

As discussed in Note 1, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the PUCO's approval of the ESP. However, since certain portions of Commercial Power's operations are not subject to regulatory accounting pursuant to SFAS No. 71, reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs for which recovery is not automatic under the ESP. Commercial Power may be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

FERC 203 Application. On April 23, 2008 (supplemented on May 6, 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 FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio was in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. As part of the settlement that was approved by the PUCO on December 17, 2008 (see discussion above) Duke Energy Ohio agreed to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers and the PUCO approved of the transfer for the remaining generating facilities. Duke Energy Ohio filed a new application requesting FERC approval to transfer to affiliate companies only the remaining generating facilities not designated to serve Ohio customers, which was conditionally approved by the FERC on February 19, 2009. As a condition of approval, the FERC requires that all acquisition premiums related to generating assets being transferred to Cinergy Power be removed from Duke Energy Ohio's financial statements when Duke Energy Ohio submits its final accounting entries and that any debt associated with the generation assets being transferred be transferred to the generating facility before Duke Energy Ohio submits its final accounting entries. In addition, the FERC will hold Duke Energy Ohio to its commitments to have the affiliate company receiving assets pay taxes associated with the proposed transaction rather than Duke Energy Ohio, to maintain a minimum equity to total capital ratio of 30%, and to retain an amount of debt that will accommodate the preservation of Duke Energy Ohio's current credit ratings.

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 during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying and dismissing the RPM Buyer's complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM Buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Other Matters.

Application for the Establishment of a Regulatory Asset. On November 14, 2008, Duke Energy Kentucky petitioned the KPSC for permission to create a regulatory asset to defer for future recovery approximately $5 million for its expenses incurred to repair damage and restore service to its customers following extensive storm-related damage caused by Hurricane Ike on September 14, 2008. The KPSC approved the requested accounting order on January 7, 2009.

5. Joint Ownership of Generating and Transmission Facilities

Duke Energy Ohio, Columbus Southern Power Company (CSP), and Dayton Power & Light (DP&L) jointly own electric generating units and related transmission facilities in Ohio. Duke Energy Kentucky and DP&L jointly own an electric generating unit. Duke Energy Ohio and Wabash Valley Power Association Inc. jointly own the Vermillion generating station in Indiana.

Duke Energy Ohio's share of jointly-owned plant or facilities included on the December 31, 2008 Consolidated Balance Sheet were as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
		(in millions)		
Duke Energy Ohio				
Production:				
Miami Fort Station (Units 7 and 8)[b]	64.0%	$ 591	$160	$ 4
W.C. Beckjord Station (Unit 6)[b]	37.5	55	31	1
J.M. Stuart Station[a][b]	39.0	426	200	342
Conesville Station (Unit 4)[a][b]	40.0	82	56	174
W.M. Zimmer Station[b]	46.5	1,321	509	10
Killen Station[a][b]	33.0	207	128	96
Vermillion[b]	75.0	197	47	—
Transmission[c]	Various	90	51	—
Duke Energy Kentucky				
Production:				
East Bend Station[c]	69.0	423	219	5

(a) Station is not operated by Duke Energy Ohio.
(b) Included in Commercial Power segment.
(c) Included in Franchised Electric and Gas segment.

Duke Energy Ohio's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line on the Consolidated Statements of Operations. Each participant in the jointly owned facilities must provide its own financing.

6. Income Taxes

Prior to the merger of Cinergy and Duke Energy on April 3, 2006, the taxable income of Duke Energy Ohio was reflected in Cinergy's U.S. federal and state income tax returns. After the merger, the taxable income of Duke Energy Ohio is reflected in Duke Energy's U.S. federal and state income tax returns. As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into 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 Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

The following details the components of income tax expense from continuing operations:

Income Tax Expense

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
		(in millions)		
Current income taxes				
Federal	$110	$120	$ 139	$55
State	9	13	22	6
Total current income taxes[b]	119	133	161	61
Deferred income taxes				
Federal	52	19	(100)	11
State	2	1	(18)	(3)
Total deferred income taxes	54	20	(118)	8
Investment tax credit amortization	(2)	(2)	(2)	(1)
Total income tax expense from continuing operations	171	151	41	68
Total income tax benefit from discontinued operations	—	—	(3)	(1)
Total income tax expense from extraordinary item	37	—	—	—
Total income tax expense included in Consolidated Statements of Operations	$208	$151	$ 38	$67

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Included are FIN 48 benefits of approximately $17 million in 2008 and $13 million in 2007.

Reconciliation of Income Tax Expense at the U.S. Federal Statutory Tax Rate to the Actual Tax Expense from Continuing Operations (Statutory Rate Reconciliation)

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
		(in millions)		
Income tax expense, computed at the statutory rate of 35%	$ 160	$ 145	$ 36	$ 65
State income tax, net of federal income tax effect	7	9	3	2
Depreciation and other PP&E related differences	7	9	6	2
ITC amortization	(2)	(2)	(2)	(1)
Manufacturing deduction	(6)	(10)	(2)	—
Other items, net	5	—	—	—
Total income tax expense from continuing operations	$ 171	$ 151	$ 41	$ 68
Effective Tax Rates	37.3%	36.4%	40.2%	36.6%

(a) See Note 1 for additional information on Predecessor and Successor reporting.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

The manufacturing deduction was created by the American Job Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities. During the year ended December 31, 2006, the Act provided for a 3% deduction on qualified production activities. During the years ended December 31, 2008 and 2007, the deduction increased to 6% on qualified production activities.

Net Deferred Income Tax Liability Components

	As of December 31,	
	2008	2007
	(in millions)	
Deferred credits and other liabilities	$ 13	$ 100
Other	52	54
Total deferred income tax assets	65	154
Investments and other assets	(111)	(68)
Accelerated depreciation rates	(1,373)	(1,311)
Regulatory assets and deferred debits	(142)	(195)
Total deferred income tax liabilities	(1,626)	(1,574)
Total net deferred income tax liabilities	$(1,561)	$(1,420)

The above amounts have been classified in the Consolidated Balance Sheets as follows:

Net Deferred Income Tax Liabilities

	As of December 31,	
	2008	2007
	(in millions)	
Current deferred tax assets, included in other current assets	$ 64	$ 26
Current deferred tax liabilities, included in other current liabilities	(6)	(10)
Non-current deferred tax liabilities	(1,619)	(1,436)
Total net deferred income tax liabilities	$(1,561)	$(1,420)

Changes to Unrecognized Tax Benefits

	2008	2007
	Increase/ (Decrease)	Increase/ (Decrease)
	(in millions)	(in millions)
Unrecognized Tax Benefits—January 1	$ 47	$ 63
Unrecognized Tax Benefits Changes		
Gross increases—tax positions in prior periods	—	9
Gross decreases—tax positions in prior periods	(22)	(19)
Gross increases—current period tax positions	—	—
Settlements	(10)	(6)
Total Changes	(32)	(16)
Unrecognized Tax Benefits—December 31	$ 15	$ 47

At December 31, 2008 and December 31, 2007, no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate.

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Notes To Consolidated Financial Statements—(Continued)

It is reasonably possible that Duke Energy Ohio will reflect an approximate $6 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the years ended December 31, 2008 and December 31, 2007, Duke Energy Ohio recognized net interest income of approximately $7 million and a net interest expense of approximately $2 million, respectively. At December 31, 2008 and December 31, 2007, Duke Energy Ohio had approximately $1 million of interest receivable and $7 million of interest payable, respectively, which reflects all interest related to income taxes. No amount has been accrued for the payment of penalties in the Consolidated Balance Sheets at either December 31, 2008 or 2007.

Duke Energy Ohio 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

As of December 31, 2008 and 2007, approximately $64 million and $26 million, respectively, of deferred income taxes were included in Other within Current Assets on the Consolidated Balance Sheets. At December 31, 2008 this balance exceeded 5% of total current assets.

7. Asset Retirement Obligations

Asset retirement obligations, which represent legal obligations associated with the retirement of certain tangible long-lived assets, are computed as the present value of the projected costs for the future retirement of specific assets and are recognized in the period in which the liability is incurred, if a reasonable estimate of fair value can be made. The present value of the liability is added to the carrying amount of the associated asset in the period the liability is incurred. This additional carrying amount is then depreciated over the life of the asset. Subsequent to the initial recognition, the liability is adjusted for any revisions to the estimated future cash flows associated with the asset retirement obligation (with corresponding adjustments to property, plant and equipment), which can occur due to a number of factors including, but not limited to, cost escalation, changes in technology applicable to the assets to be retired and changes in federal, state or local regulations, as well as for accretion of the liability due to the passage of time until the obligation is settled. Depreciation expense is adjusted prospectively for any increases or decreases to the carrying amount of the associated asset. There is no impact on the earnings of Duke Energy Ohio's regulated operations within the Franchised Electric and Gas business segment when an asset retirement obligation is recognized as the effects of the recognition and subsequent accounting are offset by the establishment of regulatory assets and liabilities to defer all income statement impacts related to SFAS No. 143.

Asset retirement obligations at Duke Energy Ohio relate primarily to the retirement of gas mains, asbestos abatement at certain generating stations and closure and post-closure activities of landfills. In accordance with SFAS No. 143, Duke Energy Ohio identified certain assets that have an indeterminate life, and thus the fair value of the retirement obligation is not reasonably estimable. These assets included transmission pipelines. A liability for these asset retirement obligations will be recorded when a fair value is determinable.

The following table presents the changes to liability associated with asset retirement obligations during the years ended December 31, 2008 and 2007:

	Years Ended December 31,	
	2008	2007
	(in millions)	
Balance as of January 1,	$31	$ 41
Accretion expense	2	2
Liabilities settled[(a)]	—	(12)
Balance as of December 31,	$33	$ 31

(a) Liabilities settled during 2007 were related to the retirement of gas mains.

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Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio's regulated electric and regulated natural gas operations accrue costs of removal for property that does not have an associated legal retirement obligation based on regulatory orders from the PUCO and the KPSC. These costs of removal are recorded as a regulatory liability in accordance with regulatory treatment under SFAS No. 71. Duke Energy Ohio does not accrue the estimated cost of removal when no legal obligation associated with retirement or removal exists for any non-regulated assets (including Duke Energy Ohio's generation assets). The total amount of removal costs included in Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets was $189 million and $181 million as of December 31, 2008 and 2007, respectively. Duke Energy Ohio's non-regulated operations expense cost of removal as incurred.

8. Risk Management and Hedging Activities and Credit Risk

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased within its non-regulated operations, as well as within its regulated operations, to the extent there is excess capacity from generation assets that are dedicated to serve Ohio native load customers. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options. For Duke Energy Ohio, commodity price risk has been somewhat reduced by the December 17, 2008 PUCO approval of Duke Energy Ohio's ESP, which resulted in the reapplication of SFAS No. 71 to certain portions of Duke Energy Ohio's Commercial Power business segment operations as of that date.

As discussed in Note 1, on January 1, 2008, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy 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.

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

	Years Ended December 31,	
	2008	2007
	(in millions)	
Hedging	$ (9)	$(23)
Undesignated	(70)	7
Total	$(79)	$(16)

The amounts in the table above represent the combination of amounts presented as assets and liabilities for unrealized gains and losses on mark-to-market and hedging transactions on Duke Energy Ohio's Consolidated Balance Sheets.

Transfer of Certain Duke Energy Assets and Commodity Cash Flow Hedges. As part of the merger with Duke Energy on April 3, 2006, Duke Energy Ohio acquired certain generation assets from Duke Energy, representing approximately 3,600 MW of power generation and those assets were added to Duke Energy Ohio's non-regulated generation portfolio. Duke Energy Ohio also assumed approximately $63 million of pre-tax deferred losses ($39 million, after-tax) associated with contracts formerly designated as cash flow hedges of forecasted power sales and gas purchases from Duke Energy's Midwestern generation fleet. These contracts were sold by Duke Energy in 2005 and the deferred losses remain on the Consolidated Balance Sheet in AOCI until the related hedged transactions (gas purchases and power sales) occur. See Note 1 and Note 3 for further details on the completed merger and for details on the transfer of generation assets. During 2007, Duke Energy Ohio entered into additional contracts to protect margins for a portion of future sales and generation revenues and fuel expenses for the Midwestern generation fleet. Duke Energy Ohio is hedging exposures to the price variability of these commodities for a maximum period of 2 years. All derivatives related to the Midwestern generation fleet are included in Duke Energy Ohio's Consolidated Balance Sheets at December 31, 2008 and 2007.

As of December 31, 2008, $24 million of pre-tax deferred net losses on derivative instruments related to commodity cash flow hedges accumulated on the Consolidated Balance Sheet in AOCI are expected to be recognized in earnings during the next twelve

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

months. However, due to the volatility of the commodities markets, the corresponding value in AOCI will likely change prior to its reclassification into earnings.

Other Derivative Contracts. *Trading.* Duke Energy Ohio had been exposed to the impact of market fluctuations in the prices of natural gas, electricity and other energy-related products marketed and purchased as a result of proprietary trading activities. In June 2006, Cinergy sold CMT, including certain of Duke Energy Ohio's trading contracts, to Fortis. The results of this trading activity up through the date of the sale, which was completed in October 2006, has been reflected in Loss from Discontinued Operations, net of tax, in the Consolidated Statements of Operations. In connection with the sale, Duke Energy Ohio entered into a series of Total Return Swaps (TRS) with Fortis (see Note 14). As of December 31, 2008, all of the underlying contracts that were part of the TRS had been transferred to Fortis and, as a result, Duke Energy Ohio has no future exposure associated with these TRS.

Undesignated. Duke Energy Ohio uses derivative contracts to manage the market risk exposures that arise from energy supply, structured origination, marketing, risk management, and commercial optimization services to large energy customers, energy aggregators and other wholesale companies, and to manage interest rate exposures. This category would include changes in fair value for derivatives that no longer qualify for the NPNS scope exception and disqualified hedge contracts, unless the derivative contract is subsequently re-designated as a hedge. The contracts in this category as of December 31, 2008 are primarily associated with forward power sales and coal purchases, as well as forward contracts to purchase SO_2 emission allowances and certain interest rate derivatives, for the Commercial Power and Franchised Electric and Gas operations. Duke Energy Ohio's exposure to price risk is influenced by a number of factors, including contract size, length, market liquidity, location and unique or specific contract terms.

During the years ended December 31, 2008 and 2007, Duke Energy Ohio included in earnings approximately $75 million of pre-tax losses and approximately $13 million of pre-tax gains, respectively, related to mark-to-market adjustments within Commercial Power, which are reported primarily in operating revenues within Non-regulated electric and other and Fuel used in electric generation and purchased power—non-regulated on the Consolidated Statements of Operations. As discussed in Note 1 and Note 4, beginning on December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the approval of the ESP. The reapplication of SFAS No. 71 on December 17, 2008 resulted in an approximate $67 million after-tax (approximately $103 million pre-tax) extraordinary gain related to total mark-to-market losses previously recorded in earnings associated with open forward hedge contracts, which the ESP allows to be recovered through an FPP rider. Subsequent to December 17, 2008, mark-to-market gains and losses on certain open hedge positions related to native load generation will be deferred as regulatory assets or liabilities and recovered through the FPP rider.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Ohio to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters into financial derivative instruments, including interest rate swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. Duke Energy Ohio's existing interest rate derivative instruments and related ineffectiveness were insignificant to its consolidated results of operations, cash flows and financial position in 2008, 2007, and 2006.

As of December 31, 2008, approximately $2 million of pre-tax net losses on terminated interest rate hedges were accumulated on the Consolidated Balance Sheets in AOCI and are expected to be recognized in earnings during the next twelve months as the hedged transactions occur.

Normal Purchases and Normal Sales Exception. Duke Energy Ohio has applied the normal purchases and normal sales scope exception, as provided in SFAS No. 133 and interpreted by Derivatives Implementation Group Issue C15, "*Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity,*" and amended by SFAS No. 149, "*Amendment of Statement 133 on Derivative Instruments and Hedging Activities,*" to certain contracts involving the purchase and sale of electricity at fixed prices in future periods. These contracts, which relate primarily to the delivery of electricity over the next 6 years, are not included in the table above.

Credit Risk. Where exposed to credit risk, Duke Energy Ohio analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis.

Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Ohio also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

9. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Ohio adopted SFAS No. 157. Duke Energy Ohio'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 until January 1, 2009 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 Duke Energy Ohio 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 in the U.S. 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 Duke Energy Ohio 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. In October 2008, the FASB issued FSP No. FAS 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*" (FSP FAS 157-3), which illustrated key considerations in determining the fair value of a financial asset when the market for that asset is not active. The application of FSP FAS 157-3 did not change the way Duke Energy Ohio determined fair value of its financial assets and liabilities.

Duke Energy Ohio 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:

Level 1 inputs—unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Ohio 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. Duke Energy Ohio 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 Duke Energy Ohio, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio 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, Duke Energy Ohio may elect to measure certain financial instruments at fair value in accordance with this standard.

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Notes To Consolidated Financial Statements—(Continued)

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 Duke Energy Ohio's Consolidated Balance Sheets at fair value at December 31, 2008. Amounts presented in the table below exclude cash collateral amounts which are disclosed separately in Note 1.

Description	Total Fair Value Amounts at December 31, 2008	Level 1	Level 2	Level 3
		(in millions)		
Derivative assets	$ 68	$ 9	$—	$ 59
Derivative liabilities	$(147)	$(88)	$ (8)	$(51)

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)
Year Ended December 31, 2008	
Balance at January 1, 2008	$(22)
Total pre-tax realized or unrealized gains (losses) included in earnings:	
Revenue, non-regulated electric and other	(1)
Fuel used in electric generation and purchased power—non-regulated	96
Net purchases, sales, issuances and settlements	(63)
Total losses included on balance sheet as regulatory asset or liability or as non-current liability	(2)
Balance at December 31, 2008	$ 8
Pre-tax gains (losses) included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at December 31, 2008:	
Revenue, non-regulated electric and other	$ 7
Fuel used in electric generation and purchased power—non-regulated	30
Total	$ 37

The valuation method of the primary fair value measurements disclosed above is as follows:

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 Duke Energy Ohio classifies as Level 1 measurements.

Fair Value Disclosures Required Under SFAS No. 107, "*Disclosures About Fair Value of Financial Instruments.*" The fair value of financial instruments, excluding financial assets and liabilities included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of December 31, 2008 and 2007, are not necessarily indicative of the amounts Duke Energy Ohio could have realized in current markets.

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Notes To Consolidated Financial Statements—(Continued)

Financial Instruments

	As of December 31,			
	2008		2007	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in millions)			
Long-term debt, including current maturities	$1,883	$1,729	$1,936	$1,914

The fair value of cash and cash equivalents, accounts receivable, restricted funds held in trust, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

10. Goodwill and Intangibles

Duke Energy Ohio evaluates the impairment of goodwill under the guidance of SFAS No. 142. There were no goodwill impairment charges in 2008, 2007 or 2006 as a result of the annual impairment tests required by SFAS No. 142. As discussed further in Note 3, in April 2006, Duke Energy and Cinergy consummated their merger, which resulted in Duke Energy Ohio recording goodwill of approximately $2.3 billion. Duke Energy Ohio had no goodwill prior to this date. The following table shows the components of goodwill at December 31, 2008 and 2007:

Carrying Amount of Goodwill

	Balance at December 31, 2007	Changes	Balance at December 31, 2008
		(in millions)	
Commercial Power	$1,188	$ 18	$1,206
Franchised Electric and Gas	1,137	17	1,154
Total Goodwill	$2,325	$ 35	$2,360

	Balance at December 31, 2006	Changes	Balance at December 31, 2007
		(in millions)	
Commercial Power	$1,200	$(12)	$1,188
Franchised Electric and Gas	1,148	(11)	1,137
Total Goodwill	$2,348	$(23)	$2,325

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Notes To Consolidated Financial Statements—(Continued)

Intangible Assets

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

	December 31, 2008	December 31, 2007
	(in millions)	
Emission allowances	$ 239	$365
Gas, coal, and power contracts	271	271
Other	9	9
Total gross carrying amount	519	645
Accumulated amortization—gas, coal, and power contracts	(111)	(89)
Accumulated amortization—other	(5)	(5)
Total accumulated amortization	(116)	(94)
Total intangible assets, net	$ 403	$551

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Duke Energy's merger with Cinergy and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the years ended December 31, 2008 and 2007 is as follows:

	December 31, 2008	December 31, 2007
	(in millions)	
Gross carrying value at beginning of period	$365	$ 495
Purchases of emission allowances	17	23
Sales and consumption of emission allowances[a][b]	(69)	(154)
Impairment of emission allowances[c]	(82)	—
Other changes	8	1
Gross carrying value at end of period	$239	$ 365

(a) Carrying values of emission allowances are recognized via a charge to expense when consumed. Carrying values of emission allowances sold or consumed during the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006 were $69 million, $154 million, $267 million and $36 million, respectively.

(b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the years ended December 31, 2008, 2007 and 2006.

(c) See Note 11 for discussion of impairments of the carrying value of emission allowances during the year ended December 31, 2008.

Amortization expense for gas, coal and power contracts and other intangible assets for Duke Energy Ohio was approximately $22 million and $51 million for the years ended December 31, 2008 and 2007, respectively, approximately $43 million for the nine months ended December 31, 2006 and approximately $1 million for the three months ended March 31, 2006.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2008. The expected amortization expense includes estimates of emission allowances consumption and estimates of consumption of commodities such as gas and coal under existing contracts. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2009	2010	2011	2012	2013
	(in millions)				
Expected amortization expense	$90	$31	$29	$29	$26

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Intangible Liabilities

In connection with the merger with Cinergy in April 2006, Duke Energy recorded an intangible liability of approximately $113 million associated with the market-based standard service offer in Ohio, which was recognized in earnings over the regulatory period that ended on December 31, 2008. The carrying amount of this intangible liability was zero and approximately $67 million at December 31, 2008 and 2007, respectively. Duke Energy also recorded approximately $56 million of intangible liabilities associated with other power sale contracts in connection with the merger with Cinergy. The carrying amount of these intangible liabilities was approximately $16 million and $22 million at December 31, 2008 and 2007, respectively. During the years ended December 31, 2008, 2007 and 2006, Duke Energy amortized approximately $73 million, $45 million and $35 million, respectively, to income related to intangible liabilities. The remaining balance of approximately $16 million will be amortized to income as follows: approximately $6 million in each of the years 2009 through 2010, and approximately $4 million in 2011. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

11. Impairment Charges

Emission Allowances. 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). In December 2008, a federal appeals court reinstated the CAIR while the EPA develops a new clean air program (see Note 18 for additional information). However, as a result of the July 11, 2008 decision temporarily vacating the CAIR, there were sharp declines in market prices of SO_2 and NO_x allowances in the third quarter of 2008 due to uncertainty associated with future federal requirements to reduce emissions. Accordingly, pursuant to SFAS No. 144, Duke Energy Ohio evaluated the carrying value of emission allowances held by its regulated and non-regulated businesses for impairment during the third quarter of 2008.

At the time of its repeal, the CAIR required 50% reductions in SO_2 emissions beginning in 2010 and further 30% reductions in SO_2 emissions in 2015 beyond specified requirements. These reductions were to be achieved by requiring the surrender of SO_2 allowances in a ratio of two allowances per ton of SO_2 emitted beginning in 2010, up from a current one-to-one ratio, escalating to 2.86 allowances per ton of SO_2 emitted beginning in 2015. Taking into account these increases in emission allowance requirements under the CAIR, Commercial Power's forecasted SO_2 emissions needed through 2037 exceeded the number of emission allowances held prior to the vacating of the CAIR. Subsequent to the decision to vacate the CAIR, Commercial Power determined that it had SO_2 allowances in excess of forecasted emissions and those allowances held in excess of forecasted emissions from future generation required an impairment evaluation. In performing the impairment evaluation for SO_2 allowances in the third quarter of 2008, management compared quoted market prices for each vintage year allowance to the carrying value of the related allowances in excess of forecasted emissions through 2038. Due to the sharp decline in market prices of SO_2 allowances, as discussed above, during the third quarter of 2008, Commercial Power recorded pre-tax impairment charges of approximately $77 million related to forecasted excess SO_2 allowances held. Additionally, Commercial Power recorded pre-tax impairment charges of approximately $5 million in the third quarter of 2008 related to annual NO_x allowances as these were also affected by the decision to vacate the CAIR. These impairment charges are recorded in Impairment Charges within Operating Expenses on the Consolidated Statements of Operations.

As a result of the reinstatement of the CAIR, as discussed above, all emission allowances and certain commitments to purchase emission allowances held by Commercial Power as of December 31, 2008 are anticipated to be utilized for future emission allowance requirements under the CAIR, unless the EPA develops a new clean air program that changes the existing requirements under the CAIR.

See Note 10 for further information regarding the carrying value of emission allowances.

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Notes To Consolidated Financial Statements—(Continued)

12. Related Party Transactions

Duke Energy Ohio 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 December 31, 2008 and December 31, 2007 are as follows:

	December 31, 2008[a]	December 31, 2007[a]
	(in millions)	
Current assets[b]	$ 55	$ 58
Non-current assets[c]	$ 5	$ —
Current liabilities[d]	$ (138)	$ (266)
Non-current liabilities[e]	$ (4)	$ —
Net deferred tax liabilities[f]	$(1,519)	$(1,385)

(a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

(b) Of the balance at December 31, 2008, approximately $18 million is classified as Receivables, approximately $2 million is classified as Unrealized gains on mark-to-market and hedging transactions and approximately $35 million is classified as Other within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.

(c) The balance at December 31, 2008 is classified as Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets on the Consolidated Balance Sheets.

(d) Of the balance at December 31, 2008, approximately ($133) million is classified as Accounts payable, approximately ($2) million is classified as Taxes accrued and approximately ($3) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately ($256) million is classified as Accounts payable and approximately ($10) million is classified as Taxes accrued on the Consolidated Balance Sheets.

(e) The balance at December 31, 2008 is classified as Unrealized losses on mark-to-market and hedging transactions within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

(f) Of the balance at December 31, 2008, approximately ($1,580) million is classified as Deferred income taxes and approximately $61 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately ($1,409) million is classified as Deferred income taxes and approximately $24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is charged its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations were as follows:

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
			(in millions)	
Corporate governance and shared services expenses	$319	$249	$290	$112

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Duke Energy Ohio incurs expenses related to certain insurance coverages 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 $18 million, $24 million, and $12 million for the years ended December 31, 2008, 2007 and 2006, respectively. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy, as well as income associated with certain other recoveries of cost. Rental income and other cost recoveries were approximately $13 million, $12 million, $9 million and $2 million for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006, respectively.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 19). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Cinergy of approximately $416 million and $266 million at December 31, 2008 and 2007, respectively. The above amounts have been classified in the Consolidated Balance Sheets as follows:

	December 31, 2008	December 31, 2007
	(in millions)	
Other current liabilities	$ 5	$ 5
Accrued pension and other post-retirement benefit costs	$406	$259
Other deferred credits and other liabilities	$ 5	$ 2

Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately $174 million and $189 million as of December 31, 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 $21 million and $25 million for the years ended December 31, 2008 and 2007, respectively.

See Note 17 for a discussion of dividends Duke Energy Ohio paid to its parent, Cinergy.

During the second quarter of 2007 Duke Energy Ohio received a $29 million capital contribution from its parent, Cinergy.

See Note 3 for a discussion of amounts paid to Duke Energy Ohio as a result of the agreement between Duke Energy and Duke Energy Ohio related to Duke Energy's contribution of its ownership interests in five plants to Duke Energy Ohio.

As discussed further in Note 16, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of December 31, 2008 and December 31, 2007, Duke Energy Ohio was in a payable position of $63 million and $189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations, for the years ended December 31, 2008 and 2007, nine months ended December 31, 2006 and three months ended March 31, 2006 were approximately $3 million, $11 million, $6 million and $2 million, respectively.

13. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Ohio 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 SFAS No. 140, and, accordingly, Cinergy does not consolidate Cinergy Receivables and the transfers of receivables are accounted for as sales.

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 (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $174 million and $189 million at December 31, 2008 and 2007, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Consolidated Balance Sheets at December 31, 2008 and 2007.

The carrying values of the retained interests are determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions in estimating fair value are the anticipated credit losses, the selection of discount rates, and expected receivables turnover rate. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Ohio's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. Interest accrues to Duke Energy Ohio on the retained

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred (which is unlikely unless credit losses on the receivables far exceed the anticipated level).

The key assumptions used in estimating the fair value are as follows:

	Years Ended December 31,		
	2008	2007	2006
Anticipated credit loss rate	0.7%	0.7%	0.8%
Discount rate on expected cash flows	5.3%	7.7%	7.4%
Receivables turnover rate	12.4%	12.4%	12.7%

The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history.

Duke Energy Ohio retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Ohio in the event of a loss. While no direct recourse to Duke Energy Ohio exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Ohio approximates a market rate.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the periods ending:

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Receivables sold as of period end	$ 473	$ 437	$ 370	
Less: Retained interests	174	189	133	
Net receivables sold as of period end	$ 299	$ 248	$ 237	
Sales during period				
Receivables sold	$3,316	$3,189	$1,982	$869
Loss recognized on sale	38	46	29	12
Cash flows during period				
Cash proceeds from receivables sold	$3,276	$3,086	$1,935	$919
Collection fees received	3	3	2	—
Return received on retained interests	21	25	13	8

(a) See Note 1 for additional information on Predecessor and Successor reporting.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

14. Discontinued Operations and Assets Held for Sale

In June 2006, Cinergy agreed to sell CMT, including certain of Duke Energy Ohio's trading contracts, to Fortis, a Benelux-based financial services group. In October 2006, the sale was completed. Results of operations for these trading contracts have been reflected in Loss from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. In October 2006, in connection with this transaction, Duke Energy Ohio entered into a series of TRS with Fortis, which were accounted for as mark-to-market derivatives. The TRS was cancelled for each underlying contract as each was transferred to Fortis. As of December 31, 2008, all of the underlying contracts that were part of the TRS had been transferred to Fortis and, as a result, Duke Energy Ohio has no future exposure associated with these TRS.

The following table summarizes the results classified as Loss from Discontinued Operations, net of tax, in the accompanying Consolidated Statements of Operations. There was no discontinued operations activity in 2008 or 2007.

	Successor[a]	Predecessor[a]
	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)	
Revenues	$ 5	$ 9
Operating Loss		
Loss before taxes	(6)	(3)
Income tax benefit	(2)	(1)
Loss from Discontinued Operations, net of tax	$(4)	$ (2)
Net Loss on Dispositions		
Pre-tax loss on dispositions	$(3)	$—
Income tax benefit	(1)	—
Loss on dispositions, net of tax	$(2)	$—
Total Loss from Discontinued Operations, net of tax	$(6)	$ (2)

(a) *See Note 1 for additional information on* Predecessor and Successor reporting.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

15. Property, Plant and Equipment

	Estimated Useful Life	December 31, 2008	December 31, 2007
	(Years)	(in millions)	
Land	—	$ 126	$ 129
Plant—Regulated			
Electric generation, distribution and transmission[a]	8 – 100	3,262	3,197
Natural gas transmission and distribution[a]	12 – 60	1,566	1,436
Other buildings and improvements[a]	25 – 100	103	129
Plant—Unregulated			
Electric generation, distribution and transmission	8 – 100	3,710	3,813
Other buildings and improvements	30	190	25
Equipment	5 – 25	60	64
Construction in process	—	843	594
Other	5 – 20	187	190
Total property, plant and equipment		10,047	9,577
Total accumulated depreciation—regulated[b]		(1,646)	(1,640)
Total accumulated depreciation—unregulated		(631)	(457)
Total net property, plant and equipment		$ 7,770	$ 7,480

(a) Includes capitalized leases of approximately $109 million for 2008 and $88 million for 2007.
(b) Includes accumulated amortization of capitalized leases: $6 million for 2008 and $10 million for 2007.

Capitalized interest, which includes the interest expense component of AFUDC, amounted to $19 million for the year ended December 31, 2008, $30 million for the year ended December 31, 2007, $14 million for the nine months ended December 31, 2006 and $3 million for the three months ended March 31, 2006.

16. Debt and Credit Facilities

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	December 31, 2008	December 31, 2007
			(in millions)	
Unsecured debt	5.8%	2012 – 2036	$1,225	$1,345
Capital leases	5.2%	2009 – 2020	51	59
Other debt[a]	2.0%	2011 – 2041	646	572
Notes payable	2.2%		280	—
Money pool	0.5%		63	189
Unamortized debt discount and premium, net			(39)	(40)
Total debt			2,226	2,125
Current maturities of long-term debt			(27)	(126)
Short-term notes payable			(343)	(189)
Total long-term debt			$1,856	$1,810

(a) Includes $538 million of Duke Energy Ohio pollution control bonds as of both December 31, 2008 and 2007. As of December 31, 2008 and 2007, zero and $84 million, respectively, was secured by first and refunding mortgage bonds and $62 million and $12 million, respectively, was secured by a letter of credit.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Unsecured and Other Debt. In December 2008, Duke Energy Kentucky refunded $50 million of tax-exempt auction rate bonds through the issuance of $50 million of tax-exempt variable-rate demand bonds, which are supported by a direct-pay letter of credit. The variable-rate demand bonds, which are due August 1, 2027, had an initial interest rate of 0.65% which is reset on a weekly basis.

In December 2007, Duke Energy Ohio issued $140 million in tax-exempt floating-rate bonds. The bonds are structured as insured auction rate securities, subject to an auction process every 35 days and bear a final maturity of 2041. The bonds were issued through the Ohio Air Quality Development Authority to fund a portion of the environmental capital expenditures at the Conesville, Stuart and Killen Generation Stations in Ohio.

Money Pool. Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their 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 Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of December 31, 2008 and December 31, 2007, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately $63 million and $189 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. During the year ended December 31, 2008, the $126 million decrease in the money pool activity is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the year ended December 31, 2007, the $85 million decrease in the money pool activity is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the nine months ended December 31, 2006, the $52 million increase in the money pool activity is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended March 31, 2006, the $108 million increase in the money pool activity is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

Floating Rate Debt. Unsecured debt and other debt included approximately $611 million and $538 million of floating-rate debt as of December 31, 2008 and 2007, respectively. Floating-rate debt is primarily based on commercial paper rates or a spread relative to an index such as a London Interbank Offered Rate (LIBOR) for debt denominated in U.S. dollars. As of December 31, 2008 and 2007, the weighted-average interest rate associated with floating-rate debt was approximately 1.9% and 4.4%, respectively.

Auction Rate Debt. As of December 31, 2008, Duke Energy Ohio had approximately $390 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In February 2008, Duke Energy Ohio began to experience failed auctions on these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 2.0 times one-month LIBOR. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially affect Duke Energy Ohio's consolidated results of operations, cash flows or financial position. The weighted-average interest rate associated with Duke Energy Ohio's auction rate pollution control bonds, was 1.58% as of December 31, 2008 and 4.56% as of December 31, 2007.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Maturities, Call Options and Acceleration Clauses.

Annual Maturities as of December 31, 2008

	(in millions)
2009	$ 27
2010	6
2011	31
2012	579
2013	5
Thereafter	1,235
Total long-term debt including current maturities[(a)]	$1,883

(a) *Excludes short-term notes payable of $343 million.*

Duke Energy Ohio has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than the above as a result of Duke Energy Ohio's ability to repay these obligations prior to their scheduled maturity.

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. In June 2007, Duke Energy closed the syndication of an amended and restated credit facility, which replaced existing credit facilities, with a 5-year, $2.65 billion master credit facility. 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. In October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately $63 million of credit commitment under its master credit facility. The total credit facility capacity under the master credit facility subsequent to this termination is approximately $3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At December 31, 2008, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of $650 million and $100 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility, of which Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately $279 million and $74 million, respectively. Duke Energy Ohio's and Duke Energy Kentucky's amounts remained outstanding as of December 31, 2008. The loans, which are revolving credit loans, bear interest at one-month LIBOR plus an applicable spread ranging from 19 to 24 basis points and are due in September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at December 31, 2008. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Notes payable within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At December 31, 2008 and December 31, 2007, approximately $146 million and $96 million, respectively, of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio'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 Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Of the $146 million of pollution control bonds outstanding at December 31, 2008, approximately $84 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

In September 2008, Duke Energy Kentucky and Duke Energy Indiana, Inc. (Duke Energy Indiana), a wholly-owned subsidiary of Duke Energy, collectively entered into a $330 million letter of credit agreement with a syndicate of banks. Under this letter of credit agreement, Duke Energy Kentucky may request the issuance of letters of credit up to approximately $51 million on its behalf to support various series of variable rate demand bonds issued or to be issued on behalf of Duke Energy Kentucky. This credit facility, which is not part of Duke Energy's master credit facility, may not be used for any purpose other than to support variable rate demand bonds issued by Duke Energy Kentucky and Duke Energy Indiana, Inc.

Restrictive Debt Covenants. Duke Energy's debt and 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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the 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.

Other Assets Pledged as Collateral. As of December 31, 2008, substantially all of Franchised Electric and Gas' electric plant in service is mortgaged under the mortgage bond indenture of Duke Energy Ohio.

17. Common and Preferred Stock

Common Stock. Cinergy owns all of the common stock of Duke Energy Ohio. In April 2006, Duke Energy acquired 100 percent of Cinergy's outstanding stock. See Note 3 for additional information.

In April 2006, Duke Energy Ohio filed a petition with the FERC for a declaratory ruling that its payment of dividends out of its paid-in capital account, using the balance transferred from the retained earnings account, resulting from purchase accounting arising from the Duke Energy/Cinergy merger, would not violate section 305(a) of the Federal Power Act, which generally precludes the payment of dividends out of paid-in capital. Such a ruling was necessary because purchase/push-down accounting reset retained earnings to zero as of April 3, 2006, thus potentially precluding Duke Energy Ohio from using pre-merger retained earnings to pay dividends. Without this approval, Duke Energy Ohio's ability to pay dividends to Duke Energy or Cinergy would have been constrained to earnings since April 3, 2006. In May 2006, the FERC issued an order approving Duke Energy Ohio's petition. For further discussion of restrictions on Duke Energy Ohio's ability to pay dividends to its parent, see Note 4.

During the years ended December 31, 2008, 2007 and 2006, Duke Energy Ohio paid dividends to its parent, Cinergy, of $200 million, $135 million and $102 million, respectively.

Preferred Stock. In March 2006, Duke Energy Ohio redeemed all outstanding shares of its $16.98 million notional amount 4% Cumulative Preferred Stock and its $3.5 million notional amount 4.75% Cumulative Preferred Stock at a price of $108 per share and $101 per share, respectively, plus accrued and unpaid dividends.

18. Commitments and Contingencies

General Insurance

Effective with the date of the merger between Duke Energy and Cinergy, Duke Energy Ohio carries, either directly or through Duke Energy's captive insurance company, Bison Insurance Company Limited, insurance and reinsurance coverages consistent with companies engaged in similar commercial operations with similar type properties. Duke Energy Ohio's insurance coverage includes (1) commercial general public liability insurance for liabilities arising to third parties for bodily injury and property damage resulting from Duke Energy Ohio's operations; (2) workers' compensation liability coverage to required statutory limits; (3) automobile liability insurance for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage; (4) insurance policies in support of the indemnification provisions of Duke Energy Ohio's by-laws and (5) property insurance covering the replacement value of all real and personal property damage, excluding electric transmission and distribution lines, including damages arising from boiler and machinery breakdowns, earthquake, flood damage and extra expense. All coverages are subject to certain deductibles, terms and conditions common for companies with similar types of operations.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio also maintains excess liability insurance coverage above the established primary limits for commercial general liability and automobile liability insurance. Limits, terms, conditions and deductibles are comparable to those carried by other companies with similar types of operations.

The cost of Duke Energy Ohio's general insurance coverages continued to fluctuate over the past year reflecting the changing conditions of the insurance markets.

Environmental

Duke Energy Ohio 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 Duke Energy Ohio.

Remediation Activities. Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio 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, Duke Energy Ohio or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Ohio 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Clean Water Act 316(b). The 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. Three of six coal-fired generating facilities in which Duke Energy Ohio 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. Oral argument occurred on December 2, 2008. A decision is expected in 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, however, Duke Energy Ohio is unable to estimate at this time its costs to comply.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO_2 emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. 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. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating the CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. The EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Ohio plans to spend approximately $85 million between 2009 and 2013 to comply with Phase 1 of the CAIR. Duke Energy Ohio is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above. Duke Energy Ohio received partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP. See Note 11 for a discussion of the impacts of the D.C. Circuit Court's July 11, 2008 decision to vacate the CAIR on the carrying value of emission allowances.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

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. The U.S. EPA and the Utility Air Regulatory Group have requested that the U.S. Supreme Court review the D.C. Circuit's 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. On January 29, 2009, the EPA requested the U.S. Department of Justice withdraw its Petition for Writ of Certiorari filed on October 17, 2008. On February 23, 2009, the Supreme Court denied the Utility Air Regulatory Group's petition. The EPA will now develop emission standards for utility units under section 112 of the Clean Air Act, thus abiding by the D.C. Circuit's decision. At this point, Duke Energy Ohio 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. Duke Energy Ohio currently estimates that it will spend approximately $68 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

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 $11 million and $8 million as of December 31, 2008 and 2007, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

New Source Review (NSR). In 1999-2000, the U.S. Department of Justice (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 SO_2, NO_x and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to $32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio 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 Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. 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. Additionally, the plaintiffs had claimed that Duke Energy Ohio 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.

On October 21, 2008, Plaintiffs filed a motion for a new liability trial claiming that defendants misled the Plaintiffs and the jury by, among other things, not disclosing a consulting agreement with a fact witness and by referring to that witness as "retired" during the liability trial when in fact he was working for Duke Energy under the referenced consulting agreement in connection with the trial. On December 18, 2008, the court granted Plaintiffs' motion for a new liability trial on claims for which Duke Energy Ohio was not previously found liable. That trial is scheduled to begin on May 11, 2009. The remedy trial for violations already established at the Wabash River

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Station and W.C. Beckjord Station was held during the week beginning February 2, 2009. The parties are awaiting a decision from the trial court.

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a Notice of Violation (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. The parties reached an agreement to settle this matter in the form of a consent decree which was submitted for comment to the EPA and ultimately approved and entered by the court on October 23, 2008. The consent decree did not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

It is not possible to estimate the damages, if any, that Duke Energy Ohio 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 Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio 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, 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. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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, Duke Energy Ohio cannot predict whether the outcome of this matter will have a material impact on its consolidated results of operations, cash flows or financial position. Duke Energy Ohio intends to defend this lawsuit vigorously in court.

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.

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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 recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy will incur any liability or to estimate the damages, if any, that Duke Energy 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 Racketeer Influenced and Corrupt Organizations (RICO) statutes. Defendants have again moved to dismiss the claims. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

Asbestos-related Injuries and Damages Claims. Duke Energy Ohio has been named as a defendant or co-defendant in lawsuits related to asbestos at its electric generating stations. The impact on Duke Energy Ohio'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 Ohio's 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, Duke Energy Ohio 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.

Other Litigation and Legal Proceedings. Duke Energy Ohio 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. Duke Energy Ohio 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.

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

Other Commitments and Contingencies

General. Duke Energy Ohio 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. Some of these arrangements may be recognized at market value on the Consolidated Balance Sheets as undesignated hedge contracts or qualifying hedge positions.

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Notes To Consolidated Financial Statements—(Continued)

Operating and Capital Lease Commitments

Duke Energy Ohio leases assets in several areas of its operations. Consolidated rental expense for operating leases were approximately $31 million for the year ended December 31, 2008, approximately $32 million for the year ended December 31, 2007, approximately $20 million for the nine months ended December 31, 2006 and approximately $7 million for the three months ended March 31, 2006, which is included in Operation, Maintenance and Other on the Consolidated Statements of Operations. Capitalized lease obligations are classified as debt on the Consolidated Balance Sheets (see Note 16). Amortization of assets recorded under capital leases was included in Depreciation and Amortization on the Consolidated Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2008:

	Operating Leases	Capital Leases
	(in millions)	
2009	$ 17	$ 9
2010	15	8
2011	13	7
2012	11	7
2013	10	6
Thereafter	47	14
Total future minimum lease payments	$113	$51

19. Employee Benefit Obligations

Cinergy Retirement Plans. Duke Energy Ohio participates in qualified and non-qualified defined benefit pension plans as well as other post-retirement benefit plans sponsored by Cinergy. Cinergy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Ohio.

Upon consummation of the merger with Duke Energy, Cinergy's benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit/post-retirement costs to be allocated to Duke Energy Ohio. As a result, the discount rate used to determine net periodic benefit cost to be allocated to Duke Energy Ohio by Cinergy changed from 5.50% to 6.00% in 2006.

Cinergy adopted the funded status recognition and disclosure provisions of SFAS No. 158 effective December 31, 2006. Cinergy adopted the change in measurement date transition requirements of SFAS No. 158 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date. Previously, Cinergy used a September 30 measurement date for its defined benefit and other post-retirement plans. The adoption of SFAS No. 158 did not have a material impact on Duke Energy Ohio's consolidated results of operations or cash flows. See Note 1 for additional information related to the adoption of SFAS No. 158.

Net periodic benefit cost disclosed in the tables below for the qualified, non-qualified and other post-retirement benefit plans represent the cost of the respective plan for the periods presented. However, portions of the net periodic benefit cost disclosed in the tables have been capitalized as a component of property, plant and equipment.

Qualified Pension Plans

Cinergy's qualified defined benefit pension plans cover substantially all employees meeting certain minimum age and service requirements. The plans cover most employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities.

Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the retirement plan is 11 years. Cinergy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets over five years.

Duke Energy Ohio's qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006[b]	Three Months Ended March 31, 2006[b]
	(in millions)			
Qualified Pension Benefits[c]	**$12**	**$14**	**$20**	$6

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Includes insignificant amounts reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.
(c) Excludes approximately $4 million, $7 million and $8 million, respectively, of regulatory asset amortization resulting from purchase accounting for the years ended December 31, 2008 and 2007 and the nine months ended December 31, 2006.

The fair value of Cinergy's plan assets was approximately $1,110 million and $1,701 million as of December 31, 2008 and 2007, respectively. The projected benefit obligation for the plans was approximately $1,992 million and $1,941 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the plans was approximately $1,729 million and $1,753 million as of December 31, 2008 and 2007, respectively. The accrued qualified pension liability allocated by Cinergy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Cinergy qualified pension plan, was approximately $334 million and $118 million as of December 31, 2008 and 2007, respectively, and is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets.

Duke Energy's policy is to fund amounts on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan participants. Duke Energy did not make any contributions to its defined benefit retirement plans in 2008. Duke Energy made qualified pension benefit contributions of approximately $350 million and $124 million to the legacy Cinergy qualified pension benefit plans in 2007 and 2006, of which approximately $83 million and $22 million represents contributions made by Duke Energy Ohio for the year ended December 31, 2007 and nine months ended December 31, 2006, respectively. No amounts were contributed to the legacy Cinergy qualified pension plans for the three months ended March 31, 2006. In February 2009, Duke Energy Ohio made a cash contribution of approximately $143 million, which represented its proportionate share of an approximate $500 million total contribution to Cinergy's and Duke Energy's qualified pension plans.

Qualified Pension Plans—Amounts Recognized in Accumulated Other Comprehensive Income (Loss) and Regulatory Assets Consist of:

	As of December 31, 2008	As of December 31, 2007
	(in millions)	
Regulatory Assets	$104	$ 33
Accumulated Other Comprehensive Loss (Income)		
Deferred income tax (liability) asset	$ (21)	$ 5
Prior service cost	3	2
Net actuarial loss (gain)	53	(14)
Net amount recognized—Accumulated other comprehensive loss (income)	$ 35	$ (7)

An insignificant amount in AOCI will be recognized in net periodic pension costs in 2009.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Qualified Plans—Assumptions Used for Cinergy's Pension Benefits Accounting

	2008	2007	2006
		(percentages)	
Benefit Obligations			
Discount rate	6.50	6.00	5.75
Salary increase	4.50	5.00	5.00
Net Periodic Benefit Cost			
Discount rate[a]	6.00	5.75	5.50-6.00
Salary increase	5.00	5.00	5.00
Expected long-term rate of return on plan assets	8.50	8.50	8.50

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

Non-Qualified Pension Plans

Cinergy also maintains, and Duke Energy Ohio participates in, non-qualified, non-contributory defined benefit retirement plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of active employees covered by the non-qualified retirement plans is 11 years. There are no plan assets. The projected benefit obligation for the plans was approximately $113 million and $105 million as of December 31, 2008 and 2007, respectively. The accumulated benefit obligation for the plans was approximately $104 million and $102 million as of December 31, 2008 and 2007, respectively. The accrued non-qualified pension liability allocated by Cinergy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Cinergy non-qualified pension plan, was approximately $6 million and $7 million as of December 31, 2008 and 2007, respectively, of which approximately $4 million and $5 million, respectively, is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets at December 31, 2008 and 2007, and approximately $2 million is recognized in Other within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008 and 2007.

Duke Energy Ohio's non-qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
		(in millions)		
Non-Qualified Pension[b]	$—	$1	$1	$—

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Includes insignificant amounts in 2006, which are reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

Non-Qualified Plans—Assumptions Used for Cinergy's Pension Benefits Accounting

	2008	2007	2006
		(percentages)	
Benefit Obligations			
Discount rate	6.50	6.00	5.75
Salary increase	4.50	5.00	5.00
Net Periodic Benefit Cost			
Discount rate[a]	6.00	5.75	5.50-6.00
Salary increase	5.00	5.00	5.00

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

Other Post-Retirement Benefit Plans

Duke Energy Ohio participates in other post-retirement benefit plans sponsored by Duke Energy. Prior to January 1, 2008, Cinergy was the sponsor of the other post-retirement benefit plans. Effective January 1, 2008, Duke Energy became the sponsor of these other post-retirement benefit plans. Duke Energy provides certain health care and life insurance benefits to retired employees and their

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over approximately 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 12 years. During the third quarter of 2008, Duke Energy Ohio recorded pre-tax income of approximately $20 million related to the correction of errors in actuarial valuations prior to 2008 that would have reduced amounts recorded as other post-retirement benefit expense recorded during those historical periods.

Duke Energy Ohio's other post-retirement plan pre-tax net periodic benefit costs as allocated by Duke Energy were as follows:

	Successor[a]			Predecessor[a]
	Year Ended December 31, *2008*[d]	**Year Ended December 31, *2007***	**Nine Months Ended December 31, *2006*[b]**	**Three Months Ended March 31, 2006[b]**
	(in millions)			
***Other Post-retirement*[c]**	**$(16)**	**$11**	**$9**	$3

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Includes insignificant amounts reflected in Loss From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.
(c) Excludes approximately $2 million, $4 million and $2 million, respectively, of regulatory asset amortization resulting from purchase accounting for the years ended December 31, 2008 and 2007 and the nine months ended December 31, 2006.
(d) Includes the recognition of the approximate $20 million correction of errors discussed above.

The fair value of Duke Energy's other post-retirement benefit plans assets was approximately $23 million and $32 million as of December 31, 2008 and 2007, respectively. The accumulated other post-retirement benefit obligation for the plans was approximately $330 million and $464 million as of December 31, 2008 and 2007, respectively. The accrued other post-retirement liability allocated by Duke Energy to Duke Energy Ohio, which represents Duke Energy Ohio's proportionate share of the unfunded status of the Duke Energy other post-retirement benefit plans, was approximately $70 million and $138 million, respectively, of which approximately $68 million and $136 million, respectively, is recognized in Accrued pension and other post-retirement benefit costs within the Consolidated Balance Sheets at December 31, 2008 and 2007, and approximately $2 million is recognized in Other within Current Liabilities on the Consolidated Balance Sheets at December 31, 2008 and 2007.

Duke Energy did not make any contributions to its other post-retirement plans in 2008. Duke Energy made contributions to its other post-retirement benefit plan during 2007 of approximately $32 million to the legacy Cinergy other post-retirement plans, of which approximately $9 million represents contributions made by Duke Energy Ohio. No amounts were contributed to the legacy Cinergy other post-retirement plans for the nine months ended December 31, 2006 or three months ended March 31, 2006.

Duke Energy Ohio recognized a reduction in regulatory assets and a pre-tax credit to AOCI related to its other post-retirement benefit plans of approximately $32 million and $12 million, respectively, as of December 31, 2008 and a reduction in regulatory assets and a pre-tax credit to AOCI of $2 million and $1 million, respectively, as of December 31, 2007 within the Consolidated Balance Sheets.

An insignificant amount in AOCI will be recognized in net periodic other post-retirement benefit costs in 2009.

Assumptions Used in Duke Energy's Other Post-retirement Benefits Accounting

	2008	**2007**	**2006**
	(percentages)		
Benefit Obligations			
Discount rate	6.50	6.00	5.75
Net Periodic Benefit Cost			
Discount rate[a]	6.00	5.75	5.50-6.00
Expected long-term rate of return on plan assets	8.50	8.50	N/A

(a) Discount rate for Successor was 6.00% for the nine months ended December 31, 2006. Discount rate for Predecessor was 5.50% for the three months ended March 31, 2006 (see Note 1 for additional information on Predecessor and Successor reporting).

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Assumed Health Care Cost Trend Rates

	Medicare Trend Rate		Prescription Drug Trend Rate	
	2008	2007	2008	2007
Health care cost trend rate assumed for next year	8.50%	8.00%	11.00%	12.50%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	5.00%	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2013	2013	2022	2022

20. Other Income and Expenses, net

The components of Other Income and Expenses, net on the Consolidated Statements of Operations for the years ended December 31, 2008 and 2007, the nine months ended December 31, 2006 and the three months ended March 31, 2006 are as follows:

	Successor[a]			Predecessor[a]
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
	(in millions)			
Income/(Expense)				
Interest income	$27	$29	$15	$ 8
AFUDC equity	7	4	2	1
Other	—	(1)	—	(1)
Total	$34	$32	$17	$ 8

(a) See Note 1 for additional information on Predecessor and Successor reporting.

21. Subsequent Events

For information related to subsequent events related to regulatory matters, commitments and contingencies, and employee benefit obligations, see Notes 4, 18 and 19, respectively.

22. Quarterly Financial Data (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
			(in millions)		
2008					
Total operating revenues	$991	$795	$818	$820	$3,424
Operating income (loss)	223	263	(60)	92	518
Income (loss) before extraordinary items	133	157	(54)	51	287
Net income (loss)	133	157	(54)	118	354
2007					
Total operating revenues	$916	$763	$955	$821	$3,455
Operating income	74	95	210	104	483
Net income	37	49	118	60	264

There were no extraordinary, significant or unusual items during the first or second quarters of 2008.

During the third quarter of 2008, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring items: an approximate $82 million pre-tax impairment charge related to emission allowances (see Note 11); and pre-tax income of approximately $20 million related to the correction of errors in actuarial valuations related to other post-retirement benefit plans (see Note 19).

During the fourth quarter of 2008, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring item: an approximate $67 million after-tax (approximately $103 million pre-tax) extraordinary gain related to the reapplication of SFAS No. 71 to certain operations of Commercial Power (see Note 1).

During the first quarter of 2007, Duke Energy Ohio recorded the following extraordinary, unusual or infrequently occurring item: a temporary rate reduction of $2 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

There were no extraordinary, significant or unusual items during the second, third or fourth quarters of 2007.

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SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

	Balance at Beginning of Period	Additions: Charged to Expense	Additions: Charged to Other Accounts	Deductions[b]	Balance at End of Period
			(In millions)		
Successor[a]					
Year Ended December 31, 2008:					
Allowance for doubtful accounts	$ 3	$15	$—	$ —	$18
Environmental[c]	8	4	—	1	11
Uncertain tax provisions[d]	10	—	—	10	—
Other[e]	3	10	—	2	11
	$24	$29	$—	$13	$40
Year Ended December 31, 2007:					
Injuries and damages	$ 3	$ —	$—	$ 3	$ —
Allowance for doubtful accounts	5	1	—	3	3
Environmental[c]	8	—	—	—	8
Uncertain tax provisions[d]	26	—	—	16	10
Other[e]	11	3	—	11	3
	$53	$ 4	$—	$33	$24
Nine Months Ended December 31, 2006:					
Injuries and damages	$ 5	$ 1	$—	$ 3	$ 3
Allowance for doubtful accounts	4	4	—	3	5
Environmental[c]	8	—	—	—	8
Uncertain tax provisions[d]	28	3	—	5	26
Other[e]	18	6	—	13	11
	$63	$14	$—	$24	$53
Predecessor[a]					
Three Months Ended March 31, 2006:					
Injuries and damages	$ 4	$ 1	$—	$ —	$ 5
Allowance for doubtful accounts	4	2	—	2	4
Environmental[c]	8	—	—	—	8
Uncertain tax provisions[d]	28	—	—	—	28
Other[e]	21	5	—	8	18
	$65	$ 8	$—	$10	$63

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Principally cash payments and reserve reversals. For 2007, this also includes the impacts from the adoption of FIN 48.
(c) *Included in Other within Deferred Credits and Other Liabilities* on the Consolidated Balance Sheets.
(d) Included in Taxes accrued and Interest accrued within Current Liabilities on the Consolidated Balance Sheets. The December 31, 2007 ending balance primarily contains non-income tax reserves.
(e) Principally mark-to-market and other reserves, included in *Unrealized gains on mark-to-market and hedging transactions* within Current Assets and Other within Investments and Other Assets, Unrealized losses on mark-to-market and hedging transactions within Current Liabilities and Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended December 31, 2008, and other than the coal settlements and accounting system transition described below, have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

During the fourth quarter 2008, Duke Energy Ohio transitioned coal settlements accounting from one system to an already existing system used for purchased power. This system change is a result of an evaluation of previous systems and related processes to support evolving operational needs, and is not the result of any identified deficiencies in the previous systems. Duke Energy Ohio reviewed the implementation effort as well as the impact on Duke Energy Ohio's internal control over financial reporting and where appropriate, made changes to internal controls over financial reporting to address the system transition.

Management's Annual Report On Internal Control Over Financial Reporting

Duke Energy Ohio's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Duke Energy Ohio's internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

Duke Energy Ohio's management, including the Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of Duke Energy Ohio's internal control over financial reporting as of December 31, 2008 based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2008.

This annual report does not include an attestation report of Deloitte & Touche LLP, Duke Energy Ohio's registered independent public accounting firm, regarding internal control over financial reporting. Management's report was not subject to attestation by Deloitte & Touche LLP pursuant to temporary rules of the SEC that permit Duke Energy Ohio to provide only management's report in this annual report.

Item 14. Principal Accounting Fees and Services.

Deloitte & Touche LLP, and the member firms of Deloitte Touche Tohmatsu and their respective affiliates (collectively, "Deloitte") provided professional services to Duke Energy Corporation (Duke Energy) and its consolidated subsidiaries for 2008 and 2007. The following table presents the fees that have been allocated to Duke Energy Ohio, Inc. (Duke Energy Ohio) and its subsidiaries as part of corporate governance costs:

	FY 2008	FY 2007
	(in millions)	
Audit Fees[(a)]	$2.3	$2.6
Audit-Related Fees[(b)]	0.4	0.4
Tax Fees[(c)]	0.1	0.4
Total Fees:	$2.8	$3.4

(a) Audit Fees are fees billed or expected to be billed by Deloitte for professional services for the audit of Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for the audit of the Duke Energy Ohio consolidated financial statements included in Duke Energy Ohio's annual report on Form 10-K and review of financial statements included in Duke Energy Ohio's quarterly reports on Form 10-Q, services that are normally provided by Deloitte in connection with statutory, regulatory or other filings or engagements or any other service performed by Deloitte to comply with generally accepted auditing standards.

(b) Audit-Related Fees are fees billed by Deloitte to Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for assurance and related services that are reasonably related to the performance of an audit or review of Duke Energy Ohio's financial statements, including assistance with acquisitions and divestitures and internal control reviews.

(c) Tax Fees are fees billed by Deloitte to Duke Energy and are allocated by Duke Energy to Duke Energy Ohio for tax return assistance and preparation, tax examination assistance, and professional services related to tax planning and tax strategy.

To safeguard the continued independence of the independent auditor, the Duke Energy Audit Committee adopted a policy that provides that the independent public accountants are only permitted to provide services to Duke Energy and its consolidated subsidiaries, including Duke Energy Ohio, that have been pre-approved by the Duke Energy Audit Committee. Pursuant to the policy, detailed audit services, audit-related services, tax services and certain other services have been specifically pre-approved up to certain fee limits. In the event that the cost of any of these services may exceed the pre-approved limits, the Duke Energy Audit Committee must pre-approve the service. All other services that are not prohibited pursuant to the SEC's or other applicable regulatory bodies' rules of regulations must be specifically pre-approved by the Duke Energy Audit Committee. All services performed in 2008 and 2007 by the independent public accountant were approved by the Duke Energy Audit Committee pursuant to its pre-approval policy.

Item 15. Exhibits, Financial Statement Schedules.

(a) Consolidated Financial Statements, Supplemental Financial Data and Supplemental Schedule included in Part II of this annual report are as follows:

Consolidated Financial Statements

Consolidated Statements of Operations for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Consolidated Balance Sheets as of December 31, 2008 and 2007

Consolidated Statements of Cash Flows for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Consolidated Statements of Common Stockholder's Equity and Comprehensive Income for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Notes to the Consolidated Financial Statements

Quarterly Financial Data (unaudited, included in Note 22 to the Consolidated Financial Statements)

Consolidated Financial Statement Schedule II—Valuation and Qualifying Accounts and Reserves for the Year Ended December 31, 2008, Year Ended December 31, 2007, Nine Months Ended December 31, 2006, and the Three Months Ended March 31, 2006

Report of Independent Registered Public Accounting Firm

All other schedules are omitted because they are not required, or because the required information is included in the Consolidated Financial Statements or Notes.

(b) Exhibits—See Exhibit Index immediately following the signature page.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 13, 2009

DUKE ENERGY OHIO, INC.
(Registrant)

By: /s/ JAMES E. ROGERS
James E. Rogers
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

(i) /s/ JAMES E. ROGERS
James E. Rogers
Chief Executive Officer (Principal Executive Officer)

(ii) /s/ DAVID L. HAUSER
David L. Hauser
Group Executive and Chief Financial Officer
(Principal Financial Officer)

(iii) /s/ STEVEN K. YOUNG
Steven K. Young
Senior Vice President and Controller (Principal Accounting Officer)

(iv) Directors

/s/ JAMES E. ROGERS
James E. Rogers

/s/ DAVID L. HAUSER
David L. Hauser

/s/ JAMES L. TURNER
James L. Turner

Date: March 13, 2009

EXHIBIT INDEX

Exhibits filed herewith are designated by an asterisk (*). All exhibits not so designated are incorporated by reference to a prior filing, as indicated.

Exhibit Number	
3.1	Amended Articles of Incorporation of Duke Energy Ohio, Inc. effective October 23, 1996 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1996, File No. 1-1232).
3.1.1	Amended Articles of Consolidation, effective October 1, 2006 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2006, File No. 1-1232).
3.2	Regulations of Duke Energy Ohio, Inc., as amended on July 23, 2003 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
4.1	Original Indenture (First Mortgage Bonds) between Duke Energy Ohio, Inc. and The Bank of New York (as Trustee) dated as of August 1, 1936 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-2374).
4.1.1	Fourteenth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of November 2, 1972 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-60961).
4.1.2	Thirty-third Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of September 1, 1992 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-53578).
4.1.3	Thirty-fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 1, 1993 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1993, File No. 1-1232).
4.1.4	Thirty-fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of January 1, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
4.1.5	Thirty-sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 15, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
4.1.6	Thirty-seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 14, 1996 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1996, File No. 1-1232).
4.1.7	Thirty-eighth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 1, 2001 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 2001, File No. 1-1232).
4.1.8	Thirty-ninth Supplemental Indenture dated as of September 1, 2002, between Duke Energy Ohio, Inc. and The Bank of New York, as Trustee (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
4.2	Repayment Agreement between Duke Energy Ohio, Inc. and The Dayton Power and Light Company dated as of December 23, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1992, File No. 1-1232).

Exhibit Number	
4.3	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated as of September 13, 1995 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1995, File No. 1-1232).
4.4	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated August 1, 2001 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2001, File No. 1-1232).
4.5	Original Indenture (Unsecured Debt Securities) between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of May 15, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
4.5.1	First Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 1, 1995 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1995, File No. 1-1232).
4.5.2	Second Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 30, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
4.5.3	Third Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of October 9, 1997 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1997, File No. 1-1232).
4.5.4	Fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of April 1, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 1998, File No. 1-1232).
4.5.5	Fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 9, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1998, File No. 1-1232).
4.5.6	Sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of September 15, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
4.5.7	Seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 15, 2003 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
4.6	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of September 1, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
4.7	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series A (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
4.8	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series B (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
10.1	Employment Agreement dated February 4, 2004, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy, Indiana, Inc., and James E. Rogers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).

Exhibit Number	
10.2	Amended and Restated Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.2.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.3	Amended and Restated Employment Agreement dated October 1, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Donald B. Ingle, Jr. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.4	Amended and Restated Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.4.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.4.2	Form of amendment to employment agreement, adopted and effective December 14, 2005, between Services and each of Michael J. Cyrus and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.5	Amended and Restated Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.5.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.6	Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc. and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.6.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.7	Deferred Compensation Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/92, File No. 1-1232).
10.8	Split Dollar Insurance Agreement, effective as of May 1, 1993, between Duke Energy Ohio, Inc. and Jackson H. Randolph (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/94, File No. 1-1232).
10.9	Amended and Restated Supplemental Retirement Income Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1995 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/95, File No. 1-1232).

Exhibit Number	
10.10	Amended and Restated Supplemental Executive Retirement Income Agreement between Duke Energy Ohio, Inc. and certain executive officers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/97, File No. 1-1232).
10.11	Asset Purchase Agreement by and among Duke Energy Indiana, Inc. and Duke Energy Ohio, Inc. and Allegheny Energy Supply Company, LLC, Allegheny Energy Supply Wheatland Generating Facility, LLC and Lake Acquisition Company, L.L.C., dated as of May 6, 2005 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2005, File No. 1-1232).
10.12	$2,650,000,000 Amended and Restated Credit Agreement, dated as of June 28, 2007, among Duke Energy Corporation, Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc., Duke Energy Indiana, Inc. and Duke Energy Kentucky, Inc., as Borrowers, the banks listed therein, Wachovia Bank, National Association, as Administrative Agent, JPMorgan Chase Bank, National Association, Barclays Bank PLC, Bank of America, N.A. and Citibank, N.A., as Co-Syndication Agents and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch and Credit Suisse, as Co-Documentation Agents (filed in Form 8-K of Duke Energy Ohio, Inc., July 5, 2007, File No. 1-1232, as Exhibit 10.1).
10.12.1	Amendment No. 1 to the Amended and Restated Credit Agreement (filed on Form 8-K of Duke Energy Ohio, Inc., March 12, 2008, File No. 1-1232, as Exhibit 10.1).
10.13	Keepwell Agreement, dated April 10, 2006, between Duke Capital LLC and Duke Energy Ohio, Inc. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on April 14, 2006, File No. 1-1232).
*12	Computation of Ratio of Earnings to Fixed Charges.
*23.1	Consent of Independent Registered Public Accounting Firm.
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

EXHIBIT 12

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

The ratio of earnings to fixed charges is calculated using the Securities and Exchange Commission guidelines.

	Successor[a]			Predecessor[a]		
	Year Ended December 31, 2008	Year Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
	(in millions)					
Earnings as defined for fixed charges calculation						
Add:						
Pretax income from continuing operations	**$458**	**$415**	**$102**	$186	$412	$378
Fixed charges	**122**	**139**	**100**	35	114	106
Deduct:						
Interest capitalized[b]	**19**	**30**	**14**	3	7	5
Total earnings (as defined for the Fixed Charges calculation)	**$561**	**$524**	**$188**	$218	$519	$479
Fixed charges:						
Interest on debt, including capitalized portions	**$113**	**$130**	**$ 95**	$ 33	$105	$ 95
Estimate of interest within rental expense	**9**	**9**	**5**	2	9	11
Total fixed charges	**$122**	**$139**	**$100**	$ 35	$114	$106
Ratio of earnings to fixed charges	**4.6**	**3.8**	**1.9**	6.2	4.6	4.5

(a) See Note 1 for additional information on Predecessor and Successor reporting.
(b) Excludes equity costs related to AFUDC that are included in Other Income and Expenses in the Consolidated Statements of Operations.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-146483-01 on Form S-3 of our report dated March 13, 2009, relating to the financial statements and financial statement schedule of Duke Energy Ohio, Inc., appearing in this Annual Report on Form 10-K of Duke Energy Ohio, Inc. for the year ended December 31, 2008.

/S/ DELOITTE & TOUCHE LLP
Charlotte, North Carolina
March 13, 2009

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Rogers, certify that:

1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;
2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David L. Hauser, certify that:

1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2009

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 13, 2009

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 13, 2009

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and
Chief Financial Officer

FORM 10-K

Duke Energy Ohio, Inc. - N/A

Filed: March 19, 2008 (period: December 31, 2007)

Annual report which provides a comprehensive overview of the company for the past year

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007 or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from__________ to__________

Commission file number 1-1232

DUKE ENERGY OHIO, INC.

(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	31-0240030 (I.R.S. Employer Identification No.)
139 East Fourth Street, Cincinnati, Ohio (Address of principal executive offices)	45202 (Zip Code)

704-594-6200
(Registrant's telephone number, including area code)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes☐ No☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes☒ No☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer☐	Accelerated filer☐
Non-accelerated filer☒ (Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ☐ No ☒

The registrant meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K and is therefore filing this Form 10-K with the reduced disclosure format. Part II Items 4 and 6 and Part III Items 10, 11, 12 and 13 have been omitted in accordance with Instruction (I)(2)(a) and (c).

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853), which files reports and proxy material pursuant to the Securities Exchange Act of 1934, as amended.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy's defined benefit pension plans;

- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

Item 1. Business

GENERAL

Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through Duke Energy Kentucky, Inc. (Duke Energy Kentucky) in nearby areas of Kentucky. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale and transportation of natural gas, and energy marketing. Duke Energy Ohio's principal subsidiary is Duke Energy Kentucky, a Kentucky corporation organized in 1901. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity and the sale and transportation of natural gas in northern Kentucky. References herein to Duke Energy Ohio includes Duke Energy Ohio and subsidiaries.

In the second quarter of 2006, Duke Energy Corporation (Duke Energy) and Cinergy consummated a merger which combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States.

Duke Energy Ohio operates the following business segments: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. Each of these business units is considered to be a separate reportable segment under Statement of Financial Accounting Standards (SFAS) No. 131, "*Disclosures about Segments of an Enterprise and Related Information*." For additional information regarding this segment, including financial information, see Note 4 to the Consolidated Financial Statements, "Business Segments."

Franchised Electric and Gas consists of Duke Energy Ohio's regulated electric and gas transmission and distribution systems including its regulated electric generation in Kentucky. Franchised Electric and Gas plans, constructs, operates and maintains Duke Energy Ohio's transmission and distribution systems, which generate, transmit and distribute electric energy to consumers. Franchised Electric and Gas also sells and transports natural gas. These electric and gas operations are subject to the rules and regulations of the Federal Energy Regulatory Commission (FERC), the Public Utilities Commission of Ohio (PUCO), and the Kentucky Public Service Commission (KPSC).

Commercial Power primarily consists of Duke Energy Ohio's non-regulated generation in Ohio and certain other non-regulated generation assets discussed in Note 3 to the Consolidated Financial Statements, "Transfer of Generating Assets and Dispositions," and the energy marketing and risk management activities associated with those assets.

The remainder of Duke Energy Ohio's operations are presented as Other. While it is not considered a business segment, Other for Duke Energy Ohio includes certain allocated governance costs.

Duke Energy Ohio's principal executive offices are located at 139 East Fourth Street, Cincinnati, Ohio 45202. The telephone number is 704-594-6200. Duke Energy Ohio electronically files reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports. The public may read and copy any materials that Duke Energy Ohio files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at *http://www.sec.gov*. Additionally, information about Duke Energy Ohio, including its reports filed with the SEC, is available through Duke Energy's web site at *http://www.duke-energy.com*. Such reports are accessible at no charge through Duke Energy's web site and are made available as soon as reasonably practicable after such material is filed with or furnished to the SEC.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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PART I

GLOSSARY OF TERMS

The following terms or acronyms used in this Form 10-K are defined below:

Term or Acronym	Definition
AFUDC	Allowance for Funds Used During Construction
APB	*Accounting Principles Board*
CC	Combined Cycle
Cinergy	Cinergy Corp. (collectively with its subsidiaries)
CO_2	Carbon Dioxide
CT	Combustion Turbine
DOE	Department of Energy
DOJ	Department of Justice
Duke Energy	Duke Energy Corporation (collectively with its subsidiaries)
Duke Energy Kentucky	Duke Energy Kentucky, Inc.
Duke Energy Ohio	Duke Energy Ohio, Inc.
EITF	Emerging Issues Task Force
EPA	Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	*Federal Energy Regulatory Commission*
FIN	Financial Accounting Standards Board Interpretation
FSP	Financial Accounting Standards Board Staff Position
FTC	United States Federal Trade Commission
GAAP	United States Generally Accepted Accounting Principles
KPSC	Kentucky Public Service Commission
LIBOR	London Interbank Offered Rate
MBSSO	Market Based Standard Service Offer
Midwest ISO	Midwest Independent Transmission System Operator
MMBtu	Million British thermal units
MW	Megawatt
NO_x	Nitrogen oxide
OCC	Office of the Ohio Consumers' Counsel
PUCO	Public Utilities Commission of Ohio
RSP	Rate Stabilization Plan
RTC	Regulatory Transition Charges
SAB	Securities and Exchange Commission Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SO_2	Sulfur dioxide

The following sections describe the business and operations of each of Duke Energy Ohio's reportable business segments. (For financial information on Duke Energy's business segments, see Note 4 to the Consolidated Financial Statements, "Business Segments.")

FRANCHISED ELECTRIC AND GAS

Service Area and Customers

Franchised Electric and Gas generates, transmits, distributes and sells electricity. Franchised Electric and Gas also transports and sells natural gas. Its service area covers about 3,000 square miles with an estimated population of 2.1 million in southern Ohio and northern Kentucky. Franchised Electric and Gas supplies electric service to approximately 800,000 residential, commercial and industrial customers over approximately 19,500 miles of distribution lines and an approximate 2,500-mile transmission system in Ohio and Kentucky. Franchised Electric and Gas provides regulated transmission and distribution services for natural gas to approximately 500,000 customers via approximately 7,100 miles of gas mains (gas distribution lines that serve as a common source of supply for more than one service line) and service lines.

COMMERCIAL POWER

Service Area and Customers

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. Commercial Power's assets are comprised of approximately 7,600 net megawatts (MW) of power generation primarily located in the Midwestern U.S. The asset portfolio has a diversified fuel mix with baseload and mid-merit coal-fired units as well as combined cycle (CC) and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the Rate Stabilization Plan (RSP) through 2008. See Item 2. "Properties" for further discussion of the generating facilities and Note 5 to the Consolidated Financial Statements, "Regulatory Matters," for further discussion of the RSP.

ENVIRONMENTAL MATTERS

Duke Energy Ohio is subject to federal, state and local laws and regulations with regard to air and water quality, hazardous and solid waste disposal and other environmental matters. Environmental laws and regulations affecting Duke Energy Ohio include, but are not limited to:

- The Clean Air Act, as well as state laws and regulations impacting air emissions, including State Implementation Plans related to existing and new national ambient air quality standards for ozone and particulate matter. Owners and/or operators of air emission sources are responsible for obtaining permits and for annual compliance and reporting.
- The Clean Water Act which requires permits for facilities that discharge wastewaters into the environment.
- The Comprehensive Environmental Response, Compensation and Liability Act, which can require any individual or entity that currently owns or in the past may have owned or operated a disposal site, as well as transporters or generators of hazardous substances sent to a disposal site, to share in remediation costs.
- The Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act, which requires certain solid wastes, including hazardous wastes, to be managed pursuant to a comprehensive regulatory regime.
- The National Environmental Policy Act, which requires federal agencies to consider potential environmental impacts in their decisions, including siting approvals.

(For more information on environmental matters involving Duke Energy Ohio, including possible liability and capital costs, see Notes 5 and 17 to the Consolidated Financial Statements, "Regulatory Matters," and "Commitments and Contingencies," respectively.)

Except to the extent discussed in Note 5 to the Consolidated Financial Statements, "Regulatory Matters," and Note 17 to the Consolidated Financial Statements, "Commitments and Contingencies," compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise protecting the environment, is incorporated into the routine cost structure of our various business segments and is not expected to have a material adverse effect on the competitive position, consolidated results of operations, cash flows or financial position of Duke Energy Ohio.

Item 1A. Risk Factors.

The risk factors discussed herein relate specifically to risks associated with Duke Energy Ohio.

Duke Energy Ohio's franchised electric revenues, earnings and results are dependent on federal and state legislation and regulation that affect electric generation, transmission, distribution and related activities, which may limit Duke Energy Ohio's ability to recover costs.

Duke Energy Ohio's franchised electric businesses are regulated on a cost-of-service/rate-of-return basis subject to the statutes and regulatory commission rules and procedures of Ohio and Kentucky. If Duke Energy Ohio's franchised electric earnings exceed the returns established by the state regulatory commissions, Duke Energy Ohio's retail electric rates may be subject to review by the commissions and possible reduction, which may decrease Duke Energy Ohio's future earnings. Additionally, if regulatory bodies do not allow recovery of costs incurred in providing service on a timely basis, Duke Energy Ohio's future earnings could be negatively impacted.

Duke Energy Ohio is subject to regulation by FERC and by federal, state and local authorities under environmental laws and by state public utility commissions under laws regulating Duke Energy Ohio's businesses. Regulation affects almost every aspect of Duke Energy Ohio's businesses, including, among other things, Duke Energy Ohio's ability to: take fundamental business management actions; determine the terms and rates of Duke Energy Ohio's transmission and distribution businesses' services; as well as its regulated generation business; make acquisitions; issue debt securities; engage in transactions between Duke Energy Ohio's utilities and other subsidiaries and affiliates; and pay dividends. Changes to these regulations are ongoing, and Duke Energy Ohio cannot predict the future course of changes in this regulatory environment or the ultimate effect that this changing regulatory environment will have on Duke Energy Ohio's business. However, changes in regulation (including re-regulating previously deregulated markets) can cause delays in or affect business planning and transactions and can substantially increase Duke Energy Ohio's costs.

Deregulation or restructuring in the electric industry may result in increased competition and unrecovered costs that could adversely affect Duke Energy Ohio's results of operations, cash flows or financial position and its utilities' businesses.

Increased competition resulting from deregulation or restructuring efforts could have a significant adverse financial impact on Duke Energy Ohio and consequently on its results of operations, financial position, or cash flows. Increased competition could also result in increased pressure to lower costs, including the cost of electricity. Duke Energy Ohio cannot predict the extent and timing of entry by additional competitors into the electric markets. Duke Energy Ohio cannot predict when it will be subject to changes in legislation or regulation, nor can it predict the impact of these changes on its results of operations, cash flows or financial position.

Duke Energy Ohio may be unable to secure long-term power sales agreements or transmission agreements, which could expose Duke Energy Ohio's sales to increased volatility.

In the future, Duke Energy Ohio may not be able to secure long-term power sales agreements for its unregulated power generation facilities. If Duke Energy Ohio is unable to secure these types of agreements, its sales volumes would be exposed to increased volatility. Without the benefit of long-term customer power purchase agreements, Duke Energy Ohio cannot assure that it will be able to operate profitably. The inability to secure these agreements could materially adversely affect Duke Energy Ohio's results and business.

Competition in the unregulated markets in which Duke Energy Ohio operates may adversely affect the growth and profitability of its business.

Duke Energy Ohio may not be able to respond in a timely or effective manner to the many changes designed to increase competition in the electricity industry. To the extent competitive pressures increase, the economics of Duke Energy Ohio's business may come under long-term pressure.

Duke Energy Ohio may also face competition from new competitors that have greater financial resources than Duke Energy Ohio does, seeking attractive opportunities to acquire or develop energy assets or energy trading operations both in the United States and abroad. These new competitors may include sophisticated financial institutions, some of which are already entering the energy trading and marketing sector, and international energy players, which may enter regulated or unregulated energy businesses. This competition in generation assets in non-regulated competitive markets may adversely affect Duke Energy Ohio's ability to make investments or acquisitions.

Duke Energy Ohio operates under the RSP Market Based Standard Service Offer (MBSSO), which provides price certainty for generation in Ohio through December 31, 2008. Unfavorable resolution as to pricing once the RSP expires could have a materially adverse effect on Duke Energy Ohio's results of operations, cash flows or financial position.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Duke Energy Ohio must meet credit quality standards. If Duke Energy Ohio or its rated subsidiary is unable to maintain an investment grade credit rating, it would be required under credit agreements to provide collateral in the form of letters of credit or cash, which may materially adversely affect its liquidity. Duke Energy Ohio cannot be sure that it will maintain investment grade credit ratings.

Each of Duke Energy Ohio's or its rated subsidiary's senior unsecured long-term debt is rated investment grade by various rating agencies. Duke Energy Ohio cannot be sure that its senior unsecured long-term debt will continue to be rated investment grade.

If the rating agencies were to rate Duke Energy Ohio or its rated subsidiary below investment grade, Duke Energy Ohio's borrowing costs would increase, perhaps significantly. In addition, Duke Energy Ohio would likely be required to pay a higher interest rate in future financings, and its potential pool of investors and funding sources would likely decrease. Any downgrade or other event negatively affecting the credit ratings of Duke Energy Ohio or its rated subsidiary could also increase Cinergy's need to provide liquidity in the form of capital contributions or loans to such subsidiaries, thus reducing the liquidity and borrowing availability of the consolidated group.

A downgrade below investment grade could also trigger termination clauses in some interest rate and foreign exchange derivative agreements, which would require cash payments. All of these events would likely reduce Duke Energy Ohio's liquidity and profitability and could have a material adverse effect on its results of operations, cash flows or financial position.

Duke Energy Ohio relies on access to short-term money markets and longer-term capital markets to finance its capital requirements and support its liquidity needs, and Duke Energy Ohio's access to those markets can be adversely affected by a number of conditions, many of which are beyond its control.

Duke Energy Ohio's business is financed to a large degree through debt and the maturity and repayment profile of debt used to finance investments often does not correlate to cash flows from its assets. Accordingly, Duke Energy Ohio relies on access to both short-term money markets and longer-term capital markets as a source of liquidity for capital requirements not satisfied by the cash flow from its operations and to fund investments originally financed through debt instruments with disparate maturities. If Duke Energy Ohio is not able to access capital at competitive rates, its ability to finance its operations and implement its strategy could be adversely affected.

Market disruptions may increase Duke Energy Ohio's cost of borrowing or adversely affect its ability to access one or more financial markets. Such disruptions could include: economic downturns; the bankruptcy of an unrelated energy company; capital market conditions generally; market prices for electricity and gas; terrorist attacks or threatened attacks on Duke Energy Ohio's facilities or unrelated energy companies; or the overall health of the energy industry. Restrictions on Duke Energy Ohio's ability to access financial markets may also affect its ability to execute its business plan as scheduled. An inability to access capital may limit Duke Energy Ohio's ability to pursue improvements or acquisitions that it may otherwise rely on for future growth.

Duke Energy Ohio's ultimate parent, Duke Energy, maintains revolving credit facilities to provide back-up for commercial paper programs and/or letters of credit at various entities. These facilities typically include financial covenants which limit the amount of debt that can be outstanding as a percentage of the total capital for the specific entity. Failure to maintain these covenants at a particular entity could preclude that entity from issuing commercial paper or letters of credit or borrowing under the revolving credit facility and could require other of Duke Energy Ohio's affiliates to immediately pay down any outstanding drawn amounts under other revolving credit agreements.

Duke Energy Ohio is exposed to credit risk of counterparties with whom it does business.

Adverse economic conditions affecting, or financial difficulties of, counterparties with whom Duke Energy Ohio does business could impair the ability of these counterparties to pay for Duke Energy Ohio's services or fulfill their contractual obligations, including loss recovery payments under insurance contracts or cause them to delay such payments or obligations. Duke Energy Ohio depends on these counterparties to remit payments on a timely basis. Any delay or default in payment could adversely affect Duke Energy Ohio's cash flows, financial position or results of operations.

Poor investment performance of Cinergy's pension plan holdings and other factors impacting pension plan costs could unfavorably impact Duke Energy Ohio's liquidity and results of operations.

Duke Energy Ohio participates in certain employee benefit plans sponsored by its parent, Cinergy. Duke Energy Ohio is allocated costs and obligations related to these plans. Cinergy's costs of providing non-contributory defined benefit pension plans are dependent upon a number of factors, such as the rates of return on plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation and required or voluntary contributions made to the plans. While Cinergy complies with the minimum funding requirements as of December 31, 2007, Cinergy's qualified pension plans had obligations which exceeded the value of plan assets by approximately $240 million. Without sustained growth in the pension investments over

time to increase the value of plan assets and depending upon the other factors impacting Cinergy's costs as listed above, Duke Energy Ohio could be required to fund its parent's plans with significant amounts of cash. Such cash funding obligations could have a material impact on Duke Energy Ohio's results of operations, cash flows or financial position.

Duke Energy Ohio is subject to numerous environmental laws and regulations that require significant capital expenditures, can increase its cost of operations, and which may impact or limit its business plans, or expose it to environmental liabilities.
Duke Energy Ohio is subject to numerous environmental laws and regulations affecting many aspects of its present and future operations, including air emissions (such as reducing nitrogen oxide, sulfur dioxide and mercury emissions or potential future control of greenhouse gas emissions), water quality, wastewater discharges, solid waste and hazardous waste. These laws and regulations can result in increased capital, operating, and other costs. These laws and regulations generally require Duke Energy Ohio to obtain and comply with a wide variety of environmental licenses, permits, inspections and other approvals. Compliance with environmental laws and regulations can require significant expenditures, including expenditures for clean up costs and damages arising out of contaminated properties, and failure to comply with environmental regulations may result in the imposition of fines, penalties and injunctive measures affecting operating assets. The steps Duke Energy Ohio takes to ensure that its facilities are in compliance could be prohibitively expensive. As a result, Duke Energy Ohio may be required to shut down or alter the operation of its facilities, which may cause it to incur losses. Further, Duke Energy Ohio's regulatory rate structure and its contracts with customers may not necessarily allow it to recover capital costs Duke Energy Ohio incurs to comply with new environmental regulations. Also, Duke Energy Ohio may not be able to obtain or maintain from time to time all required environmental regulatory approvals for its operating assets or development projects. If there is a delay in obtaining any required environmental regulatory approvals, if Duke Energy Ohio fails to obtain and comply with them or if environmental laws or regulations change and become more stringent, then the operation of Duke Energy Ohio's facilities or the development of new facilities could be prevented, delayed or become subject to additional costs. Although it is not expected that the costs of complying with current environmental regulations will have a material adverse effect on Duke Energy Ohio's cash flows, financial position or results of operations, no assurance can be made that the costs of complying with environmental regulations in the future will not have such an effect.

There is growing consensus that some form of regulation will be forthcoming at the federal level with respect to greenhouse gas emissions, including carbon dioxide (CO_2), and such regulation could result in the creation of substantial compliance costs.

In addition, Duke Energy Ohio is generally responsible for on-site liabilities, and in some cases off-site liabilities, associated with the environmental condition of Duke Energy Ohio's power generation facilities and natural gas assets which it has acquired or developed, regardless of when the liabilities arose and whether they are known or unknown. In connection with some acquisitions and sales of assets, Duke Energy Ohio may obtain, or be required to provide, indemnification against some environmental liabilities. If Duke Energy Ohio incurs a material liability, or the other party to a transaction fails to meet its indemnification obligations to Duke Energy Ohio, Duke Energy Ohio could suffer material losses.

Duke Energy Ohio is involved in numerous legal proceedings, the outcomes of which are uncertain, and resolution adverse to Duke Energy Ohio could negatively affect its cash flows, financial condition or results of operations.
Duke Energy Ohio is subject to numerous legal proceedings. Litigation is subject to many uncertainties and Duke Energy Ohio cannot predict the outcome of individual matters with assurance. It is reasonably possible that the final resolution of some of the matters in which Duke Energy Ohio is involved could require it to make additional expenditures, in excess of established reserves, over an extended period of time and in a range of amounts that could have a material effect on its cash flows and results of operations. Similarly, it is reasonably possible that the terms of resolution could require Duke Energy Ohio to change its business practices and procedures, which could also have a material effect on its results of operation, cash flows or financial position.

Duke Energy Ohio's results of operations may be negatively affected by sustained downturns or sluggishness in the economy, including low levels in the market prices of commodities, all of which are beyond Duke Energy Ohio's control.
Sustained downturns or sluggishness in the economy generally affect the markets in which Duke Energy Ohio operates and negatively influence its operations. Declines in demand for electricity as a result of economic downturns in Duke Energy Ohio's franchised electric service territories will reduce overall electricity sales and lessen Duke Energy Ohio's cash flows, especially as its industrial customers reduce production and, therefore, consumption of electricity and gas. Although Duke Energy Ohio's franchised electric business is
subject to regulated allowable rates of return and recovery of fuel costs under a fuel adjustment clause, overall declines in electricity sold as a result of economic downturn or recession could reduce revenues and cash flows, thus diminishing results of operations.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Duke Energy Ohio also sells electricity into the spot market or other competitive power markets on a contractual basis. With respect to such transactions, revenues and results of operations are likely to depend, in large part, upon prevailing market prices in Duke Energy Ohio's regional markets and other competitive markets. These market prices may fluctuate substantially over relatively short periods of time and could reduce Duke Energy Ohio's revenues and margins and thereby diminish its results of operations.

Factors that could impact sales volumes, generation of electricity and market prices at which Duke Energy Ohio is able to sell electricity are as follows:

- weather conditions, including abnormally mild winter or summer weather that cause lower energy usage for heating or cooling purposes, respectively;
- supply of and demand for energy commodities;
- illiquid markets including reductions in trading volumes which result in lower revenues and earnings;
- general economic conditions, including downturns in the U.S. or other economies which impact energy consumption particularly in which sales to industrial or large commercial customers comprise a significant portion of total sales;
- transmission or transportation constraints or inefficiencies which impact Duke Energy Ohio's non-regulated energy operations;
- availability of competitively priced alternative energy sources, which are preferred by some customers over electricity produced from coal, or gas plants, and of energy-efficient equipment which reduces energy demand;
- natural gas prices;
- ability to procure satisfactory levels of fuel supplies and inventory, such as coal and natural gas;
- electric generation capacity surpluses which cause Duke Energy Ohio's non-regulated energy plants to generate and sell less electricity at lower prices and may cause some plants to become non-economical to operate;
- capacity and transmission service into, or out of, Duke Energy Ohio's markets;
- natural disasters, acts of terrorism, wars, embargoes and other catastrophic events to the extent they affect Duke Energy Ohio's operations and markets, as well as the cost and availability of insurance covering such risks; and
- federal, and state energy and environmental regulation and legislation.

Duke Energy Ohio's operating results may fluctuate on a seasonal and quarterly basis.

Electric power generation is generally a seasonal business. In most parts of the United States and in markets in which Duke Energy Ohio operates, demand for electricity peaks during the hot summer months and demand for natural gas peaks during the cold winter months, with market prices also peaking during the hot summer months for electricity and cold winter months for natural gas. Further, extreme weather conditions such as heat waves or winter storms could cause these seasonal fluctuations to be more pronounced. As a result, in the future, the overall operating results of Duke Energy Ohio's businesses may fluctuate substantially on a seasonal and quarterly basis and thus make period comparison less relevant.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

FRANCHISED ELECTRIC AND GAS

As of December 31, 2007, Franchised Electric and Gas operated two coal-fired stations with a combined net capacity of 577 MW and one combustion turbine (CT) station with a net capacity of 500 MW. Franchised Electric and Gas also owns two underground storage caverns with a total storage capacity of approximately 16 million gallons of liquid propane. The stations and caverns are located in Ohio and Kentucky.

In addition, as of December 31, 2007, Duke Energy Ohio owned approximately 2,500 conductor miles of electric transmission lines, including 1,000 miles of 345 kilovolts, 700 miles of 100 to 161 kilovolts, and 800 miles of 13 to 69 kilovolts. Duke Energy Ohio also owned approximately 19,500 conductor miles of electric distribution lines, including 14,000 miles of overhead lines and 5,500 miles of underground lines, as of December 31, 2007 and approximately 7,100 miles of gas mains and service lines. As of December 31, 2007, the electric transmission and distribution systems had approximately 250 substations. In addition, Duke Energy Ohio has access to nine million gallons of liquid propane through a storage agreement with a third party. This liquid propane is used in the three propane/air peak

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

shaving plants located in Ohio and Kentucky. Propane/air peak shaving plants vaporize the propane and mix with natural gas to supplement the natural gas supply during peak demand periods and emergencies.

Substantially all of Franchised Electric and Gas' electric plant in service is mortgaged under the indenture related to Duke Energy Ohio's various series of First and Refunding Mortgage Bonds.

COMMERCIAL POWER

As of December 31, 2007, Commercial Power jointly owns six coal-fired stations with a combined net capacity of 3,529 MW, of which Duke Energy Ohio operates three. Commercial Power also owns and operates five CT stations, one of which is jointly owned, with a combined net capacity of 1,544 MW and three CC stations with a combined net capacity of 2,480 MW. The stations are located in Ohio, Illinois, Indiana and Pennsylvania.

Item 3. Legal Proceedings.

For information regarding legal proceedings, including regulatory and environmental matters, see Note 5 to the Consolidated Financial Statements, "Regulatory Matters" and Note 17 to the Consolidated Financial Statements, "Commitments and Contingencies—Litigation" and "Commitments and Contingencies—Environmental."

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Cinergy owns all of the common stock of Duke Energy Ohio. Duke Energy owns all of the common stock of Cinergy. Duke Energy Ohio anticipates making periodic dividends to provide funding support for Duke Energy's dividend. During the year ended December 31, 2007, the three months ended March 31, 2006 and the year ended December 31, 2005, Duke Energy Ohio paid dividends to its parent, Cinergy, of $135 million, $102 million and $250 million, respectively. Duke Energy is a public registrant trading on the New York Stock Exchange under DUK.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

EXECUTIVE OVERVIEW

Management's Discussion and Analysis should be read in conjunction with the accompanying Consolidated Financial Statements and Notes for the years ended December 31, 2007, 2006 and 2005.

CINERGY MERGER WITH DUKE ENERGY

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy merged into wholly-owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (Duke Energy).

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instruction (I)(2)(a) of Form 10-K.

RESULTS OF OPERATIONS

Results of Operations and Variances

Summary of Results (in millions)

	Successor(a)		
	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Increase (Decrease)
Operating revenues	$ 2,539	$ 2,261	$ 278
Operating expenses	2,133	2,067	66
Gains(losses) on sales of other assets and other, net	3	(28)	31
Operating income	409	166	243
Other income and expenses, net	23	17	6
Interest expense	77	81	(4)
Income tax expense from continuing operations	128	41	87
Loss from discontinued operations, net of tax	—	(6)	6
Net income	$ 227	$ 55	$ 172

(a) See Note 1 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies," for additional information on Predecessor and Successor reporting.

Net Income

The $172 million increase in Duke Energy's Net income for the nine months ended December 31, 2007 compared to the same period in 2006 was primarily due to the following factors:

Operating Revenues

The $278 million increase in operating revenues was driven primarily by:

- $153 million increase as a result of higher retail generation revenue principally related to the timing of collections on Commercial Power's fuel and purchased power rider compared to the same period of 2006,

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

- $135 million increase in wholesale revenues from the Midwest gas-fired generation assets due primarily to higher generation volumes as a result of favorable weather and higher tolling and capacity revenues in 2007 compared to 2006,
- $36 million increase in retail demand resulting from favorable weather in 2007 compared to 2006,
- $30 million increase in regulated fuel revenue due to increased volume and implementation of new fuel clause rates in Kentucky,
- $26 million increase resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy, and
- $20 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky.

Partially offset by:

- $61 million decrease in net mark-to-market revenues on non-qualifying hedge accounting power and capacity contracts , consisting of $7 million of net mark-to-market losses in 2007 as compared to net mark-to-market gains of $54 million in 2006, and
- $59 million decrease in revenues from sales of fuel due to the expiration of contracts.

Operating Expenses

The $66 million increase in operating expenses was driven primarily by:

- $92 million increase in fuel and operating expenses for wholesale generation mainly due to increased generation volumes for the Midwest gas-fired generation assets as a result of favorable weather in 2007 as compared to 2006,
- $37 million increase in operation and maintenance expenses due to an increase in coal-fired generation plant outages in 2007 versus 2006,
- $30 million increase in operation and maintenance expenses primarily due to higher wage and benefit costs, including adjustments to short-term incentive accruals, distribution line expenses and increased transmission expenses,
- $23 million increase in fuel and purchased power expense resulting primarily from the increase in load due to warmer weather compared to the same period of 2006,
- $14 million increase in regulatory amortization of regulatory transition charge due to increased electric revenues and a new demand side management rider in Ohio, and
- $11 million increase in property and other taxes mainly driven by increased property taxes due to capital additions and increased revenue taxes due to increased revenues.

Partially offset by:

- $95 million decrease in net mark-to-market expenses on non-qualifying hedge accounting fuel contracts as a result of $46 million of net mark-to-market gains in 2007 as compared to net mark-to-market losses of $49 million in 2006, and
- $55 million decrease in expenses from sales of fuel due to the expiration of contracts.

Gains(losses) on Sales of Other Assets and Other, net

The improvement in Gains(losses) on sales of other assets and other, net is primarily attributable to $3 million of gains on sales of emission allowances in 2007 as compared $28 million of losses in the comparable period of 2006.

Operating Income

The increase in Operating income resulted primarily from favorable weather conditions, timing of collection of non-regulated riders, elimination of merger rate credits, new electric rates for Duke Energy Kentucky, mark-to-market results, sales of emission allowances and improved results from the Midwest gas-fired generation assets. These increases were partially offset by increased operating expenses related to increased generation outages and increased fuel costs due to the favorable weather conditions.

Income Tax Expense from Continuing Operations

The $87 million increase in income tax expense from continuing operations was due to an increase in pre-tax income.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Summary of Results (in millions)

	Successor[a] Three Months Ended March 31, 2007	Predecessor[a] Three Months Ended March 31, 2006	Increase (Decrease)
Operating revenues	$ 916	$ 963	$ (47)
Operating expenses	831	781	50
(Losses) gains on sales of other assets and other, net	(11)	26	(37)
Operating income	74	208	(134)
Other income and expenses, net	9	8	1
Interest expense	23	30	(7)
Income tax expense from continuing operations	23	68	(45)
Loss from discontinued operations, net of tax	—	(2)	2
Net income	$ 37	$ 116	$ (79)

(a) See Note 1 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies" for additional information on Predecessor and Successor reporting.

Net Income

The 68 percent decrease in Duke Energy Ohio's Net income for the three months ended March 31, 2007 compared to the same period in 2006 was primarily due to the following factors:

Operating Revenues

The $47 million decrease in Operating revenues was driven primarily by:

- $88 million as a result of mark-to-market losses on non-qualifying hedge accounting power contracts in 2007 of $45 million versus gains of $43 million in 2006, and
- $28 million as a result of decreased volumes of physical coal sales due to expiration of contracts and the increased use of financial products to manage fuel costs which are reported net in operating expenses.

Partially offset by:

- Approximately $40 million increase in generation revenues due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- $24 million increase resulting from favorable weather in 2007 compared to 2006,
- $7 million increase due to new electric base rates implemented in the first quarter of 2007 for Duke Energy Kentucky, and
- $4 million resulting from temporary rate reductions in 2006 associated with the regulatory approval of the Cinergy merger with Duke Energy.

Operating Expenses

The $50 million increase in Operating expenses was driven primarily by:

- $55 million increase in operating expenses due to Duke Energy's contribution of its five Midwest generating plants in the second quarter of 2006,
- $30 million higher fuel and emission allowance consumption expense due to recognizing coal and emission allowances at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy,
- $7 million increase in line maintenance expense as a result of ice storms in February 2007, and
- $7 million of incremental amortization expense resulting from recognizing the unregulated generation facilities at fair value as of April 1, 2006 in conjunction with the Cinergy merger with Duke Energy.

Partially offset by:

- $35 million related to $19 million of mark-to-market gains on non-qualifying hedge accounting fuel contracts in 2007 versus losses of $16 million in 2006, and
- $12 million related to 2006 costs for incentive and retention payments incurred as a result of the Duke Energy merger.

(Losses) Gains on Sales of Other Assets and Other, net
The decrease in (Losses) gains on sales of other assets and other, net is due to losses on emission allowance sales in 2007 of $11 million versus gains of $26 million in 2006. The losses in 2007 were a result of recording emission allowances at fair value as of April 1, 2006 as part of purchase accounting for the Cinergy merger with Duke Energy and decreases in market prices at the time of sale.

Income Tax Expense from Continuing Operations
The $45 million decrease in Income tax expense from continuing operations was due primarily to a $126 million decrease in pre-tax income.

Matters Impacting Future Duke Energy Ohio Results
Duke Energy Ohio's current strategy is focused on maximizing the returns and cash flows from its current portfolio. Results for Duke Energy Ohio are sensitive to changes in power supply, power demand, fuel prices, and weather. Future results for Duke Energy Ohio are subject to volatility due to the over or under-collection of fuel and purchased power costs since Duke Energy Ohio's RSP MBSSO is not subject to regulatory accounting pursuant to SFAS No. 71, *"Accounting for Certain Types of Regulation"* (SFAS No. 71). In addition, Duke Energy Ohio's RSP expires on December 31, 2008. Duke Energy Ohio is currently working with the PUCO and the Ohio legislature to establish a rate structure beyond 2008. The outcome of the rate structure could impact the results of operations in future periods. Compared to 2006 and 2007, Duke Energy Ohio's 2008 results will also be favorably impacted by the reduced impact of purchase accounting adjustments recorded in connection with the 2006 merger with Duke Energy. The outcome of the pending Duke Energy Ohio gas rate case could impact future results through the increase of base rates.

Other Matters
Duke Energy Ohio's fixed charges coverage ratio, as calculated using SEC guidelines, was 3.8 times for the year ended December 31, 2007, 1.9 times for the nine months ended December 31, 2006, 6.2 times for the three months ended March 31, 2006 and 4.6 times for the year ended December 31, 2005.

Other Issues
Global Climate Change. A majority of the public and policymakers now believe that the earth's climate is changing, caused in part by greenhouse gases emitted into the atmosphere from human activities. Although there is still much to learn about the causes and long-term effects of climate change, many advocate taking steps now to begin reducing emissions with the aim of stabilizing the atmospheric concentration of greenhouse gases at a level that avoids the potentially worst-case effects of climate change.
Greenhouse gas emissions are produced from a wide variety of human activities. The U.S. Environmental Protection Agency publishes an inventory of these emissions annually. CO_2, an essential trace gas, is a by-product of fossil fuel combustion and currently accounts for about 85% of U.S. greenhouse gas emissions. Duke Energy Ohio currently accounts for about 0.30% of total U.S. CO_2 emissions, and about 0.26% of total U.S. greenhouse gas emissions.

Duke Energy Ohio's cost of complying with any federal greenhouse gas emissions law that may be enacted will depend on the design details of the program. The major design elements of a greenhouse gas cap-and-trade program that will most influence Duke Energy Ohio's compliance costs include the required levels and timing of the cap, which will drive emission allowance prices, the emission sources covered under the cap, the number of allowances that Duke Energy Ohio is allocated on a year-to-year basis, the type of and effectiveness of the cost control mechanism employed by the program, and the availability and cost of technologies that Duke Energy Ohio can deploy to lower its emissions. Although it is likely that Congress will adopt some form of mandatory greenhouse gas emission reduction legislation in the future, the timing and specific requirements of any such legislation are highly uncertain, which means that potential future compliance costs for Duke Energy Ohio are also highly uncertain.
The 110th Congress is currently considering several potential U.S. policy responses to the climate change issue. In 2007, nearly a dozen bills were introduced in the Senate calling for mandatory limits on U.S. greenhouse gas emissions through use of a cap-and-trade program. The key differences in the bills are the sources whose emissions would be regulated, the rate at which emissions would be required to be reduced, the number of emission allowances that would be distributed at no cost to sources whose emissions would be regulated, and the method of protecting the economy from potentially high and unexpected program costs.

On December 5, 2007, the Senate Environment and Public Works Committee reported out S. 2191—America's Climate Security Act of 2007—sponsored by Senators Joseph Lieberman of Connecticut and John Warner of Virginia. The bill, which now awaits Senate floor

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

action, proposes an economy-wide greenhouse gas reduction program to begin in 2012. Several bills have also been introduced in the House of Representatives but none has yet received subcommittee or committee approval. It is unlikely that legislation establishing a mandatory federal greenhouse gas emission reduction program will be enacted in 2008.

Duke Energy Ohio supports the enactment of federal greenhouse gas cap-and-trade legislation that would apply to all parts of the economy, including power generation, industrial and commercial sources, and motor vehicles. To permit the economy to adjust rationally to the policy, legislation should establish a long-term program that first slows the growth of emissions, stops their growth and then transitions to a gradually declining emissions cap as new lower-and non-emitting technologies are developed and become *ready for wide-scale deployment.*

New technologies for reducing CO_2 emissions from coal—chief among them carbon capture and sequestration—are not expected to be developed and ready for deployment by 2012 when the Lieberman-Warner legislation, if passed, would take effect. This would pose a challenge to Duke Energy Ohio's ability to utilize all of its current coal-fired generating capacity if the legislation is enacted in its current form. This could challenge Duke Energy Ohio's ability to meet the growing electricity demand of its customers at a reasonable cost. Duke Energy Ohio's customer energy-efficiency initiative would help, but would not be enough. If the cap is too stringent in the early years of the program, Duke Energy Ohio's compliance options could be limited to purchasing emission allowances and/or relying on existing natural gas generation to replace coal generation. Achieving a large fuel switch from coal to natural gas in less than four years is not practical and, on a national scale, is not good public policy. Such a shift would significantly increase natural gas prices, posing an economic hardship to millions of natural gas customers.

Compliance cost estimates are very sensitive to various highly uncertain assumptions, including allowance prices. Under the proposed S. 2191 legislation, estimated costs of purchasing allowances in 2012, in addition to those allocated at no cost, to cover Duke Energy Ohio's projected emissions could range from about $230 million to about $680 million. Actual costs could be higher or lower than these estimates. Duke Energy Ohio would seek to recover its compliance costs through appropriate regulatory mechanisms in the jurisdictions in which it operates. Under a compliance scenario where Duke Energy Ohio continues to purchase allowances to meet its compliance obligation, annual allowance purchase costs would increase over time as the number of allowances Duke Energy Ohio is allocated under the proposed legislation decreases and allowance prices increase as the cap tightens.

At some point in the future it would be expected that Duke Energy Ohio would begin replacing existing coal-fired generation with new lower-and zero-emitting generation technologies, and/or installing new carbon capture and sequestration technology on existing coal-fired generating plants to reduce emissions when technologies become available. It is not possible at this time, however, to predict with certainty what new technologies might be developed, when they will be ready to be deployed, or what their costs will be. There is also uncertainty as to how or when certain non-technical issues that could affect the cost and availability of new technologies might be resolved by regulators. Duke Energy Ohio currently is focused on integrated gasification combined cycle generation with carbon capture and sequestration, and capture and storage retrofit technology for existing pulverized coal-fired generation as promising new technologies for generating electricity with lower or no CO_2 emissions.

In addition to relying on new technologies to reduce its CO_2 emissions, Duke Energy Ohio is seeking regulatory approval for a first-of-its-kind innovative approach in the utility industry to help meet growing customer demand with new and creative ways to increase energy efficient, thereby reducing demand (Save-A-Watt) instead of relying almost exclusively on new power plants to generate electricity.

Credit Implications of Climate Change Legislation. A credit rating agency recently announced that climate-change policies eventually could carry significant credit implications for the U.S. electric utility industry, which includes Duke Energy Ohio. While the agency stated on February 26, 2008 that it had not lowered any utility company *ratings due solely to the sizable capital expenditures needed to reduce emission levels, rating actions could result. The agency* cited a utility's financing plan and its ability to recover such costs from its ratepayers as the biggest factors in considering whether environmental-related capital expenditures negatively affect a utility's credit quality. Duke Energy Ohio cannot predict with any certainty what actions, if any, this or other credit rating agencies may take. A downgrade in Duke Energy Ohio's credit rating could adversely affect its ability to access capital at competitive rates and its ability to finance its operations and implement its strategies could be adversely affected.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Risk Management Policies

Duke Energy Ohio is exposed to market risks associated with commodity prices, credit exposure and interest rates. Management has established comprehensive risk management policies to monitor and manage these market risks. The Treasurer of Duke Energy, the ultimate parent entity of Cinergy, is responsible for the overall governance of managing credit risk and commodity price risk, including monitoring exposure limits for Duke Energy Ohio.

Commodity Price Risk

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased as a result of its ownership of its non-regulated generation portfolio. Price risk represents the potential risk of loss from adverse changes in the market price of electricity or other energy commodities, such as gas and coal. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity derivatives, such as swaps, futures, forwards and options. (See Note 1 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies" and Note 9 to the Consolidated Financial Statements, "Risk Management and Hedging Activities, Credit Risk, and Financial Instruments.")

Validation of a contract's fair value is performed by an internal group separate from Duke Energy Ohio's deal origination areas. Duke Energy Ohio's derivative contract portfolio is predominantly valued using observable market inputs with little internally developed assumptions. However, for contracts valued beyond the observable market period, Duke Energy Ohio uses common industry practices to develop its valuation techniques and changes in its pricing methodologies or the underlying assumptions could result in significantly different fair values and income recognition.

Normal Purchases and Normal Sales. Duke Energy Ohio enters into contracts on a limited basis that qualify for the normal purchases and sales exception described in paragraph 10 of SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," Derivatives Implementation Group Issue C15, "*Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity*," and amended by SFAS No. 149, "*Amendment to Statement 133 on Derivative Instruments and Hedging Activities*" (SFAS No. 149). For contracts qualifying for the scope exception, no recognition of the contract's fair value in the Consolidated Financial Statements is required until settlement of the contract which generally coincides with the physical delivery of the commodity being bought or sold.

Generation Portfolio Risks. Duke Energy Ohio is primarily exposed to market price fluctuations of wholesale power, coal, natural gas and emission allowance prices associated with its non-regulated generation portfolio. Duke Energy Ohio closely monitors the risks associated with these commodity price changes on its future generation operations and, where appropriate, uses various commodity instruments such as electricity, coal and natural gas forward contracts to mitigate the effect of such fluctuations on operations, in addition to optimizing the value of its non-regulated generation portfolio. The portfolio includes generation assets (power and capacity), fuel, and emission allowances. Modeled forecasts of future generation output, fuel requirements, and emission allowance requirements are based on forward power, fuel and emission allowance markets. The component pieces of the portfolio are bought and sold based on this model in order to manage the economic value of the portfolio, where such market transparency exists. The generation portfolio not utilized to serve native load or committed load is subject to commodity price fluctuations. Based on a sensitivity analysis as of December 31, 2007 and 2006, it was estimated that a ten percent price change per megawatt hour in forward wholesale power prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $13 million in 2008 and $17 million in 2007, respectively, excluding the impact of mark-to-market changes on non-qualifying or undesignated hedges relating to periods in excess of one year from the respective date. Based on a sensitivity analysis as of December 31, 2007 and 2006, it was estimated that a ten percent price change per MMBtu (one million British thermal units) in natural gas prices would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $9 million in 2008 and $15 million in 2007 respectively, excluding the impact of mark-to-market changes on undesignated hedges relating to periods in excess of one year from the respective date.

Undesignated Contracts. Undesignated contracts executed to manage generation portfolio risks are exposed to changes in fair value due to market price fluctuations of wholesale power and coal. Based on a sensitivity analysis as of December 31, 2007 and 2006, it was estimated that a ten percent price change in the forward price per megawatt hour of wholesale power would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $16 million in 2008 and $22 million in 2007, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated power contracts pertaining to periods in excess of one year from the respective date. Based on a sensitivity analysis as of December 31, 2007 and 2006, it was estimated that a ten percent change in the forward price per ton of coal would have a corresponding effect on Duke Energy Ohio's pre-tax income of approximately $14 million in 2008 and $12 million in 2007, respectively, resulting from the impact of mark-to-market changes on non-qualifying and undesignated coal contracts pertaining to periods in excess of one year from the respective date.

Credit Risk

Credit risk represents the loss that Duke Energy Ohio would incur if a counterparty fails to perform under its contractual obligations. To reduce credit exposure, Duke Energy Ohio seeks to enter into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties. Duke Energy Ohio attempts to further reduce credit risk with certain counterparties by entering into agreements that enable it to obtain collateral or to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events. Duke Energy Ohio may, at times, use credit derivatives or other structures and techniques to provide for third-party credit enhancement of its counterparties' obligations. Duke Energy Ohio sells certain of their accounts receivable

and related collections through Cinergy Receivables Company, LLC a bankruptcy remote, special purpose entity. While no direct recourse to Duke Energy Ohio exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. (See Note 12 to the Consolidated Financial Statements, "Sales of Accounts Receivable.")

Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Ohio also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

Based on Duke Energy Ohio's policies for managing credit risk, its exposures and its credit and other reserves, Duke Energy Ohio does not anticipate a materially adverse effect on its consolidated financial position or results of operations as a result of non-performance by any counterparty.

Interest Rate Risk

Duke Energy Ohio is exposed to risk resulting from changes in interest rates as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to percentages of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters interest rate swaps to manage and mitigate interest rate risk exposure. (See Notes 1, 9, and 15 to the Consolidated Financial Statements, "Summary of Significant Accounting Policies," "Risk Management and Hedging Activities, Credit Risk, and Financial Instruments," and "Debt and Credit Facilities.")

Based on a sensitivity analysis as of December 31, 2007, it was estimated that if market interest rates average 1% higher (lower) in 2008 than in 2007, interest expense, net of offsetting impacts in interest income, would increase (decrease) by approximately $8 million. Comparatively, based on a sensitivity analysis as of December 31, 2006, had interest rates averaged 1% higher (lower) in 2007 than in 2006, it was estimated that interest expense, net of offsetting impacts in interest income, would have increased (decreased) by approximately $7 million. These amounts were estimated by considering the impact of the hypothetical interest rates on variable-rate securities outstanding, including money pool balances, adjusted for interest rate hedges and cash and cash equivalents outstanding as of December 31, 2007 and 2006. If interest rates changed significantly, management would likely take actions to manage its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in Duke Energy Ohio's financial structure.

As of December 31, 2007 and mid-March 2008, Duke Energy Ohio had approximately $440 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. Beginning in February 2008, Duke Energy Ohio experienced failed auctions on a portion of these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 1.75 times one-month London Interbank Offered Rate. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. Duke Energy Ohio is currently pursuing a refunding and refinancing plan, which is subject to approval by applicable state or county financing authorities and utility regulators. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially effect Duke Energy Ohio's overall financial position, results of operations or cash flows. The weighted-average interest rate, associated with Duke Energy Ohio's auction rate pollution control bonds, was 4.56% as of December 31, 2007 and 5.37% as of March 6, 2008.

Further, at this time, Duke Energy Ohio does not believe the recent market developments significantly impact its ability to obtain financing and fully expects to have access to liquidity in the capital markets at reasonable rates and terms. Additionally, Duke Energy has access to unsecured revolving credit facilities, which are not restricted upon general market conditions, with aggregate bank commitments of approximately $2.65 billion, of which a portion is currently committed primarily to backstop Duke Energy's commercial paper program. Duke Energy Ohio (excluding Duke Energy Kentucky) has a borrowing sub limit of $500 million and Duke Energy Kentucky has a borrowing sub limit of $100 million under Duke Energy's master credit facility.

In March 2008, Duke Energy increased its capacity under its master credit facility by $550 million. As a result of this increase, the borrowing sub limit of Duke Energy Ohio increased by $250 million to $750 million. The borrowing sub limit of Duke Energy Kentucky did not change.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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PART II

Item 8. Financial Statements and Supplementary Data.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Duke Energy Ohio, Inc.
Charlotte, North Carolina

We have audited the accompanying consolidated balance sheets of Duke Energy Ohio, Inc. and subsidiaries (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of operations, common stockholder's equity and comprehensive income, and cash flows for the year ended December 31, 2007 and the nine months ended December 31, 2006 (successor periods), and the three months ended March 31, 2006 and the year ended December 31, 2005 (predecessor periods). Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Duke Energy Ohio, Inc. and subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for the periods stated above, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1, on April 3, 2006, Duke Energy Corporation acquired all of the outstanding common stock of Cinergy Corp. in a merger accounted for under the purchase method of accounting. The impacts of purchase accounting have been "pushed down" to the Company, resulting in its assets and liabilities being recorded at their fair values as of the merger date. Consequently, the financial statements of the successor Company are not generally comparable to those of the predecessor Company.

/s/ DELOITTE & TOUCHE LLP

Charlotte, North Carolina
March 19, 2008

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions)

	Successor		Predecessor	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
Operating Revenues				
Non-regulated electric and other	$ 1,751	$ 1,236	$ 421	$ 1,387
Regulated electric	984	638	220	613
Regulated natural gas	720	387	322	780
Total operating revenues	3,455	2,261	963	2,780
Operating Expenses				
Fuel used in electric generation and purchased power	1,070	804	196	665
Operation, maintenance and other	756	505	173	562
Natural gas purchased	449	230	232	514
Costs of fuel resold	47	83	44	189
Depreciation and amortization	392	280	68	271
Property and other taxes	250	165	68	213
Total operating expenses	2,964	2,067	781	2,414
(Losses) Gains on Sales of Other Assets and Other, net	(8)	(28)	26	125
Operating Income	483	166	208	491
Other Income and Expenses, net	32	17	8	19
Interest Expense	100	81	30	98
Income from Continuing Operations Before Income Taxes	415	102	186	412
Income Tax Expense from Continuing Operations	151	41	68	157
Income from Continuing Operations	264	61	118	255
(Loss) Income from Discontinued Operations, net of tax	—	(6)	(2)	46
Income Before Cumulative Effect of Change in Accounting Principle	264	55	116	301
Cumulative Effect of Change in Accounting Principle, net of tax	—	—	—	(3)
Net Income	264	55	116	298
Dividends and Premiums on Redemption of Preferred and Preference Stock	—	—	—	1
Earnings Available for Common Stockholder	$ 264	$ 55	$ 116	$ 297

See Notes to Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.
CONSOLIDATED BALANCE SHEETS
(In millions)

	Successor	
	December 31,	
	2007	2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 33	$ 45
Receivables (net of allowance for doubtful accounts of $3 at December 31, 2007 and $5 at December 31, 2006)	334	308
Inventory	212	217
Assets held for sale	—	25
Unrealized gains on mark-to-market and hedging transactions	26	54
Other	100	117
Total current assets	705	766
Investments and Other Assets		
Restricted funds held in trust	62	30
Goodwill	2,325	2,348
Intangibles, net	551	732
Unrealized gains on mark-to-market and hedging transactions	25	27
Assets held for sale	—	18
Other	33	21
Total investments and other assets	2,996	3,176
Property, Plant and Equipment		
Cost	9,577	9,049
Less accumulated depreciation and amortization	2,097	1,914
Net property, plant and equipment	7,480	7,135
Regulatory Assets and Deferred Debits		
Deferred debt expense	23	24
Regulatory assets related to income taxes	90	96
Other	401	533
Total regulatory assets and deferred debits	514	653
Total Assets	$ 11,695	$ 11,730

See Notes to Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.
CONSOLIDATED BALANCE SHEETS—(Continued)
(In millions, except share and per-share amounts)

	Successor	
	December 31,	
	2007	2006
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	$ 602	$ 408
Notes payable	189	274
Taxes accrued	172	301
Interest accrued	24	27
Liabilities associated with assets held for sale	—	25
Current maturities of long-term debt	126	105
Unrealized losses on mark-to-market and hedging transactions	33	46
Other	86	99
Total current liabilities	1,232	1,285
Long-term Debt	1,810	1,776
Deferred Credits and Other Liabilities		
Deferred income taxes	1,436	1,475
Investment tax credit	16	19
Accrued pension and other postretirement benefit costs	259	381
Unrealized losses on mark-to-market and hedging transactions	34	29
Liabilities associated with assets held for sale	—	18
Asset retirement obligations	31	41
Other	343	326
Total deferred credits and other liabilities	2,119	2,289
Commitments and Contingencies		
Common Stockholder's Equity		
Common stock, $8.50 par value; 120,000,000 shares authorized and 89,663,086 shares outstanding at December 31, 2007 and 2006	762	762
Additional paid-in capital	5,570	5,601
Retained earnings	227	55
Accumulated other comprehensive loss	(25)	(38)
Total common stockholder's equity	6,534	6,380
Total Liabilities and Common Stockholder's Equity	$ 11,695	$ 11,730

See Notes to Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Successor		Predecessor	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	$ 264	$ 55	$ 116	$ 298
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	395	280	68	271
Losses (gains) on sales of equity investments and other assets	8	31	(26)	(125)
Deferred income taxes	18	(120)	7	(44)
Regulatory asset/liability amortization	17	9	7	10
Cumulative effect of change in accounting principle	—	—	—	3
Accrued pension and other postretirement benefit costs	37	40	9	22
Contribution to company-sponsored pension and other postretirement benefit plans	(92)	(22)	—	(18)
(Increase) decrease in:				
Net realized and unrealized mark-to-market and hedging transactions	21	(6)	(30)	43
Receivables	(25)	132	10	(125)
Inventory	5	(84)	56	(25)
Other current assets	22	25	68	(123)
Increase (decrease) in:				
Accounts payable	181	(86)	(157)	245
Taxes accrued	(144)	54	50	29
Other current liabilities	1	(63)	(78)	155
Regulatory asset/liability deferrals	(19)	(7)	(1)	(31)
Other assets	148	175	17	48
Other liabilities	(89)	(50)	—	25
Net cash provided by operating activities	748	363	116	658
CASH FLOWS FROM INVESTING ACTIVITIES				
Capital expenditures	(593)	(391)	(135)	(434)
Purchases of emission allowances	(23)	(167)	(162)	(433)
Sales of emission allowances	29	138	105	494
Net proceeds from the sales of equity investments and other assets, and sales of and collections on notes receivable	—	32	—	—
Change in restricted funds held in trust	(31)	22	8	38
Net cash used in investing activities	(618)	(366)	(184)	(335)
CASH FLOWS FROM FINANCING ACTIVITIES				
Issuance of long-term debt	205	88	141	—
Redemption of long-term debt	(153)	(80)	(1)	—
Redemption of preferred stock of subsidiaries	—	—	(21)	—
Notes payable to affiliate, net	(85)	36	50	(66)
Dividends paid	(135)	—	(102)	(251)
Capital contribution from parent	29	—	—	—
Other	(3)	(4)	(1)	—
Net cash (used in) provided by financing activities	(142)	40	66	(317)
Net (decrease) increase in cash and cash equivalents	(12)	37	(2)	6
Cash and cash equivalents at beginning of period	45	8	10	4
Cash and cash equivalents at end of period	$ 33	$ 45	$ 8	$ 10
Supplemental Disclosures				
Cash paid for interest, net of amount capitalized	$ 91	$ 103	$ 21	$ 98
Cash paid for income taxes	$ 159	$ 77	$ —	$ 204
Significant non-cash transactions:				
Purchase accounting adjustments	$ (14)	$ 2,894	$ —	$ —
Accrued capital expenditures	$ 62	$ 49	$ —	$ —
Transfer of generating assets from Duke Energy	$ —	$ 1,462	$ —	$ —

See Notes to Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(In millions)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss): Net Gains (Losses) on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss): Minimum Pension Liability Adjustment	Accumulated Other Comprehensive Income (Loss): SFAS No. 158 Adjustment	Total
Successor							
Nine Months Ended December 31, 2006							
Balance at April 1, 2006	$ 762	$ 4,123	$ —	$ —	$ —	$ —	$ 4,885(b)
Net income	—	—	55	—	—	—	55
Other comprehensive income, net of tax effect of ($2) Cash flow hedges	—	—	—	3	—	—	3
Total comprehensive income							58
Transfer of generating assets from Duke Energy[(a)]	—	1,462	—	(39)	—	—	1,423
Contribution from parent company for reallocation of taxes	—	16	—	—	—	—	16
SFAS No. 158 funded status provision	—	—	—	—	—	(2)	(2)
Balance at December 31, 2006	$ 762	$ 5,601	$ 55	$ (36)	$ —	$ (2)	$ 6,380
Year Ended December 31, 2007							
Balance at December 31, 2006	$ 762	$ 5,601	$ 55	$ (36)	$ —	$ (2)	$ 6,380
Net income	—	—	264	—	—	—	264
Other comprehensive income, net of tax effect of ($8)							
Cash flow hedges	—	—	—	4	—	—	4
SFAS 158 net actuarial gain[(c)]	—	—	—	—	—	11	11
Total comprehensive income							279
Capital contribution from parent	—	29	—	—	—	—	29
Push-down accounting adjustments	—	(14)	—	—	—	—	(14)
Adoption of SFAS No. 158—measurement date provision	—	—	(3)	—	—	(2)	(5)
Common stock dividends	—	(46)	(89)	—	—	—	(135)
Balance at December 31, 2007	$ 762	$ 5,570	$ 227	$ (32)	$ —	$ 7	$ 6,534
Predecessor							
Year Ended December 31, 2005							
Balance at December 31, 2004	$ 762	$ 585	$ 610	$ (19)	$ (20)	$ —	$ 1,918
Net income	—	—	298	—	—	—	298
Other comprehensive income, net of tax effect of $1							
Minimum pension liability adjustment	—	—	—	—	(13)	—	(13)
Cash flow hedges	—	—	—	5	—	—	5
Total comprehensive income							290
Common stock dividends	—	—	(250)	—	—	—	(250)
Preferred stock dividends	—	—	(1)	—	—	—	(1)
Contribution from parent company for reallocation of taxes	—	18	—	—	—	—	18
Balance at December 31, 2005	$ 762	$ 603	$ 657	$ (14)	$ (33)	$ —	$ 1,975
Three Months Ended March 31, 2006							
Balance at December 31, 2005	$ 762	$ 603	$ 657	$ (14)	$ (33)	$ —	$ 1,975
Net income	—	—	116	—	—	—	116
Other comprehensive income							
Minimum pension liability adjustment	—	—	—	—	1	—	1
Cash flow hedges	—	—	—	1	—	—	1
Total comprehensive income							118
Common stock dividends	—	—	(102)	—	—	—	(102)
Balance at March 31, 2006	$ 762	$ 603	$ 671	$ (13)	$ (32)	$ —	$ 1,991(b)

(a) Includes $39 (net of tax benefit of $24) related to deferred losses on terminated cash flow hedges included in Accumulated Other Comprehensive Income (Loss).

(b) Difference in equity balances at March 31, 2006 and April 1, 2006 is due to the application of push-down accounting reflecting Duke Energy's merger with Cinergy (see Notes 1 and 2 to the Consolidated Financial Statements).

(c) Excludes $50 reflected as regulatory assets.

See Notes to Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements
For the Years Ended December 31, 2007, 2006 and 2005

1. Summary of Significant Accounting Policies

Nature of Operations and Basis of Consolidation. Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through Duke Energy Kentucky, Inc. (Duke Energy Kentucky) in nearby areas of Kentucky. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Ohio's principal subsidiary is Duke Energy Kentucky, a Kentucky corporation organized in 1901. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. References herein to Duke Energy Ohio includes Duke Energy Ohio and its subsidiaries. In October 2006, Cinergy and Duke Energy Ohio completed the sale of Duke Energy Ohio's trading contracts to Fortis Bank S.A./N.V. (Fortis), a Benelux-based financial services group. See Note 13 for additional information.

On April 3, 2006, Duke Energy Corporation (Old Duke Energy) and Cinergy merged into wholly-owned subsidiaries of Duke Energy Holding Corp. (Duke Energy HC), resulting in Duke Energy HC becoming the parent entity. In connection with the closing of the merger transactions, Duke Energy HC changed its name to Duke Energy Corporation (New Duke Energy or Duke Energy) and Old Duke Energy converted into a limited liability company named Duke Power Company LLC (subsequently renamed Duke Energy Carolinas, LLC effective October 1, 2006). As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of common stock of New Duke Energy, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 2 for additional information regarding the merger. Both Old Duke Energy and New Duke Energy are referred to as Duke Energy herein. Duke Energy is a public registrant trading on the New York Stock Exchange under DUK.

As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into 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 Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger.

These Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control. These Consolidated Financial Statements also reflect Duke Energy Ohio's proportionate share of certain generation and transmission facilities.

Predecessor and Successor Reporting. In connection with the Duke Energy merger, Duke Energy acquired all of the outstanding common stock of Cinergy. The merger has been accounted for under the purchase method of accounting with Duke Energy treated as the acquirer for accounting purposes. As a result, the assets and liabilities of Cinergy were recorded at their respective fair values as of the merger consummation date. Purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006 (see Note 2). Except for an adjustment related to pension and other postretirement benefit obligations, as mandated by the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 87, "*Employers' Accounting for Pensions*," and SFAS No. 106, "*Employers' Accounting for Postretirement Benefits Other Than Pensions*," the accompanying consolidated financial statements do not reflect any adjustments related to Duke Energy Ohio's regulated operations that are accounted for pursuant to SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*" (SFAS No. 71), which are comprised of Duke Energy Ohio's regulated transmission and distribution operations and Duke Energy Kentucky. Under the rate setting and recovery provisions currently in place for these regulated operations which provide revenues derived from cost, the fair values of the individual tangible and intangible assets and liabilities are considered to approximate their carrying values.

Duke Energy Ohio's Consolidated Statements of Operations subsequent to the merger include amortization expense relating to purchase accounting adjustments and depreciation of fixed assets based upon their fair value as of the merger date. Therefore, the Duke Energy Ohio financial data prior to the merger will not generally be comparable to its financial data subsequent to the merger. See Note 2 for additional information.

Due to the impact of push-down accounting, the financial statements and certain note presentations separate Duke Energy Ohio's presentations into two distinct periods, the period before the consummation of the merger (labeled "Predecessor") and the period after that date (labeled "Successor"), to indicate the application of different bases of accounting between the periods presented.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States, 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.

Cash and Cash Equivalents. All highly liquid investments with original maturities of three months or less at the date of purchase are considered cash equivalents.

Restricted Funds Held In Trust. At December 31, 2007 and 2006, Duke Energy Ohio had approximately $62 million and $30 million, respectively, of restricted cash related primarily to proceeds from debt issuances that are held in trust, primarily for the purpose of funding future environmental expenditures.

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.

Components of Inventory

	Successor(a)	
	December 31, 2007	December 31, 2006
	(In millions)	
Inventory		
Gas held in storage	$ 69	$ 82
Fuel for use in electric generation	77	74
Materials and supplies	66	61
Total Inventory	$ 212	$ 217

(a) See "Predecessor and Successor Reporting" in Note 1 for additional information on Predecessor and Successor reporting.

Cost-Based Regulation. Duke Energy Ohio accounts for certain of its regulated operations under the provisions of 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, Duke Energy Ohio 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 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. Duke Energy Ohio 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, Duke Energy Ohio may have to reduce its asset balances to reflect a market basis less than cost and write-off their associated regulatory assets and liabilities. (For further information see Note 5.)

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. Accordingly, application of SFAS No. 71 was discontinued for the generation portion of Duke Energy Ohio's business. Duke Energy Ohio has a RTC balance of approximately $239 million and $331 million as of December 31, 2007 and 2006, respectively, which is classified in Other Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

Duke Energy Ohio operates under the Rate Stabilization Plan (RSP), a market based standard service offer (MBSSO) which was approved by the PUCO in November 2004, and which provides price certainty through December 31, 2008. In March 2005, the Office of the Ohio Consumers' Counsel (OCC) appealed the PUCO's approval of the MBSSO and in November 2006, the Ohio Supreme Court remanded the PUCO's order approving the MBSSO for further evidentiary support and explanation, and to require Duke Energy Ohio to

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

disclose certain confidential commercial agreements between an affiliate of Duke Energy Ohio and certain Duke Energy Ohio customers which had been previously requested by the OCC. Duke Energy Ohio has complied with the disclosure order and on October 24, 2007, the PUCO issued its order in response to the remand. On February 15, 2008, Duke Energy Ohio filed a notice of appeal with the Ohio Supreme Court challenging a portion of PUCO's order on remand issued in October 2007 (see Note 5). The MBSSO consists of the following discrete charges:

- Annually Adjusted Component—intended to provide cost recovery primarily for environmental compliance expenditures. This component is avoidable (or by-passable) for the first 25% of residential load and 50% of non-residential load to switch to an alternative electric service provider.

- Infrastructure Maintenance Fund Charge—intended to compensate Duke Energy Ohio for committing its physical capacity. This charge is unavoidable (or non-by-passable).

- System Reliability Tracker—intended to provide actual cost recovery for capacity purchases, purchased power, reserve capacity, and related market costs for purchases to meet capacity needs. This charge is non-by-passable for residential load and by-passable for non-residential load under certain circumstances.

- Rate Stabilization Charge—intended to compensate Duke Energy Ohio for maintaining a fixed price through 2008. This charge is by-passable by the first 25% of residential load and 50% of non-residential load to switch.

- Generation Prices and Fuel Recovery—A market price has been established for generation service. A component of the market price is a fuel cost recovery mechanism that is adjusted quarterly for fuel, emission allowances, and certain purchased power costs, that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. These new prices were applied to non-residential customers beginning January 1, 2005 and to residential customers beginning January 1, 2006.

- Transmission Cost Recovery—A transmission cost recovery mechanism was established beginning January 1, 2005 for non-residential customers and beginning January 1, 2006 for residential customers. The transmission cost recovery mechanism is designed to permit Duke Energy Ohio to recover certain Midwest Independent Transition System Operator, Inc. (Midwest ISO) charges, all Federal Energy Regulatory Commission (FERC) approved transmission costs, and all congestion costs allocable to retail ratepayers that are provided service by Duke Energy Ohio.

Excluding Duke Energy Ohio's deregulated generation-related assets and liabilities, as of December 31, 2007, Duke Energy Ohio continues to meet the criteria to apply SFAS No. 71.

Energy Purchases and Fuel Costs. As part of the PUCO's November 2004 approval of Duke Energy Ohio's RSP, a cost tracking recovery mechanism was established to recover costs of retail fuel and emission allowances that exceed the amount originally included in the rates frozen in the Duke Energy Ohio transition plan. This mechanism was effective January 1, 2005 for non-residential customers and January 1, 2006 for residential customers. Also, Duke Energy Ohio began utilizing a tracking mechanism approved by the PUCO for the recovery of system reliability capacity costs related to certain specified purchases of power. This mechanism was effective January 1, 2005 for non-residential customers and January 1, 2006 for residential customers. Because Duke Energy Ohio does not apply SFAS No. 71 to its generation operations, differences between fuel costs billed and costs incurred are not recorded as regulatory assets or liabilities.

Accounting for Risk Management and Hedging Activities and Financial Instruments. Duke Energy Ohio uses a number of different derivative and non-derivative instruments in connection with its commodity price and interest rate risk management activities, including swaps, futures, forwards and options. All derivative instruments not designated and qualifying for the normal purchases and normal sales exception under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*", as amended, (SFAS No. 133), are recorded on the Consolidated Balance Sheets at their fair value. Cash inflows and outflows related to derivative instruments, except those that contain financing elements and those related to other investing activities, are a component of operating cash flows in the accompanying Consolidated Statements of Cash Flows. Cash inflows and outflows related to derivative instruments containing financing elements are a component of financing cash flows in the accompanying Consolidated Statements of Cash Flows while cash inflows and outflows from derivatives related to investing activities are a component of investing cash flows in the accompanying Consolidated Statements of Cash Flows.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio designates all energy commodity derivatives as either trading or non-trading. Gains and losses for all derivative contracts that do not represent physical delivery contracts are reported on a net basis in the Consolidated Statements of Operations. For each of Duke Energy Ohio's physical delivery contracts that are derivatives, the accounting model and presentation of gains and losses, or revenue and expense in the Consolidated Statements of Operations is shown below.

Classification of Contract	Duke Energy Ohio Accounting Model	Presentation of Gains & Losses or Revenue & Expense
Trading derivatives	Mark-to-market[(a)]	Net basis in Non-regulated electric and other
Non-trading derivatives:		
Cash flow hedge	Accrual[(b)]	Gross basis in the same Statement of Operations category as the related hedged item
Fair value hedge	Accrual[(b)]	Gross basis in the same Statement of Operations category as the related hedged item
Normal purchase or sale	Accrual[(b)]	Gross basis upon settlement in the corresponding Statement of Operations category based on commodity type
Undesignated	Mark-to-market[(a)]	Net basis in the related Statement of Operations category for interest rate and commodity derivatives

(a) An accounting term used by Duke Energy Ohio to refer to derivative contracts for which an asset or liability is recognized at fair value and the change in the fair value of that asset or liability is recognized in the Consolidated Statements of Operations. This term is applied to trading and undesignated non-trading derivative contracts. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.

(b) An accounting term used by Duke Energy Ohio to refer to contracts for which there is generally no recognition in the Consolidated Statements of Operations for any changes in fair value until the service is provided, the associated delivery period occurs or there is hedge ineffectiveness. As discussed further below, this term is applied to derivative contracts that are accounted for as cash flow hedges, fair value hedges, and normal purchases or sales, as well as to non-derivative contracts used for commodity risk management purposes. As this term is not explicitly defined within GAAP, Duke Energy Ohio's application of this term could differ from that of other companies.

Where Duke Energy Ohio's derivative instruments are subject to a master netting agreement and the criteria FASB Interpretation (FIN) No. 39, "*Offsetting of Amounts Related to Certain Contracts—an Interpretation of Accounting Principles Board (APB) Opinion No. 10 and FASB Statement No. 105*" (FIN 39), are met, Duke Energy Ohio presents its derivative assets and liabilities, and accompanying receivables and payables, separately on a net basis in the accompanying Consolidated Balance Sheets.

Cash Flow and Fair Value Hedges. Qualifying energy commodity and other derivatives may be designated as either a hedge of a forecasted transaction or future cash flows (cash flow hedge) or a hedge of a recognized asset, liability or firm commitment (fair value hedge). For all contracts accounted for as a hedge, Duke Energy Ohio prepares formal documentation of the hedge in accordance with SFAS No. 133. In addition, at inception and at least every three months thereafter, Duke Energy Ohio formally assesses whether the hedge contract is highly effective in offsetting changes in cash flows or fair values of hedged items. Duke Energy Ohio documents hedging activity by transaction type (futures/swaps) and risk management strategy (commodity price risk/interest rate risk).

Changes in the fair value of a derivative designated and qualified as a cash flow hedge, to the extent effective, are included in the Consolidated Statements of Common Stockholder's Equity and Comprehensive Income as Accumulated Other Comprehensive Loss (AOCI) until earnings are affected by the hedged item. Duke Energy Ohio discontinues hedge accounting prospectively when it has determined that a derivative no longer qualifies as an effective hedge, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative no longer qualifies as an effective hedge, the derivative is subject to the Mark-to-Market model of accounting (MTM Model) prospectively. Gains and losses related to discontinued hedges that were previously accumulated in AOCI will remain in AOCI until the underlying contract is reflected in earnings; unless it is probable that the hedged forecasted transaction will not occur at which time associated deferred amounts in AOCI are immediately recognized in current earnings.

For derivatives designated as fair value hedges, Duke Energy Ohio recognizes the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item in earnings, to the extent effective, in the current period. All derivatives designated and accounted for as hedges are classified in the same category as the item being hedged in the Consolidated Statements of Cash Flows. In addition, all components of each derivative gain or loss are included in the assessment of hedge effectiveness.

Normal Purchases and Normal Sales. On a limited basis, Duke Energy Ohio applies the normal purchase and normal sales exception to certain contracts. If contracts cease to meet this exception, the fair value of the contracts is recognized on the Consolidated Balance Sheets and the contracts are accounted for using the MTM Model unless immediately designated as a cash flow or fair value hedge.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Valuation. When available, quoted market prices or prices obtained through external sources are used to measure a contract's fair value. For contracts with a delivery location or duration for which quoted market prices are not available, fair value is determined based on internally developed valuation techniques or models. For derivatives recognized under the MTM Model, valuation adjustments are also recognized in the Consolidated Statements of Operations.

Goodwill. Duke Energy Ohio evaluates goodwill for potential impairment under the guidance of SFAS No. 142, "*Goodwill and Other Intangible Assets*" (SFAS No. 142). Under this provision, goodwill is subject to an annual test for impairment. Duke Energy Ohio has designated August 31 as the date it performs the annual review for goodwill impairment for its reporting units. Under the provisions of SFAS No. 142, Duke Energy Ohio performs the annual review for goodwill impairment at the reporting unit level, which Duke Energy Ohio has determined to be an operating segment.

Impairment testing of goodwill consists of a two-step process. The first step involves a comparison of the determined fair value of a reporting unit with its carrying amount. If the carrying amount of the reporting unit exceeds its fair value, the second step of the process involves a comparison of the fair value and carrying value of the goodwill of that reporting unit. If the carrying value of the goodwill of a reporting unit exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to the excess. Additional impairment tests are performed between the annual reviews if events or changes in circumstances make it more likely than not that the fair value of a reporting unit is below its carrying amount.

Duke Energy Ohio primarily uses a discounted cash flow analysis to determine fair value. Key assumptions in the determination of fair value include the use of an appropriate discount rate, estimated future cash flows and estimated run rates of operation, maintenance, and general and administrative costs. In estimating cash flows, Duke Energy Ohio incorporates expected growth rates, regulatory stability and ability to renew contracts as well as other factors into its revenue and expense forecasts.

Property, Plant and Equipment. As discussed under "Predecessor and Successor Reporting" above, recorded balances for property, plant and equipment existing as of April 3, 2006 were adjusted to reflect fair values as of that date. Due to rate setting and recovery provisions currently in place for regulated operations, the fair values of property plant and equipment of the regulated operations were considered to approximate their carrying values as of the date of Duke Energy's merger with Cinergy. Accumulated depreciation was not reset to zero as of the merger date for the regulated property, plant and equipment due primarily to regulatory reporting implications. Unregulated property, plant and equipment were recorded at respective fair values and accumulated deprecation was reset to zero as of the merger date. Otherwise, property, plant and equipment are stated at the lower of historical cost less accumulated depreciation or fair value, if impaired. Duke Energy Ohio capitalizes all construction-related direct labor and material costs, as well as indirect construction costs. Indirect costs include general engineering, taxes and the cost of funds used during construction. The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of property, plant and equipment, is expensed as incurred. Depreciation is generally computed over the asset's estimated useful life using the straight-line method. The composite weighted-average depreciation rates were 2.6% for 2007, 2.7% for 2006, and 2.4% for 2005. Also, see "Allowance for Funds Used During Construction (AFUDC)," discussed below.

When Duke Energy Ohio retires its regulated property, plant and equipment, it charges the original cost plus the cost of retirement, less salvage value, to accumulated depreciation and amortization. When it sells entire regulated operating units, or retires or sells non-regulated properties, the cost is removed from the property account and the related accumulated depreciation and amortization accounts are reduced. Any gain or loss is recorded in earnings, unless otherwise required by the applicable regulatory body.

Duke Energy Ohio recognizes asset retirement obligations (ARO's) in accordance with SFAS No. 143, "*Accounting For Asset Retirement Obligations*" (SFAS No. 143), for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset and FIN No. 47, "*Accounting for Conditional Asset Retirement Obligations*" (FIN 47), for conditional ARO's. The term conditional asset retirement obligation as used in SFAS No. 143 and FIN 47 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Both SFAS No. 143 and FIN 47 require that the fair value of a liability for an ARO be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the estimated useful life of the asset. See Note 8 for further information.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Long-Lived Asset Impairments, Assets Held For Sale and Discontinued Operations. Duke Energy Ohio evaluates whether long-lived assets, excluding goodwill, have been impaired when circumstances indicate the carrying value of those assets may not be recoverable. For such long-lived assets, an impairment exists when its carrying value exceeds the sum of estimates of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. When alternative courses of action to recover the carrying amount of a long-lived asset are under consideration, a probability-weighted approach is used for developing estimates of future undiscounted cash flows. If the carrying value of the long-lived asset is not recoverable based on these estimated future undiscounted cash flows, the impairment loss is measured as the excess of the asset's carrying value over its fair value, such that the asset's carrying value is adjusted to its estimated fair value.

Management assesses the fair value of long-lived assets using commonly accepted techniques, and may use more than one source. Sources to determine fair value include, but are not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. Significant changes in market conditions resulting from events such as changes in commodity prices or the condition of an asset, or a change in management's intent to utilize the asset may generally require management to re-assess the cash flows related to the long-lived assets.

Duke Energy Ohio uses the criteria in SFAS No. 144 "*Accounting for the Impairment of or Disposal of Long-Lived Assets*" (SFAS No. 144), to determine when an asset is classified as "held for sale." Upon classification as "held for sale," the long-lived asset or asset group is measured at the lower of its carrying amount or fair value less cost to sell, depreciation is ceased and the asset or asset group is separately presented on the Consolidated Balance Sheets. When an asset or asset group meets the SFAS No. 144 criteria for classification as held for sale within the Consolidated Balance Sheets, Duke Energy Ohio does not retrospectively adjust prior period balance sheets to conform to current year presentation.

Duke Energy Ohio uses the criteria in SFAS No. 144 and Emerging Issues Task Force (EITF) Issue No. 03-13, "*Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*" (EITF 03-13), to determine whether components of Duke Energy Ohio that are being disposed of, are classified as held for sale or have been wound down are required to be reported as discontinued operations in the Consolidated Statements of Operations. To qualify as a discontinued operation under SFAS No. 144, the component being disposed of must have clearly distinguishable operations and cash flows. Additionally, pursuant to EITF 03-13, Duke Energy Ohio must not have significant continuing involvement in the operations after the disposal (i.e. Duke Energy Ohio must not have the ability to influence the operating or financial policies of the disposed component) and cash flows of the operations being disposed of must have been eliminated from Duke Energy Ohio's ongoing operations (i.e. Duke Energy Ohio does not expect to generate significant direct cash flows from activities involving the disposed component after the disposal transaction is completed). Assuming both preceding conditions are met, the related results of operations for the current and prior periods, including any related impairments, are reflected as (Loss) Income From Discontinued Operations, net of tax, in the Consolidated Statements of Operations. If an asset held for sale does not meet the requirements for discontinued operations classification, any impairments and gains or losses on sales are recorded in continuing operations as (Losses) Gains on Sales of Other Assets and Other, net, in the Consolidated Statements of Operations. Impairments for all other long-lived assets are recorded in Operating Expenses in the Consolidated Statements of Operations.

Unamortized Debt Premium, Discount and Expense. Premiums, discounts and expenses incurred with the issuance of outstanding long-term debt are amortized over the terms of the debt issues. Any call premiums or unamortized expenses associated with refinancing higher-cost debt obligations to finance regulated assets and operations are amortized consistent with regulatory treatment of those items, where appropriate. The amortization expense is recorded in continuing operations as interest expense in the Consolidated Statements of Operations. The amortization expense is reflected as Depreciation and amortization within Net cash provided by operating activities on the Consolidated Statements of Cash Flows.

Loss Contingencies. Duke Energy Ohio is involved in certain legal and environmental matters that arise in the normal course of business. Loss contingencies are accounted for under SFAS No. 5, "*Accounting for Contingencies*," (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is determined that it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. When a range of the probable loss exists and no amount within the range is a better estimate than any other amount, Duke Energy Ohio records a loss contingency at the minimum amount in the range. Unless otherwise required by GAAP, legal fees are expensed as incurred. See Note 17 for further information.

Environmental Expenditures. Duke Energy Ohio expenses environmental expenditures related to conditions caused by past operations that do not generate current or future revenues. Environmental expenditures related to operations that generate current or future

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

revenues are expensed or capitalized, as appropriate. Liabilities are recorded on an undiscounted basis when the necessity for environmental remediation becomes probable and the costs can be reasonably estimated, or when other potential environmental liabilities are reasonably estimable and probable.

Revenue Recognition and 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 for Commercial Power, which are recorded as Receivables in Duke Energy Ohio's Consolidated Balance Sheet at December 31, 2007 and 2006, were approximately $38 million and $56 million, respectively. The receivables for unbilled revenues for Franchised Electric and Gas ($145 million and $132 million at December 31, 2007 and 2006, respectively) are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). See Note 12 for additional information.

Allowance for Funds Used During Construction (AFUDC). AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities, consists of two components, an equity component and an interest component. The equity component is a non-cash item. AFUDC is capitalized as a component of Property, Plant and Equipment cost, with offsetting credits to the Consolidated Statements of Operations. After construction is completed, Duke Energy Ohio is permitted to recover these costs through inclusion in the rate base and in the depreciation provision. The total amount of AFUDC included within income from continuing operations in the Consolidated Statements of Operations was $34 million in 2007, which consisted of an after-tax equity component of $4 million and a before-tax interest expense component of $30 million. The total amount of AFUDC included within income from continuing operations in the Consolidated Statements of Operations for the nine months ended December 31, 2006 was $16 million, which consisted of an after-tax equity component of $2 million and a before-tax interest expense component of $14 million. The total amount of AFUDC included within income from continuing operations in the Consolidated Statements of Operations for the three months ended March 31, 2006 was $4 million, which consisted of an after-tax equity component of $1 million and a before-tax interest expense component of $3 million. The total amount of AFUDC included within income from continuing operations in the Consolidated Statements of Operations was $8 million in 2005, which consisted of an after-tax equity component of $1 million and a before-tax interest expense component of $7 million.

Accounting For Purchases and Sales of Emission Allowances. Duke Energy Ohio recognizes emission allowances in earnings as they are consumed or sold. Gains or losses on sales of emission allowances for non-regulated businesses are presented on a net basis in (Losses) Gains on Sales of Other Assets and Other, net, in the accompanying Consolidated Statements of Operations. For regulated businesses that provide for direct recovery of emission allowances, any gains or losses on sales of recoverable emission allowances are included in the rate structure of the regulated entity and are deferred as a regulatory asset or liability. Future rates charged to retail customers are impacted by any gain or loss on sales of recoverable emission allowances and, therefore, as the recovery of the gain or loss is recognized in operating revenues, the regulatory asset or liability related to the emission allowance activity is recognized as a component of Fuel Used in Electric Generation and Purchased Power in the Consolidated Statements of Operations. Purchases and sales of emission allowances are presented gross as investing activities on the Consolidated Statements of Cash Flows.

Income Taxes. As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into 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 or benefits. The accounting for income taxes essentially represents the income taxes that Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger. Deferred income taxes have been provided for temporary differences between the GAAP and tax carrying amounts of assets and liabilities. These differences create taxable or tax-deductible amounts for future periods. Investment tax credits have been deferred and are being amortized over the estimated useful lives of the related properties.

Management evaluates and records uncertain tax positions in accordance with FIN 48, "*Accounting For Uncertainty in Income Taxes—an Interpretation of FASB Statement 109*," (FIN 48), which was adopted by Duke Energy Ohio on January 1, 2007. Duke Energy Ohio records unrecognized tax benefits for positions taken or expected to be taken on tax returns, including the decision to exclude certain income or transactions from a return, when a more-likely-than-not threshold is met for a tax position and management believes that the position will be sustained upon examination by the taxing authorities. Management evaluates each position based solely on the

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. In accordance with FIN 48, Duke Energy Ohio records the largest amount of the unrecognized tax benefit that is greater than 50% likely of being realized upon settlement or effective settlement. Management considers a tax position effectively settled for the purpose of recognizing previously unrecognized tax benefits when the following conditions exist: (i) the taxing authority has completed its examination procedures, including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax positions, (ii) Duke Energy Ohio does not intend to appeal or litigate any aspect of the tax position included in the completed examination, and (iii) it is remote that the taxing authority would examine or reexamine any aspect of the tax position. See Note 7 for further information.

Duke Energy Ohio records, as it relates to taxes, interest expense as Interest Expense and interest income and penalties in Other Income and Expenses, net, in the Consolidated Statements of Operations.

Excise Taxes. Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio 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. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as revenues in the accompanying Consolidated Statements of Operations were as follows:

Successor(a)		Predecessor(a)	
Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)		
$119	$ 77	$ 38	$ 115

(a) See "Predecessor and Successor Reporting" in Note 1 for additional information on Predecessor and Successor reporting.

Segment Reporting. SFAS No. 131, *"Disclosures about Segments of an Enterprise and Related Information"* (SFAS No. 131), establishes standards for a public company to report financial and descriptive information about its reportable operating segments in annual and interim financial reports. Operating segments are components of an enterprise about which separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. Two or more operating segments may be aggregated into a single reportable segment provided aggregation is consistent with the objective and basic principles of SFAS No. 131, if the segments have similar economic characteristics, and the segments are considered similar under criteria provided by SFAS No. 131. There is no aggregation within Duke Energy Ohio's reportable business segments. SFAS No. 131 also establishes standards and related disclosures about the way the operating segments were determined, including products and services, geographic areas and major customers, differences between the measurements used in reporting segment information and those used in the general-purpose financial statements, and changes in the measurement of segment amounts from period to period. The description of Duke Energy Ohio's reportable segments, consistent with how business results are reported internally to management and the disclosure of segment information in accordance with SFAS No. 131, are presented in Note 4.

Statements of Consolidated Cash Flows. Duke Energy Ohio has made certain classification elections within its Consolidated Statements of Cash Flows related to discontinued operations and debt restricted for qualified capital and maintenance expenditures. Cash flows from discontinued operations are combined with cash flows from continuing operations within operating, investing and financing cash flows within the Consolidated Statements of Cash Flows. Proceeds from debt issued with restrictions to fund future capital and maintenance expenditures are presented on a gross basis, with the debt proceeds classified as a financing cash inflow and the changes in the restricted funds held in trust presented as a component of investing activities.

Cumulative Effect of Changes in Accounting Principles. As of December 31, 2005, Duke Energy Ohio adopted the provisions of FIN 47. In accordance with the transition guidance of this standard, Duke Energy Ohio recorded a net-of-tax cumulative effect adjustment of approximately $3 million.

Reclassifications and Revisions. Certain prior period amounts have been reclassified to conform to the presentation for the current period.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

New Accounting Standards. The following new accounting standards were adopted by Duke Energy Ohio during the year ended December 31, 2007 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). In February 2006, the FASB issued SFAS No. 155, which amends SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" and SFAS No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*" (SFAS No. 140). SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for at fair value at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement (new basis) event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise have to be bifurcated. SFAS No. 155 was effective for Duke Energy Ohio for all financial instruments acquired, issued, or subject to remeasurement after January 1, 2007, and for certain hybrid financial instruments that had been bifurcated prior to the effective date, for which the effect is to be reported as a cumulative-effect adjustment to beginning retained earnings. The adoption of SFAS No. 155 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (SFAS No. 156). In March 2006, the FASB issued SFAS No. 156, which amends SFAS No. 140. SFAS No. 156 requires recognition of a servicing asset or liability when an entity enters into arrangements to service financial instruments in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to subsequently measure its servicing assets or servicing liabilities using either an amortization method or a fair value method. SFAS No. 156 was effective for Duke Energy Ohio as of January 1, 2007, and must be applied prospectively, except that where an entity elects to remeasure separately recognized existing arrangements and reclassify certain available-for-sale securities to trading securities, any effects must be reported as a cumulative-effect adjustment to retained earnings. The adoption of SFAS No. 156 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158). In October 2006, the FASB issued SFAS No. 158, which changes the recognition and disclosure provisions and measurement date requirements for an employer's accounting for defined benefit pension and other postretirement plans. The recognition and disclosure provisions require an employer to (1) recognize the funded status of a benefit plan—measured as the difference between plan assets at fair value and the benefit obligation—in its statement of financial position, (2) recognize as a component of other comprehensive loss, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, and (3) disclose in the notes to financial statements certain additional information. SFAS No. 158 does not change the amounts recognized in the income statement as net periodic benefit cost. Duke Energy Ohio recognized the funded status of its defined benefit pension and other postretirement plans and provided the required additional disclosures as of December 31, 2006. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in an increase in total assets of approximately \$33 million (consisting of an increase in regulatory assets of \$31 million and an increase in deferred tax assets of \$2 million), an increase in total liabilities of approximately \$35 million and a decrease in AOCI, net of tax, of approximately \$2 million as of December 31, 2006.

Under the measurement date requirements of SFAS No. 158, an employer is required to measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions). Historically, Duke Energy Ohio has measured its plan assets and obligations up to three months prior to the fiscal year-end, as allowed under the authoritative accounting literature. Duke Energy Ohio adopted the change in measurement date effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date, pursuant to the transition requirements of SFAS No. 158. Net periodic benefit cost of approximately \$3 million for the three-month period between September 30, 2006 and December 31, 2006 was recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, in the first quarter of 2007, the changes in plan assets and plan obligations between the September 30, 2006 and December 31, 2006 measurement dates not related to net periodic benefit cost was required to be recognized, net of tax, as a separate adjustment of the opening balance of AOCI and regulatory assets. This adjustment was not material. During the second quarter of 2007, Duke Energy Ohio completed these calculations. The finalization of these actuarial calculations resulted in a \$2 million adjustment to AOCI and an immaterial adjustment to regulatory assets.

The adoption of SFAS No. 158 did not have a material impact on Duke Energy Ohio's consolidated results of operations or cash flows.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

FIN No. 48. In July 2006, the FASB issued FIN 48, which provides guidance on accounting for income tax positions about which Duke Energy Ohio has concluded there is a level of uncertainty with respect to the recognition of a tax benefit in Duke Energy Ohio's financial statements. FIN 48 prescribes the minimum recognition threshold a tax position is required to meet. Tax positions are defined very broadly and include not only tax deductions and credits but also decisions not to file in a particular jurisdiction, as well as the taxability of transactions. Duke Energy Ohio adopted FIN 48 effective January 1, 2007. See Note 7 for additional information.

FASB Staff Position (FSP) No. FIN 48-1, Definition of "Settlement" in FASB Interpretation No. 48 (FSP No. FIN 48-1). In May, 2007, the FASB staff issued FSP No. FIN 48-1 which clarifies the conditions under FIN 48 that should be met for a tax position to be considered effectively settled with the taxing authority. Duke Energy Ohio's adoption of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

The following new accounting standard was adopted by Duke Energy Ohio during the year ended December 31, 2006 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108). In September 2006 the Securities and Exchange Commission (SEC) issued SAB No. 108, which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Traditionally, there have been two widely-recognized approaches for quantifying the effects of financial statement misstatements. The income statement approach focuses primarily on the impact of a misstatement on the income statement—including the reversing effect of prior year misstatements—but its use can lead to the accumulation of misstatements in the balance sheet. The balance sheet approach, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (a "dual approach") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material.

SAB No. 108 was effective for Duke Energy Ohio's year ending December 31, 2006. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii), under certain circumstances, recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Duke Energy Ohio has historically used a dual approach for quantifying identified financial statement misstatements. Therefore, the adoption of SAB No. 108 did not have a material impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

The following new accounting standard was adopted by Duke Energy Ohio during the year ended December 31, 2005 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

FIN No. 47. In March 2005, the FASB issued FIN 47, which clarifies the accounting for conditional asset retirement obligations as used in SFAS No. 143. A conditional asset retirement obligation is an unconditional legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Therefore, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation under SFAS No. 143 if the fair value of the liability can be reasonably estimated. The provisions of FIN 47 were effective for Duke Energy Ohio as of December 31, 2005, and resulted in a decrease in assets of $7 million, a net increase in liabilities of $12 million and a before tax cumulative effect adjustment to earnings of $5 million. The net- of-tax cumulative adjustment to earnings was $3 million.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of December 31, 2007:

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. The application of SFAS No. 157 may change Duke Energy Ohio's current practice for measuring fair values under other accounting pronouncements that require fair value measurements. For Duke Energy Ohio, SFAS No. 157 is effective as of January 1, 2008. In February 2008, the FASB issued FSP No. 157-2, which delays the effective date of SFAS No. 157 for one year for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Duke Energy Ohio does not expect to report any material cumulative-effect adjustment to beginning retained earnings as is required by SFAS No. 157 for certain limited matters. Duke Energy Ohio continues to monitor additional proposed

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

interpretative guidance regarding the application of SFAS No. 157. To date, no matters have been identified regarding implementation of SFAS No. 157 that would have any material impact on Duke Energy Ohio's consolidated results of operations or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). In February 2007, the FASB issued SFAS No. 159, which permits entities to choose to measure many financial instruments and certain other items at fair value. For Duke Energy Ohio, SFAS No. 159 is effective as of January 1, 2008 and will have no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio 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, Duke Energy Ohio may elect to measure certain financial instruments at fair value in accordance with this standard.

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 Duke Energy Ohio, 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 Duke Energy Ohio 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.

2. Duke Energy/Cinergy Merger

Duke Energy Ohio 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 date of acquisition. The purchase price minus the estimated fair value of the acquired assets and liabilities meeting the definition of a business as defined in EITF Issue No. 98-3, "*Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*" (EITF 98-3), 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 April 3, 2006, the merger between Duke Energy and Cinergy was consummated (see Note 1 for additional information on the merger, purchase accounting and Predecessor and Successor reporting). For accounting purposes, the effective date of the merger was April 1, 2006. The merger combined the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the midwestern United States (Midwest).

Based on the market price of Duke Energy common stock during the period, including the two trading days before, through the two trading days after, May 9, 2005, the date Duke Energy and Cinergy announced the merger, the transaction was valued at approximately $9,115 million and resulted in goodwill recorded at Duke Energy Ohio of approximately $2,348 million.

As discussed in Note 1 above, purchase accounting impacts, including goodwill recognition, have been "pushed down" to Duke Energy Ohio, resulting in the assets and liabilities of Duke Energy Ohio being recorded at their respective fair values as of April 3, 2006. The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the merger with Duke Energy had occurred at the beginning of the periods presented:

Unaudited Consolidated Pro Forma Results (Predecessor)

	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)	
Operating revenues	$ 966	$ 2,793
Income from continuing operations	88	133
Net income	86	176
Earnings available for common stockholder	86	175

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Pro forma results for the nine months ended December 31, 2006 are not presented since the merger occurred at the beginning of the period presented. Additionally, pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of Cinergy's merger with Duke Energy.

Prior to consummation of the merger, certain regulatory approvals were received from the state utility commissions and the FERC. See Note 5 for a discussion of the regulatory impacts of the merger.

3. Transfer of Generating Assets and Dispositions

Transfer of Certain Duke Energy Generating Assets to Duke Energy Ohio. In April 2006, Duke Energy contributed to Duke Energy Ohio its ownership interest in five plants, representing a mix of combined cycle and peaking plants, with a combined capacity of 3,600 megawatts (MW). The transaction was effective in April 2006 and was accounted for at Duke Energy's net book value for these assets. The entities holding these generating plants, which were indirect subsidiaries of Duke Energy, were first distributed to Duke Energy, which then contributed them to Cinergy which, in turn, contributed them to Duke Energy Ohio. In the final step, the entities were then merged into Duke Energy Ohio.

The following unaudited consolidated pro forma financial results for Duke Energy Ohio are presented as if the contribution of the Duke Energy generating assets to Duke Energy Ohio had occurred at the beginning of the periods presented:

Unaudited Consolidated Pro Forma Results (Predecessor)

	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)	
Operating revenues	$ 971	$ 2,951
Income from continuing operations	106	222
Net income	104	266
Earnings available for common stockholder	104	265

These pro forma results do not include any significant transactions completed by Duke Energy Ohio other than the impact of the transfer of the ownership interest in the five plants as discussed above. As part of this transaction, Duke Energy agreed to reimburse Duke Energy Ohio, on a quarterly basis, through April 2016 in the event of certain cash shortfalls related to the performance of the five plants. Based on the assessment of the performance of the five plants on a quarterly basis during 2007, Duke Energy Ohio did not incur any qualifying shortfalls related to the performance of the five plants and thus no cash reimbursement was required from Duke Energy. During the third quarter of 2006, Duke Energy reimbursed Duke Energy Ohio $1.9 million for certain cash shortfalls that occurred during the second quarter of 2006. However, as a result of the calculation pertaining to the third quarter 2006 performance of the five plants, the $1.9 million received by Duke Energy Ohio from Duke Energy was returned to Duke Energy during the fourth quarter of 2006. Duke Energy Ohio accounts for any payments from or return of payments to Duke Energy in Common Stockholder's Equity as an adjustment to Additional paid-in capital.

Dispositions. For the year ended December 31, 2007, the nine months ended December 31, 2006, the three months ended March 31, 2006 and the year ended December 31, 2005, the sale of emission allowances resulted in approximately $29 million, $138 million, $105 million and $494 million, respectively, in proceeds and net pre-tax (losses) gains of ($7) million, ($28) million, $26 million and $125 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances. See Note 13 for dispositions related to discontinued operations.

4. Business Segments

Duke Energy Ohio operates the following business segments, which are all considered reportable business segments under SFAS No. 131: Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's management believes these reportable business segments properly align the various operations of Duke Energy Ohio with how the chief operating decision maker views the business. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these reportable business

segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky. Franchised Electric and Gas also transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky. These electric and gas operations are subject to the rules and regulations of the FERC, the PUCO and the Kentucky Public Service Commission (KPSC).

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and the five Midwestern gas-fired non-regulated generation assets. Commercial Power's assets comprise approximately 7,600 MW of power generation primarily located in the Midwestern United States. The asset portfolio has a diversified fuel mix with base-load and mid-merit coal-fired units as well as combined cycle and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the RSP.

The remainder of Duke Energy Ohio's operations are presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 11).

Duke Energy Ohio's reportable business segments offer different products and services and are managed separately. Accounting policies for Duke Energy Ohio's segments are the same as those described in Note 1. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT).

On a segment basis, EBIT excludes discontinued operations, represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes. Cash, cash equivalents and short-term investments are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

Transactions between reportable business segments are accounted for on the same basis as revenues and expenses in the accompanying Consolidated Financial Statements.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Business Segment Data[(a)]

	Unaffiliated Revenues	Intersegment Revenues	Total Revenues	Segment EBIT/ Consolidated Income from Continuing Operations before Income Taxes	Depreciation and Amortization	Capital and Investment Expenditures	Segment Assets[(b)(d)]
				(in millions)			
Successor[(c)]							
Twelve Months Ended December 31, 2007							
Franchised Electric and Gas	$ 1,707	$ —	$ 1,707	$ 257	$ 228	$ 275	$ 5,530
Commercial Power	1,748	—	1,748	304	164	318	6,165
Total reportable segments	3,455	—	3,455	561	392	593	11,695
Other	—	—	—	(75)	—	—	—
Eliminations and reclassifications	—	—	—	—	—	—	—
Interest expense	—	—	—	(100)	—	—	—
Interest income and other	—	—	—	29	—	—	—
Total consolidated	$ 3,455	$ —	$ 3,455	$ 415	$ 392	$ 593	$ 11,695
Nine Months Ended December 31, 2006							
Franchised Electric and Gas	$ 1,027	$ —	$ 1,027	$ 130	$ 160	$ 198	$ 5,381
Commercial Power	1,234	1	1,235	93	120	193	6,349
Total reportable segments	2,261	1	2,262	223	280	391	11,730
Other	—	—	—	(56)	—	—	—
Eliminations and reclassifications	—	(1)	(1)	—	—	—	—
Interest expense	—	—	—	(81)	—	—	—
Interest income and other	—	—	—	16	—	—	—
Total consolidated	$ 2,261	$ —	$ 2,261	$ 102	$ 280	$ 391	$ 11,730
Predecessor[(c)]							
Three Months Ended March 31, 2006							
Franchised Electric and Gas	$ 543	$ —	$ 543	$ 80	$ 50	$ 75	
Commercial Power	420	1	421	166	18	60	
Total reportable segments	963	1	964	246	68	135	
Other	—	—	—	(39)	—	—	
Eliminations and reclassifications	—	(1)	(1)	—	—	—	
Interest expense	—	—	—	(30)	—	—	
Interest income and other	—	—	—	9	—	—	
Total consolidated	$ 963	$ —	$ 963	$ 186	$ 68	$ 135	
Twelve Months Ended December 31, 2005							
Franchised Electric and Gas	$ 1,561	$ —	$ 1,561	$ 219	$ 183	$ 232	$ 3,932
Commercial Power	1,219	169	1,388	371	88	202	3,309
Total reportable segments	2,780	169	2,949	590	271	434	7,241
Other	—	—	—	(97)	—	—	—
Eliminations and reclassifications	—	(169)	(169)	—	—	—	—
Interest expense	—	—	—	(98)	—	—	—
Interest income and other	—	—	—	17	—	—	—
Total consolidated	$ 2,780	$ —	$ 2,780	$ 412	$ 271	$ 434	$ 7,241

(a) Segment results exclude results of entities classified as discontinued operations.

(b) Includes assets held for sale.

(c) See Note 1 for additional information on Predecessor and Successor reporting.

(d) Amounts include goodwill recorded as of December 31, 2007 and December 31, 2006 resulting from Duke Energy's merger with Cinergy in the amount of $2,325 million and $2,348 million, respectively. Franchised Electric and Gas' allocated amount as of December 31, 2007 and December 31, 2006 was $1,137 million and $1,148 million, respectively. Commercial Power's allocated amount as of December 31, 2007 and December 31, 2006 was $1,188 million and $1,200 million, respectively.

All of Duke Energy Ohio's revenues are generated domestically and its long-lived assets are in the U.S.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

5. Regulatory Matters

Regulatory Assets and Liabilities. Duke Energy Ohio's regulated operations are subject to SFAS No. 71. Accordingly, Duke Energy Ohio records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. See Note 1 for further information.

Duke Energy Ohio's Regulatory Assets and Liabilities:

	Successor[a] As of December 31, 2007	Successor[a] As of December 31, 2006	Recovery/Refund Period Ends
	(in millions)		
Regulatory Assets[b]			
Regulatory Transition Charges (RTC)[c]	$ 239	$ 331	2011
Accrued pension and postretirement[c][i]	120	147	(h)
Net regulatory asset related to income taxes	90	96	(f)
Capital-related distribution costs[c]	22	29	(j)
Unamortized costs of reacquiring debt[m]	11	12	(f)
Vacation accrual[k]	10	14	2008
Deferred operating expense[c][d]	7	6	2066
Hedge costs and other deferrals[c]	5	7	2033
Other[c]	9	12	(h)
Total Regulatory Assets	$ 513	$ 654	
Regulatory Liabilities[b]			
Removal costs[d][e]	$ 181	$ 158	(g)
Accrued pension and postretirement[e]	27	—	(h)
Other[l]	8	9	(h)
Total Regulatory Liabilities	$ 216	$ 167	

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) All regulatory assets and liabilities are excluded from rate base unless otherwise noted.

(c) Included in Other Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

(d) Included in rate base.

(e) Included in Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

(f) Recovery/refund is over the life of the associated asset or liability.

(g) Liability is extinguished over the lives of the associated assets.

(h) Recovery/Refund period currently unknown.

(i) The 2006 amount includes $31 million related to adoption of SFAS No. 158 (see Note 18) and $116 million related to impacts of purchase accounting as a result of Duke Energy's merger with Cinergy (see Note 2).

(j) Recovered via revenue rider or 2010.

(k) Included in Other Current Assets on the Consolidated Balance Sheets.

(l) Included in Accounts Payable or Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

(m) Included in Deferred Debt Expense on the Consolidated Balance Sheets.

Regulatory Merger Approvals. As discussed in Note 1 and Note 2, 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 KPSC required that certain merger related savings be shared with consumers in Ohio and Kentucky, respectively. The commissions also required Duke Energy Ohio and Duke Energy Kentucky to meet additional 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 had completed its merger related rate reductions and filed a report with the PUCO to terminate the merger credit riders. Approximately $2 million and $34 million of these rate reductions were passed through to customers during the years ended December 31, 2007 and 2006, respectively.

- 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 $2 million of the rate reduction was passed through to customers during each of the years ended December 31, 2007 and 2006, respectively.

- The FERC approved the merger without conditions.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Franchised Electric and Gas. *Rate Related Information.* The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. The PUCO approves rates and market prices for retail electric and gas services within the state of Ohio, except that non-regulated sellers of gas and electric generation also are allowed to operate in Ohio (see "Commercial Power" below). 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 OCC appealed the PUCO's approval of the MBSSO to the Supreme Court of Ohio and the Court issued its decision in November 2006. It upheld the MBSSO in virtually every respect but remanded to the PUCO on two issues. The Court 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.

In October 2007, the PUCO issued its ruling in response to the Supreme Court's decision. The PUCO affirmed the MBSSO, with certain modifications, and maintained the current price. The ruling provides 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 rescinded the requirement that Duke Energy Ohio transfer its generating assets to an exempt wholesale generator (EWG) and required 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 (1) whether certain pricing components may be avoided by customers, (2) the right to transfer generating assets, and (3) 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 Commission 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 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 suppler. The OCC also has filed a notice of appeal challenging the PUCO's October 2007 decision as unlawful and unreasonable. Pending the Ohio Supreme Court's consideration of its appeal, the OCC has requested that the PUCO stay implementation of the Infrastructure Maintenance Fund charge approved in the October 2007 order to be collected from customers. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision or whether the PUCO will grant the OCC's request for a stay. 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.

In August 2006, Duke Energy Ohio filed an application with the PUCO to amend its MBSSO through 2010. The proposal provides for continued electric system reliability, a simplified market price structure and clear price signals for customers, while helping to maintain a stable revenue stream for Duke Energy Ohio. On November 30, 2007, due to new legislation pending in the Ohio General Assembly regarding the pricing of competitive retail generation services, Duke Energy Ohio requested PUCO approval to withdraw its application to amend its MBSSO. Upon approval of the new legislation, Duke Energy Ohio will likely seek approval of a new generation pricing formula.

Duke Energy Ohio's MBSSO includes a fuel clause, System Reliability Tracker to recover reserve capacity costs and an Annually Adjusted Component (AAC) to recover changes in environmental, tax and homeland security costs. These price components are audited annually by the PUCO. In April 2007 Duke Energy Ohio entered into a settlement resolving all open issues identified in the 2006 audits and application to amend the 2007 AAC market price with some of the parties. After an evidentiary hearing, the PUCO issued its order approving the partial settlement on November 20, 2007.

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

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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Notes To Consolidated Financial Statements—(Continued)

the spring of 2008. The application also requests approval to continue tracker recovery of costs associated with an accelerated gas main replacement program. The PUCO accepted the application for filing in September 2007. 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 calls for an annual revenue increase of $18.2 million overall, or 3 percent, and will permit continued recovery of costs through 2018 for Duke Energy Ohio's accelerated main replacement program. The parties, however, did not agree on one aspect of Duke Energy Ohio's proposed rate design. That issue and the settlement agreement were presented to the PUCO in an evidentiary hearing on March 5-6, 2008, for consideration and approval.

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 requested increase was attributable to recovery of the current cost of the accelerated 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 continues to utilize tracking mechanisms in its billed rates to customers. At this time, Duke Energy Kentucky cannot predict the outcome of these proceedings.

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 recovered 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.

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. An order on the application is expected in the first quarter of 2008.

New Legislation. On September 25, 2007, at the request of the Governor of Ohio, the Ohio Senate introduced a bill (SB 221) that proposes a comprehensive change to Ohio's 1999 electric energy industry restructuring legislation. If enacted, SB 221 would expand the PUCO's authority over generation to: implement the state's revised energy policy; regulate electric distribution utility prices for standard service; and permit the PUCO to implement rules for advanced energy portfolio and energy efficiency standards, greenhouse gas emission reporting requirements, and pilot project carbon sequestration activities in conjunction with other state agencies. Under SB 221, electric distribution utilities have the ability to apply for PUCO approval of one of two generation pricing alternatives – a market option, or an Electric Security Plan (ESP) option. The market option is based upon a competitive bidding process. The ESP option will allow for the recovery of specified costs. The PUCO, however, would have authority to disallow the market option and compel the ESP option. SB 221, if enacted, would limit the ability of a utility to transfer its dedicated generating assets to an EWG absent PUCO approval. SB 221 passed the Ohio Senate on October 31, 2007, and is currently pending before the Ohio House of Representatives.

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Notes To Consolidated Financial Statements—(Continued)

On February 21, 2008, new legislation (HB 487) that would establish annual alternative energy benchmarks for electric distribution utilities and electric service companies, and energy efficiency standards for electric distribution utilities, was also introduced in the Ohio House of Representatives. Under this legislation, specified portions of the electricity supply of such utilities and companies must be generated from advanced energy or renewable energy resources, including specifically, solar resources. The legislation provides for the PUCO to annually review a utility's or company's compliance and to impose penalties for non-compliance with the benchmarks. HB 487 also establishes policies regarding the geologic storage of carbon dioxide and requires the reporting of greenhouse gas emissions. HB 487 is currently pending in the Ohio House of Representatives. At this time, Duke Energy Ohio is not able to estimate the impact these legislative initiatives might have on its consolidated results of operations, cash flows, or financial position.

Other. 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 an expert report, which concluded that certain types of risers are prone to leaks under various conditions, including over-tightening during initial installation. 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 interveners and will be completed at the end of 2012.

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 Issues Electric Reliability Standards Consistent with reliability provisions of the Energy Policy Act of 2005, on July 20, 2006, FERC issued its Final Rule certifying the North American Electric Reliability Council (NERC) as the Electric Reliability Organization. NERC has filed over 100 proposed reliability standards with FERC. On March 16, 2007, FERC issued a final rule establishing mandatory, enforceable reliability standards for the nation's bulk power system. In the final rule, FERC approved 83 of the 107 standards submitted by the NERC and compliance with these standards became mandatory on June 18, 2007. FERC has since approved several additional standards. Compliance with the remaining standards is expected to continue on a voluntary basis as good utility practice. Duke Energy Ohio does not believe that the issuance of these standards will have a material impact on its consolidated results of operations, cash flows, or financial position.

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. While the proposal has been filed for approval from the FERC, it currently lacks enforcement and financial settlement mechanisms. Given that the proposal has not yet been approved by the FERC, it is difficult to estimate its impact on Duke Energy Ohio, but at this time Duke Energy Ohio does not believe the resource adequacy requirement will have a material impact on its consolidated results of operations, cash flows, or financial position.

Commercial Power. Reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs, including fuel and purchased power, since Commercial Power is not subject to regulatory accounting pursuant to SFAS No. 71. In addition, Commercial Power could be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

6. Joint Ownership of Generating and Transmission Facilities

Duke Energy Ohio, Columbus Southern Power Company (CSP), and Dayton Power & Light (DP&L) jointly own electric generating units and related transmission facilities in Ohio. Duke Energy Kentucky and DP&L jointly own an electric generating unit. Duke Energy Ohio and Wabash Valley Power Association, Inc jointly own the Vermillion generating station in Indiana.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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Notes To Consolidated Financial Statements—(Continued)

As of December 31, 2007, Duke Energy Ohio's shares in jointly-owned plant or facilities were as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work In Progress
		(in millions)		
Duke Energy Ohio				
Production:				
Miami Fort Station (Units 7 and 8)[b]	64.0%	$ 592	$ 157	$ 12
W.C. Beckjord Station (Unit 6)[b]	37.5	47	33	4
J.M. Stuart Station[a][b]	39.0	426	188	265
Conesville Station (Unit 4)[a][b]	40.0	81	54	85
W.M. Zimmer Station[b]	46.5	1,328	499	5
Killen Station[a][b]	33.0	207	123	85
Vermillion Station[b]	75.0	197	41	—
Transmission[c]	Various	88	49	2
Duke Energy Kentucky				
Production:				
East Bend Station[c]	69.0	429	220	1

(a) Station is not operated by Duke Energy Ohio.

(b) Included in Commercial Power segment.

(c) Included in Franchised Electric and Gas segment.

Duke Energy Ohio's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line on the Consolidated Statements of Operations. Each participant in the jointly owned facilities must provide its own financing.

7. Income Taxes

Prior to the merger of Cinergy and Duke Energy on April 3, 2006, the taxable income of Duke Energy Ohio was reflected in Cinergy's U.S. federal and state income tax returns. After the merger, the taxable income of Duke Energy Ohio is reflected in Duke Energy's U.S. federal and state income tax returns. As a result of Duke Energy's merger with Cinergy, Duke Energy Ohio entered into 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 Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation. The current tax sharing agreement Duke Energy Ohio has with Duke Energy is substantially the same as the tax sharing agreement between Duke Energy Ohio and Cinergy prior to the merger.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

The following details the components of income tax expense from continuing operations:

Income Tax Expense from Continuing Operations

	Successor[a] Twelve Months Ended December 31, 2007	Successor[a] Nine Months Ended December 31, 2006	Predecessor[a] Three Months Ended March 31, 2006	Predecessor[a] Twelve Months Ended December 31, 2005
	(in millions)			
Current income taxes				
Federal	$ 120	$ 139	$ 55	$ 188
State	13	22	6	13
Total current income taxes[b]	133	161	61	201
Deferred income taxes				
Federal	19	(100)	11	(47)
State	1	(18)	(3)	8
Total deferred income taxes	20	(118)	8	(39)
Investment tax credit amortization	(2)	(2)	(1)	(5)
Total income tax expense from continuing operations	151	41	68	157
Total income tax (benefit) expense from discontinued operations	—	(3)	(1)	27
Total income tax benefit from cumulative effect of change in accounting principle	—	—	—	(2)
Total income tax expense included in Consolidated Statements of Operations	$ 151	$ 38	$ 67	$ 182

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Included in the "Total current income taxes" line above is a Fin 48 benefit of approximately $13 million.

Reconciliation of Income Tax Expense at the U.S. Federal Statutory Tax Rate to the Actual Tax Expense from Continuing Operations (Statutory Rate Reconciliation)

	Successor[a] Twelve Months Ended December 31, 2007	Successor[a] Nine Months Ended December 31, 2006	Predecessor[a] Three Months Ended March 31, 2006	Predecessor[a] Twelve Months Ended December 31, 2005
	(in millions)			
Income tax expense, computed at the statutory rate of 35%	$ 145	$ 36	$ 65	$ 144
State income tax, net of federal income tax effect	9	3	2	14
Depreciation and other PP&E related differences	9	6	2	3
ITC amortization	(2)	(2)	(1)	(5)
Manufacturing Deduction	(10)	(2)	—	—
Other items, net	—	—	—	1
Total income tax expense from continuing operations	$ 151	$ 41	$ 68	$ 157
Effective Tax Rates	36.4%	40.2%	36.6%	38.1%

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

The manufacturing deduction was created by the American Job Creation Act of 2004 (the Act). The Act provides a deduction for income from qualified domestic production activities. During the years ended December 31, 2006 and 2005, the Act provided for a 3% deduction on qualified production activities. During the year ended December 31, 2007, the deduction increased to 6% on qualified production activities.

Net Deferred Income Tax Liability Components

	Successor[a] As of December 31,	
	2007	2006
	(in millions)	
Deferred credits and other liabilities	$ 100	$ 112
Other	54	66
Total deferred income tax assets	154	178
Investments and other assets	(68)	(72)
Accelerated depreciation rates	(1,311)	(1,308)
Regulatory assets and deferred debits	(195)	(252)
Total deferred income tax liabilities	(1,574)	(1,632)
Total net deferred income tax liabilities	$ (1,420)	$ (1,454)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The above amounts have been classified in the Consolidated Balance Sheets as follows:

Net Deferred Income Tax Liabilities

	Successor[a] As of December 31,	
	2007	2006
	(in millions)	
Current deferred tax assets, included in other current assets	$ 26	$ 21
Current deferred tax liabilities, included in other current liabilities	(10)	—
Non-current deferred tax liabilities	(1,436)	(1,475)
Total net deferred income tax liabilities	$ (1,420)	$ (1,454)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

On January 1, 2007, Duke Energy Ohio adopted FIN 48. The following table shows the impacts of adoption of FIN 48 on Duke Energy Ohio's Consolidated Balance Sheets.

	Increase/ (Decrease) (in millions)
Assets	
Goodwill	$ 4
Liabilities	
Other Liabilities (non-current)[a]	$ 51
Interest Accrued (current)	(11)
Deferred Income Taxes	(36)
Total	$ 4
Common Stockholder's Equity	
Retained Earnings—Cumulative Effect of Accounting Change	$ —

(a) Includes liability for unrecognized tax benefits and accrued interest and penalties, including reserves against gain contingencies. These gain contingencies were not recorded prior to the adoption of FIN 48.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Effective with the adoption of FIN 48 on January 1, 2007, Duke Energy Ohio recognized approximately $6 million of accrued interest payable, which reflects all interest related to income taxes, and no accrued penalties.

The following table details the changes in Duke Energy Ohio's unrecognized tax benefits from January 1, 2007 to December 31, 2007.

	Increase/ (Decrease) (in millions)
Unrecognized Tax Benefits – January 1, 2007	$ 63
Unrecognized Tax Benefits Changes	
Gross increases – tax positions in prior periods	$ 9
Gross decreases – tax positions in prior periods	(19)
Gross increases – current period tax positions	—
Settlements	(6)
Lapse of statute of limitations	—
Total Changes	$ (16)
Unrecognized Tax Benefits – December 31, 2007	$ 47

At December 31, 2007, no portion of the total unrecognized tax benefits would, if recognized, affect the effective tax rate. Additionally, at December 31, 2007, Duke Energy Ohio has approximately $7 million of unrecognized tax benefits related to pre-merger tax positions that, if recognized, would affect goodwill. It is reasonably possible that Duke Energy Ohio will reflect an approximate $35 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

During the year ended December 31, 2007, Duke Energy Ohio recognized net interest expense of approximately $2 million. At December 31, 2007, Duke Energy Ohio had approximately $7 million of interest payable, which reflects all interest related to income taxes, and no accrued penalties.

Duke Energy Ohio 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

8. Asset Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, which was adopted by Duke Energy Ohio on January 1, 2003. SFAS No. 143 addresses financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and the related asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset. This additional carrying amount is then depreciated over the life of the asset. The liability increases due to the passage of time based on the time value of money until the obligation is settled. Subsequent to the initial recognition, the liability is adjusted for any revisions to the expected value of the retirement obligation (with corresponding adjustments to property, plant, and equipment), and for accretion of the liability due to the passage of time. Additional depreciation expense is recorded prospectively for any increases to the carrying amount of the associated asset.

Asset retirement obligations at Duke Energy Ohio relate primarily to the retirement of gas mains, asbestos abatement at certain generating stations and closure and post-closure activities of landfills. In accordance with SFAS No. 143, Duke Energy Ohio identified certain assets that have an indeterminate life, and thus the fair value of the retirement obligation is not reasonably estimable. These assets included transmission pipelines. A liability for these asset retirement obligations will be recorded when a fair value is determinable.

The adoption of SFAS No. 143 had no impact on the income of the regulated electric and gas operations, as the effects were offset by the establishment of regulatory assets and liabilities pursuant to SFAS No. 71.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

In March 2005, the FASB issued FIN 47. As a result of the adoption of FIN 47 in 2005, net property, plant and equipment decreased by approximately $7 million, regulatory liabilities decreased by approximately $27 million, and ARO liabilities increased by approximately $39 million. The adoption of FIN 47 had no impact on the income of the regulated electric operations, as the effects were offset by the establishment of regulatory assets and liabilities pursuant to SFAS No. 71. For obligations related to other operations, a before tax cumulative effect adjustment of approximately $5 million was recorded in the fourth quarter of 2005 as a reduction in earnings (see Note 1).

The pro forma effects of adopting FIN 47, including the impact on the balance sheet and net income are not presented due to the immaterial impact.

The asset retirement obligation is adjusted each period for any liabilities incurred or settled during the period, accretion expense and any revisions made to the estimated cash flows.

Reconciliation of Asset Retirement Obligation Liability (in millions)

Successor[a]	
Balance as of January 1, 2007	$ 41
Accretion expense	2
Liabilities settled[b]	(12)
Balance as of December 31, 2007	$ 31
Balance as of April 1, 2006	$ 41
Accretion expense	2
Revisions in estimated cash flows	(2)
Balance as of December 31, 2006	$ 41
Predecessor[a]	
Balance as of January 1, 2006	$ 41
Accretion expense	1
Revisions in estimated cash flows	(1)
Balance as of March 31, 2006	$ 41

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Liabilities settled during 2007 were related to the retirement of gas mains.

Upon adoption of SFAS No. 143, Duke Energy Ohio's regulated electric and regulated natural gas operations classifies removal costs for property that does not have an associated legal retirement obligation as a regulatory liability, in accordance with regulatory treatment under SFAS No. 71. Duke Energy Ohio does not accrue the estimated cost of removal when no legal obligation associated with retirement or removal exists for any non-regulated assets (including Duke Energy Ohio's generation assets). The total amount of removal costs included in Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets was $181 million and $158 million as of December 31, 2007 and 2006, respectively.

9. Risk Management and Hedging Activities, Credit Risk, and Financial Instruments

Duke Energy Ohio is exposed to the impact of market fluctuations in the prices of electricity, coal, natural gas and other energy-related products marketed and purchased as a result of its ownership of its non-regulated generation portfolio. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Ohio employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio's Derivative Portfolio Carrying Value as of December 31, 2007

Asset/(Liability)	Maturity in 2008	Maturity in 2009	Maturity in 2010	Maturity in 2011 and Thereafter	Total Carrying Value
			(in millions)		
Hedging	$ (12)	$ (9)	$ —	$ (2)	$ (23)
Undesignated	5	2	—	—	7
Total	$ (7)	$ (7)	$ —	$ (2)	$ (16)

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

Transfer of Certain Duke Energy Assets and Commodity Cash Flow Hedges. As part of the merger with Duke Energy on April 3, 2006, Duke Energy Ohio acquired certain generation assets from Duke Energy, representing approximately 3,600 MW of power generation and those assets were added to Duke Energy Ohio's non-regulated generation portfolio. All derivatives related to the Midwestern generation fleet are included in Duke Energy Ohio's Consolidated Balance Sheets at December 31, 2007 and 2006. Duke Energy Ohio also assumed approximately $63 million of pre-tax deferred losses ($39 million, net of tax) associated with contracts formerly designated as cash flow hedges of forecasted power sales and gas purchases from Duke Energy's Midwestern generation fleet. These contracts were sold by Duke Energy in 2005 and the deferred losses remain on the Consolidated Balance Sheet in AOCI until the related hedged transactions (gas purchases and power sales) occur. (See Note 1 and Note 2 for further details on the completed merger and Note 3 for details on the transfer of generation assets.) During 2007, Duke Energy Ohio entered into additional contracts to protect margins for a portion of future sales and generation revenues and fuel expenses for the non-regulated portfolio. Duke Energy Ohio is hedging exposures to the price variability of these commodities for a maximum period of 2 years.

As of December 31, 2007, $26 million of pre-tax deferred net losses on derivative instruments related to commodity cash flow hedges were accumulated on the Consolidated Balance Sheet in AOCI, and are expected to be recognized in earnings during the next twelve months. However, due to the volatility of the commodities markets, the corresponding value in AOCI will likely change prior to its reclassification into earnings.

Other Derivative Contracts. *Trading.* Duke Energy Ohio has been exposed to the impact of market fluctuations in the prices of natural gas, electricity and other energy-related products marketed and purchased as a result of proprietary trading activities. In June 2006, Cinergy sold its commercial marketing and trading business, including certain of Duke Energy Ohio's trading contracts, to Fortis. The results of this trading activity have been reflected in (Loss) Income from Discontinued Operations, net of tax in the Consolidated Statements of Operations, including prior periods. In October 2006, the sale transaction was completed and Duke Energy Ohio entered into a series of Total Return Swaps (TRS) with Fortis (see Note 13).

Undesignated. In addition, Duke Energy Ohio uses derivative contracts to manage the market risk exposures that arise from commodity price risk associated with its future production from its non-regulated generation fleet. For those contracts serving as economic hedges to manage price risk associated with the generation portfolio, Duke Energy Ohio is subject to earnings volatility associated with mark-to-market gains and losses from changes in the value of the derivative contracts.

Normal Purchases and Normal Sales Exception. Duke Energy Ohio has applied the normal purchases and normal sales scope exception, as provided in SFAS No. 133 and interpreted by Derivatives Implementation Group Issue C15, "*Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity*," and amended by SFAS No. 149, "*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*," to certain contracts involving the purchase and sale of electricity at fixed prices in future periods. These contracts, which relate primarily to the delivery of electricity over the next 7 years, are not included in the table above.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Ohio to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Ohio also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Duke Energy Ohio's recognized interest rate derivative ineffectiveness was not material to its consolidated results of operations, cash flows or financial position for the year ended December 31, 2007, nine month period ended December 31, 2006 and the predecessor three months ended March 31, 2006 and the twelve months ended December 31, 2005. As of December 31, 2007, $3 million of pre-tax deferred net losses on derivative instruments related to interest rate cash flow hedges were accumulated on the Consolidated Balance Sheets in a separate component of Common stockholder's equity, in AOCI, and are expected to be recognized in earnings during the next twelve months as the hedged transactions occur. However, due to the volatility of interest rates, the corresponding value in AOCI for unsettled positions will likely change prior to its reclassification into earnings.

Credit Risk. Where exposed to credit risk, Duke Energy Ohio analyzes the counterparties' financial condition prior to entering into an agreement, establishes credit limits and monitors the appropriateness of those limits on an ongoing basis.

Duke Energy Ohio's industry has historically operated under negotiated credit lines for physical delivery contracts. Duke Energy Ohio may use master collateral agreements to mitigate certain credit exposures. The collateral agreements provide for a counterparty to post cash or letters of credit to the exposed party for exposure in excess of an established threshold. The threshold amount represents an unsecured credit limit, determined in accordance with the corporate credit policy. Collateral agreements also provide that the inability to post collateral is sufficient cause to terminate contracts and liquidate all positions.

Duke Energy Ohio also obtains cash or letters of credit from customers to provide credit support outside of collateral agreements, where appropriate, based on its financial analysis of the customer and the regulatory or contractual terms and conditions applicable to each transaction.

Financial Instruments. The fair value of financial instruments, excluding derivatives included elsewhere in this Note, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of December 31, 2007 and 2006, are not necessarily indicative of the amounts Duke Energy Ohio could have realized in current markets.

Financial Instruments

	Successor[a]			
	As of December 31,			
	2007		2006	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in millions)			
Long-term debt[b]	$ 1,936	$ 1,914	$ 1,881	$ 1,872

(a) See Note 1 to the Consolidated Financial Statements for additional information on Predecessor and Successor reporting.

(b) Includes current maturities.

The fair value of cash and cash equivalents, accounts receivable, restricted funds held in trust, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

10. Goodwill and Intangibles

Duke Energy Ohio evaluates the impairment of goodwill under the guidance of SFAS No. 142. There were no goodwill impairment charges in 2007, 2006 or 2005 as a result of the annual impairment tests required by SFAS No. 142. As discussed further in Note 2, in April 2006, Duke Energy and Cinergy consummated their merger, which resulted in Duke Energy Ohio recording goodwill of approximately $2.3 billion. Duke Energy Ohio had no goodwill prior to this date. The following table shows the components of goodwill at December 31, 2007:

Carrying Amount of Goodwill

	Successor(a)		
	Balance at December 31, 2006	Changes	Balance at December 31, 2007
		(in millions)	
Commercial Power	$ 1,200	$ (12)	$ 1,188
Franchised Electric and Gas	1,148	(11)	1,137
Total Goodwill	$ 2,348	$ (23)	$ 2,325

	Successor(a)		
	Balance at April 1, 2006	Changes	Balance at December 31, 2006
		(in millions)	
Commercial Power	$ 1,111	$ 89	$ 1,200
Franchised Electric and Gas	1,062	86	1,148
Total Goodwill	$ 2,173	$ 175(b)	$ 2,348

(a) See Note 1 for additional information on Successor reporting.

(b) The approximate $175 million increase in goodwill resulting from the merger between Duke Energy and Cinergy reflects efforts to finalize valuations and related allocations of goodwill.

Intangible Assets

The carrying amount and accumulated amortization of intangible assets as of December 31, 2007 and December 31, 2006 are as follows:

	Successor(a)	
	December 31, 2007	December 31, 2006
	(in millions)	
Emission allowances	$ 365	$ 495
Gas, coal, and power contracts	271	271
Other	9	9
Total gross carrying amount	645	775
Accumulated amortization—gas, coal, and power contracts	(89)	(40)
Accumulated amortization—other	(5)	(3)
Total accumulated amortization	(94)	(43)
Total intangible assets, net	$ 551	$ 732

(a) See Note 1 for additional information on Predecessor and Successor reporting.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Carrying values of emission allowances sold or consumed were as follows:

Successor[a]		Predecessor[a]	
Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
(in millions)			
$154	$267	$36	$227

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Amortization expense for gas, coal and power contracts and other intangible assets recorded for Duke Energy Ohio was as follows:

Successor[a]		Predecessor[a]	
Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
(in millions)			
$51	$ 43	$ 1	$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2007. The expected amortization expense includes estimates of emission allowances consumption and estimates of consumption of commodities such as gas and coal under existing contracts. The amortization amounts discussed below are estimates. Actual amounts may differ from these estimates due to such factors as changes in consumption patterns, sales or impairments of emission allowances or other intangible assets, additional intangible acquisitions and other events.

	2008	2009	2010	2011	2012
	(in millions)				
Expected amortization expense	$ 122	$ 75	$ 32	$ 39	$ 36

Intangible Liabilities

In connection with the Duke Energy and Cinergy merger, Duke Energy Ohio recorded an intangible liability amounting to approximately $113 million associated with the MBSSO in Ohio that will be recognized in earnings through December 31, 2008. The carrying amount of this intangible liability was approximately $67 million and $95 million at December 31, 2007 and 2006, respectively. The remaining $67 million will be amortized to income in 2008. Duke Energy Ohio also recorded approximately $56 million of intangible liabilities associated with other power sale contracts. The carrying amount of these intangible liabilities was approximately $22 million and $39 million at December 31, 2007 and 2006, respectively. This balance will be amortized to income as follows: approximately $6 million in each of the years 2008 through 2010, and approximately $4 million in 2011.

11. Related Party Transactions

Duke Energy Ohio engages in related party transactions. These transactions 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 December 31, 2007 and December 31, 2006 are as follows:

	Successor[a][b]	
	December 31, 2007	December 31, 2006
	(in millions)	
Current assets[c]	$ 58	$ 51
Non-current assets[d]	$ —	$ 1
Current liabilities[e]	$ (266)	$ (196)
Net deferred tax liabilities[f]	$ (1,401)	$ (1,417)

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Balances exclude assets or liabilities associated with accrued pension and other postretirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

(c) The balance at December 31, 2007 and 2006 is classified as Receivables on the Consolidated Balance Sheets.

(d) The balance at December 31, 2006 is classified as Other non-current assets on the Consolidated Balance Sheets.

(e) Of the balance at December 31, 2007, approximately ($256) million is classified as Accounts payable and ($10) million is classified as Taxes accrued on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately ($95) million is classified as Accounts payable and ($101) million is classified as Taxes accrued on the Consolidated Balance Sheets.

(f) Of the balance at December 31, 2007, approximately ($1,409) million is classified as Deferred income taxes, ($16) million is classified as Investment tax credit and $24 million is classified as Other current assets on the Consolidated Balance Sheets. Of the balance at December 31, 2006, approximately ($1,417) million is classified as Deferred income taxes, ($19) million is classified as Investment tax credit and $19 million is classified as Other current assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Ohio is also allocated its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. 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.

The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations were as follows:

	Successor(a)		Predecessor(a)	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)			
Corporate governance and shared services expenses	$ 249	$ 290	$ 112	$ 370

(a) See Note 1 for additional information on Predecessor and Successor reporting.

See Note 18 for detail on expense amounts allocated from Cinergy to Duke Energy Ohio related to Duke Energy Ohio's participation in Cinergy's qualified and non-qualified defined benefit pension plans and postretirement health care and insurance benefits. Additionally, Duke Energy Ohio has been allocated accrued pension and other postretirement benefit obligations from Cinergy of approximately $266 million at December 31, 2007 and approximately $393 million at December 31, 2006. The above amounts have been classified in the Consolidated Balance Sheets as follows:

	Successor(a)	
	December 31, 2007	December 31, 2006
	(in millions)	
Other current liabilities	$ 5	$ 9
Accrued pension and other postretirement benefit costs	$ 259	$ 381
Other deferred credits and other liabilities	$ 2	$ 3

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Additionally, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 by Duke Energy Ohio as Receivables in the Consolidated Balance Sheets and was approximately $189 million and $133 million as of December 31, 2007 and December 31, 2006, respectively.

During the second quarter of 2007 Duke Energy Ohio received a $29 million capital contribution from its parent, Cinergy.

See Note 3 for a discussion of amounts paid to Duke Energy Ohio as a result of the agreement between Duke Energy and Duke Energy Ohio related to Duke Energy's contribution of its ownership interests in five plants to Duke Energy Ohio. See Note 16 for a discussion of dividends Duke Energy Ohio paid to its parent, Cinergy.

Duke Energy Ohio participates in a money pool with Duke Energy and other Duke Energy subsidiaries. As of December 31, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of *$189 million and $274 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. The expenses* associated with money pool activity for Duke Energy Ohio, which are recorded in Interest Expense on the Consolidated Statements of Operations for the twelve months ended December 31, 2007, nine months ended December 31, 2006, three months ended March 31, 2006 and twelve months ended December 31, 2005 were $11 million, $6 million, $2 million and $6 million, respectively. See Note 15 for further discussion of the money pool arrangement.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

12. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Ohio sells certain of its accounts receivable and related collections through Cinergy Receivables a bankruptcy remote, special purpose entity. Cinergy Receivables is a wholly-owned non-consolidated limited liability company of Cinergy. As a result of the securitization, Duke Energy Ohio sells, on a revolving basis, its retail accounts receivable, including estimated unbilled revenues, and related collections. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140.

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 (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $189 million and $133 million at December 31, 2007 and 2006, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Consolidated Balance Sheets at December 31, 2007 and 2006.

The carrying values of the retained interests are determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions in estimating fair value are the anticipated credit losses, the selection of discount rates, and expected receivables turnover rate. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Ohio's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. Interest accrues to Duke Energy Ohio on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred (which is unlikely unless credit losses on the receivables far exceed the anticipated level).

The key assumptions used in estimating the fair value are as follows:

	Years Ended December 31,		
	2007	2006	2005
Anticipated credit loss rate	0.7%	0.8%	0.8%
Discount rate on expected cash flows	7.7%	7.4%	5.7%
Receivables turnover rate	12.4%	12.7%	13.0%

The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history.

Duke Energy Ohio retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Ohio in the event of a loss. While no direct recourse to Duke Energy Ohio exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Ohio approximates a market rate.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the periods ending:

	Successor(a)		Predecessor(a)	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)			
Receivables sold as of period end	$ 437	$ 370		
Less: Retained interests	189	133		
Net receivables sold as of period end	$ 248	$ 237		
Sales during period				
Receivables sold	$ 3,189	$ 1,982	$ 869	$ 2,636
Loss recognized on sale	46	29	12	35
Cash flows during period				
Cash proceeds from sold receivables(b)	$ 3,086	$ 1,935	$ 919	$ 2,546
Collection fees received	3	2	—	2
Return received on retained interests	25	13	8	14

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Cash flows from the sale of receivables are reflected within Operating Activities on the Consolidated Statements of Cash Flows.

13. Discontinued Operations and Assets Held for Sale

In June 2006, Cinergy agreed to sell its commercial marketing and trading businesses, including certain of Duke Energy Ohio's trading contracts, to Fortis, a Benelux-based financial services group. In October 2006, the sale was completed. Results of operations for these trading contracts have been reflected in (Loss) Income from Discontinued Operations, net of tax in the accompanying Consolidated Statements of Operations. In October 2006, in connection with this transaction, Duke Energy Ohio entered into a series of TRS with Fortis, which were accounted for as mark to market derivatives. The TRS offset the net fair value of the contracts sold to Fortis. The TRS was cancelled for each underlying contract as each was transferred to Fortis. All economic and credit risk associated with the contracts was transferred to Fortis as of the date of the sale through the TRS. As of December 31, 2007, all of the contracts have been novated by Fortis.

The following table summarizes the results classified as (Loss) Income from Discontinued Operations, net of tax, in the accompanying Consolidated Statements of Operations. There was no discontinued operations activity in 2007.

	Successor(a)	Predecessor(a)	
	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)		
Revenues	$ 5	$ 9	$ 119
Operating Income (Loss)			
Income (Loss) Before Taxes	(6)	(3)	73
Income Tax Expense (Benefit)	(2)	(1)	27
(Loss) Income from Discontinued Operations, net of tax	$ (4)	$ (2)	$ 46
Net Loss on Dispositions			
Pre-tax loss on dispositions	$ (3)	$ —	$ —
Income tax benefit	(1)	—	—
Loss on dispositions, net of tax	$ (2)	$ —	$ —
Total (Loss) Income from Discontinued Operations, net of tax	$ (6)	$ (2)	$ 46

(a) See Note 1 for additional information on Predecessor and Successor reporting.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

The following table presents the carrying values of the major classes of assets and associated liabilities held for sale in the accompanying Consolidated Balance Sheets as of December 31, 2006. There were no assets held for sale or liabilities associated with assets held for sale at December 31, 2007.

	Successor[(a)] December 31, 2006
	(in millions)
Assets Held for Sale	
Current assets	$ 25
Other assets	18
Total Assets Held for Sale	$ 43
Liabilities Associated with Assets Held for Sale	
Current liabilities	$ 25
Other	18
Total Liabilities Associated with Assets Held for Sale	$ 43

(a) See Note 1 for additional information on Predecessor and Successor reporting.

14. Property, Plant and Equipment

	Estimated Useful Life	Successor[(a)]	
		December 31, 2007	December 31, 2006
	(Years)	(in millions)	
Land	—	$ 129	$ 127
Plant—Regulated			
Electric generation, distribution and transmission[(b)]	8 – 100	3,197	3,068
Natural gas transmission and distribution[(b)]	12 – 60	1,436	1,339
Other buildings and improvements[(b)]	25 – 100	129	122
Plant—Unregulated			
Electric generation, distribution and transmission	8 – 100	3,813	3,547
Other buildings and improvements	30	25	25
Equipment	5 – 25	64	59
Construction in process	—	594	576
Other	5 – 20	190	186
Total property, plant and equipment		9,577	9,049
Total accumulated depreciation—regulated[(c)]		(1,640)	(1,569)
Total accumulated depreciation—unregulated		(457)	(345)
Total net property, plant and equipment		$ 7,480	$ 7,135

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes capitalized leases of approximately $88 million for 2007 and $74 million for 2006.

(c) Includes accumulated amortization of capitalized leases: $10 million for 2007 and $8 million for 2006.

Capitalized interest, which includes the interest expense component of AFUDC, amounted to $30 million for the year ended December 31, 2007, $14 million for the nine months ended December 31, 2006, $3 million for the three months ended March 31, 2006, and $7 million for the year ended December 31, 2005.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

15. Debt and Credit Facilities

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	Successor[a] December 31, 2007	Successor[a] December 31, 2006
			(in millions)	
Unsecured debt	5.8%	2008 – 2036	$ 1,345	$ 1,445
Capital leases	5.2%	2008 – 2020	59	54
Other debt[b]	4.5%	2011 – 2041	572	424
Money Pool	5.4%		189	274
Unamortized debt discount and premium, net			(40)	(42)
Total debt			2,125	2,155
Current maturities of long-term debt			(126)	(105)
Short-term notes payable			(189)	(274)
Total long-term debt			$ 1,810	$ 1,776

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes $538 million and $398 million, respectively, of Duke Energy Ohio pollution control bonds as of December 31, 2007 and 2006, respectively. As of December 31, 2007 and 2006, $84 million and $131 million, respectively, was secured by first and refunding mortgage bonds and $12 million was secured by a letter of credit.

Unsecured Debt. As of December 31, 2007 and 2006, approximately $96 million of certain pollution control bonds, which are short-term obligations by nature, were classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio'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 gives Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis.

In December 2007, Duke Energy Ohio issued $140 million in tax-exempt floating-rate bonds. The bonds are structured as insured auction rate securities, subject to an auction process every 35 days and bear a final maturity of 2041. The bonds were issued through the Ohio Air Quality Development Authority to fund a portion of the environmental capital expenditures at the Conesville, Stuart and Killen Generation Stations in Ohio.

In August 2006, Duke Energy Kentucky issued approximately $77 million principal amount of floating rate tax-exempt notes due August 1, 2027. Proceeds from the issuance were used to refund a like amount of debt on September 1, 2006 then outstanding at Duke Energy Ohio. Approximately $27 million of floating rate debt was swapped to a fixed rate concurrent with closing.

Money Pool. Duke Energy Ohio receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement, which allows Duke Energy Ohio to better manage its cash and working capital requirements. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. Prior to the merger, Duke Energy Ohio participated in a similar money pool arrangement with Cinergy and other Cinergy subsidiaries. As of December 31, 2007 and December 31, 2006, Duke Energy Ohio was in a payable position of $189 million and $274 million, respectively, classified within Notes payable in the accompanying Consolidated Balance Sheets. During the year ended December 31, 2007, the $85 million change in the money pool is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the nine months ended December 31, 2006, the $52 million change in the money pool is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the three months ended March 31, 2006, the $108 million change in the money pool is reflected as a cash inflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows. During the year ended December 31, 2005, the $66 million change in the money pool is reflected as a cash outflow in Notes payable to affiliate, net within Net cash (used in) provided by financing activities on the Consolidated Statements of Cash Flows.

Floating Rate Debt. Unsecured debt and other debt included approximately $538 million and $451 million of floating-rate debt as of December 31, 2007 and 2006, respectively. Floating-rate debt is primarily based on commercial paper rates or a spread relative to an index such as a London Interbank Offered Rate (LIBOR) for debt denominated in U.S. dollars. As of December 31, 2007 and 2006, the weighted-average interest rate associated with floating-rate debt was approximately 4.4 % and 4.2%, respectively.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

As of December 31, 2007 and mid-March 2008, Duke Energy Ohio had approximately $440 million of auction rate pollution control bonds outstanding. While these debt instruments are long-term in nature and cannot be put back to Duke Energy Ohio prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. Beginning in February 2008, Duke Energy Ohio experienced failed auctions on a portion of these debt instruments. When failed auctions occur on a series of this debt, Duke Energy Ohio is required to pay the maximum auction rate as prescribed by the bond document. The maximum auction rate for the auction rate debt is 1.75 times one-month LIBOR. Payment of the failed-auction interest rates will continue until Duke Energy Ohio is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. Duke Energy Ohio is currently pursuing a refunding and refinancing plan, which is subject to approval by applicable state or county financing authorities and utility regulators. However, even if Duke Energy Ohio is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially effect Duke Energy Ohio's overall financial position, results of operations or cash flows. The weighted-average interest rate, associated with Duke Energy Ohio's auction rate pollution control bonds, was 4.56% as of December 31, 2007 and 5.37% as of March 6, 2008.

Maturities, Call Options and Acceleration Clauses.
Annual Maturities as of December 31, 2007

		(in millions)
2008	$	126
2009		27
2010		6
2011		31
2012		506
Thereafter		1,240
Total long-term debt (including current maturities)	$	1,936

Duke Energy Ohio has the ability under certain debt facilities to call and repay the obligation prior to its scheduled maturity. Therefore, the actual timing of future cash repayments could be materially different than the above as a result of Duke Energy Ohio's ability to repay these obligations prior to their scheduled maturity.

Available Credit Facilities and Restrictive Debt Covenants. In June 2007, Duke Energy closed on the syndication of an amended and restated credit facility, replacing the existing credit facilities totaling $2.65 billion with a 5-year, $2.65 billion master credit facility. Duke Energy Ohio (excluding Duke Energy Kentucky) has a borrowing sub limit of $500 million and Duke Energy Kentucky has a borrowing sub limit of $100 million under the master credit facility. Concurrent with the syndication of the master credit facility, Duke Energy established a new $1.5 billion commercial paper program at Duke Energy and terminated Cinergy's previously existing commercial paper program.

In March 2008, Duke Energy increased its capacity under its master credit facility by $550 million. As a result of this increase, the borrowing sub limit of Duke Energy Ohio increased by $250 million to $750 million. The borrowing sub limit of Duke Energy Kentucky did not change.

The issuance of commercial paper, letters of credit and other borrowings reduces the amount available under the credit facility.

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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2007, Duke Energy and Duke Energy Ohio were in compliance with those covenants. 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.

Other Assets Pledged as Collateral. As of December 31, 2007, substantially all of Franchised Electric and Gas' electric plants in service are mortgaged under the indenture relating to Duke Energy Ohio.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Other Matters. In October 2007, Duke Energy filed a registration statement (Form S-3) with the SEC. Under this Form S-3, which is uncapped, Duke Energy and certain subsidiaries, including Duke Energy Ohio, may issue debt in the future at amounts, prices and with terms to be determined at the time of future offerings.

16. Common and Preferred Stock

Common Stock. Cinergy owns all of the common stock of Duke Energy Ohio. In April 2006, Duke Energy acquired 100 percent of Cinergy's outstanding stock for 1.56 shares of Duke Energy common stock per outstanding share of Cinergy common stock. This conversion resulted in the issuance of approximately 313 million shares of Duke Energy common stock. See Note 2 for additional information.

In April 2006, Duke Energy Ohio filed a petition with the FERC for a declaratory ruling that its payment of dividends out of its paid-in capital account, using the balance transferred from the retained earnings account, resulting from purchase accounting arising from the Duke Energy/Cinergy merger, would not violate section 305(a) of the Federal Power Act, which generally precludes the payment of dividends out of paid-in capital. Such a ruling was necessary because purchase/push-down accounting reset retained earnings to zero as of April 3, 2006, thus potentially precluding Duke Energy Ohio from using pre-merger retained earnings to pay dividends. Without this approval, Duke Energy Ohio's ability to pay dividends would have been constrained to earnings since April 3, 2006. In May 2006, the FERC issued an order approving Duke Energy Ohio's petition.

During the year ended December 31, 2007, the three months ended March 31, 2006, and the year ended December 31, 2005, Duke Energy Ohio paid dividends to its parent, Cinergy, of $135 million $102 million and $250 million, respectively.

Preferred Stock. In March 2006, Duke Energy Ohio redeemed all outstanding shares of its $16.98 million notional amount 4% Cumulative Preferred Stock and its $3.5 million notional amount 4.75% Cumulative Preferred Stock at a price of $108 per share and $101 per share, respectively, plus accrued and unpaid dividends.

17. Commitments and Contingencies

General Insurance

Effective with the date of the merger between Duke Energy and Cinergy, Duke Energy Ohio carries, either directly or through Duke Energy's captive insurance company, Bison Insurance Company Limited, insurance and reinsurance coverages consistent with companies engaged in similar commercial operations with similar type properties. Duke Energy Ohio's insurance coverage includes (1) commercial general public liability insurance for liabilities arising to third parties for bodily injury and property damage resulting from Duke Energy Ohio's operations; (2) workers' compensation liability coverage to required statutory limits; (3) automobile liability insurance for all owned, non-owned and hired vehicles covering liabilities to third parties for bodily injury and property damage; (4) insurance policies in support of the indemnification provisions of Duke Energy Ohio's by-laws and (5) property insurance covering the replacement value of all real and personal property damage, excluding electric transmission and distribution lines, including damages arising from boiler and machinery breakdowns, earthquake, flood damage and extra expense. All coverages are subject to certain deductibles, terms and conditions common for companies with similar types of operations.

Duke Energy Ohio also maintains excess liability insurance coverage above the established primary limits for commercial general liability and automobile liability insurance. Limits, terms, conditions and deductibles are comparable to those carried by other companies with similar types of operations.

The cost of Duke Energy Ohio's general insurance coverages continued to fluctuate over the past year reflecting the changing conditions of the insurance markets.

Environmental

Duke Energy Ohio 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 Duke Energy Ohio.

Remediation activities. Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke

Energy Ohio 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, Duke Energy Ohio or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Ohio 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. Duke Energy Ohio 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. Three of six coal-fired generating facilities in which Duke Energy Ohio 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 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. Duke Energy Ohio is still unable to estimate costs to comply with the EPA's rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Clean Air Mercury Rule (CAMR) and Clean Air Interstate Rule (CAIR). The EPA finalized its CAMR and CAIR in May 2005. The CAMR was to have limited total annual mercury emissions from coal-fired power plants across the United States through a two-phased cap-and-trade program beginning in 2010. The CAIR limits total annual and summertime nitrogen oxides (NO_x) emissions and annual sulfur dioxide (SO_2) emissions from electric generating facilities across the Eastern United States through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2.

Duke Energy Ohio currently estimates that it will spend approximately $150 million between 2008 and 2012 to comply with Phase 1 of CAIR at plants that Duke Energy Ohio owns or partially owns but does not operate. Duke Energy Ohio currently estimates that it will not incur any significant costs for complying with Phase 2 of CAIR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 5).

On February 8, 2008 the U.S. Court of Appeals for the District of Columbia issued its opinion in *New Jersey v. EPA*, No. 05-1097 vacating the CAMR. The decision creates uncertainty regarding future mercury emission reduction requirements and their timing. Barring reversal of the decision if appealed, there will be a delay in the implementation of federal mercury requirements for existing coal-fired power plants while EPA conducts a new rulemaking. Duke Energy Ohio is unable to estimate the costs to comply with a new EPA rule, although it is expected that costs will increase as a result of the court's decision. The magnitude of any such increase cannot be estimated at this time.

Manufactured Gas Plant (MGP) Sites. Duke Energy Ohio has performed site assessments on certain of its sites where MGP activities are believed to have occurred at some point in the past and have found no imminent risk to the environment. At this time, Duke Energy Ohio cannot predict whether investigation and/or remediation will be required in the future at any of these sites.

Coal Combustion Product (CCP) Management. Duke Energy Ohio currently estimates that it will spend approximately $75 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.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Consolidated Balance Sheets were total accruals related to extended environmental-related activities of approximately $8 million for each year ending December 31, 2007 and 2006, respectively. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Duke Energy Ohio believes that completion or resolution of these matters will have no material impact on its consolidated results of operations, cash flows or financial position.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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Notes To Consolidated Financial Statements—(Continued)

Litigation

New Source Review (NSR). In 1999-2000, the U.S. Justice Department, acting on behalf of the EPA, 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 SO_2, 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 $27,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio 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 United States brought a lawsuit in the United States Federal District Court for the Southern District of Indiana against Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. The lawsuit alleges that Duke Energy Ohio violated the CAA by not obtaining Prevention of Significant Deterioration, Non-Attainment NSR and Ohio's State Implementation Plan (SIP) permits for 8 projects undertaken at those plants. Additionally, the suit claims that Duke Energy Ohio violated an Administrative Consent Order entered into in 1998 between the EPA and Cinergy relating to alleged violations of Ohio's SIP provisions governing particulate matter at Unit 1 at Duke Energy Ohio's W.C. Beckjord Station. Three northeast states and two environmental groups have intervened in the case. In June 2007, the trial court ruled, as a matter of law that 6 of the 8 projects undertaken at the Duke Energy Ohio plants do not qualify for the "routine" exception in the regulations. The court ruled further that the defendants had "fair notice" of EPA's interpretation of the applicable regulations. The defendants filed motions for reconsideration; which were denied. A jury trial has been set to commence on May 5, 2008.

In March 2000, the United States also filed suit in the United States District Court for the Southern District of Ohio an amended complaint in a separate lawsuit alleging violations of the CAA regarding various generating stations, including a generating station operated by CSP and jointly-owned by CSP, DP&L, and Duke Energy Ohio. This suit is being defended by CSP (the CSP case). A trial on liability issues was conducted in July 2005. On October 9, 2007, CSP announced a settlement of its case. The settlement includes commitments by CSP to construct environmental equipment or otherwise to reduce emissions at certain plants and the payment of penalties and money to various environmental projects. Duke Energy Ohio does not expect the settlement to have a material impact on its consolidated results of operations, cash flows, or financial position.

In addition, Duke Energy Ohio has been informed by DP&L that in June 2000, the EPA issued a Notice of Violation (NOV) to DP&L for alleged violations of CAA requirements at a station operated by DP&L and jointly-owned by DP&L, 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. On December 14, 2007, the Court ordered a stay of the litigation for sixty days pending settlement negotiations among the parties. A trial has been set to commence in August 2008.

Other than the CSP case, it is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with these matters. Ultimate resolution of these matters, even in settlement, could have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio 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, 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.

Carbon Dioxide (CO_2) 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 United States District Court for the Southern District of New York

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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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 United States 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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 United States 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, Duke Energy Ohio cannot predict whether the outcome of this matter will have a material impact on its consolidated financial position, cash flows or results of operations. Duke Energy Ohio intends to defend this lawsuit vigorously in court.

Ontario, Canada Lawsuit. Duke Energy Ohio understands that a class action lawsuit was filed in Superior Court in Ontario, Canada on July 3, 2005 against Duke Energy Ohio and approximately 20 other utility and power generation companies alleging various claims relating to environmental emissions from coal-fired power generation facilities in the United States and Canada and damages of approximately $50 billion, with continuing damages in the amount of approximately $4 billion annually. Duke Energy Ohio understands that the lawsuit also claims entitlement to punitive and exemplary damages in the amount of $1 billion. Duke Energy Ohio had not yet been served in this lawsuit by the deadline of July 3, 2007. However, if served, Duke Energy Ohio intends to defend this lawsuit vigorously in court. At this time, Duke Energy Ohio is not able to predict whether resolution of this matter would have a material effect on its consolidated financial position, cash flows or results of operations.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the United States 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. In October 2006, Cinergy was served with this lawsuit. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their notice of appeal to the Fifth Circuit Court of Appeals. Briefing is ongoing in the Fifth Circuit. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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 strongly denies the allegations made in the lawsuit and intends to defend itself vigorously. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

Asbestos-related Injuries and Damages Claims. Duke Energy Ohio has been named as a defendant or co-defendant in lawsuits related to asbestos at its electric generating stations. The impact on Duke Energy Ohio'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 Ohio's 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, Duke Energy Ohio 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.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Other Litigation and Legal Proceedings. Duke Energy Ohio 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. Duke Energy Ohio 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.

Duke Energy Ohio has exposure to certain legal matters that are described herein. As of December 31, 2007 and 2006, Duke Energy Ohio has recorded immaterial reserves for these proceedings and exposures. Duke Energy Ohio expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

Other. Duke Energy Ohio 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.

Operating and Capital Lease Commitments

Duke Energy Ohio leases assets in several areas of its operations. Consolidated rental expense for operating leases were $32 million for the year ended December 31, 2007, $20 million for the nine months ended December 31, 2006, $7 million for the three months ended March 31, 2006, and $30 million for the year ended December 31, 2005, which is included in Operation, Maintenance and Other on the Consolidated Statements of Operations. Capitalized lease obligations are classified as debt on the Consolidated Balance Sheets (see Note 15). Amortization of assets recorded under capital leases was included in Depreciation and Amortization on the Consolidated Statements of Operations. The following is a summary of future minimum lease payments under operating leases, which at inception had a noncancelable term of more than one year, and capital leases as of December 31, 2007:

	Operating Leases	Capital Leases
	(in millions)	
2008	$ 15	$ 8
2009	12	9
2010	10	8
2011	8	7
2012	5	7
Thereafter	49	20
Total future minimum lease payments	$ 99	$ 59

18. Employee Benefit Obligations

Cinergy Retirement Plans. Duke Energy Ohio participates in qualified and non-qualified defined benefit pension plans as well as other post-retirement benefit plans sponsored by Cinergy. Cinergy allocates pension and other post-retirement obligations and costs related to these plans to Duke Energy Ohio.

Upon consummation of the merger with Duke Energy, Cinergy's benefit plan obligations were remeasured. Cinergy updated the assumptions used to determine their accrued benefit obligations and prospective net periodic benefit/post-retirement costs to be allocated to Duke Energy Ohio. As a result, the discount rate used to determine net periodic benefit cost to be allocated to Duke Energy Ohio by Cinergy changed from 5.50% to 6.00% in 2006.

Cinergy adopted the funded status recognition and disclosure provisions of SFAS No. 158 effective December 31, 2006. Cinergy adopted the change in measurement date transition requirements of SFAS No. 158 effective January 1, 2007 by remeasuring plan assets and benefit obligations as of that date. Previously, Cinergy used a September 30 measurement date for its defined benefit and other post-retirement plans.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Qualified Pension Plans

Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. The plans cover most U.S. employees using a cash balance formula. Under a cash balance formula, a plan participant accumulates a retirement benefit consisting of pay credits that are based upon a percentage (which varies with age and years of service) of current eligible earnings and current interest credits. Certain legacy Cinergy U.S. employees are covered under plans that use a final average earnings formula. Under a final average earnings formula, a plan participant accumulates a retirement benefit equal to a percentage of their highest 3-year average earnings, plus a percentage of the their highest 3-year average earnings in excess of covered compensation per year of participation (maximum of 35 years), plus a percentage of their highest 3-year average earnings times years of participation in excess of 35 years.

Funding for the qualified defined benefit pension plans is based on actuarially determined contributions, the maximum of which is generally the amount deductible for tax purposes and the minimum being that required by the Employee Retirement Income Security Act of 1974, as amended. The pension plans' assets consist of investments in equity and debt securities.

Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the retirement plan is 11 years. Cinergy determines the market-related value of plan assets using a calculated value that recognizes changes in fair value of the plan assets over five years.

Duke Energy Ohio's qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor[a]			Predecessor[a]	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006[b]		Three Months Ended March 31, 2006[b]	Twelve Months Ended December 31, 2005[b]
			(in millions)		
Qualified Pension Benefits[c]	$ 14	$ 20		$ 6	$ 13

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes immaterial amounts reflected in (Loss) Income From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

(c) Excludes approximately $7 million for the twelve months ended December 31, 2007 and approximately $8 million for the nine months ended December 31, 2006 of regulatory asset amortization resulting from purchase accounting.

The fair value of Cinergy's plan assets was approximately $1,701 million as of December 31, 2007 and approximately $1,302 million as of September 30, 2006. The projected benefit obligation for the plans was approximately $1,941 million as of December 31, 2007 and approximately $1,976 million as of September 30, 2006. The accumulated benefit obligation for the plans was approximately $1,753 million as of December 31, 2007 and approximately $1,688 million at September 30, 2006. The accrued pension liability as allocated by Cinergy to Duke Energy Ohio and recognized in Accrued pension and other postretirement benefit costs within the Consolidated Balance Sheets at December 31, 2007 and 2006 was approximately $118 million and approximately $246 million, respectively.

Duke Energy made qualified pension benefit contributions of approximately $350 million, $124 million and $102 million to the legacy Cinergy qualified pension benefit plans, of which approximately $83 million, $22 million and $18 million represents contributions made by Duke Energy Ohio for the year ended December 31, 2007, nine months ended December 31, 2006 and the year ended December 31, 2005, respectively. No amounts were contributed to the legacy Cinergy qualified pension plans for the three months ended March 31, 2006.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Qualified Pension Plans—Amounts Recognized in Accumulated Other Comprehensive Income (Loss) and Regulatory Assets Consist of:

	Successor(a) As of December 31, 2007	Successor(a) As of December 31, 2006
	(in millions)	
Regulatory Assets	$ 33	$ 27
Accumulated Other Comprehensive Income		
Deferred income tax asset	$ 5	$ (2)
Prior service cost	2	—
Net actuarial (gain) loss	(14)	4
Net amount recognized—Accumulated other comprehensive income (loss)	$ (7)	$ 2

(a) See Note 1 for additional information on Predecessor and Successor reporting.

An immaterial amount in AOCI will be recognized in net periodic pension costs in 2008.

Assumptions Used for Cinergy's Pension Benefits Accounting

	2007	2006	2005
	(percentages)		
Benefit Obligations			
Discount rate	6.00	5.75	5.75
Salary increase	5.00	5.00	4.00
Net Periodic Benefit Cost			
Discount rate[a]	5.75	5.50-6.00	5.75
Salary increase	5.00	5.00	4.00
Expected long-term rate of return on plan assets	8.50	8.50	8.50

(a) Discount rate for Successor was 5.75% and 6.00% for the year ended December 31, 2007 and for the nine months ended December 31, 2006, respectively. Discount rates for Predecessor was 5.50% and 5.75% for the three months ended March 31, 2006 and the year ended December 31, 2005, respectively (see Note 1 for additional information on Predecessor and Successor reporting).

Non-Qualified Pension Plans

In addition, Cinergy also maintains, and Duke Energy Ohio participates in, non-qualified, non-contributory defined benefit retirement plans (plans that do not meet the criteria for certain tax benefits) that cover officers, certain other key employees, and non-employee directors. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of active employees covered by the non-qualified retirement plans is 11 years. There are no plan assets. The projected benefit obligation for the plans was approximately $105 million as of December 31, 2007 and approximately $114 million as of September 30, 2006. The accumulated benefit obligation for the plans was approximately $102 million as of December 31, 2007 and approximately $109 million at September 30, 2006. The accrued pension liability as allocated by Cinergy to Duke Energy Ohio and recognized in Accrued pension and other postretirement benefit costs within the Consolidated Balance Sheets at December 31, 2007 and 2006 was approximately $5 million and $6 million, respectively, and as recognized in Other Current Liabilities within the Consolidated Balance Sheet at December 31, 2007 and 2006 was approximately $2 million.

Duke Energy Ohio's non-qualified pension plan pre-tax net periodic pension benefit costs as allocated by Cinergy were as follows:

	Successor(a) Twelve Months Ended December 31, 2007	Successor(a) Nine Months Ended December 31, 2006	Predecessor(a) Three Months Ended March 31, 2006	Predecessor(a) Twelve Months Ended December 31, 2005
	(in millions)			
Non-Qualified Pension[b]	$ 1	$ 1	$ —	$ 1

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes immaterial amounts reflected in (Loss) Income From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

Non-Qualified Plans—Assumptions Used for Cinergy's Pension Benefits Accounting

	2007	2006	2005
		(percentages)	
Benefit Obligations			
Discount rate	6.00	5.75	5.75
Salary increase	5.00	5.00	4.00
Net Periodic Benefit Cost			
Discount rate[a]	5.75	5.50-6.00	5.75
Salary increase	5.00	5.00	4.00

(a) Discount rate for Successor was 5.75% and 6.00% for the year ended December 31, 2007 and the nine months ended December 31, 2006, respectively. Discount rates for Predecessor was 5.50% and 5.75% for the three months ended March 31, 2006 and the year ended December 31, 2005, respectively (see Note 1 for additional information on Predecessor and Successor reporting).

Other Post-Retirement Benefit Plans

Duke Energy Ohio participates in other postretirement benefit plans sponsored by Cinergy. Cinergy provides certain health care and life insurance benefits to retired United States employees and their eligible dependents on a contributory and non-contributory basis. These benefits are subject to minimum age and service requirements. The health care benefits include medical coverage, dental coverage, and prescription drug coverage and are subject to certain limitations, such as deductibles and co-payments. These benefit costs are accrued over an employee's active service period to the date of full benefits eligibility. The net unrecognized transition obligation is amortized over approximately 20 years. Actuarial gains and losses are amortized over the average remaining service period of the active employees. The average remaining service period of the active employees covered by the plan is 12 years. Duke Energy Ohio's Other Post-Retirement Plan pre-tax Net Periodic Benefit costs as allocated by Cinergy were as follows:

	Successor(a)		Predecessor(a)	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006(b)	Three Months Ended March 31, 2006(b)	Twelve Months Ended December 31, 2005(b)
	(in millions)			
Other Postretirement(c)	$ 11	$ 9	$ 3	$ 8

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Includes immaterial amounts reflected in (Loss) Income From Discontinued Operations, net of tax, in the Consolidated Statements of Operations.

(c) Excludes approximately $4 million for the twelve months ended December 31, 2007 and approximately $2 million for the nine months ended December 31, 2006 of regulatory asset amortization resulting from purchase accounting.

The fair value of Cinergy's other post-retirement benefit plans assets was approximately $32 million as of December 31, 2007 and zero as of September 30, 2006. The accumulated other post-retirement benefit obligation for the plans was approximately $464 million as of December 31, 2007 and $497 million as of September 30, 2006. The accrued other post-retirement liability as allocated by Cinergy to Duke Energy Ohio and recognized in Accrued pension and other postretirement benefit costs within the Consolidated Balance Sheets at December 31, 2007 and 2006 was $136 million and $129 million, respectively and as recognized in Other Current Liabilities within the Consolidated Balance Sheet at December 31, 2007 and 2006 was $2 million and $7 million, respectively.

Duke Energy made other postretirement plan contributions during 2007 of approximately $32 million to the legacy Cinergy other postretirement plans, of which approximately $9 million represents contribution made by Duke Energy Ohio. No amounts were contributed to the legacy Cinergy other postretirement plans for the nine months ended December 31, 2006, three months ended March 31, 2006, or year ended December 31, 2005.

Duke Energy Ohio recognized regulatory assets and AOCI related to its other post-retirement benefit plans of approximately $2 million and $1 million as of December 31, 2007, respectively, and $4 million and zero, as of December 31, 2006, respectively, within the Consolidated Balance Sheets.

An immaterial amount in AOCI will be recognized in net periodic other postretirement benefit costs in 2008.

DUKE ENERGY OHIO, INC.
Notes To Consolidated Financial Statements—(Continued)

Assumptions Used in Cinergy's Other Postretirement Benefits Accounting

	2007	2006	2005
	(percentages)		
Benefit Obligations			
Discount rate	6.00	5.75	5.50
Net Periodic Benefit Cost			
Discount rate(a)	5.75	5.50-6.00	5.50
Expected long-term rate of return on plan assets	5.53-8.50	N/A	N/A

(a) Discount rate for Successor was 5.75% and 6.00% for the year ended December 31, 2007 and the nine months ended December 31, 2006, respectively. Discount rate for Predecessor was 5.50% and 6.00% for the three months ended March 31, 2006 and the year ended December 31, 2005, respectively (see Note 1 for additional information on Predecessor and Successor reporting).

Assumed Health Care Cost Trend Rates

	Medicare Trend Rate		Prescription Drug Trend Rate	
	2007	2006	2007	2006
Health care cost trend rate assumed for next year	8.00%	8.50%	12.50%	13.00%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	5.00%	4.75%	5.00%	4.75%
Year that the rate reaches the ultimate trend rate	2013	2013	2022	2022

19. Other Income and Expenses, net

The components of Other Income and Expenses, net on the Consolidated Statements of Operations for the year ended December 31, 2007, the nine months ended December 31, 2006, the three months ended March 31, 2006 and the year ended December 31 2005 are as follows:

	Successor(a)		Predecessor(a)	
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006	Twelve Months Ended December 31, 2005
	(in millions)			
Income/(Expense)				
Interest income	$ 29	$ 15	$ 8	$ 17
AFUDC equity	4	2	1	1
Other	(1)	—	(1)	1
Total	$ 32	$ 17	$ 8	$ 19

(a) See Note 1 for additional information on Predecessor and Successor reporting.

20. Subsequent Events

For information related to subsequent events related to regulatory matters, debt and credit facilities, and commitments and contingencies, see Notes 5, 15 and 17, respectively.

DUKE ENERGY OHIO, INC.

Notes To Consolidated Financial Statements—(Continued)

21. Quarterly Financial Data (Unaudited)

	Successor(a)				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
			(in millions)		
2007					
Total operating revenues	$ 916	$ 763	$ 955	$ 821	$ 3,455
Operating Income	74	95	210	104	483
Net income	37	49	118	60	264

	Predecessor(a)	Successor(a)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
			(in millions)		
2006					
Total operating revenues	$ 963	$ 696	$ 776	$ 789	$ 2,261
Operating Income	208	41	90	35	166
Net income (loss)	116	(7)	60	2	55

(a) See Note 1 for additional information on Predecessor and Successor reporting.

During the first quarter 2007, Duke Energy Ohio recorded the following unusual or infrequently occurring items: a temporary rate reduction of $2 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

During the first quarter 2006, Duke Energy Ohio recorded the following unusual or infrequently occurring item: approximately $12 million in integration costs related to the merger of Duke Energy and Cinergy.

During the second quarter 2006, Duke Energy Ohio recorded the following unusual or infrequently occurring items: approximately $2 million in integration costs related to the merger of Duke Energy and Cinergy and a temporary rate reduction of $16 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

During the third quarter 2006, Duke Energy Ohio recorded the following unusual or infrequently occurring items: approximately $7 million in integration costs related to the merger of Duke Energy and Cinergy and a temporary rate reduction of $10 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

During the fourth quarter 2006, Duke Energy Ohio recorded the following unusual or infrequently occurring items: approximately $4 million in integration costs related to the merger of Duke Energy and Cinergy and a temporary rate reduction of $8 million due to merger approval obtained from PUCO related to the merger between Duke Energy and Cinergy.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

DUKE ENERGY OHIO, INC.

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

	Balance at Beginning of Period	Additions: Charged to Expense	Additions: Charged to Other Accounts	Deductions(2)	Balance at End of Period
	(In millions)				
Successor(1)					
Year Ended December 31, 2007:					
Injuries and damages	$ 3	$ —	$ —	$ 3	$ —
Allowance for doubtful accounts	5	1	—	3	3
Uncertain tax provisions(3)	26	—	—	16	10
Other(4)	19	3	—	11	11
	$ 53	$ 4	$ —	$ 33	$ 24
Nine Months Ended December 31, 2006:					
Injuries and damages	$ 5	$ 1	$ —	$ 3	$ 3
Allowance for doubtful accounts	4	4	—	3	5
Uncertain tax provisions(3)	28	3	—	5	26
Other(4)	26	6	—	13	19
	$ 63	$ 14	$ —	$ 24	$ 53
Predecessor(1)					
Three Months Ended March 31, 2006:					
Injuries and damages	$ 4	$ 1	$ —	$ —	$ 5
Allowance for doubtful accounts	4	2	—	2	4
Uncertain tax provisions(3)	28	—	—	—	28
Other(4)	29	5	—	8	26
	$ 65	$ 8	$ —	$ 10	$ 63
Year Ended December 31, 2005:					
Injuries and damages	$ 4	$ 1	$ —	$ 1	$ 4
Allowance for doubtful accounts	1	3	1	1	4
Uncertain tax provisions(3)	24	8	—	4	28
Other(4)	8	18	5	2	29
	$ 37	$ 30	$ 6	$ 8	$ 65

(1) See Note 1 for additional information on Predecessor and Successor reporting.

(2) Principally cash payments and reserve reversals. For 2007, this also includes the impacts from the adoption of FIN 48.

(3) Included in Taxes accrued and Interest accrued within Current Liabilities on the Consolidated Balance Sheets. The December 31, 2007 ending balance primarily contains non-income tax reserves.

(4) Principally environmental and other reserves, included in Unrealized gains on mark-to-market and hedging transactions within Current Assets and Investments and Other Assets, Unrealized losses on mark-to-market and hedging transactions within Current Liabilities and Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.
The valuation and reserve amounts above do not include unrecognized tax benefits amounts or deferred tax asset valuation allowance amounts.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2007, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended December 31, 2007 and have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

Management's Annual Report On Internal Control Over Financial Reporting

Duke Energy Ohio's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

Duke Energy Ohio's management, including our Chief Executive Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2007 based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2007.

This annual report does not include an attestation report of Deloitte & Touche LLP, Duke Energy Ohio's independent registered public accounting firm, regarding internal control over financial reporting. Management's report was not subject to attestation by Deloitte & Touche LLP pursuant to temporary rules of the SEC that permit Duke Energy Ohio to provide only management's report in this annual report.

Item 14. Principal Accounting Fees and Services.

The following table presents fees for professional services rendered by Deloitte & Touche LLP, and the member firms of Deloitte Touche Tohmatsu and their respective affiliates (collectively, "Deloitte") for Duke Energy Ohio for the periods ended:

	Successor[a]		Predecessor[a]
	Twelve Months Ended December 31, 2007	Nine Months Ended December 31, 2006	Three Months Ended March 31, 2006
		(in millions)	
Audit Fees[b]	$ 1.4	$ 1.2	$ 0.4
Audit-Related Fees[c]	0.2	0.2	0.1
Tax Fees[d]	—	—	0.1
Total Fees:	$ 1.6	$ 1.4	$ 0.6

(a) See Note 1 for additional information on Predecessor and Successor reporting.

(b) Audit Fees are fees billed or expected to be billed by Deloitte for professional services for the audit of Duke Energy Ohio's consolidated financial statements included in Duke Energy Ohio's annual report on Form 10-K and review of financial statements included in Duke Energy Ohio's quarterly reports on Form 10-Q, services that are normally provided by Deloitte in connection with statutory, regulatory or other filings or engagements or any other service performed by Deloitte to comply with generally accepted auditing standards and include comfort and consent letters in connection with SEC filings and financing transactions.

(c) Audit-Related Fees are fees billed by Deloitte for assurance and related services that are reasonably related to the performance of an audit or review of Duke Energy Ohio's financial statements, including assistance with acquisitions and divestitures and internal control reviews.

(d) Tax Fees are fees billed by Deloitte for tax return assistance and preparation, tax examination assistance, and professional services related to tax planning and tax strategy.

To safeguard the continued independence of the independent auditor, the Duke Energy Audit Committee adopted a policy that provides that the independent public accountants are only permitted to provide services to Duke Energy Ohio that have been pre-approved by the Duke Energy Audit Committee. Pursuant to the policy, detailed audit services, audit-related services, tax services and certain other services have been specifically pre-approved up to certain fee limits. In the event that the cost of any of these services may exceed the pre-approved limits, the Duke Energy Audit Committee must pre-approve the service. All other services that are not prohibited pursuant to the SEC's or other applicable regulatory bodies' rules of regulations must be specifically pre-approved by the Duke Energy Audit Committee. All services performed in 2007 by the independent public accountant were approved by the Duke Energy Audit Committee pursuant to its pre-approval policy.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

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PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Consolidated Financial Statements, Supplemental Financial Data and Supplemental Schedule included in Part II of this annual report are as follows:

Consolidated Financial Statements

Consolidated Statements of Operations for the Twelve Months Ended December 31, 2007, Nine Months Ended December 31, 2006, Three Months Ended March 31, 2006 and the Twelve Months Ended December 31, 2005

Consolidated Balance Sheets as of December 31, 2007 and 2006

Consolidated Statements of Cash Flows for the Twelve Months Ended December 31, 2007, Nine Months Ended December 31, 2006, Three Months Ended March 31, 2006, and the Twelve Months Ended December 31, 2005

Consolidated Statements of Common Stockholder's Equity and Comprehensive Income for the Year Ended December 31, 2007, Nine Months Ended December 31, 2006, Three Months Ended March 31, 2006 and the Year Ended December 31, 2005

Notes to the Consolidated Financial Statements

Quarterly Financial Data (unaudited, included in Note 21 to the Consolidated Financial Statements)

Consolidated Financial Statement Schedule II—Valuation and Qualifying Accounts and Reserves for the Year Ended December 31, 2007, Nine Months Ended December 31, 2006, Three Months Ended March 31, 2006 and the Year Ended December 31, 2005

Report of Independent Registered Public Accounting Firm

All other schedules are omitted because they are not required, or because the required information is included in the Consolidated Financial Statements or Notes.

(c) Exhibits—See Exhibit Index immediately following the signature page.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 19, 2008

DUKE ENERGY OHIO, INC.
(Registrant)

By: /s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

(i) /s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer (Principal Executive Officer)

(ii) /s/ DAVID L. HAUSER

David L. Hauser
Group Executive and Chief Financial Officer (Principal Financial Officer)

(iii) /s/ STEVEN K. YOUNG

Steven K. Young
Senior Vice President and Controller (Principal Accounting Officer)

(iv) Directors

/s/ JAMES E. ROGERS

James E. Rogers

/s/ DAVID L. HAUSER

David L. Hauser

/s/ JAMES L. TURNER

James L. Turner

Date: March 19, 2008

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

EXHIBIT INDEX

Exhibits filed herewith are designated by an asterisk (*). All exhibits not so designated are incorporated by reference to a prior filing, as indicated.

Exhibit Number	
3.1	Amended Articles of Incorporation of Duke Energy Ohio, Inc. effective October 23, 1996 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1996, File No. 1-1232).
3.1.1	Amended Articles of Consolidation, effective October 1, 2006 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2006, File No. 1-1232).
3.2	Regulations of Duke Energy Ohio, Inc., as amended on July 23, 2003 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
4.1	Original Indenture (First Mortgage Bonds) between Duke Energy Ohio, Inc. and The Bank of New York (as Trustee) dated as of August 1, 1936 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-2374).
4.1.1	Fourteenth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of November 2, 1972 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-60961).
4.1.2	Thirty-third Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of September 1, 1992 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-53578).
4.1.3	Thirty-fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 1, 1993 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1993, File No. 1-1232).
4.1.4	Thirty-fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of January 1, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
4.1.5	Thirty-sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 15, 1994 (filed with Registration Statement of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) File No. 2-52335).
4.1.6	Thirty-seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of October 14, 1996 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1996, File No. 1-1232).
4.1.7	Thirty-eighth Supplemental Indenture between Duke Energy Ohio, Inc. and The Bank of New York dated as of February 1, 2001 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 2001, File No. 1-1232).
4.1.8	Thirty-ninth Supplemental Indenture dated as of September 1, 2002, between Duke Energy Ohio, Inc. and The Bank of New York, as Trustee (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
4.2	Loan Agreement between Duke Energy Ohio, Inc. and the County of Boone, Kentucky dated as of February 1, 1985 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1984, File No. 1-1232).
4.3	Repayment Agreement between Duke Energy Ohio, Inc. and The Dayton Power and Light Company dated as of December 23, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1992, File No. 1-1232).

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Exhibit Number	
4.4	Loan Agreement between Duke Energy Ohio, Inc. and the County of Boone, Kentucky dated as of January 1, 1994 (filed with form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1993, File No. 1-1232).
4.5	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated as of December 1, 1985 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1998, File No. 1-1232).
4.6	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated as of September 13, 1995 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1995, File No. 1-1232).
4.7	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Water Development Authority dated as of January 1, 1994 (filed with the Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1993, File No. 1-1232).
4.8	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated as of January 1, 1994 (filed with the Form 10-K of Duke Energy Ohio, Inc (formerly The Cincinnati Gas & Electric Company) for the year ended December 31, 1993, File No. 1-1232).
4.9	Loan Agreement between Duke Energy Ohio, Inc. and the State of Ohio Air Quality Development Authority dated August 1, 2001 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2001, File No. 1-1232).
4.10	Original Indenture (Unsecured Debt Securities) between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of May 15, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
4.10.1	First Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 1, 1995 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1995, File No. 1-1232).
4.10.2	Second Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 30, 1995 (filed with the registration statement on Form 8-A, filed on July 24, 1995, File No. 1-1232).
4.10.3	Third Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of October 9, 1997 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 1997, File No. 1-1232).
4.10.4	Fourth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of April 1, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended March 31, 1998, File No. 1-1232).
4.10.5	Fifth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 9, 1998 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 1998, File No. 1-1232).
4.10.6	Sixth Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of September 15, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).
4.10.7	Seventh Supplemental Indenture between Duke Energy Ohio, Inc. and The Fifth Third Bank dated as of June 15, 2003 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2003, File No. 1-1232).
4.11	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of September 1, 2002 (filed with the Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended September 30, 2002, File No. 1-1232).

Exhibit Number	
4.12	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series A (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
4.13	Loan Agreement between Duke Energy Ohio, Inc. and the Ohio Air Quality Development Authority dated as of November 1, 2004, relating to Series B (filed with the Form 8-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on November 19, 2004, File No. 1-1232).
10.1	Employment Agreement dated February 4, 2004, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy, Indiana, Inc., and James E. Rogers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.2	Amended and Restated Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.2.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated October 11, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and William J. Grealis (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.3	Amended and Restated Employment Agreement dated October 1, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Donald B. Ingle, Jr. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.4	Amended and Restated Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.4.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 12, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Michael J. Cyrus (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.4.2	Form of amendment to employment agreement, adopted and effective December 14, 2005, between Services and each of Michael J. Cyrus and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/02, File No. 1-1232).
10.5	Amended and Restated Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.5.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated September 24, 2002, among Cinergy Corp., Services, Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and James L. Turner (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.6	Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc. and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.6.1	Amended Employment Agreement effective December 17, 2003 to Employment Agreement dated November 15, 2002, among Cinergy Corp., Duke Energy Ohio, Inc., and Duke Energy Indiana, Inc., and Marc E. Manly (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/03, File No. 1-1232).
10.7	Deferred Compensation Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1992 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/92, File No. 1-1232).

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

Exhibit Number	
10.8	Split Dollar Insurance Agreement, effective as of May 1, 1993, between Duke Energy Ohio, Inc. and Jackson H. Randolph (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/94, File No. 1-1232).
10.9	Amended and Restated Supplemental Retirement Income Agreement between Duke Energy Ohio, Inc. and Jackson H. Randolph dated January 1, 1995 (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/95, File No. 1-1232).
10.10	Amended and Restated Supplemental Executive Retirement Income Agreement between Duke Energy Ohio, Inc. and certain executive officers (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the year ended 12/31/97, File No. 1-1232).
10.11	Asset Purchase Agreement by and among Duke Energy Indiana, Inc. and Duke Energy Ohio, Inc. and Allegheny Energy Supply Company, LLC, Allegheny Energy Supply Wheatland Generating Facility, LLC and Lake Acquisition Company, L.L.C., dated as of May 6, 2005 (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2005, File No. 1-1232).
10.12	$2,000,000,000 Amended and Restated Credit Agreement among the registrant, such subsidiaries, the banks listed therein, Barclays Bank PLC, as Administrative Agent, and JPMorgan Chase Bank, N.A., as Syndication Agent (filed with Form 10-Q of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company) for the quarter ended June 30, 2006, File No. 1-1232).
10.12.1	$2,650,000,000 Amended and Restated Credit Agreement, dated as of June 28, 2007, among Duke Energy Corporation, Duke Energy Carolinas, LLC, Duke Energy Ohio, Inc., Duke Energy Indiana, Inc. and Duke Energy Kentucky, Inc., as Borrowers, the banks listed therein, Wachovia Bank, National Association, as Administrative Agent, JPMorgan Chase Bank, National Association, Barclays Bank PLC, Bank of America, N.A. and Citibank, N.A., as Co-Syndication Agents and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch and Credit Suisse, as Co-Documentation Agents (filed in Form 8-K of Duke Energy Ohio, Inc., July 5, 2007, File No. 1-1232, as Exhibit 10.1).
10.13	Keepwell Agreement, dated April 10, 2006, between Duke Capital LLC and Duke Energy Ohio, Inc. (filed with Form 10-K of Duke Energy Ohio, Inc. (formerly The Cincinnati Gas & Electric Company), filed on April 14, 2006, File No. 1-1232).
*12	Computation of Ratio of Earnings to Fixed Charges.
*23.1	Consent of Independent Registered Public Accounting Firm.
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

EXHIBIT 12

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

The ratio of earnings to fixed charges is calculated using the Securities and Exchange Commission guidelines.

	Successor(1)		Predecessor(1)			
	Twelve months ended December 31, 2007	Nine months ended December 31, 2006	Three months ended March 31, 2006	Twelve months ended December 31, 2005	Twelve months ended December 31, 2004	Twelve months ended December 31, 2003
	(in millions)					
Earnings as defined for fixed charges calculation						
Add:						
Pretax income from continuing operations	$ 415	$ 102	$ 186	$ 412	$ 378	$ 460
Fixed charges	139	100	35	114	106	134
Deduct:						
Interest capitalized[a]	30	14	3	7	5	9
Total earnings (as defined for the Fixed Charges calculation)	$ 524	$ 188	$ 218	$ 519	$ 479	$ 585
Fixed charges:						
Interest on debt, including capitalized portions	$ 130	$ 95	$ 33	$ 105	$ 95	$ 124
Estimate of interest within rental expense	9	5	2	9	11	10
Total fixed charges	$ 139	$ 100	$ 35	$ 114	$ 106	$ 134
Ratio of earnings to fixed charges	3.8	1.9	6.2	4.6	4.5	4.4

(a) Excludes equity costs related to AFUDC that are included in Other Income and Expenses in the Consolidated Statements of Operations.

(1) See Note 1 for additional information on Predecessor and Successor reporting.

Source: Duke Energy Ohio, In, 10-K, March 19, 2008

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-146483-01 on Form S-3 of our report dated March 19, 2008, relating to the financial statements and financial statement schedule of Duke Energy Ohio, Inc. and subsidiaries (the "Company") (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the Company's application of "push-down accounting" effective April 3, 2006), appearing in this Annual Report on Form 10-K of Duke Energy Ohio, Inc. for the year ended December 31, 2007.

/s/ DELOITTE & TOUCHE LLP
Charlotte, North Carolina
March 19, 2008

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Rogers, certify that:

1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 19, 2008

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David L. Hauser, certify that:

1) I have reviewed this annual report on Form 10-K of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 19, 2008

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 19, 2008

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-K for the period ending December 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

Date: March 19, 2008

/s/ DAVID L. HAUSER
David L. Hauser
Group Executive and Chief Financial Officer

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FORM 10-Q

Duke Energy Ohio, Inc. - N/A

Filed: May 13, 2009 (period: March 31, 2009)

Quarterly report which provides a continuing view of a company's financial position

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EX-32.2 (SECTION 906 CFO CERTIFICATION)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2009 Or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_________ to__________

Commission file number 1-1232

DUKE ENERGY OHIO, INC.

(Exact Name of Registrant as Specified in its Charter)

Ohio (State or Other Jurisdiction of Incorporation)	31-0240030 (IRS Employer Identification No.)
139 East Fourth Street Cincinnati, OH (Address of Principal Executive Offices)	45202 (Zip code)

704-594-6200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes☒ No☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐	Accelerated filer☐
Non-accelerated filer ☒ (Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes☐ No☒

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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DUKE ENERGY OHIO, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2009

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth or decline in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories, customer base or customer usage patterns;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, droughts and tornados;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities,
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of credit worthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop domestic power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In millions)

Item 1. Financial Statements.

	Three Months Ended March 31,	
	2009	2008
Operating Revenues		
Regulated electric	$ 590	$ 242
Non-regulated electric and other	116	392
Regulated natural gas	300	357
Total operating revenue	1,006	991
Operating Expenses		
Fuel used in electric generation and purchased power—regulated	208	33
Fuel used in electric generation and purchased power—non-regulated	59	144
Cost of natural gas and coal sold	193	250
Operation, maintenance and other	202	182
Depreciation and amortization	103	99
Property and other taxes	78	73
Total operating expenses	843	781
Gains on Sales of Other Assets and Other, net	4	13
Operating Income	167	223
Other Income and Expenses, net	—	9
Interest Expense	35	26
Income Before Income Taxes	132	206
Income Tax Expense	47	73
Net Income	$ 85	$ 133

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In millions)

	March 31, 2009	December 31, 2008
ASSETS		
Current Assets		
Cash and cash equivalents	$ 26	$ 27
Receivables (net of allowance for doubtful accounts of $17 at March 31, 2009 and $18 at December 31, 2008)	533	303
Inventory	185	180
Unrealized gains on mark-to-market and hedging transactions	44	51
Other	299	336
Total current assets	1,087	897
Investments and Other Assets		
Restricted funds held in trust	10	10
Goodwill	2,360	2,360
Intangibles, net	386	403
Unrealized gains on mark-to-market and hedging transactions	17	17
Other	54	55
Total investments and other assets	2,827	2,845
Property, Plant and Equipment		
Cost	10,103	10,047
Less accumulated depreciation and amortization	2,341	2,277
Net property, plant and equipment	7,762	7,770
Regulatory Assets and Deferred Debits		
Deferred debt expense	24	23
Regulatory assets related to income taxes	105	103
Other	487	451
Total regulatory assets and deferred debits	616	577
Total Assets	$ 12,292	$ 12,089

See Notes to Unaudited Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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PART I

DUKE ENERGY OHIO, INC.

CONSOLIDATED BALANCE SHEETS—(Continued)
(Unaudited)
(In millions, except share and per-share amounts)

	March 31, 2009	December 31, 2008
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	$ 347	$ 511
Notes payable	279	343
Taxes accrued	128	134
Interest accrued	20	24
Current maturities of long-term debt	27	27
Unrealized losses on mark-to-market and hedging transactions	36	47
Other	100	93
Total current liabilities	937	1,179
Long-term Debt	2,304	1,856
Deferred Credits and Other Liabilities		
Deferred income taxes	1,630	1,619
Investment tax credits	13	14
Accrued pension and other post-retirement benefit costs	286	406
Unrealized losses on mark-to-market and hedging transactions	14	15
Asset retirement obligations	34	33
Other	310	297
Total deferred credits and other liabilities	2,287	2,384
Commitments and Contingencies		
Common Stockholder's Equity		
Common Stock, $8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at March 31, 2009 and December 31, 2008	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	466	381
Accumulated other comprehensive loss	(34)	(43)
Total common stockholder's equity	6,764	6,670
Total Liabilities and Common Stockholder's Equity	$ 12,292	$ 12,089

See Notes to Unaudited Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In millions)

	Three Months Ended March 31, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 85	$ 133
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	104	100
Gains on sales of other assets and other	(4)	(13)
Deferred income taxes	26	8
Accrued pension and other post-retirement benefit costs	3	6
Contributions to qualified pension plans	(143)	—
(Increase) decrease in		
Net realized and unrealized mark-to-market and hedging transactions	(16)	(38)
Receivables	16	52
Inventory	(5)	59
Other current assets	33	32
Increase (decrease) in		
Accounts payable	(163)	(132)
Taxes accrued	(6)	49
Other current liabilities	(19)	3
Regulatory asset/liability deferrals	7	7
Other assets	33	24
Other liabilities	1	(24)
Net cash (used in) provided by operating activities	(48)	266
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(91)	(133)
Net proceeds from the sales of other assets	—	4
Purchases of emission allowances	(7)	—
Sales of emission allowances	5	12
Notes due from affiliate, net	(243)	—
Net cash used in investing activities	(336)	(117)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	450	—
Redemption of long-term debt	(2)	(2)
Notes payable to affiliate, net	(63)	(142)
Other	(2)	—
Net cash provided by (used in) financing activities	383	(144)
Net (decrease) increase in cash and cash equivalents	(1)	5
Cash and cash equivalents at beginning of period	27	33
Cash and cash equivalents at end of period	$ 26	$ 38
Supplemental Disclosures		
Significant non-cash transactions:		
Accrued capital expenditures	$ 55	$ 39

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

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

				Accumulated Other Comprehensive Income (Loss)		
	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Pension and OPEB Related Adjustments to AOCI	Total
Balance at December 31, 2007	$ 762	$ 5,570	$ 227	$ (32)	$ 7	$ 6,534
Net income	—	—	133	—	—	133
Other comprehensive income						
Cash flow hedges(a)	—	—	—	2	—	2
Total comprehensive income						135
Balance at March 31, 2008	$ 762	$ 5,570	$ 360	$ (30)	$ 7	$ 6,669
Balance at December 31, 2008	$ 762	$ 5,570	$ 381	$ (15)	$ (28)	$ 6,670
Net income	—	—	85	—	—	85
Other comprehensive income						
Cash flow hedges(a)	—	—	—	9	—	9
Total comprehensive income						94
Balance at March 31, 2009	$ 762	$ 5,570	$ 466	$ (6)	$ (28)	$ 6,764

(a) Net of $4 tax expense in 2009 and $1 tax expense in 2008.

See Notes to Unaudited Consolidated Financial Statements

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements

1. Basis of Presentation

Nature of Operations and Basis of Consolidation. Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as unregulated electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky. These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

These Unaudited 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 and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Unaudited Consolidated Financial Statements do not include all of the information and notes required by GAAP in the U.S. for annual financial statements. Because the interim Unaudited Consolidated Financial Statements and Notes do not include all of the information and notes required by GAAP in the U.S. for annual financial statements, the Unaudited Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2008.

These Unaudited Consolidated Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Ohio's financial position and results of operations. Amounts reported in the interim Unaudited 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 to GAAP in the U.S., management makes estimates and assumptions that affect the amounts reported in the Unaudited Consolidated Financial Statements and Notes. Although these estimates are based on management's best available information at the time, actual results could differ.

Unbilled Revenue. Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled retail 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 Mcfs delivered but not billed. Unbilled wholesale energy revenues are calculated by applying the contractual rate per megawatt hour (MWh) to the number of estimated MWh delivered, but not yet billed. Unbilled wholesale demand revenues are calculated by applying the contractual rate per megawatt (MW) to the MW volume not yet billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors, including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are primarily recorded as Receivables on the Consolidated Balance Sheets, primarily relate to wholesale sales at Commercial Power and were approximately $45 million and $41 million, at March 31, 2009 and December 31, 2008, respectively. Additionally, Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail and wholesale accounts receivable and related collections to Cinergy Receivables Company, LLC (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 Financial Accounting Standards Board (FASB) 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*" (SFAS No. 140), and, accordingly, the transfers of receivables are accounted for as sales. Receivables for unbilled revenues of approximately $92 million and $149 million at March 31, 2009 and December 31, 2008, respectively, related to retail and wholesale accounts receivable at Duke Energy Ohio and Duke Energy Kentucky were included in the sales of accounts receivable to Cinergy Receivables.

Other Regulatory Assets and Deferred Debits. 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,

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

"*Accounting for Certain Types of Regulation*" (SFAS No. 71), was discontinued for the generation portion of Duke Energy Ohio's business at that time (see below for subsequent reapplication of SFAS No. 71 to certain portions of Commercial Power's business). Duke Energy Ohio has a RTC related regulatory asset balance of approximately $123 million and $138 million as of March 31, 2009 and December 31, 2008, respectively, which is classified in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

Reapplication of SFAS No. 71 to Portions of Generation in Ohio. Duke Energy Ohio's generation operations within its Commercial Power business segment (see Note 2) include generation assets located in Ohio that are dedicated to serve Ohio native load customers. These assets, as excess capacity allows, also generate revenues through sales outside the native load customer base, and such revenue is termed non-native.

Prior to December 17, 2008, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 due to the comprehensive electric deregulation legislation passed by the state of Ohio in 1999. As described further below, effective December 17, 2008, the PUCO approved Duke Energy Ohio's Electric Security Plan (ESP), which resulted in the reapplication of SFAS No. 71 to certain portions of Commercial Power's operations as of that date.

From January 1, 2005 through December 31, 2008, Duke Energy Ohio, including its Commercial Power business segment, had been operating under a rate stabilization plan (RSP), which was a market-based standard service offer. Although the RSP contained certain trackers that enhanced the potential for cost recovery, there was no assurance of stranded cost recovery upon the expiration of the RSP on December 31, 2008 since it was initially anticipated that, upon the expiration of the RSP, there would be a move to full competitive markets. Accordingly, Duke Energy Ohio's Commercial Power business segment did not apply the provisions of SFAS No. 71 to any of its generation operations prior to December 17, 2008. As discussed further in Note 10, in April 2008, new legislation (SB 221) was passed in Ohio and signed by the Governor of Ohio on May 1, 2008. The new law codified the PUCO's authority to approve an electric utility's standard service offer either through an ESP or a Market Rate Option (MRO). The MRO is a price determined through a competitive bidding process. On July 31, 2008, Duke Energy Ohio filed an ESP, and with certain amendments, the ESP was approved by the PUCO on December 17, 2008. The ESP became effective on January 1, 2009.

In connection with the approval of the ESP, Duke Energy Ohio reassessed the applicability of SFAS No. 71 to Commercial Power's generation operations as SB 221 substantially increased the PUCO's oversight authority over generation in the state of Ohio, including giving the PUCO complete approval of generation rates and the establishment of an earnings test to determine if a utility has earned significantly excessive earnings. Duke Energy Ohio determined that certain costs and related rates (riders) of Commercial Power's operations related to generation serving native load meet the criteria established by SFAS No. 71 for regulatory accounting treatment as SB 221 and Duke Energy Ohio's approved ESP solidified the automatic recovery of certain costs of its generation serving native load within its Commercial Power business segment and increased the likelihood that Commercial Power's operations will remain under a cost recovery model for certain costs for the foreseeable future.

Under the ESP, Duke Energy Ohio bills for its native load generation via numerous riders. SB 221 and the ESP resulted in the approval of the automatic recovery of certain of these riders, which includes, but is not limited to, a price-to-compare fuel and purchased power rider and certain portions of a price-to-compare cost of environmental compliance rider. Accordingly, Duke Energy Ohio's Commercial Power business segment began applying SFAS No. 71 to the corresponding RSP riders granting automatic recovery under the ESP on December 17, 2008. The remaining portions of Commercial Power's native load generation operations, revenues from which are reflected in rate riders for which the ESP does not specifically allow automatic cost recovery, as well as all generation operations associated with non-native customers, including Commercial Power's Midwest gas-fired generation assets, continue to not apply regulatory accounting as those operations do not meet the criteria of SFAS No. 71. Moreover, generation remains a competitive market in Ohio and native load customers continue to have the ability to switch to alternative suppliers for their electric generation service. As customers switch, there is a risk that some or all of the regulatory assets will not be recovered through the established riders. Duke Energy Ohio will continue to monitor the amount of native load customers that have switched to alternative suppliers when assessing the recoverability of its regulatory assets established for its native load generation operations within its Commercial Power business segment.

Despite certain portions of the Ohio native load operations not being subject to the accounting provisions of SFAS No. 71, all of Duke Energy Ohio's native load operations' rates are subject to approval by the PUCO, and thus these operations are referred to herein as Duke Energy Ohio's regulated operations. Accordingly, beginning January 1, 2009, these revenues and corresponding fuel and purchased power expenses are recorded in Regulated Electric within Operating Revenues and Fuel Used in Electric Generation and Purchased Power—Regulated within Operating Expenses, respectively, on the Consolidated Statements of Operations.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

2. Business Segments

Duke Energy Ohio operates the following business segments, which are all considered reportable business segments under SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's management believes these reportable business segments properly align the various operations of Duke Energy Ohio with how the chief operating decision maker views the business. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these reportable business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's defined business segments.

Franchised Electric and Gas generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky and transports and sells natural gas in southwestern Ohio and northern Kentucky. It conducts operations primarily through Duke Energy Ohio and Duke Energy Kentucky. These electric and gas operations are subject to the rules and regulations of the Federal Energy Regulatory Commission (FERC), the PUCO and the Kentucky Public Service Commission (KPSC). Substantially all of Franchised Electric and Gas' operations are regulated and, accordingly, these operations are accounted for under the provisions of SFAS No. 71.

Commercial Power owns, operates and manages power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants, as well as other contractual positions. Commercial Power's asset portfolio comprises approximately 7,550 net MW and its generation assets consist of a diversified fuel mix with baseload and mid-merit coal-fired units, as well as combined cycle and peaking natural gas-fired units. Commercial Power's portfolio includes the five Midwestern gas-fired generation assets that were transferred from Duke Energy in 2006. Through December 31, 2008, most of the generation asset output in Ohio was contracted through the RSP (see Note 10). Effective January 1, 2009, Commercial Power began operating under an ESP, which expires on December 31, 2011. As a result of the approval of the ESP, certain of Commercial Power's operations reapplied the provisions of SFAS No. 71 effective December 17, 2008. See Notes 1 and 10 for a discussion of the reapplication of the provisions of SFAS No. 71 to certain of Commercial Power's operations, as well as for further discussion related to the RSP and ESP.

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 8).

Duke Energy Ohio's reportable business segments offer different products and services or operate under different competitive environments and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2008. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents, and short-term investments, if any, are managed centrally by Cinergy and Duke Energy, so the interest and dividend income on those balances are excluded from the segments' EBIT.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

Business Segment Data

	Unaffiliated Revenues[(a)]	Segment EBIT/ Consolidated Income Before Income Taxes	Depreciation and Amortization
		(in millions)	
Three Months Ended March 31, 2009			
Franchised Electric and Gas	$ 540	$ 80	$ 52
Commercial Power	466	99	51
Total reportable segments	1,006	179	103
Other	—	(15)	—
Interest expense	—	(35)	—
Interest income and other	—	3	—
Total consolidated	$ 1,006	$ 132	$ 103
Three Months Ended March 31, 2008			
Franchised Electric and Gas	$ 599	$ 97	$ 58
Commercial Power	392	145	41
Total reportable segments	991	242	99
Other	—	(18)	—
Interest expense	—	(26)	—
Interest income and other	—	8	—
Total consolidated	$ 991	$ 206	$ 99

(a) There were no intersegment revenues for the three months ended March 31, 2009 and 2008.

Segment Assets

	March 31, 2009	December 31, 2008
	(in millions)	
Franchised Electric and Gas	$ 6,028	$ 5,857
Commercial Power	6,459	6,249
Total reportable segments	12,487	12,106
Other	1	17
Eliminations and reclassifications	(196)	(34)
Total consolidated assets	$ 12,292	$ 12,089

3. Sales of Other Assets

For the three months ended March 31, 2009 and 2008, the sale of other assets resulted in proceeds of approximately $5 million and $16 million, respectively, and net pre-tax gains of approximately $4 million and $13 million, respectively, recorded in Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

4. Inventory

Inventory consists primarily of coal held for electric generation and materials and supplies and is recorded primarily using the average cost method. Inventory related to Duke Energy Ohio's regulated operations is valued at historical cost consistent with ratemaking treatment. Materials and supplies are recorded as inventory when purchased and subsequently charged to expense or capitalized to plant when installed. Inventory related to Duke Energy Ohio's non-regulated operations is valued at the lower of cost or market.

	March 31, 2009	December 31, 2008
	(in millions)	
Coal held for electric generation	$ 95	$ 89
Materials and supplies	87	88
Natural gas	3	3
Total Inventory	$ 185	$ 180

Effective November 1, 2008, Duke Energy Ohio and Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Ohio and Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Ohio and Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately $18 million and $81 million being held by a third party as of March 31, 2009 and December 31, 2008, respectively, has been classified as Other within Current Assets on the Consolidated Balance Sheets.

5. Debt and Credit Facilities

First and Refunding Mortgage Bonds. In March 2009, Duke Energy Ohio issued $450 million principal amount of first mortgage bonds, which carry a fixed interest rate of 5.45% and mature April 1, 2019. Proceeds from this issuance will be used to repay short-term notes and for general corporate purposes, including funding capital expenditures.

Money Pool. Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their 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 Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of March 31, 2009, Duke Energy Ohio and Duke Energy Kentucky had combined net receivables of approximately $243 million, which is classified within Receivables in the accompanying Consolidated Balance Sheets. As of December 31, 2008, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately $63 million, which is classified within Notes Payable in the accompanying Consolidated Balance Sheets. The $243 million increase in receivables during the three months ended March 31, 2009 is reflected in Notes due from affiliate, net within Net cash used in investing activities on the Consolidated Statements of Cash Flows. In addition, the $63 million decrease in payables during the three months ended March 31, 2009 is reflected in Notes payable to affiliate, net within Net cash provided by (used in) financing activities on the Consolidated Statements of Cash Flows.

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. The total credit facility capacity under Duke Energy's master credit facility is approximately $3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At March 31, 2009, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of $650 million and $100 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

At March 31, 2009, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, had outstanding borrowings of approximately $750 million under Duke Energy's master credit facility, of which Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately $279 million and $74 million, respectively. The loans, which are revolving credit loans, bear interest at one-month London Interbank Offered Rate (LIBOR) plus an applicable spread ranging from 19 to 24 basis points and are due in

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at March 31, 2009. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Notes Payable within Current Liabilities on the Consolidated Balance Sheets at March 31, 2009. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At both March 31, 2009 and December 31, 2008, approximately $146 million of certain pollution control bonds, which are short-term obligations by nature, were classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio'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 Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Of the $146 million of pollution control bonds outstanding at March 31, 2009, approximately $84 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.

Restrictive Debt Covenants. Duke Energy's debt and credit agreement contains various financial and other covenants. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2009, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the 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.

6. Employee Benefit Obligations

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Net periodic pension cost discussed below for qualified and other post-retirement benefit plans represents the allocated cost of the respective pension plan for the periods presented. However, portions of the net periodic pension cost discussed below have been capitalized as a component of property, plant and equipment. Duke Energy Ohio's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	(in millions)	
Qualified Pension Benefits[a]	$ 1	$ 2
Other Post-retirement Benefits[b]	$ —	$ 3

(a) These amounts exclude approximately $1 million of regulatory asset amortization resulting from purchase accounting adjustments in connection with Duke Energy's merger with Cinergy in April 2006 for each of the three months ended March 31, 2009 and 2008.

(b) These amounts exclude approximately $1 million and an insignificant amount of regulatory asset amortization resulting from purchase accounting adjustments in connection with Duke Energy's merger with Cinergy in April 2006 for the three months ended March 31, 2009 and 2008, respectively.

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. In February 2009, Duke Energy Ohio made a cash contribution of approximately $143 million, which represented its proportionate share of an approximate $500 million total contribution to Cinergy's and Duke Energy's qualified pension plans. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008. Duke Energy does not anticipate making additional contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2009. Cinergy also sponsors employee savings plans that cover substantially all employees. Duke Energy Ohio expensed pre-tax employer matching contributions of approximately $1 million for each of the three months ended March 31, 2009 and 2008.

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

7. Goodwill and Intangibles

Goodwill

The carrying amount of goodwill as of both March 31, 2009 and December 31, 2008 was approximately $2,360 million, of which approximately $1,206 million was reflected in the Commercial Power segment and approximately $1,154 million was reflected in the Franchised Electric and Gas segment.

Intangible Assets

The carrying amount and accumulated amortization of intangible assets as of March 31, *2009* and December 31, *2008* are as follows:

	March 31, 2009	December 31, 2008
	(in millions)	
Emission allowances	$ 228	$ 239
Gas, coal and power contracts	271	271
Other	9	9
Total gross carrying amount	508	519
Accumulated amortization—gas, coal and power contracts	(116)	(111)
Accumulated amortization—other	(6)	(5)
Total accumulated amortization	(122)	(116)
Total intangible assets, net	$ 386	$ 403

Emission allowances in the table above include emission allowances which were recorded at the then fair value on the date of Duke Energy's merger with Cinergy in April 2006 and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the three months ended March 31, 2009 is as follows:

	(in millions)
Gross carrying value at beginning of period	$ 239
Purchases of emission allowances	7
Sales and consumption of emission allowances[(a)(b)]	(18)
Gross carrying value at end of period	$ 228

(a) Carrying values of emission allowances are recognized via a charge to expense when consumed. *Carrying values of emission allowances sold or consumed during the* three months ended March 31, 2008 was approximately $16 million.

(b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the three months ended March 31, 2009 and 2008.

Amortization expense for gas, coal and power contracts and other intangible assets for both the three months ended March 31, 2009 and 2008 was approximately $6 million.

Intangible Liabilities

In connection with the Duke Energy and Cinergy merger, Duke Energy Ohio recorded an intangible liability of approximately $113 million associated with the RSP in Ohio, which was recognized in earnings over the regulatory period that ended on December 31, 2008. This liability became fully amortized in the fourth quarter of 2008. Duke Energy Ohio also recorded approximately $56 million of intangible liabilities associated with other power sale contracts in connection with the Duke Energy and Cinergy merger. The carrying amount of these intangible liabilities associated with other power sale contracts was approximately $15 million and $16 million at March 31, 2009 and December 31, 2008, respectively. During the three months ended March 31, 2009 and 2008, Duke Energy Ohio amortized approximately $1 million and $18 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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Notes To Unaudited Consolidated Financial Statements—(Continued)

8. Related Party Transactions

Duke Energy Ohio 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 March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009[a]	December 31, 2008[a]
	(in millions)	
Current assets[b]	$ 52	$ 55
Non-current assets[c]	$ 4	$ 5
Current liabilities[d]	$ (63)	$ (138)
Non-current liabilities[e]	$ (5)	$ (4)
Net deferred tax liabilities[f]	$ (1,546)	$ (1,519)

(a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements as discussed below.

(b) Of the balance at March 31, 2009, approximately $38 million is classified as Receivables, approximately $2 million is classified as Unrealized gains on mark-to-market and hedging transactions within Current Assets and approximately $12 million is classified as Other within Current Assets. Of the balance at December 31, 2008, approximately $18 million is classified as Receivables, approximately $2 million is classified as Unrealized gains on mark-to-market and hedging transactions within Current Assets and approximately $35 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

(c) The balances at March 31, 2009 and December 31, 2008 are classified as Unrealized gains on mark-to-market and hedging transactions within Investments and Other Assets on the Consolidated Balance Sheets.

(d) Of the balance at March 31, 2009, approximately $(56) million is classified as Accounts payable, approximately $(3) million is classified as Taxes accrued and approximately $(4) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets. Of the balance at December 31, 2008, approximately $(133) million is classified as Accounts payable, approximately $(2) million is classified as Taxes accrued and approximately $(3) million is classified as Unrealized losses on mark-to-market and hedging transactions within Current Liabilities on the Consolidated Balance Sheets.

(e) The balances at March 31, 2009 and December 31, 2008 are classified as Unrealized losses on mark-to-market and hedging transactions within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

(f) Of the balance at March 31, 2009, approximately $(1,595) million is classified as Deferred income taxes and approximately $49 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2008, approximately $(1,580) million is classified as Deferred income taxes and approximately $61 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is charged its proportionate share of corporate governance and other costs by an unconsolidated affiliate that is a consolidated affiliate of Duke Energy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. During the three months ended March 31, 2009 and 2008, Duke Energy Ohio recorded governance and shared services expenses of approximately $100 million and $61 million, respectively, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Consolidated Statements of Operations.

Duke Energy Ohio incurs expenses related to certain insurance coverages 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 $4 million for each of the three months ended March 31, 2009 and 2008. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy, as well as income associated with certain other recoveries of cost. Rental income and other cost recoveries were approximately $2 million for each of the three months ended March 31, 2009 and 2008.

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 6). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately $296 million at March 31, 2009 and approximately $416 million at December 31, 2008. These amounts have been classified in the Consolidated Balance Sheets as follows:

	March 31, 2009	December 31, 2008
	(in millions)	
Other current liabilities	$ 5	$ 5
Accrued pension and other post-retirement benefit costs	$ 286	$ 406
Other deferred credits and other liabilities	$ 5	$ 5

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Ohio to Cinergy Receivables, an unconsolidated entity formed by Cinergy. 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 $154 million and $174 million as of March 31, 2009 and December 31, 2008, 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 $5 million and $8 million for the three months ended March 31, 2009 and 2008, respectively.

As discussed further in Note 5, Duke Energy Ohio participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2009, Duke Energy Ohio was in a receivable position of approximately $243 million. As of December 31, 2008, Duke Energy Ohio was in a payable position of approximately $63 million. The expenses associated with money pool activity, which are recorded in Interest Expense on the Consolidated Statements of Operations for the three months ended March 31, 2009 and 2008 were insignificant and approximately $1 million, respectively.

9. Risk Management, Derivative Instruments and Hedging Activities

The primary risks Duke Energy Ohio manages by utilizing derivative instruments are commodity price risk and interest rate risk. Duke Energy Ohio closely monitors the risks associated with commodity price changes and changes in interest rates on its operations and, where appropriate, uses various commodity and interest rate instruments to manage these risks. Certain of these derivative instruments are designated as hedging instruments under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" (SFAS No. 133), while others either do not qualify as a hedge or have not been designated as hedges by Duke Energy Ohio (hereinafter referred to as undesignated contracts). Duke Energy Ohio's primary use of energy commodity derivatives is to hedge its generation portfolio against exposure to the prices of power and fuel. Interest rate swaps are entered into to manage interest rate risk primarily associated with Duke Energy Ohio's variable-rate and fixed-rate borrowings.

SFAS No. 133 requires the recognition of all derivative instruments as either assets or liabilities at fair value in the Consolidated Balance Sheets. In accordance with SFAS No. 133, Duke Energy Ohio may elect to designate qualifying commodity and interest rate derivatives as either cash flow hedges or fair value hedges.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss is reported as a component of Accumulated Other Comprehensive Income (AOCI) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any gains or losses on the derivative that represent either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item are recognized in earnings, to the extent effective, in the current period. Duke Energy Ohio includes the gain or loss on the hedged items in the same line item as the offsetting loss or gain on the derivative in the Consolidated Statements of Operations. Additionally, Duke Energy Ohio enters into derivative agreements that are economic hedges that either do not qualify for hedge accounting or have not been designated as a hedge. These derivative instruments are typically reflected on the Consolidated Balance Sheets at fair value with changes in the value of the derivative instrument reflected in regulatory assets or liabilities, as discussed below, or, if appropriate, in current earnings.

As Duke Energy Ohio's regulated operations within its Franchised Electric and Gas and Commercial Power business segments apply the provisions of SFAS No. 71, certain gains and losses associated with undesignated contracts are deferred as regulatory liabilities and assets, respectively, thus there is no immediate earnings impact associated with the change in fair values associated with these derivative contracts.

Commodity Price Risk

Duke Energy Ohio is exposed to the impact of market changes in the future prices of electricity (energy, capacity and financial transmission rights), coal, natural gas and emission allowances (sulfur dioxide (SO_2), seasonal nitrogen oxide (NO_X) and annual NO_X) as a result of its energy operations such as electric generation and natural gas distribution. With respect to commodity price risks associated with electric generation, Duke Energy Ohio is exposed to changes including, but not limited to, the cost of coal and natural gas used to generate electricity, the prices of electricity in wholesale markets, the cost of capacity required to purchase and sell electricity in wholesale markets and the cost of emission allowances for SO_2, seasonal NO_X and annual NO_X, primarily at Duke Energy Ohio's coal fired power plants. Duke Energy Ohio closely monitors the risks associated with commodity price changes on its future operations and, where appropriate, uses various commodity contracts to mitigate the effect of such fluctuations on operations. Duke Energy Ohio's exposure to commodity price risk is influenced by a number of factors, including, but not limited to, the term of the contract, the liquidity of the market and delivery location.

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Notes To Unaudited Consolidated Financial Statements—(Continued)

Commodity derivatives associated with the risk management of Duke Energy Ohio's energy operations are accounted for as either cash flow hedges or fair value hedges if the derivative instrument qualifies as a hedge under SFAS No. 133, or as an undesignated contract if either the derivative instrument does not qualify as a hedge or Duke Energy Ohio has elected to not designate the contract as a hedge. Additionally, Duke Energy Ohio enters into various contracts that qualify for the normal purchase and normal sales (NPNS) exception described in paragraph 10 of SFAS No. 133, as amended. Duke Energy Ohio primarily applies the NPNS exception to contracts within the Franchised Electric and Gas and Commercial Power business segments that relate to the physical delivery of electricity over the next 5 years.

Commodity Fair Value Hedges. At March 31, 2009, Duke Energy Ohio did not have any open commodity derivative instruments that were designated as fair value hedges under SFAS No. 133.

Commodity Cash Flow Hedges. Duke Energy Ohio uses commodity instruments, such as swaps, futures, forwards and options, to protect margins for a portion of future revenues and fuel and purchased power expenses. Duke Energy Ohio generally uses commodity cash flow hedges to mitigate exposures to the price variability of the underlying commodities for a maximum period of 1 year.

Undesignated Contracts. Duke Energy Ohio uses derivative contracts as economic hedges to manage the market risk exposures that arise from providing electric generation and capacity to large energy customers, energy aggregators and other wholesale companies. Undesignated contracts include contracts not designated as a hedge, contracts that do not qualify for hedge accounting, derivatives that no longer qualify for the NPNS scope exception, and de-designated hedge contracts that were not re-designated as a hedge. The contracts in this category as of March 31, 2009 are primarily associated with forward power sales and coal purchases, as well as forward SO_2 emission allowances, for the Commercial Power and Franchised Electric and Gas business segments.

Interest Rate Risk

Duke Energy Ohio is exposed to risk resulting from changes in interest rates as a result of its issuance or anticipated issuance of variable and fixed-rate debt and commercial paper. Duke Energy Ohio manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. To manage risk associated with changes in interest rates, Duke Energy Ohio may enter into financial contracts, primarily interest rate swaps and U.S. Treasury lock agreements. All of Duke Energy Ohio's derivative instruments related to interest rate risk are categorized as undesignated contracts. At March 31, 2009, the total notional amount of Duke Energy Ohio's receive variable/pay-fixed interest rate swaps was approximately $27 million.

Volumes

The following table shows information relating to the volume of Duke Energy Ohio's derivative activity as of March 31, 2009. Amounts disclosed represent the notional volumes of commodities and the notional dollar amounts of debt subject to derivative contracts accounted for at fair value in accordance with SFAS No. 133. For option contracts, notional amounts include only the delta-equivalent volumes which represent the notional volumes times the probability of exercising the option based on current price volatility. Volumes associated with contracts qualifying for the NPNS exception have been excluded from the table below. Amounts disclosed represent the absolute value of notional amounts. Duke Energy Ohio has netted contractual amounts where offsetting purchase and sale contracts exist with identical delivery locations and times of delivery.

Underlying Notional Amounts for Derivative Instruments Accounted for At Fair Value

		March 31, 2009
Commodity contracts		
Electricity-energy (Gigawatt hours)		4,370
Electricity-capacity (Gigawatt months)		2
Emission allowances: SO_2 (thousands of tons)		18
Emission allowances: NOX (thousands of tons)		4
Natural gas (millions of decatherms)		9
Coal (millions of tons)		3
Financial contracts		
Interest rates (dollars in millions)	$	27

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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The following table shows fair value amounts of derivative contracts as of March 31, 2009 and the line item(s) in the Consolidated Balance Sheets in which such amounts are included. The fair values of derivative contracts are presented on a gross basis, even when the derivative instruments are subject to master netting arrangements. Cash collateral payables and receivables associated with the derivative contracts have not been netted against the fair value amounts.

Location and Fair Value Amounts of Derivatives reflected in the Consolidated Balance Sheets

Balance Sheet Location	March 31, 2009 Asset Derivatives	March 31, 2009 Liability Derivatives
	(in millions)	
Derivatives designated as hedging instruments under SFAS No. 133		
Commodity contracts		
Investments and Other Assets: Other	$ 1	$ —
Current Liabilities: Other	—	4
Total derivatives designated as hedging instruments under SFAS No. 133	$ 1	$ 4
Derivatives not designated as hedging instruments under SFAS No. 133		
Commodity contracts		
Current Assets: Other	$ 55	$ 12
Investments and Other Assets: Other	23	6
Current Liabilities: Other	223	326
Deferred Credits and Other Liabilities: Other	23	121
Interest rate contracts		
Current Liabilities: Other	—	1
Deferred Credits and Other Liabilities: Other	—	6
Total derivatives not designated as hedging instruments under SFAS No. 133	$ 324	$ 472
Total Derivatives	$ 325	$ 476

The following table shows the amount of the gains and losses recognized on derivative instruments designated and qualifying as cash flow hedges by type of derivative contract during the three months ended March 31, 2009 and the financial statement line items in which such gains and losses are included.

Cash Flow Hedges—Location and Amount of Pre-tax Losses Recognized in Comprehensive Income

	Three Months Ended March 31, 2009
	(in millions)
Location of Pre-tax Losses Reclassified from AOCI into Earnings[a]	
Commodity contracts	
Revenue, non-regulated electric and other	$ (7)
Fuel used in electric generation and purchased power-non-regulated	(6)
Total Pre-tax Losses Reclassified from AOCI into Earnings	$ (13)

(a) Represents the gains and losses on cash flow hedges previously recorded in AOCI during the term of the hedging relationship and reclassified into earnings during the current period.

The effective portion of gains on cash flow hedges that were recognized in AOCI during the three months ended March 31, 2009 were insignificant. In addition, there was no hedge ineffectiveness during the three months ended March 31, 2009. No gains or losses have been excluded from the assessment of hedge effectiveness. As of March 31, 2009, approximately $11 million of pre-tax deferred net losses on derivative instruments related to commodity cash flow hedges accumulated on the Consolidated Balance Sheets in AOCI are expected to be recognized in earnings during the next twelve months as the hedged transactions occur.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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The following table shows the amount of the pre-tax gains and losses recognized on undesignated hedges by type of derivative instrument during the three months ended March 31, 2009 and the line item(s) in the Consolidated Statements of Operations in which such gains and losses are included or deferred on the Consolidated Balance Sheets as regulatory assets.

Undesignated Hedges—Location and Amount of Pre-tax Gains and (Losses) Recognized in Income or as Regulatory Assets

	Three Months Ended March 31, 2009
	(in millions)
Location of Pre-tax Gains and (Losses) Recognized in Earnings	
Commodity contracts	
Revenue, non-regulated electric and other	$ 8
Fuel used in electric generation and purchased power-non-regulated	(8)
Total Pre-tax Gains and (Losses) Recognized in Earnings	$ —
Location of Pre-tax Gains and (Losses) Recognized as Regulatory Assets	
Commodity contracts	
Regulatory Asset	$ (77)
Interest rate contracts	
Regulatory Asset	1
Total Pre-tax Losses Recognized as Regulatory Assets	$ (76)

Certain of Duke Energy Ohio's derivative contracts contain contingent credit features, such as material adverse change clauses or payment acceleration clauses that could result in immediate payments, the posting of letters of credit or the termination of the derivative contract before maturity if specific events occur, such as a downgrade of Duke Energy Ohio's credit rating below investment grade.

The following table shows information with respect to derivative contracts that are in a net liability position and contain objective credit-risk related payment provisions. The amounts disclosed in the table below represents the aggregate fair value amounts of such derivative instruments at the end of the reporting period, the aggregate fair value of assets that are already posted as collateral under such derivative instruments at the end of the reporting period, and the aggregate fair value of additional assets that would be required to be transferred in the event that credit-risk-related contingent features were triggered at March 31, 2009.

Information Regarding Derivative Instruments that Contain Credit-risk Related Contingent Features

	March 31, 2009
	(in millions)
Aggregate Fair Value Amounts of Derivative Instruments in a Net Liability Position	$ 440
Collateral Already Posted	$ 219
Additional Cash Collateral or Letters of Credit in the Event Credit-risk-related Contingent Features were Triggered at the End of the Reporting Period	$ 26

Netting of cash collateral and derivative assets and liabilities under master netting arrangements. In accordance with 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), Duke Energy Ohio 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. At March 31, 2009 and December 31, 2008, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately $162 million and $85 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount, respectively, that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had $60 million and approximately $57 million in cash collateral receivables under master netting arrangements that have not been offset against net derivative positions at March 31, 2009 and December 31, 2008, respectively, as these amounts primarily represent initial margin deposits related to New York Mercantile

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

Exchange (NYMEX) futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at March 31, 2009 and December 31, 2008.

See Note 12 for additional information on fair value disclosures related to derivatives required by SFAS No. 157, "*Fair Value Measurements*" (SFAS No. 157).

10. Regulatory Matters

Franchised Electric and Gas.

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. 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 (see "Commercial Power" below). The FERC approves rates for electric sales to wholesale customers served under cost-based and market-based rates.

Duke Energy Ohio Electric Rate Filings. 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 ESP, which would allow for pricing structures similar to those under the historic RSP. Electric utilities are required to file an ESP and may also file an application for a MRO at the same time. The MRO is a price determined through a competitive bidding process. If a MRO price is approved, the utility would blend in the RSP or ESP price with the MRO 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 a 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 designated generating assets to an exempt wholesale generator absent PUCO approval.

On July 31, 2008, Duke Energy Ohio filed a new generation pricing formula to be effective January 1, 2009, when the current RSP expired. Among other things, the plan provides pricing mechanisms for compensation related to the advanced energy, renewable energy supply and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and was filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit was presented to the PUCO for a ruling. Parties to this proceeding who did not support the Stipulation were free to litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately $36 million, $74 million and $98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as save-a-watt, to achieve the energy efficiency mandate pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program was also presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to $50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO issued its finding and order resolving the two litigated issues and adopting a modified Stipulation. Specifically, the PUCO modified the Stipulation to permit certain non-residential customers to opt out of utility-sponsored energy efficiency initiatives and to allow residential governmental aggregation customers who leave Duke Energy Ohio's system to avoid some charges. Applications for rehearing of the PUCO's decision have been filed by environmental groups and a residential customer advocate group. On February 11, 2009, the PUCO issued an Entry denying the rehearing requests. On April 13, 2009, the Office of the Ohio Consumers' Counsel (OCC) filed a notice of appeal to the Ohio Supreme Court, challenging the

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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PUCO's interpretation of the system-reliability-adjustment capacity dedication rider (SRA-CD). The OCC claims that the PUCO incorrectly determined that SRA-CD is unavoidable for residential governmental aggregation customers. Duke Energy Ohio has moved to intervene as an appellee in the proceeding.

As discussed further below within "Commercial Power" and in Note 1, as a result of the approval of the ESP, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations.

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 Ohio Partners for Affordable Energy (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. On September 16 and 19, 2008, respectively, the OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue. Merit briefs were filed with the Ohio Supreme Court on February 2, 2009. On April 17, 2009, and after providing the required notice to the PUCO, the OCC filed a motion to stay implementation of Stage 3 of the rate design, which was approved to take effect on June 1, 2009. Duke Energy Ohio filed a memorandum in opposition to this request on April 27, 2009. At this time, Duke Energy Ohio cannot predict whether the Ohio Supreme Court will reverse the PUCO's decision of May 28, 2008.

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. On December 22, 2008, Duke Energy Ohio filed an application requesting deferral of approximately $31 million related to damage to its distribution system from a September 14, 2008 windstorm. On January 14, 2009, the PUCO granted Duke Energy Ohio's deferral request. Accordingly, a regulatory asset was recorded as of December 31, 2008 for $31 million. On March 31, 2009, Duke Energy Ohio and Parties to the case filed a Stipulation and Recommendation which settles all issues in the case. The Stipulation provides for a revenue increase of $55.3 million or approximately a 2.9% overall increase. The Parties also agreed that Duke Energy Ohio will recover any approved costs associated with the September 14, 2008 wind storm restoration through a separate rider recovery mechanism. Duke Energy Ohio agreed to file a separate application to set the rider and the PUCO will review the request and determine the appropriate amount of storm costs that should be recovered. The Stipulation includes, among other things, a weatherization and energy efficiency program, and recovery of uncollectible expenses through a rider mechanism. The Stipulation is subject to approval by the PUCO.

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 June 2005, the Kentucky General Assembly enacted Kentucky Revised Statue 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. In December 2005, the KPSC approved an annual rate increase of $8 million and re-approved the tracking mechanism through

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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, which were approved prior to enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order, Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

Energy Efficiency. On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). The DSM 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 program costs are 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. Duke Energy Ohio filed the save-a-watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of save-a-watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. On December 17, 2008, the PUCO approved the ESP, including allowing for the implementation of a new save-a-watt energy efficiency compensation model. However, the PUCO determined that certain non-residential customers may opt out of Duke Energy Ohio's energy efficiency initiative. Applications for rehearing of this issue were denied by the PUCO and no further appeals of this issue have been taken.

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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a save-a-watt Energy Efficiency Plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. Intervenor testimony is due on May 11, 2009. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

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. As of January 1, 2009, Duke Energy Ohio had approximately 80,000 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 expected to be completed at the end of 2012.

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

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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.

Midwest ISO's Establishment of an Ancillary Services Market (ASM). On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time 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 in the Midwest ISO area. The Midwest ISO launched the ASM on January 6, 2009.

Commercial Power.

As discussed in Note 1, effective December 17, 2008, Commercial Power reapplied the provisions of SFAS No. 71 to certain portions of its operations due to the passing of SB 221 and the PUCO's approval of the ESP. However, since certain portions of Commercial Power's operations are not subject to regulatory accounting pursuant to SFAS No. 71, reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs for which recovery is not automatic under the ESP. Commercial Power may be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

FERC 203 Application. On April 23, 2008 (supplemented on May 6, 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 FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio was in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. As part of the settlement that was approved by the PUCO on December 17, 2008 (see discussion above) Duke Energy Ohio agreed to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers and the PUCO approved of the transfer for the remaining generating facilities. Duke Energy Ohio filed a new application requesting FERC approval to transfer to affiliate companies only the remaining generating facilities not designated to serve Ohio customers, which was conditionally approved by the FERC on February 19, 2009. As a condition of approval, the FERC requires that all acquisition premiums related to generating assets being transferred to an affiliate of Duke Energy be removed from Duke Energy Ohio's financial statements when Duke Energy Ohio submits its final accounting entries and that any debt associated with the generation assets being transferred be transferred to the generating facility before Duke Energy Ohio submits its final accounting entries. In addition, the FERC will hold Duke Energy Ohio to its commitments to not pay taxes associated with the proposed transaction, to maintain a minimum equity to total capital ratio of 30%, and to retain an amount of debt that will accommodate the preservation of Duke Energy Ohio's current credit ratings.

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 the FERC. The complaint asks the 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 during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying and dismissing the RPM Buyer's complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM Buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.

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11. Commitments and Contingencies

Environmental

Duke Energy Ohio 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 Duke Energy Ohio.

Remediation Activities. *Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites.* These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio 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, Duke Energy Ohio or its affiliates could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Ohio 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable. During 2009, it is reasonably possible that Duke Energy Ohio will incur costs associated with remediation activities at certain of its sites.

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. Three of six coal-fired generating facilities in which Duke Energy Ohio is either a whole or partial owner are affected sources under that rule. On April 1, 2009, the U.S. Supreme Court ruled in favor of the plaintiff that the EPA may consider costs when determining which technology option each site should implement. Depending on how the cost-benefit analysis is incorporated into the revised EPA rule, the analysis could narrow the range of technology options required for each of the three affected facilities. Because of the wide range of potential outcomes, Duke Energy Ohio is unable to estimate its costs to comply at this time.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO_2 emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. 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. On July 11, *2008, the D.C. Circuit issued its decision in North Carolina v. EPA No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on* September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating the CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. The EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Ohio plans to spend approximately $85 million between 2009 and 2013 to comply with Phase 1 of the CAIR. Duke Energy Ohio is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above. Duke Energy Ohio received partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP and continues to be able to recover a portion of these costs through the ESP.

Coal Combustion Product (CCP) Management. Duke Energy Ohio currently estimates that *it will spend approximately $68 million over the period 2009-2013 to install* synthetic caps and liners at existing and new CCP landfills and to convert some of its CCP handling systems from wet to dry systems.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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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 $11 million as of both March 31, 2009 and December 31, 2008. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

New Source Review (NSR). In 1999-2000, the U.S. Department of Justice, 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 SO_2, NO_x and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to $32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio 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 Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. 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 and Duke Energy Ohio. Additionally, the plaintiffs had claimed that Duke Energy Ohio 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.

On October 21, 2008, plaintiffs filed a motion for a new liability trial claiming that defendants misled the plaintiffs and the jury by, among other things, not disclosing a consulting agreement with a fact witness and by referring to that witness as "retired" during the liability trial when in fact he was working for Duke Energy under the referenced consulting agreement in connection with the trial. On December 18, 2008, the court granted plaintiffs' motion for a new liability trial on claims for which Duke Energy Ohio was not previously found liable. That trial began on May 11, 2009. The remedy trial for violations already established at the W.C. Beckjord Station was held during the week beginning February 2, 2009. The parties are awaiting a decision from the trial court.

It is not possible to estimate the damages, if any, that Duke Energy Ohio 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 Duke Energy Ohio's consolidated results of operations, cash flows or financial position. However, Duke Energy Ohio 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, 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. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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Carbon Dioxide (CO_2) 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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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. In March 2009, a settlement in principle was reached with the class plaintiffs, subject to execution of a definitive settlement document and approval by the court. The settlement, as currently structured, will not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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 recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy will incur any liability or to estimate the damages, if any, that Duke Energy 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 Racketeer Influenced and Corrupt Organizations (RICO) statutes. Defendants have again moved to dismiss the claims. On March 31, 2009, the District Court granted Duke Energy Ohio's motion to dismiss. Plaintiffs have filed a motion to alter or set aside the judgment.

Asbestos-related Injuries and Damages Claims. Duke Energy Ohio has been named as a defendant or co-defendant in lawsuits related to asbestos at its electric generating stations. The impact on Duke Energy Ohio'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 Ohio's 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, Duke Energy Ohio 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.

Other Litigation and Legal Proceedings. Duke Energy Ohio 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. Duke Energy Ohio believes that the

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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final disposition of these proceedings will not have a material adverse effect on its consolidated results of operations, cash flows or financial position.

Duke Energy Ohio has exposure to certain legal matters that are described herein. As of both March 31, 2009 and December 31, 2008, Duke Energy Ohio has recorded insignificant reserves for these proceedings and exposures. Duke Energy Ohio expenses legal costs related to the defense of loss contingencies as incurred.

Other Commitments and Contingencies

General. Duke Energy Ohio 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. Some of these arrangements may be recognized at market value on the Consolidated Balance Sheets as undesignated hedge contracts or qualifying hedge positions.

12. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Ohio adopted SFAS No. 157. Through December 31, 2008, Duke Energy Ohio's adoption of SFAS No. 157 was limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. FAS 157-2, *"Effective Date of FASB Statement No. 157,"* which delayed the effective date of SFAS No. 157 until January 1, 2009 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 Duke Energy Ohio 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 in the U.S. 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 Duke Energy Ohio 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.

Duke Energy Ohio 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:

Level 1 inputs—unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Ohio 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. Duke Energy Ohio 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 Duke Energy Ohio, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio 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, Duke Energy Ohio may elect to measure certain financial instruments at fair value in accordance with this standard.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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The following tables provide 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 Duke Energy Ohio's Consolidated Balance Sheets at fair value at March 31, 2009 and December 31, 2008. Amounts presented in the tables below exclude cash collateral amounts which are disclosed separately in Note 9.

Description	Total Fair Value Amounts at March 31, 2009	Level 1	Level 2	Level 3
	(in millions)			
Derivative Assets	$ 61	$ 9	$ —	$ 52
Derivative Liabilities	(212)	(162)	(7)	(43)
Net (Liabilities) Assets	$ (151)	$ (153)	$ (7)	$ 9

Description	Total Fair Value Amounts at December 31, 2008	Level 1	Level 2	Level 3
	(in millions)			
Derivative Assets	$ 68	$ 9	$ —	$ 59
Derivative Liabilities	(147)	(88)	(8)	(51)
Net (Liabilities) Assets	$ (79)	$ (79)	$ (8)	$ 8

The following table provides a reconciliation of beginning and ending balances of assets 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)
Balance at January 1, 2009	$ 8
Total pre-tax realized or unrealized gains included in earnings:	
Fuel used in electric generation and purchased power-non-regulated	1
Total pre-tax gains included in other comprehensive income	1
Net purchases, sales, issuances and settlements	(5)
Total gains included on balance sheet as regulatory asset or liability or as non-current liability	4
Balance at March 31, 2009	$ 9
Pre-tax (losses) gains included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at March 31, 2009:	
Revenue, non-regulated electric, and other	$ (5)
Fuel used in electric generation and purchased power-non-regulated	18
Total	$ 13
Balance at January 1, 2008	$ (22)
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated electric and other	8
Total pre-tax losses included in other comprehensive income	(3)
Net purchases, sales, issuances and settlements	(8)
Balance at March 31, 2008	$ (25)
Pre-tax gains included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at March 31, 2008:	
Revenue, non-regulated electric and other	$ 1
Total	$ 1

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The valuation method of the primary fair value measurements disclosed above are as follows:

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 Duke Energy Ohio classifies as Level 1 measurements.

Fair Value Disclosures Required Under FSP No. FAS 107-1 and Accounting Principles Board (APB) 28-1, "*Interim Disclosures About Fair Value of Financial Instruments.*" The fair value of financial instruments, excluding financial assets included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2009 and December 31, 2008 are not necessarily indicative of the amounts Duke Energy Ohio could have realized in current markets.

	As of March 31, 2009		As of December 31, 2008	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
	(in millions)			
Long-term debt, including current maturities	$ 2,331	$ 2,130	$ 1,883	$ 1,729

The fair value of cash and cash equivalents, accounts receivable, restricted funds held in trust, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

13. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Ohio subsequent to March 31, 2008 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

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 Duke Energy Ohio, 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 Duke Energy Ohio 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. Additionally, SFAS No. 141R changes the accounting for income taxes related to prior business combinations.

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. Duke Energy Ohio adopted SFAS No. 161 as of January 1, 2009. The adoption of SFAS No. 161 did not have any impact on Duke Energy Ohio's consolidated results of operations, cash flows or financial position. See Note 9 for the disclosures required under SFAS No. 161.

14. Income Taxes and Other Taxes

The taxable income of Duke Energy Ohio is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Ohio 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 Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

Changes to Unrecognized Tax Benefits

	Increase/(Decrease)
	(in millions)
Unrecognized Tax Benefits—January 1, 2009	$ 15
Unrecognized Tax Benefits Changes	
Gross increases—tax positions in prior periods	3
Gross decreases—tax positions in prior periods	(1)
Settlements	(5)
Total Changes	(3)
Unrecognized Tax Benefits—March 31, 2009	$ 12

At March 31, 2009, no portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Duke Energy Ohio does not anticipate a significant increase or decrease in unrecognized tax benefits in the next twelve months.

Duke Energy Ohio has the following tax years open:

Jurisdiction	Tax Years
Federal	2005 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 March 31, 2009 was approximately 35.4% as compared to the effective tax rate of approximately 35.7% for the same period in 2008.

As of March 31, 2009 and December 31, 2008, approximately $63 million and $64 million, respectively, of deferred income taxes were included in Other within Current Assets on the Consolidated Balance Sheets. At March 31, 2009 and December 31, 2008, these balances exceeded 5% of total current assets.

Excise Taxes. Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio 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. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as revenues in the accompanying Consolidated Statements of Operations were approximately $40 million and $39 million for the three months ended March 31, 2009 and 2008, respectively.

15. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Ohio and Duke Energy Kentucky sell, on a revolving basis, nearly all of their retail and wholesale accounts receivable and related collections to Cinergy Receivables. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140 and, accordingly, the transfers of receivables are accounted for as sales.

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 (typically approximates 25% of the total proceeds). The note, which amounts to approximately $154 million and $174 million at March 31, 2009 and December 31, 2008, respectively, is subordinate to senior loans that Cinergy Receivables obtains from commercial paper conduits controlled by unrelated financial institutions, which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Consolidated Balance Sheets at March 31, 2009 and December 31, 2008.

In 2008, Cinergy Receivables and Duke Energy Ohio and Duke Energy Kentucky amended the governing purchase and sale agreement to allow Cinergy Receivables to convey its bankrupt receivables to the applicable originator for consideration equal to the fair market value of such receivables as of the disposition date. The amount of bankrupt receivables sold is limited to 1% of aggregate sales of the originator during the most recently completed 12 month period. Cinergy Receivables and Duke Energy Ohio and Duke Energy Kentucky completed a sale under this amendment in 2008.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

Duke Energy Ohio and Duke Energy Kentucky retain servicing responsibilities for their role as collection agents on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Ohio and Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Ohio and Duke Energy Kentucky exists, these entities risk loss in the event collections are not sufficient to allow for full recovery of their retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Ohio approximates a market rate.

The carrying value of the retained interest is determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions used in estimating the fair value for 2009 were an anticipated credit loss ratio of 0.7%, a discount rate of 2.8% and a receivable turnover rate of 12.5%. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Ohio's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Ohio and Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the three months ended March 31, 2009:

	Three Months Ended March 31, 2009
	(in millions)
Receivables sold as of March 31,	$ 441
Less: Retained interests	154
Net receivables sold as of March 31,	$ 287
Sales	
Receivables sold	$ 958
Loss recognized on sale	8
Cash flows	
Cash proceeds from receivables sold	$ 970
Collection fees received	—
Return received on retained interests	5

The loss recognized on the sale of receivables is calculated monthly by multiplying the receivables sold during the month by the required discount which is derived monthly utilizing a three year weighted average formula that considers charge-off history, late charge history, and turnover history on the sold receivables, as well as a component for the time value of money. The discount rate, or component for the time value of money, is calculated monthly by summing the prior month-end LIBOR rate plus a fixed rate of 2.39%.

16. Subsequent Events

For information on subsequent events related to regulatory matters and commitments and contingencies, see Notes 10 and 11, respectively.

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PART I

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

Management's Discussion and Analysis should be read in conjunction with the Unaudited Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio) is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

DUKE ENERGY OHIO

	Three Months Ended March 31,		
	2009	2008	Increase (Decrease)
	(in millions)		
Operating revenues	$ 1,006	$ 991	$ 15
Operating expenses	843	781	62
Gains on sales of other assets and other, net	4	13	(9)
Operating income	167	223	(56)
Other income and expenses, net	—	9	(9)
Interest expense	35	26	9
Income before income taxes	132	206	(74)
Income tax expense	47	73	(26)
Net income	$ 85	$ 133	$ (48)

Net Income

The $48 million decrease in Duke Energy Ohio's Net Income was primarily due to the following factors:

Operating Revenues. The increase was primarily driven by:

- A $52 million increase in retail electric revenues resulting from higher retail pricing principally related to the implementation of the Electric Security Plan (ESP) in 2009;
- A $27 million increase in revenues due to higher generation volumes and PJM capacity revenues from the Midwest gas-fired assets in 2009 compared to 2008; and
- A $23 million increase in net mark-to-market revenues on non-qualifying power and capacity hedge contracts, consisting of mark-to-market gains of $9 million in 2009 compared to losses of $14 million in 2008.

Partially offsetting these increases were:

- A $47 million decrease in regulated fuel revenues driven primarily by lower natural gas costs and reduced sales;
- A $13 million decrease in retail electric revenues resulting from lower retail volumes due to the overall declining economic conditions, which are primarily impacting the industrial sector;
- A $12 million decrease in wholesale electric revenues due to lower generation margin and hedge realization in 2009 compared to 2008;
- A $9 million decrease related to native load due to milder weather in 2009 compared to 2008; and
- A $9 million decrease in retail electric revenues resulting from the expiration of the Ohio electric Regulatory Transition Charge (RTC) for residential customers.

Source. Duke Energy Ohio, In, 10-Q, May 13, 2009

Operating Expenses. The increase was primarily driven by:

- A $66 million increase in mark-to-market fuel expense on non-qualifying fuel hedge contracts, consisting of mark-to-market losses of $8 million in 2009 compared to gains of $58 million in 2008;
- A $21 million increase in fuel and operating expenses for the Midwest gas-fired assets primarily due to higher generation volumes in 2009 compared to 2008;
- A $16 million increase in plant maintenance expenses resulting from increased plant outages and maintenance in 2009 compared to 2008; and
- A $9 million increase in operating and maintenance expenses primarily due to higher storm costs largely driven by the impact of an ice storm in January 2009.

Partially offsetting these increases were:

- A $52 million decrease in regulated fuel expense primarily due to lower natural gas costs and reduced purchases; and
- A $9 million decrease in regulatory asset amortization resulting from the expiration of the Ohio electric RTC for residential customers.

Gains on Sales of Other Assets and Other, net. The decrease in 2009 as compared to 2008 is attributable to lower gains on sales of emission allowances in 2009 compared to 2008.

Other Income and Expenses, net. The decrease in 2009 as compared to 2008 is primarily attributable to reduced interest income on the subordinated note from Cinergy Receivables Company, LLC, a wholly-owned subsidiary of Cinergy, to which Duke Energy Ohio sells certain of its accounts receivable, resulting from lower interest rates and a reduction in interest income accrued for uncertain income tax positions.

Interest Expense. The increase was primarily due to higher debt balances in the first quarter of 2009 as compared to the same period in 2008.

Income Tax Expense. The decrease was primarily the result of lower pre-tax income.

Matters Impacting Future Results

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "*Goodwill and Intangible Assets.*" For further information on key assumptions that impact Duke Energy Ohio's goodwill impairment assessments, see Critical Accounting Policy for Goodwill Impairment in Duke Energy Ohio's Form 10-K for the year ended December 31, 2008. As of the date of the August 2008 annual impairment test, the fair value of Duke Energy Ohio's reporting units exceeded their respective carrying values, thus no goodwill impairment charges were recorded. However, management is continuing to monitor the impact of recent market and economic events to determine if it is more likely than not that the carrying values of Duke Energy Ohio's reporting units have been impaired. Should any such triggering events or circumstances occur in 2009 prior to the annual August 2009 testing date that would more likely than not reduce the fair value of a reporting unit below its carrying value, management would perform an interim detailed impairment test of Duke Energy Ohio's goodwill and it is possible that goodwill impairment charges could be recorded as a result of these tests. At March 31, 2009, Duke Energy Ohio had goodwill of approximately $2,360 million.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2009, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2009 and have concluded no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For information regarding legal proceedings that became reportable events or in which there were material developments in the first quarter of 2009, see Note 10 to the Consolidated Financial Statements, "Regulatory Matters" and Note 11 to the Consolidated Financial Statements, "Commitments and Contingencies."

Item 1A. Risk Factors

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect Duke Energy Ohio's financial condition or future results. Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

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PART II

Item 6. Exhibits

(a) Exhibits

Exhibits filed or furnished herewith are designated by an asterisk (*). All exhibits not so designated are incorporated by reference to a prior filing, as indicated. Items constituting management contracts or compensatory plans or arrangements are designated by a double asterisk (**).

Exhibit Number	
4.1**	Fortieth Supplemental Indenture, dated as of March 23, 2009 to the First Mortgage, dated as of August 1, 1936, between Duke Energy Ohio, Inc. and The Bank of New York Mellon Trust Company, N.A., as successor trustee (filed on Form 8-K of Duke Energy Ohio, March 24, 2009, File No. 1-01232, as Exhibit 4.1).
10.1**	Underwriting Agreement, dated March 18, 2009, between Duke Energy Ohio, Inc. and Barclays Capital Inc., Deutsche Bank Securities Inc., SunTrust Robinson Humphrey, Inc. and UBS Securities LLC, as representatives of the several underwriters named therein (filed on Form 8-K of Duke Energy Ohio, March 24, 2009, File No. 1-01232, as Exhibit 4.1).
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: May 13, 2009

/s/ DAVID L. HAUSER
David L. Hauser
Group Executive and
Chief Financial Officer

Date: May 13, 2009

/s/ STEVEN K. YOUNG
Steven K. Young
Senior Vice President and
Controller

Source: Duke Energy Ohio, In, 10-Q, May 13, 2009

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Rogers, certify that:

1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2009

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David L. Hauser, certify that:

1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 13, 2009

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer
May 13, 2009

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ DAVID L. HAUSER
David L. Hauser
Group Executive and Chief Financial Officer
May 13, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2008 Or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________ to _________

Commission file number 1-1232

DUKE ENERGY OHIO, INC.

(Exact Name of Registrant as Specified in its Charter)

Ohio	31-0240030
(State or Other Jurisdiction of Incorporation)	(IRS Employer Identification No.)

139 East Fourth Street Cincinnati, OH	45202
(Address of Principal Executive Offices)	(Zip code)

704-594-6200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐
Non-accelerated filer ☒ Smaller reporting company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes ☐ No ☒

All of the registrant's common stock is indirectly owned by Duke Energy Corporation (File No. 1-32853) which is a reporting company under the Securities Exchange Act of 1934, as amended.

The registrant meets the conditions set forth in General Instructions H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format specified in General Instructions H(2) of Form 10-Q.

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DUKE ENERGY OHIO, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2008

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This document includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on management's beliefs and assumptions. These forward-looking statements are identified by terms and phrases such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "plan," "project," "predict," "will," "potential," "forecast," "target," and similar expressions. Forward-looking statements involve risks and uncertainties that may cause actual results to be materially different from the results predicted. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- State and federal legislative and regulatory initiatives, including costs of compliance with existing and future environmental requirements;
- State and federal legislative and regulatory initiatives and rulings that affect cost and investment recovery or have an impact on rate structures;
- Costs and effects of legal and administrative proceedings, settlements, investigations and claims;
- Industrial, commercial and residential growth in Duke Energy Ohio, Inc.'s (Duke Energy Ohio) service territories;
- Additional competition in electric markets and continued industry consolidation;
- The influence of weather and other natural phenomena on Duke Energy Ohio's operations, including the economic, operational and other effects of storms, hurricanes, tornados, droughts and other natural phenomena;
- The timing and extent of changes in commodity prices and interest rates;
- Unscheduled generation outages, unusual maintenance or repairs and electric transmission system constraints;
- The performance of electric generation facilities;
- The results of financing efforts, including Duke Energy Ohio's ability to obtain financing on favorable terms, which can be affected by various factors, including Duke Energy Ohio's credit ratings and general economic conditions;
- Declines in the market prices of equity securities and resultant cash funding requirements of Duke Energy Ohio for Cinergy Corp.'s defined benefit pension plans;
- The level of creditworthiness of counterparties to Duke Energy Ohio's transactions;
- Employee workforce factors, including the potential inability to attract and retain key personnel;
- Growth in opportunities for Duke Energy Ohio's business units, including the timing and success of efforts to develop power and other projects; and
- The effect of accounting pronouncements issued periodically by accounting standard-setting bodies.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than Duke Energy Ohio has described. Duke Energy Ohio undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In millions)

Item 1. *Financial Statements.*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Operating Revenues				
Non-regulated electric and other	$446	$613	$1,292	$1,381
Regulated electric	286	278	756	742
Regulated natural gas	86	64	556	511
Total operating revenue	818	955	2,604	2,634
Operating Expenses				
Fuel used in electric generation and purchased power—non-regulated	332	310	612	728
Fuel used in electric generation and purchased power—regulated	49	49	116	116
Cost of natural gas and coal sold	42	32	341	356
Operation, maintenance and other	205	186	571	553
Depreciation and amortization	106	107	305	295
Property and other taxes	62	60	197	195
Impairments and other charges	82	—	82	—
Total operating expenses	878	744	2,224	2,243
(Losses) Gains on Sales of Other Assets and Other, net	—	(1)	46	(12)
Operating (Loss) Income	(60)	210	426	379
Other Income and Expenses, net	8	5	23	22
Interest Expense	23	28	72	73
(Loss) Income Before Income Taxes	(75)	187	377	328
Income Tax (Benefit) Expense	(21)	69	141	124
Net (Loss) Income	$ (54)	$118	$ 236	$ 204

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In millions)

	September 30, 2008	December 31, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 341	$ 33
Receivables (net of allowance for doubtful accounts of $18 at September 30, 2008 and $3 at December 31, 2007)	186	334
Inventory	270	212
Unrealized gains on mark-to-market and hedging transactions	104	22
Other	172	94
Total current assets	1,073	695
Investments and Other Assets		
Restricted funds held in trust	60	62
Goodwill	2,324	2,325
Intangibles, net	416	551
Unrealized gains on mark-to-market and hedging transactions	30	17
Other	33	33
Total investments and other assets	2,863	2,988
Property, Plant and Equipment		
Cost	9,954	9,577
Less accumulated depreciation and amortization	2,277	2,097
Net property, plant and equipment	7,677	7,480
Regulatory Assets and Deferred Debits		
Deferred debt expense	23	23
Regulatory assets related to income taxes	100	90
Other	318	401
Total regulatory assets and deferred debits	441	514
Total Assets	$12,054	$11,677

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

CONSOLIDATED BALANCE SHEETS—(Continued)
(Unaudited)
(In millions, except share and per-share amounts)

	September 30, 2008	December 31, 2007
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	$ 400	$ 602
Notes payable and commercial paper	492	189
Taxes accrued	231	172
Interest accrued	23	24
Current maturities of long-term debt	27	126
Unrealized losses on mark-to-market and hedging transactions	76	24
Other	70	86
Total current liabilities	1,319	1,223
Long-term Debt	1,856	1,810
Deferred Credits and Other Liabilities		
Deferred income taxes	1,482	1,436
Investment tax credit	14	16
Accrued pension and other post-retirement benefit costs	242	259
Unrealized losses on mark-to-market and hedging transactions	28	25
Asset retirement obligations	33	31
Other	296	343
Total deferred credits and other liabilities	2,095	2,110
Commitments and Contingencies		
Common Stockholder's Equity		
Common Stock, $8.50 par value, 120,000,000 shares authorized; 89,663,086 shares outstanding at September 30, 2008 and December 31, 2007	762	762
Additional paid-in capital	5,570	5,570
Retained earnings	463	227
Accumulated other comprehensive loss	(11)	(25)
Total common stockholder's equity	6,784	6,534
Total Liabilities and Common Stockholder's Equity	$12,054	$11,677

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In millions)

	Nine Months Ended September 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 236	$ 204
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	308	295
(Gains) losses on sales of other assets and other, net	(46)	12
Impairment charges	82	—
Deferred income taxes	(37)	45
Accrued pension and other post-retirement benefit costs	16	28
Contribution to company-sponsored pension and other post-retirement benefit plans	—	(92)
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	(19)	31
Receivables	168	71
Inventory	(58)	(14)
Other current assets	(36)	(1)
Increase (decrease) in:		
Accounts payable	(209)	(56)
Taxes accrued	70	(153)
Other current liabilities	(10)	(6)
Regulatory asset/liability deferrals	(24)	(20)
Other assets	21	141
Other liabilities	(73)	(46)
Net cash provided by operating activities	389	439
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(381)	(461)
Purchases of emission allowances	(15)	(14)
Sales of emission allowances	60	25
Change in restricted funds held in trust	2	21
Other	3	(1)
Net cash used in investing activities	(331)	(430)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	73	6
Redemption of long-term debt	(139)	(5)
Notes payable and commercial paper	276	—
Notes payable to affiliate, net	40	74
Dividends to parent	—	(135)
Capital contribution from parent	—	29
Net cash provided by (used in) financing activities	250	(31)
Net increase (decrease) in cash and cash equivalents	308	(22)
Cash and cash equivalents at beginning of period	33	45
Cash and cash equivalents at end of period	$ 341	$ 23
Supplemental Disclosures		
Significant non-cash transactions:		
Purchase accounting adjustments	$ —	$ (8)
Accrued capital expenditures	$ 60	$ 13

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

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

				Accumulated Other Comprehensive Income (Loss)		
	Common Stock	Additional Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Pension and OPEB Related Adjustments to AOCI	Total
Balance at December 31, 2006	**$762**	**$5,601**	**$ 55**	**$(36)**	**$(2)**	**$6,380**
Net income	—	—	204	—	—	204
Other comprehensive income						
Cash flow hedges[a]	—	—	—	1	—	1
Pension and OPEB-related Adjustments to AOCI	—	—	—	—	1	1
Total comprehensive income						206
Capital contribution from parent	—	29	—	—	—	29
Push-down accounting adjustments	—	(8)	—	—	—	(8)
Adoption of SFAS No. 158—measurement[b] date provision	—	—	(3)	—	(2)	(5)
Dividend to parent	—	(46)	(89)	—	—	(135)
Balance at September 30, 2007	**$762**	**$5,576**	**$167**	**$(35)**	**$(3)**	**$6,467**
Balance at December 31, 2007	**$762**	**$5,570**	**$227**	**$(32)**	**$ 7**	**$6,534**
Net income	—	—	236	—	—	236
Other comprehensive income						
Cash flow hedges[c]	—	—	—	12	—	12
Pension and OPEB-related Adjustments to AOCI[d]	—	—	—	—	2	2
Total comprehensive income						250
Balance at September 30, 2008	**$762**	**$5,570**	**$463**	**$(20)**	**$ 9**	**$6,784**

(a) Net of $1 tax expense in 2007.
(b) Net of $2 tax benefit in 2007.
(c) Net of $7 tax expense in 2008.
(d) Net of insignificant tax expense in 2008.

See Notes to Unaudited Consolidated Financial Statements

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements

1. Basis of Presentation

Nature of Operations and Basis of Consolidation. Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio is a combination electric and gas public utility company that provides service in the southwestern portion of Ohio and through its wholly-owned subsidiary, Duke Energy Kentucky, Inc. (Duke Energy Kentucky), in nearby areas of Kentucky, as well as unregulated electric generation in parts of Ohio, Illinois, Indiana and Pennsylvania. Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Except where separately noted, references to Duke Energy Ohio herein relate to the consolidated operations of Duke Energy Ohio, including Duke Energy Kentucky. These Unaudited Consolidated Financial Statements include, after eliminating intercompany transactions and balances, the accounts of Duke Energy Ohio and all majority-owned subsidiaries where Duke Energy Ohio has control, as well as Duke Energy Ohio's proportionate share of certain generation and transmission facilities in Ohio, Kentucky and Indiana.

These Unaudited 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 and with the instructions to Form 10-Q and Regulation S-X. Accordingly, these Unaudited Consolidated Financial Statements do not include all of the information and notes required by GAAP in the U.S. for annual financial statements. Because the interim Unaudited Consolidated Financial Statements and Notes do not include all of the information and notes required by GAAP in the U.S. for annual financial statements, the Unaudited Consolidated Financial Statements and other information included in this quarterly report should be read in conjunction with the Unaudited Consolidated Financial Statements and Notes in Duke Energy Ohio's Form 10-K for the year ended December 31, 2007.

These Unaudited Consolidated Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Ohio's financial position and results of operations. Amounts reported in the interim Unaudited 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 to GAAP in the U.S., management makes estimates and assumptions that affect the amounts reported in the Unaudited Consolidated Financial Statements and Notes. Although these estimates are based on management's best available information 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. (FIN) 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, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy Ohio 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, Duke Energy Ohio 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 September 30, 2008 and December 31, 2007, Duke Energy Ohio had receivables related to the right to reclaim cash collateral of approximately $9 million and $5 million, respectively, and had payables related to obligations to return cash collateral of an insignificant amount at each balance sheet date that have been offset against net derivative positions in the Consolidated Balance Sheets. Duke Energy Ohio had cash collateral receivables of approximately $64 million and $15 million under master netting arrangements that have not been offset against net derivative positions at September 30, 2008 and December 31, 2007 respectively, as these amounts primarily represent initial margin deposits related to NYMEX futures contracts. Duke Energy Ohio had insignificant cash collateral payables under master netting arrangements that have not been offset against net derivative positions at September 30, 2008 and 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 sig-

DUKE ENERGY OHIO, INC.
Notes To Unaudited Consolidated Financial Statements—(Continued)

nificantly 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 at Commercial Power and were approximately $36 million and $38 million at September 30, 2008 and December 31, 2007, respectively. Additionally, receivables for unbilled revenues of approximately $105 million and $145 million at September 30, 2008 and December 31, 2007, respectively, related to retail accounts receivable at Duke Energy Ohio and Duke Energy Kentucky are included in the sales of accounts receivable to Cinergy Receivables Company, LLC (Cinergy Receivables). Duke Energy Ohio 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. 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 $162 million and $239 million as of September 30, 2008 and December 31, 2007, respectively, which is classified in Other within Regulatory Assets and Deferred Debits on the Consolidated Balance Sheets.

2. Business Segments

Duke Energy Ohio operates the following business segments, which are considered reportable business segments under SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*": Franchised Electric and Gas and Commercial Power. Duke Energy Ohio's chief operating decision maker regularly reviews financial information about each of these business segments in deciding how to allocate resources and evaluate performance. There is no aggregation within Duke Energy Ohio's reportable business segments.

Franchised Electric and Gas, which conducts operations primarily through Duke Energy Ohio and its wholly-owned subsidiary Duke Energy Kentucky, generates, transmits, distributes and sells electricity in southwestern Ohio and northern Kentucky, as well as transports and sells natural gas in southwestern Ohio and northern Kentucky.

Commercial Power owns, operates and manages non-regulated power plants and engages in the wholesale marketing and procurement of electric power, fuel and emission allowances related to these plants as well as other contractual positions. Commercial Power's generation asset fleet consists of Duke Energy Ohio's non-regulated generation in Ohio and five Midwestern gas-fired non-regulated generation assets that were transferred from Duke Energy in connection with Duke Energy's merger with Cinergy in April 2006. Commercial Power's assets comprise approximately 7,600 megawatts of power generation primarily located in the Midwestern U.S. The asset portfolio has a diversified fuel mix with baseload and mid-merit coal-fired units as well as combined cycle and peaking natural gas-fired units. Most of the generation asset output in Ohio has been contracted through the rate stabilization plan (RSP) (see Note 11).

The remainder of Duke Energy Ohio's operations is presented as Other. While it is not considered a business segment, Other primarily includes certain allocated governance costs (see Note 9).

Duke Energy Ohio's reportable segments offer different products and services and are managed separately as business units. Accounting policies for Duke Energy Ohio's segments are the same as those described in the Notes to the Consolidated Financial Statements in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007. Management evaluates segment performance based on earnings before interest and taxes from continuing operations (EBIT). On a segment basis, EBIT excludes discontinued operations and represents all profits from continuing operations (both operating and non-operating and excluding corporate governance costs) before deducting interest and taxes.

Cash, cash equivalents, and short-term investments, if any, are managed centrally by Duke Energy, so the interest and dividend income on those balances are excluded from segment EBIT. Transactions between reportable segments, if any, are included in segment EBIT.

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

Business Segment Data

	Unaffiliated Revenues[(a)]	Segment EBIT/ Consolidated (Loss) Income Before Income Taxes	Depreciation and Amortization
		(in millions)	
Three Months Ended September 30, 2008			
Franchised Electric and Gas	$ 372	$ 59	$ 65
Commercial Power	446	(105)	41
Total reportable segments	818	(46)	106
Other	—	(11)	—
Interest expense	—	(23)	—
Interest income and other	—	5	—
Total consolidated	$ 818	$ (75)	$106
Three Months Ended September 30, 2007			
Franchised Electric and Gas	$ 344	$ 54	$ 65
Commercial Power	611	175	42
Total reportable segment	955	229	107
Other	—	(19)	—
Interest expense	—	(28)	—
Interest income and other	—	5	—
Total consolidated	$ 955	$ 187	$107
Nine Months Ended September 30, 2008			
Franchised Electric and Gas	$1,312	$ 197	$181
Commercial Power	1,292	282	124
Total reportable segment	2,604	479	305
Other	—	(48)	—
Interest expense	—	(72)	—
Interest income and other	—	18	—
Total consolidated	$2,604	$ 377	$305
Nine Months Ended September 30, 2007			
Franchised Electric and Gas	$1,255	$ 183	$172
Commercial Power	1,379	255	123
Total reportable segment	2,634	438	295
Other	—	(58)	—
Interest expense	—	(73)	—
Interest income and other	—	21	—
Total consolidated	$2,634	$ 328	$295

(a) There were no intersegment revenues for the three and nine months ended September 30, 2008 and 2007.

DUKE ENERGY OHIO, INC.
Notes To Unaudited Consolidated Financial Statements—(Continued)

Segment Assets

	September 30, 2008	December 31, 2007
	(in millions)	
Franchised Electric and Gas	$ 5,689	$ 5,530
Commercial Power	6,352	6,147
Total reportable segments	12,041	11,677
Other	13	—
Total consolidated assets	$12,054	$11,677

3. Sales of Other Assets

For the three months ended September 30, 2008, the sale of other assets resulted in approximately $4 million in proceeds and net pre-tax gains of an insignificant amount. For the nine months ended September 30, 2008, the sale of other assets resulted in approximately $64 million in proceeds and net pre-tax gains of approximately $46 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These gains primarily relate to Commercial Power's sales of zero cost basis emission allowances.

For the three months ended September 30, 2007, the sale of other assets resulted in approximately $1 million in proceeds and net pre-tax losses of approximately $1 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. For the nine months ended September 30, 2007, the sale of other assets resulted in approximately $25 million in proceeds and net pre-tax losses of approximately $12 million recorded in (Losses) Gains on Sales of Other Assets and Other, net on the Consolidated Statements of Operations. These amounts primarily relate to Commercial Power's sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy 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.

	September 30, 2008	December 31, 2007
	(in millions)	
Coal held for electric generation	$ 85	$ 77
Materials and supplies	84	66
Natural gas	101	69
Total inventory	$270	$212

5. Debt and Credit Facilities

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. 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. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At September 30, 2008, Duke Energy Ohio and Duke Energy Kentucky had borrowing sub limits under Duke Energy's master credit facility of $700 million and $100 million, respectively. In October 2008, Duke Energy reallocated the borrowing sub limits under the master credit facility, which resulted in the reduction of Duke Energy Ohio's borrowing sub limit by $50 million to $650 million. Additionally, in October 2008, Duke Energy terminated the participation of one of the financial institutions supplying approximately $63 million of credit commitment under its master credit facility, which reduced the total credit facility capacity under Duke Energy's master credit facility to approximately $3.14 billion. This termination reduced Duke Energy Ohio's and Duke Energy Kentucky's borrowing sub limits by approximately $13 million and $2 million, respectively. The amount available to Duke Energy Ohio and Duke Energy Kentucky under their sub limits to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Ohio and Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility. Of the approximate $1 billion, Duke Energy Ohio's and Duke Energy Kentucky's portions are approximately $276 million and $73 million, respectively. The loan, which is a revolving credit loan, bears interest at the bank prime rate and is due in September 2009; however, Duke Energy Ohio and Duke Energy Kentucky have the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Consolidated Balance Sheets at September 30, 2008. Since Duke Energy Ohio does not have the intent to refinance these obligations on a long-term basis, Duke Energy Ohio's borrowing is reflected in Current Liabilities within Notes Payable and Commercial Paper on the Consolidated Balance Sheets at September 30, 2008. These borrowings reduce Duke Energy Ohio's and Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

Duke Energy Ohio and its wholly-owned subsidiary, Duke Energy Kentucky, receive support for their short-term borrowing needs through their 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 Duke Energy Ohio and Duke Energy Kentucky separately manage their cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of Duke Energy Ohio and Duke Energy Kentucky, as each of these entities independently participate in the money pool. As of September 30, 2008, Duke Energy Kentucky had net receivables of approximately $1 million, which are classified within Receivables in the accompanying Consolidated Balance Sheets, and Duke Energy Ohio had net borrowings of approximately $229 million, of which approximately $216 million is classified within Notes Payable and Commercial Paper, and approximately $13 million is classified as Long-Term Debt in the accompanying Consolidated Balance Sheets, as discussed below. As of December 31, 2007, Duke Energy Ohio and Duke Energy Kentucky had combined net borrowings of approximately $189 million, which are classified within Notes Payable and Commercial Paper in the accompanying Consolidated Balance Sheets. The $40 million and $74 million increases in the money pool borrowings during the nine months ended September 30, 2008 and 2007, respectively, are reflected in Notes Payable to Affiliate, net within Net cash provided by (used in) financing activities on the Consolidated Statements of Cash Flows. The $1 million increase in the money pool receivables during the nine months ended September 30, 2008 is reflected in Other within Net cash used in investing activities on the Consolidated Statements of Cash Flows.

At September 30, 2008 and December 31, 2007, approximately $84 million and $96 million, respectively, of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio'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 Duke Energy Ohio the ability to refinance these short-term obligations on a long-term basis. Additionally, at September 30, 2008, approximately $13 million of borrowings via the money pool are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Ohio's intent and ability to utilize such borrowings as long-term financing. Of the $84 million of pollution control bonds outstanding at September 30, 2008, approximately $72 million were backstopped by Duke Energy's master credit facility, with the remaining balance backstopped by other specific credit facilities separate from the master credit facility.

In September 2008, Duke Energy Kentucky and Duke Energy Indiana, Inc., a wholly-owned subsidiary of Duke Energy, collectively entered into a $330 million letter of credit agreement with a syndicate of banks. Under this letter of credit agreement, Duke Energy Kentucky may request the issuance of letters of credit up to approximately $51 million on its behalf to support various series of variable rate demand bonds issued or to be issued on behalf of Duke Energy Kentucky. This credit facility, which is not part of Duke Energy's master credit facility, may not be used for any purpose other than to support variable rate demand bonds issued by Duke Energy Kentucky and Duke Energy Indiana, Inc.

Restrictive Debt Covenants. 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 and Duke Energy Kentucky to not exceed 65%. Duke Energy Ohio's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of September 30, 2008, Duke Energy, Duke Energy Ohio and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Ohio's or Duke Energy Kentucky's ability to borrow funds under the debt and credit facilities. In addition, some credit agreements may allow for

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

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.

6. Employee Benefit Obligations

Duke Energy Ohio participates in pension and other post-retirement benefit plans sponsored by Cinergy. Duke Energy Ohio's net periodic benefit costs, as allocated by Cinergy, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Qualified Pension Benefits[a]	$ 3	$5	$9	$12
Other Post-retirement Benefits[b]	$(2)	$4	$3	$ 9

(a) These amounts exclude approximately $1 million and $(2) million for the three months ended September 30, 2008 and 2007, respectively, and approximately $3 million and $5 million for the nine months ended September 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

(b) These amounts exclude insignificant amounts for the three months ended September 30, 2008 and 2007, respectively, and approximately $1 million and $2 million for the nine months ended September 30, 2008 and 2007, respectively, of regulatory asset amortization resulting from purchase accounting.

During the third quarter of 2008, Duke Energy Ohio recorded pre-tax income of approximately $23 million related to the correction of errors related to the accounting for Duke Energy Ohio's other post-retirement benefit plans. Of this amount, approximately $20 million relates to errors in actuarial valuations prior to 2008 that would have reduced amounts recorded as other post-retirement benefit expense recorded during those historical periods and approximately $3 million relates to an error reflected in other post-retirement benefit expense for the first six months of 2008.

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. Duke Energy did not require Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three and nine months ended September 30, 2008 and Duke Energy does not anticipate requiring Duke Energy Ohio to make contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2008. During the nine months ended September 30, 2007, approximately $350 million of qualified pension plan contributions were made to the legacy Cinergy qualified pension plans, of which approximately $83 million represents contributions made by Duke Energy Ohio. During the three and nine months ended September 30, 2007, approximately $32 million of other post-retirement plan contributions were made to the legacy Cinergy other post-retirement plans, of which approximately $9 million represents contributions made by Duke Energy Ohio. Additionally, Duke Energy Ohio participates in Cinergy sponsored employee savings plans that cover substantially all Duke Energy Ohio employees. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately $2 million and $5 million during the three and nine months ended September 30, 2008, respectively. Duke Energy Ohio made its proportionate share of pre-tax employer matching contributions of approximately $1 million and $3 million during the three and nine months ended September 30, 2007, respectively.

7. Goodwill and Intangibles

Carrying Amount of Goodwill

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "*Goodwill and Other Intangible Assets*" (SFAS No. 142). At a minimum, SFAS No. 142 requires a goodwill impairment test to be performed annually as of the same date each year. Duke Energy Ohio performs its annual impairment testing of goodwill as of August 31 of each year, or more frequently if events or circumstances occur that would indicate the probability of impairment. As the fair value of each of Duke Energy Ohio's reporting units exceeded their respective carrying values at August 31, 2008, Duke Energy Ohio did not record any impairment charges in the third quarter of 2008 as a result of its annual impairment test. However, in light of recent market and economic events, management is reassessing the potential for any impairments to recorded goodwill balances. These assessments are in their early stages and management cannot yet predict the outcome, but it is possible that the current assessments could result in goodwill impairments being recorded at one or more reporting units.

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Notes To Unaudited Consolidated Financial Statements—(Continued)

The following table shows the components of goodwill by reportable business segment at September 30, 2008 and December 31, 2007:

	Balance December 31, 2007	Changes	Balance September 30, 2008
		(in millions)	
Commercial Power	$1,188	$(1)	$1,187
Franchised Electric and Gas	1,137	—	1,137
Total Goodwill	$2,325	$(1)	$2,324

Intangible Assets

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

	September 30, 2008	December 31, 2007
	(in millions)	
Emission allowances	$ 246	$365
Gas, coal, and power contracts	271	271
Other	9	9
Total gross carrying amount	526	645
Accumulated amortization—gas, coal, and power contracts	(105)	(89)
Accumulated amortization—other	(5)	(5)
Total accumulated amortization	(110)	(94)
Total intangible assets, net	$ 416	$551

Emission allowances in the table above include emission allowances which were recorded at fair value on the date of Duke Energy's merger with Cinergy and emission allowances purchased by Duke Energy Ohio. Additionally, Duke Energy Ohio is allocated certain zero cost emission allowances on an annual basis. The change in the gross carrying value of emission allowances during the nine months ended September 30, 2008 is as follows:

	(in millions)
Gross carrying value at January 1, 2008	$365
Purchases of emission allowances	15
Sales and consumption of emission allowances[a][b]	(59)
Impairment of emission allowances[c]	(82)
Other changes	7
Gross carrying value at September 30, 2008	$246

(a) Carrying value of emission allowances are recognized via a charge to expense when consumed. Carrying value of emission allowances sold or consumed during the three months ended September 30, 2008 and 2007 were $17 million and $34 million, respectively. Carrying value of emission allowances sold or consumed during the nine months ended September 30, 2008 and 2007 were $59 million and $134 million, respectively.

(b) See Note 3 for a discussion of gains and losses on sales of emission allowances by Commercial Power during the three and nine months ended September 30, 2008 and 2007.

(c) See Note 8 for discussion of impairments of the carrying value of emission allowances of approximately $82 million during the three months ended September 30, 2008.

Amortization expense for gas, coal and power contracts and other intangible assets for the three months ended September 30, 2008 and 2007 was approximately $6 million and $13 million, respectively. Amortization expense for gas, coal and power contracts and other intangible assets for the nine months ended September 30, 2008 and 2007 was approximately $16 million and $38 million, respectively.

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

Intangible Liabilities

In connection with the Duke Energy and Cinergy merger in April 2006, Duke Energy Ohio 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 $17 million and $67 million at September 30, 2008 and December 31, 2007, respectively. Duke Energy Ohio also recorded approximately $56 million of intangible liabilities associated with other power sale contracts in connection with the Duke Energy and Cinergy merger. The carrying amount of this intangible liability was approximately $18 million and $22 million at September 30, 2008 and December 31, 2007, respectively. During the three and nine months ended September 30, 2008, Duke Energy Ohio amortized approximately $18 million and $54 million, respectively, to income related to these intangible liabilities. During the three and nine months ended September 30, 2007, Duke Energy Ohio amortized approximately $15 million and $29 million, respectively, to income related to these intangible liabilities. Intangible liabilities are classified as Other within Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

8. Impairment Charges

Emission Allowances. 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 12 for further discussion of the decision, which resulted in sharp declines in market prices of sulfur dioxide (SO_2) and nitrogen oxide (NO_x) allowances in the third quarter of 2008 due to uncertainty associated with future federal requirements to reduce emissions. Accordingly, pursuant to SFAS No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets,*" Duke Energy Ohio evaluated the carrying value of emission allowances held by its non-regulated businesses for impairment at September 30, 2008.

Prior to its repeal, the CAIR required 50% reductions in SO_2 emissions beginning in 2010 and further 30% reductions in SO_2 emissions in 2015 beyond specified requirements. These reductions were to be achieved by requiring the surrender of SO_2 allowances in a ratio of two allowances per ton of SO_2 emitted beginning in 2010, up from a current one-to-one ratio, escalating to 2.86 allowances per ton of SO_2 emitted beginning in 2015. Taking into account these increases in emission allowance requirements under CAIR, Commercial Power's forecasted SO_2 emissions needed through 2037 exceeded the number of emission allowances held prior to the vacating of the CAIR. Subsequent to the decision to vacate CAIR, Commercial Power determined that it had SO_2 allowances in excess of forecasted emissions and those allowances held in excess of forecasted emissions from future generation required an impairment evaluation. In performing the impairment evaluation for SO_2 allowances at September 30, 2008, management compared quoted market prices for each vintage year allowance to the carrying value of the related allowances in excess of forecasted emissions through 2038. Due to the sharp decline in market prices of SO_2 allowances, as discussed above, Commercial Power recorded pre-tax impairment charges of approximately $77 million related to forecasted excess SO_2 allowances held at September 30, 2008. Additionally, Commercial Power recorded pre-tax impairment charges of approximately $5 million related to annual NO_x allowances during the three months ended September 30, 2008 as these were also affected by the decision to vacate the CAIR. These impairment charges are recorded in Impairments and Other Charges within Operating Expenses on the Consolidated Statements of Operations.

Management will continue to assess the forecasted usage and carrying value of emission allowances going forward to determine if further impairment write-downs are necessary. See Note 7 for further information regarding the carrying value of emission allowances.

9. Related Party Transactions

Duke Energy Ohio 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 September 30, 2008 and December 31, 2007 are as follows:

	September 30, 2008	December 31, 2007
	(in millions)	
Current assets due from affiliated companies[a][b]	$ 30	$ 58
Current liabilities due to affiliated companies[a][c]	$ (197)	$ (266)
Non-current liabilities due to affiliated companies[a][d]	$ (5)	$ —
Net deferred tax liabilities to Duke Energy[a][e]	$(1,399)	$(1,401)

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Notes To Unaudited Consolidated Financial Statements—(Continued)

(a) Balances exclude assets or liabilities associated with accrued pension and other post-retirement benefits, Cinergy Receivables and money pool arrangements, all of which are discussed below.
(b) Of the balance at September 30, 2008, approximately $26 million is classified as Receivables, and approximately $4 million is classified as Other within Current Assets on the Consolidated Balance Sheets. The balance at December 31, 2007 is classified as Receivables on the Consolidated Balance Sheets.
(c) Of the balance at September 30, 2008, approximately $(125) million is classified as Accounts Payable, approximately $(70) million is classified as Taxes Accrued, and approximately $(2) million is classified as Unrealized Losses on Mark-to-Market and Hedging Transactions on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately $(256) million is classified as Accounts Payable and approximately $(10) million is classified as Taxes Accrued on the Consolidated Balance Sheets.
(d) The balance at September 30, 2008 is classified as Unrealized Losses on Mark-to-Market and Hedging Transactions on the Consolidated Balance Sheets.
(e) Of the balance at September 30, 2008, approximately $(1,458) million is classified as Deferred Income Taxes, approximately $(14) million is classified as Investment Tax credit, and approximately $73 million is classified as Other within Current Assets on the Consolidated Balance Sheets. Of the balance at December 31, 2007, approximately $(1,409) million is classified as Deferred Income Taxes, approximately $(16) million is classified as Investment Tax Credit, and approximately $24 million is classified as Other within Current Assets on the Consolidated Balance Sheets.

Duke Energy Ohio is allocated its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy and a consolidated affiliate of Cinergy. 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. The expenses associated with certain allocated corporate governance and other service costs for Duke Energy Ohio, which are recorded in Operation, maintenance and other within Operating Expenses on the Consolidated Statements of Operations were approximately $83 million and $67 million for the three months ended September 30, 2008 and 2007, respectively, and approximately $203 million and $183 million for the nine months ended September 30, 2008 and 2007, respectively.

Duke Energy Ohio 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 $4 million and $3 million for the three months ended September 30, 2008 and 2007, respectively, and approximately $11 million and $17 million for the nine months ended September 30, 2008 and 2007, respectively. Additionally, Duke Energy Ohio records income associated with the rental of office space to a consolidated affiliate of Duke Energy. Rental income was approximately $2 million for each of the three months ended September 30, 2008 and 2007, respectively, and approximately $7 million for each of the nine months ended September 30, 2008 and 2007, respectively.

Duke Energy Ohio participates in Cinergy's qualified pension plan, non-qualified pension plan and other post-retirement benefit plans and is allocated its proportionate share of expenses associated with these plans (see Note 6). Additionally, Duke Energy Ohio has been allocated accrued pension and other post-retirement benefit obligations from Cinergy of approximately $252 million at September 30, 2008 and approximately $266 million at December 31, 2007. These amounts have been classified in the Consolidated Balance Sheets as follows:

	September 30, 2008	December 31, 2007
	(in millions)	
Other current liabilities	$ 5	$ 5
Accrued pension and other post-retirement benefit costs	$242	$259
Other deferred credits and other liabilities	$ 5	$ 2

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Ohio 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 $118 million and $189 million, as of September 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 $5 million and $6 million for three months ended September 30, 2008 and 2007, respectively, and approximately $17 million and $19 million for the nine months ended September 30, 2008 and 2007, respectively.

During the nine months ended September 30, 2007, Duke Energy Ohio received a $29 million capital contribution from its parent, Cinergy. Additionally, during the nine months ended September 30, 2007, Duke Energy Ohio paid dividends to its parent, Cinergy, of $135 million.

As discussed further in Note 5, Duke Energy Ohio 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 $4 million for the three months ended September 30, 2008 and 2007, respectively, and approximately $3 million and $7 million for the nine months ended September 30, 2008 and 2007, respectively.

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10. Risk Management Instruments

As discussed in Note 1, on January 1, 2008, Duke Energy Ohio adopted FSP No. FIN 39-1. In accordance with FSP No. FIN 39-1, Duke Energy Ohio 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 Duke Energy Ohio's derivative portfolio as of September 30, 2008, and December 31, 2007.

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

	September 30, 2008	December 31, 2007
	(in millions)	
Hedging	$(14)	$(23)
Undesignated	35	7
Total	$ 21	$(16)

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 Duke Energy Ohio's Consolidated Balance Sheets.

The $9 million change in the fair value of the hedging portfolio is due primarily to a gain on cash flow hedges at Commercial Power.

The $28 million increase in the undesignated derivative portfolio fair value is due primarily to unrealized mark-to-market gains within Commercial Power, which primarily consists of in-the-money contracts to purchase coal as a result of higher coal prices at September 30, 2008 as compared to December 31, 2007.

During the three and nine months ended September 30, 2008, Duke Energy Ohio included in earnings approximately $128 million of pre-tax losses and approximately $28 million of pre-tax gains, respectively, related to mark-to-market adjustments on derivative contracts that do not qualify for hedge accounting. Duke Energy Ohio included in earnings approximately $4 million of pre-tax gains and an insignificant amount during the three and nine months ended September 30, 2007, respectively, related to mark-to-market adjustments on derivative contracts that do not qualify for hedge accounting. These amounts, which relate to the balances included within undesignated in the above table, primarily represent the mark-to-market impacts of derivative contracts used in Duke Energy Ohio's hedging of a portion of the economic value of its generation assets in Commercial Power.

Commodity Cash Flow Hedges. As of September 30, 2008, approximately $30 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 nine months ended September 30, 2008 and 2007, respectively. The amount recognized for transactions that no longer qualified as cash flow hedges was insignificant for the three and nine months ended September 30, 2008 and September 30, 2007, respectively.

See Note 13 for additional information related to the fair value of Duke Energy Ohio's derivative instruments.

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11. 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 Duke Energy Ohio and Duke Energy Kentucky to meet additional 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 nine months ended September 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. Less than $1 million and approximately $2 million of the rate reduction was passed through to customers during the three and nine months ended both September 30, 2008 and 2007, respectively.
- The FERC approved the merger without conditions.

Restrictions on the Ability of Duke Energy Ohio to Make Dividends, Advances and Loans to Duke Energy Corporation. As a condition of approving the merger of Duke Energy and Cinergy, the state utility commissions imposed conditions (the Merger Conditions) on the ability of Duke Energy Ohio and Duke Energy Kentucky to transfer funds to Duke Energy through loans or advances, as well as restricted amounts available to pay dividends to Duke Energy. Duke Energy Ohio will not declare and pay dividends out of capital or unearned surplus without the prior authorization of the PUCO. Duke Energy Kentucky is required to pay dividends solely out of retained earnings and to maintain a minimum of 35% equity in its capital structure. At September 30, 2008, Duke Energy Ohio had restricted net assets of approximately $6.3 billion that may not be transferred to Duke Energy without appropriate approval based on the aforementioned Merger Conditions.

Franchised Electric and Gas

Rate Related Information. The KPSC approves rates for retail electric and gas services within the Commonwealth of Kentucky. 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 (see "Commercial Power" below). 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' Counsel (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.

In October 2007, the PUCO issued its ruling affirming the MBSSO, with certain modifications, and maintained 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 non-residential 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

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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 October 2007 decision. Additionally, Duke Energy Ohio cannot predict the outcome of the MBSSO rider appeal.

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 (MRO) at the same time. The MRO is a price determined through a competitive bidding process. If a MRO price is approved, the utility would blend in the MBSSO or ESP price with the MRO 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 a 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 designated generating assets to an EWG absent PUCO approval.

On July 31, 2008, Duke Energy Ohio filed 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, renewables and energy efficiency portfolio standards established by SB 221.

On October 27, 2008, Duke Energy Ohio filed a Stipulation and Recommendation (Stipulation) for consideration by the PUCO regarding Duke Energy Ohio's July 31, 2008 ESP filing. The Stipulation reflects agreement on all but two issues in this proceeding and is filed with the support of most of the parties to this proceeding. In addition to the Stipulation, the ability for residential governmental aggregation customers to avoid certain charges and to receive a shopping credit will be presented to the PUCO for a ruling. Parties to this proceeding who do not support the Stipulation may litigate any, or all, issues.

The Stipulation agrees to a net increase in base generation revenues of approximately $36 million, $74 million and $98 million in 2009, 2010 and 2011, respectively, including termination of the residential and non-residential RTC. Such amounts result in a residential net rate increase of 2% in 2009 and in 2010, and a non-residential net rate increase of 2% in 2009, 2010 and 2011. The Stipulation also allows the recovery of expenditures incurred to deploy SmartGrid infrastructure modernization technology on the distribution system. The recovery of such expenditures, net of savings, is subject to an annual residential revenue cap. Further, the Stipulation allows for the implementation of a new energy efficiency compensation model, referred to as Save-A-Watt, to achieve the energy efficiency mandate

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pursuant to the recent electric energy legislation. The criteria customers must meet to be exempt from Duke Energy Ohio's program will also be presented to the PUCO for a ruling in this case. Also, under the Stipulation, Duke Energy Ohio may defer up to $50 million of certain operation and maintenance costs incurred at the W.C. Beckjord generating station and amortize such costs over a three-year period.

The PUCO will consider the Stipulation and hear evidence beginning on November 10, 2008.

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. On September 16 and 19, 2008 respectively, OCC and OPAE filed their notices of appeal to the Ohio Supreme Court opposing the residential rate design issue.

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. The rate case test period may be updated to reflect certain expenses, such as costs related to storm damage.

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 and continues to utilize tracking mechanisms in its billed rates to customers. Duke Energy Kentucky and the KPSC appealed these cases to the Kentucky Court of Appeals. In November 2008, the Kentucky Court of Appeals ruled that the KPSC had no legal authority to approve tracker recovery of gas main replacement costs prior to 2005. Duke Energy Kentucky is evaluating this ruling and cannot predict the outcome of these proceedings.

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Energy Efficiency. On July 11, 2007, the PUCO approved Duke Energy Ohio's Demand Side Management/Energy Efficiency Program (DSM Program). A series of DSM 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 program costs are 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. Duke Energy Ohio filed the Save-A-Watt Energy Efficiency Plan as part of its ESP filed with the PUCO on July 31, 2008 (discussed above). A Stipulation and Recommendation for consideration by the PUCO regarding Duke Energy Ohio's ESP filing, including implementation of Save-A-Watt, was filed on October 27, 2008. The ESP hearing occurred on November 10, 2008. A decision on the stipulation is expected by the end of the year.

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. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level.

Other Matters

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.

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.

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. Duke Energy Ohio does not believe the resource adequacy requirement will have a material impact on its consolidated results of operations, cash flows or financial position.

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

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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 to January 6, 2009. At this time, Duke Energy Ohio does not believe the establishment of the Midwest ASM will have a material impact on its consolidated results of operations, cash flows or financial position.

Commercial Power

Reported results for Commercial Power are subject to volatility due to the over- or under-collection of certain costs, including fuel and purchased power, since Commercial Power is not subject to regulatory accounting pursuant to SFAS No. 71. In addition, Commercial Power could be impacted by certain of the regulatory matters discussed above, including the Duke Energy Ohio electric rate filings.

FERC 203 Application. On April 23, 2008 (supplemented on May 6, 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 FERC filing, if approved, does not obligate Duke Energy to make the transfer of the electric generating facilities, and does not impact Duke Energy Ohio's current rates. On October 10, 2008, Duke Energy Ohio and affiliates filed a notice with the FERC reporting that Duke Energy Ohio is in settlement discussions with all parties in the Ohio proceeding regarding Duke Energy Ohio's application to establish an ESP, as discussed above. Duke Energy Ohio advised the FERC that it believes that in light of those discussions good cause exists for the FERC to extend the time to consider Duke Energy Ohio's Section 203 application. On October 17, 2008, the FERC issued an order extending the time for the FERC to act on the application by 180 additional days, and ordered Duke Energy Ohio to inform the FERC of the status of settlement discussions by November 16, 2008. The settlement in Ohio has been agreed to by most parties and was filed with the PUCO on October 27, 2008. Pursuant to the settlement, if approved by the PUCO, Duke Energy Ohio agrees to withdraw that portion of its application for approval related to the transfer of its generating facilities designated to serve Ohio customers. Acceptance of the settlement by the PUCO would constitute its approval of the transfer for the remaining generating facilities.

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 during the years 2008-2011 are at risk, as Duke Energy Ohio planned to supply capacity to this market. On July 11, 2008, Duke Energy Ohio filed a response to the complaint with the FERC. On September 19, 2008, the FERC issued an Order denying the Buyer's complaint. The FERC dismissed the RPM Buyers' complaint, finding that, for the transition auctions, no party violated PJM's tariff and the prices determined during the auctions were in accordance with the tariff provisions governing the auctions. On October 20, 2008, the RPM buyers filed a Request for Rehearing with the FERC that raised the same issues as in the initial complaint that was denied by the FERC.

12. Commitments and Contingencies

Environmental

Duke Energy Ohio 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 Duke Energy Ohio.

Remediation Activities. Duke Energy Ohio and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Ohio operations, sites formerly owned or used by Duke Energy Ohio 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, Duke Energy Ohio or its affiliates could potentially be held

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responsible for contamination caused by other parties. In some instances, Duke Energy Ohio 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. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

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. Three of six coal-fired generating facilities in which Duke Energy Ohio 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. Oral argument is scheduled for December 2, 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 Duke Energy Ohio 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 NO_x emissions and annual SO_2 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 SO_2. Phase 2 was to begin in 2015 for both NO_x and SO_2. 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. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. A decision is pending on that petition. Subsequent to the filing of the rehearing petitions, the D.C. Circuit ordered all Petitioners (including Duke Energy) to file briefs on the petition for rehearing. The D.C. Circuit directed the parties to address whether any party is seeking vacatur of CAIR, and whether the Court should stay its mandate until the EPA promulgates a revised rule. Duke Energy has responded to the request accordingly. The D.C. Circuit's decision creates uncertainty regarding future NO_x and SO_2 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 it decides whether to grant rehearing. Duke Energy Ohio's plan had been to spend approximately $150 million between 2008 and 2012 to comply with Phase 1 of CAIR. It has not been determined how the court's decision will affect these planned expenditures but each of the states in which Duke Energy Ohio operates is considering adopting state regulations to address the court's decision. Duke Energy Ohio did not expect to incur any significant costs for complying with Phase 2 of CAIR. Duke Energy Ohio receives partial recovery of depreciation and financing costs related to environmental compliance projects for 2005-2008 through its RSP (see Note 11).

Duke Energy Ohio is unable to estimate the costs to comply with any new rule the EPA or states may issue as a result of this decision. See Note 8 for a discussion of the impacts 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. The U.S. EPA and the Utility Air Regulatory Group have requested that the U.S. Supreme Court review the D.C. Circuit's 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, Duke Energy Ohio 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. Duke Energy Ohio currently estimates that it will spend approximately $50 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.

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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 $8 million as of both September 30, 2008 and December 31, 2007. These accruals represent Duke Energy Ohio's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

New Source Review (NSR). In 1999-2000, the U.S. Department of Justice (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 SO_2, NO_x and particulate matter. The complaints seek injunctive relief to require installation of pollution control technology on various generating units that allegedly violated the CAA, and unspecified civil penalties in amounts of up to $32,500 per day for each violation. Two of Duke Energy Ohio's plants have been subject to these allegations. Duke Energy Ohio 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 Duke Energy Ohio alleging various violations of the CAA at Duke Energy Ohio's W.C. Beckjord and Miami Fort Stations. 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. Additionally, the plaintiffs had claimed that Duke Energy Ohio 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 Duke Energy Ohio with respect to this allegation and it will be considered during the February 2009 remedy phase as well.

Duke Energy Ohio has been informed by Dayton Power and Light (DP&L) that in June 2000, the EPA issued a Notice of Violation (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. The parties reached an agreement to settle this matter in the form of a consent decree which was submitted for comment to the EPA and ultimately approved and entered by the court on October 23, 2008. The consent decree will not have a material adverse effect on Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

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, 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. Briefing in that case is under way. At this time, Duke Energy Ohio cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) 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

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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 CO_2 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 CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 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 Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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, Duke Energy Ohio cannot predict whether the outcome of this matter will have a material impact on its consolidated results of operations, cash flows or financial position. Duke Energy Ohio intends to defend this lawsuit vigorously in court.

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 recusal of one of the judges on the Fifth Circuit panel, the Court has scheduled the second oral argument for the week of November 3, 2008. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio 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 Racketeer Influenced and Corrupt Organizations (RICO) statutes. Defendants have again moved to dismiss the claims. It is not possible to predict with certainty whether Duke Energy Ohio will incur any liability or to estimate the damages, if any, that Duke Energy Ohio might incur in connection with this matter.

Asbestos-related Injuries and Damages Claims. Duke Energy Ohio has been named as a defendant or co-defendant in lawsuits related to asbestos at its electric generating stations. The impact on Duke Energy Ohio'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 Ohio's 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, Duke Energy Ohio 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.

Other Litigation and Legal Proceedings. Duke Energy Ohio 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. Duke Energy Ohio 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.

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

Other Commitments and Contingencies

General. Duke Energy Ohio 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.

13. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Ohio adopted SFAS No. 157, "*Fair Value Measurements*" (SFAS No. 157). Duke Energy Ohio'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 Duke Energy Ohio 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 in the U.S. 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 Duke Energy Ohio 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.

Duke Energy Ohio 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:

Level 1 inputs—unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Ohio 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. Duke Energy Ohio 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 Duke Energy Ohio, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Ohio 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, Duke Energy Ohio may elect to measure certain financial instruments at fair value in accordance with this standard.

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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 Duke Energy Ohio's Consolidated Balance Sheets at fair value at September 30, 2008. Amounts presented in the table below exclude cash collateral amounts which are disclosed separately in Note 1.

	Total Fair Value Amounts at September 30, 2008	Level 1	Level 2	Level 3
	(in millions)			
Description				
Derivative assets	$ 133	$ 10	$—	$123
Derivative liabilities	$(112)	$(25)	$ (2)	$ (85)

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 September 30, 2008	
Balance at July 1, 2008	$ 29
Total pre-tax realized or unrealized gains included in earnings:	
Revenue, non-regulated electric and other	10
Fuel used in electric generation and purchased power—non-regulated	4
Total pre-tax gains included in other comprehensive income	9
Net purchases, sales, issuances and settlements	(14)
Balance at September 30, 2008	$ 38
Nine Months Ended September 30, 2008	
Balance at January 1, 2008	$ (22)
Total pre-tax realized or unrealized gains (losses) included in earnings:	
Revenue, non-regulated electric and other	(14)
Fuel used in electric generation and purchased power—non-regulated	105
Net purchases, sales, issuances and settlements	(31)
Balance at September 30, 2008	$ 38
Pre-tax amounts included in the Consolidated Statements of Operations related to Level 3 measurements outstanding at September 30, 2008:	
Revenue, non-regulated electric and other	$ (4)
Fuel used in electric generation and purchased power—non-regulated	62
Total	$ 58

The valuation method of the primary fair value measurements disclosed above is as follows:

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 Duke Energy Ohio classifies as Level 1 measurements.

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14. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Ohio subsequent to September 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 13 for a discussion of Duke Energy Ohio's adoption of SFAS No. 157.

SFAS No. 159. Refer to Note 13 for a discussion of Duke Energy Ohio's adoption of SFAS No. 159.

FSP No. FIN 39-1. Refer to Notes 1 and 10 for a discussion of Duke Energy Ohio's adoption of FSP No. FIN 39-1.

The following new accounting standards have been issued, but have not yet been adopted by Duke Energy Ohio as of September 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 Duke Energy Ohio, 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 Duke Energy Ohio 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. 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. Duke Energy Ohio 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 Duke Energy Ohio's consolidated results of operations, cash flows or financial position.

15. Income Taxes and Other Taxes

The taxable income of Duke Energy Ohio is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Ohio 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 Duke Energy Ohio would incur if Duke Energy Ohio were a separate company filing its own tax return as a C-Corporation.

At September 30, 2008, Duke Energy Ohio has approximately $46 million recorded for unrecognized tax benefits and no portion of the total unrecognized tax benefits, if recognized, would affect the effective tax rate. Additionally, at September 30, 2008, Duke Energy Ohio has approximately $7 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 Duke Energy Ohio will reflect an approximate $35 million reduction in unrecognized tax benefits within the next twelve months due to expected settlements.

Duke Energy Ohio 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

DUKE ENERGY OHIO, INC.

Notes To Unaudited Consolidated Financial Statements—(Continued)

The effective tax rate for the three months ended September 30, 2008 was approximately 28% as compared to the effective tax rate of approximately 37% for the same period in 2007. The decrease in the effective tax rate for the three months ended September 30, 2008 is due primarily to adjustments related to prior year tax returns. The effective tax rate for the nine months ended September 30, 2008 was approximately 37% as compared to the effective tax rate of approximately 38% for the same period in 2007.

As of September 30, 2008 and December 31, 2007, approximately $80 million and $27 million, respectively, of deferred income taxes were included in Other within Current Assets in the Consolidated Balance Sheets. At September 30, 2008, this balance exceeded 5% of total current assets.

Excise Taxes. Certain excise taxes levied by state or local governments are collected by Duke Energy Ohio from its customers. These taxes, which are required to be paid regardless of Duke Energy Ohio's ability to collect from the customer, are accounted for on a gross basis. When Duke Energy Ohio 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. Duke Energy Ohio's excise taxes accounted for on a gross basis and recorded as Operating Revenues in the accompanying Consolidated Statements of Operations were approximately $27 million for both the three months ended September 30, 2008 and 2007, respectively, and approximately $95 million and $93 million for the nine months ended September 30, 2008 and 2007, respectively.

16. 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 September 30, 2008 and 2007. Components of other comprehensive income and total comprehensive income for the nine months ended September 30, 2008 and 2007 are presented in the Consolidated Statements of Common Stockholder's Equity and Comprehensive Income.

Total Comprehensive (Loss) Income

	Three Months Ended September 30,	
	2008	2007
	(in millions)	
Net (Loss) Income	$(54)	$118
Other comprehensive income (loss)		
Cash flow hedges[a]	11	(7)
Pension and OPEB-related Adjustments to AOCI[b]	2	1
Other comprehensive income (loss), net of tax	13	(6)
Total Comprehensive (Loss) Income	$(41)	$112

(a) Cash flow hedges, net of $6 million tax expense and $4 million tax benefit for the three months ended September 30, 2008 and 2007, respectively.
(b) Pension and OPEB-related Adjustments to AOCI, net of an insignificant tax expense for each of the three months ended September 30, 2008 and 2007.

17. Subsequent Events

For information on subsequent events related to debt and credit facilities, regulatory matters and commitments and contingencies, see Notes 5, 11 and 12, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

Management's Discussion and Analysis should be read in conjunction with the Unaudited Consolidated Financial Statements.

Duke Energy Ohio, Inc. (Duke Energy Ohio) is a wholly-owned subsidiary of Cinergy Corp. (Cinergy). Cinergy is a wholly-owned subsidiary of Duke Energy Corporation (Duke Energy). Duke Energy Ohio's principal lines of business include generation, transmission and distribution of electricity, the sale of and/or transportation of natural gas, and energy marketing.

BASIS OF PRESENTATION

The results of operations and variance discussion for Duke Energy Ohio is presented in a reduced disclosure format in accordance with General Instructions H(2) of Form 10-Q.

DUKE ENERGY OHIO

	Nine Months Ended September 30,		
	2008	2007	Increase (Decrease)
	(in millions)		
Operating revenues	$2,604	$2,634	$(30)
Operating expenses	2,224	2,243	(19)
Gains (losses) on sales of other assets and other, net	46	(12)	58
Operating income	426	379	47
Other income and expenses, net	23	22	1
Interest expense	72	73	(1)
Income before income taxes	377	328	49
Income tax expense	141	124	17
Net income	$ 236	$ 204	$ 32

The $32 million increase in Duke Energy Ohio's Net Income was primarily due to the following factors:

Operating Revenues. The decrease was primarily due to:

- A $36 million decrease in volumes of coal sales due to expiration of contracts,
- A $22 million decrease in retail electric revenues primarily due to lower retail pricing principally related to timing of collections on the Fuel and Purchased Power rider of the Rate Stabilization Plan (RSP), net of increased amortization of purchase accounting valuation liability of the RSP,
- A $21 million decrease due to milder weather in 2008 compared to 2007, and
- A $19 million decrease in wholesale electric revenues due to lower generation volumes primarily resulting from higher plant outages and lower hedge realization in 2008 compared to 2007.

Partially offsetting these decreases were:

- A $23 million increase in regulated fuel revenues driven mainly by higher natural gas costs,
- A $13 million increase due to implementation of new gas rates in Ohio,
- A $9 million increase related to the Demand Side Management (DSM) rider implemented in the third quarter of 2007, and
- An $8 million increase in Ohio electric base transmission due to a change in the Transmission Cost Recovery rider.

Operating Expenses. The decrease was primarily due to:

- A $52 million decrease due primarily to lower sulfur dioxide emission allowance expenses due to installation of flue gas desulphurization equipment and lower generation volumes resulting from increased plant outages in 2008 as compared to 2007,
- A $36 million decrease in expenses associated with coal sales due to expiration of contracts,

- A $27 million decrease in fuel expense due to mark-to-market gains on non-qualifying fuel hedge contracts of $73 million in 2008 compared to gains of $46 million in 2007,
- A $20 million decrease in other post-employment benefits due to an adjustment to the liability recorded for these benefits,
- A $13 million decrease in corporate governance and administrative costs, partially offset by higher plant maintenance expenses resulting from increased plant outages in 2008 as compared to 2007,
- A $13 million decrease in short-term incentive costs, and
- A $7 million decrease in retail fuel and purchased power expenses due to realized gains from the settlement of certain fuel contracts, partially offset by higher purchased power as a result of increased plant outages.

Partially offsetting these decreases were:

- An $82 million impairment of emission allowances due to the invalidation of the Clean Air Interstate Rule in July 2008,
- A $34 million increase due to storm restoration work for damage caused by Hurricane Ike,
- A $23 million increase in regulated fuel expense primarily due to higher natural gas costs, and
- A $12 million increase in regulatory amortization of the Ohio DSM costs and regulatory transition charge.

Gains (Losses) on Sales of Other Assets and Other, net. The increase is attributable to gains on sales of emission allowances in 2008 compared to losses on sales of emission allowances in 2007. Gains in 2008 were primarily a result of sales of zero cost basis emission allowances. Losses in 2007 were a result of sales of emission allowances acquired in connection with Duke Energy's merger with Cinergy in April 2006 which were written up to fair value as part of purchase accounting.

Income Tax Expense. Income Tax Expense increased primarily as a result of higher pre-tax income.

MATTERS IMPACTING FUTURE RESULTS AND OTHER MATTERS

Duke Energy Ohio has approximately $440 million of auction rate pollution control bonds outstanding. The maximum auction rate for these pollution control bonds outstanding is 2.0 times one-month London Interbank Offered Rate (LIBOR). While Duke Energy Ohio intends to refund and refinance these tax exempt auction rate bonds, the timing of such refinancing transactions is uncertain and subject to market conditions.

Duke Energy Ohio evaluates the carrying amount of its recorded goodwill for impairment under the guidance of SFAS No. 142, "*Goodwill and Other Intangible Assets*". As the fair value of each of Duke Energy Ohio's reporting units exceeded their respective carrying values at August 31, 2008, Duke Energy Ohio did not record any impairment charges in the third quarter of 2008 as a result of its annual impairment test. However, in light of recent market and economic events, management is reassessing the potential for any impairments to recorded goodwill balances. These assessments are in their early stages and management cannot yet predict the outcome, but it is possible that the current assessments could result in goodwill impairments being recorded at one or more reporting units.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized, and reported, within the time periods specified by the Securities and Exchange Commission's (SEC) rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Duke Energy Ohio in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Duke Energy Ohio has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended September 30, 2008 and other than the third quarter financial system changes described below, have concluded that no change has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

During the third quarter of 2008, Duke Energy Ohio converted the general ledger and consolidation systems to those currently used by other Duke Energy operations. Additionally, Duke Energy Ohio implemented a new income tax system and upgraded the asset accounting system. These system changes are a result of an evaluation of previous systems and related processes to support evolving operational needs, and are not the result of any identified deficiencies in the previous systems. Duke Energy Ohio reviewed the implementation effort as well as the impact on Duke Energy Ohio's internal control over financial reporting and where appropriate, made changes to internal controls over financial reporting to address these system changes.

Item 1. Legal Proceedings

For information regarding legal proceedings that became reportable events or in which there were material developments in the third quarter of 2008, see Note 11 to the Consolidated Financial Statements, "Regulatory Matters" and Note 12 to the Consolidated Financial Statements, "Commitments and Contingencies."

Item 1A. Risk Factors

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part I, "Item 1A. Risk Factors" in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect Duke Energy Ohio's financial condition or future results. In addition to the risk factors included in Duke Energy Ohio's Annual Report on Form 10-K for the year ended December 31, 2007, Duke Energy Ohio has identified the following risk factor as of September 30, 2008:

Current Levels of Market Volatility are Unprecedented

The capital and credit markets have been experiencing extreme volatility and disruption. In recent months, the volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on stock prices and credit capacity for certain issuers. If current levels of market disruption and volatility continue or worsen, Duke Energy Ohio may be forced to meet its other liquidity needs by further drawing upon contractually committed lending agreements primarily provided by global banks, although there is no assurance that the commitments made by lenders under Duke Energy's master credit facility will be available if needed due to the recent turmoil throughout the financial services industry. This could require Duke Energy Ohio to seek other funding sources. However, under such extreme market conditions, there can be no assurance other funding sources would be available or sufficient.

Additional risks and uncertainties not currently known to Duke Energy Ohio or that Duke Energy Ohio currently deems to be immaterial also may adversely affect Duke Energy Ohio's financial condition and/or results of operations.

Item 6. Exhibits

(a) Exhibits

Exhibits filed or furnished herewith are designated by an asterisk (*).

Exhibit Number	
*31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The total amount of securities of the registrant or its subsidiaries authorized under any instrument with respect to long-term debt not filed as an exhibit does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees, upon request of the Securities and Exchange Commission, to furnish copies of any or all of such instruments to it.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DUKE ENERGY OHIO, INC.

Date: November 13, 2008

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and
Chief Financial Officer

Date: November 13, 2008

/s/ STEVEN K. YOUNG

Steven K. Young
Senior Vice President and
Controller

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James E. Rogers, certify that:

1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2008

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David L. Hauser, certify that:

1) I have reviewed this quarterly report on Form 10-Q of Duke Energy Ohio, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2008

/s/ David L. Hauser

David L. Hauser
Group Executive and
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Rogers, Chief Executive Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ JAMES E. ROGERS

James E. Rogers
Chief Executive Officer
November 13, 2008

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Duke Energy Ohio, Inc. ("Duke Energy Ohio") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David L. Hauser, Group Executive and Chief Financial Officer of Duke Energy Ohio, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Duke Energy Ohio.

/s/ DAVID L. HAUSER

David L. Hauser
Group Executive and Chief Financial Officer
November 13, 2008