Duke Energy®

DUKE ENERGY CORPORATION
139 East Fourth St.
PO Box 960
Cincinnati, OH 45201-0960

RECEIVED
MAR 31 2008
PUBLIC SERVICE COMMISSION

VIA OVERNIGHT MAIL

March 27, 2008

Ms. Joyce Speer
Public Service Commission
Commonwealth of Kentucky
211 Sower Boulevard
Frankfort, KY 40602-0615

Re: In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control, Case No. 2005-0228.

Dear Ms. Speer:

Pursuant to the Commission's Orders in Case No. 2005-00228, I have enclosed Duke Energy Kentucky, Inc.'s financial statements dated December 31, 2007. Please sign and date the attached copy and return to me in the envelope provided.

If you have any questions regarding the financial statements, please contact Ms. Peggy A. Laub, Manager, USFE&G Midwest Accounting at (513) 287-4291.

Very truly yours,

Gwen Pate

Gwen Pate
Director of General Accounting - Midwest

Enclosure

cc: Ms. Peggy A. Laub
Mr. Rocco D'Ascenzo

Duke Energy of Kentucky

December 31, 2006

Financial Statements

and Auditors' Report

Deloitte

Deloitte & Touche LLP
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USA

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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

DUKE ENERGY KENTUCKY
STATEMENTS OF OPERATIONS

	Years Ended December 31, 2006	Years Ended December 31, 2005
	(in thousands)	
Operating Revenues		
Electric	**$ 267,917**	$ 239,801
Gas	**136,535**	148,326
Total Operating Revenues	**404,452**	388,127
Operating Expenses		
Natural gas and petroleum products purchased	**92,105**	100,663
Operation, maintenance, and other	**115,911**	67,292
Fuel used in electric generation and purchased power	**116,314**	168,158
Depreciation and amortization	**37,750**	20,625
Property and other taxes	**10,067**	4,955
Total Operating Expenses	**372,147**	361,693
Operating Income	**32,305**	26,434
Other Income and Expenses, net	**2,209**	2,947
Interest Expense	**15,776**	6,903
Income Before Income Taxes	**18,738**	22,478
Income Tax Expense	**8,015**	7,833
Net Income	**$ 10,723**	$ 14,645

See Notes to Financial Statements

DUKE ENERGY KENTUCKY
BALANCE SHEETS

ASSETS	December 31, 2006	December 31, 2005
	(in thousands)	
Current Assets		
Cash and cash equivalents	$ 6,593	$ 9,876
Receivables (net of allowance for doubtful accounts of $242 at December 31, 2006 and $162 at December 31, 2005)	32,768	37,452
Inventory	29,002	10,767
Other	8,555	4,500
Total current assets	76,918	62,595
Investments and Other Assets		
Intangible assets	12,470	1,093
Other	1,541	560
Total investments and other assets	14,011	1,653
Property, Plant, and Equipment		
Cost	1,451,463	634,079
Less accumulated depreciation and amortization	599,625	188,614
Net property, plant, and equipment	851,838	445,465
Regulatory Assets and Deferred Debits		
Deferred debt expense	5,827	3,111
Other	31,739	5,390
Total regulatory assets and deferred debits	37,566	8,501
Total Assets	$ 980,333	$ 518,214

See Notes to Financial Statements

DUKE ENERGY KENTUCKY
BALANCE SHEETS

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

		December 31, 2006		December 31, 2005
		(in thousands)		
Current Liabilities				
Accounts payable	$	**45,423**	$	53,021
Notes payable and commercial paper		**42,603**		29,777
Taxes accrued		**6,603**		6,769
Interest accrued		**2,808**		1,374
Current maturities of long-term debt		**1,318**		1,233
Other		**10,827**		8,965
Total current liabilities		**109,582**		101,139
Long-term Debt		**283,192**		105,503
Deferred Credits and Other Liabilities				
Deferred income taxes		**149,016**		52,800
Investment tax credit		**6,634**		2,373
Accrued pension and other postretirement benefit costs		**36,497**		19,354
Regulatory liabilities		**29,432**		29,038
Asset retirement obligations		**8,266**		6,306
Other		**8,366**		5,242
Total deferred credits and other liabilities		**238,211**		115,113
Common Stockholder's Equity				
Common stock – $15.00 par value, 1,000,000 shares authorized and 585,333 shares outstanding at December 31, 2006 and December 31, 2005		**8,780**		8,780
Paid-in capital		**164,344**		23,760
Retained earnings		**176,965**		166,242
Accumulated other comprehensive loss		**(741)**		(2,323)
Total Common Stock Equity		**349,348**		196,459
Total Liabilities and Stockholder's Equity	**$**	**980,333**	$	518,214

See Notes to Financial Statements

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

	Common Stock	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	Tota[illegible] Comm[illegible] Stockhol[illegible] Equi[illegible]
Balance at December 31, 2004	$ 8,780	$ 23,455	$ 161,562	$ -	$ (1,286)	$ 1[illegible]
Net income			14,645			
Other comprehensive income, net of tax effect of $608						
Minimum pension liability adjustment					(1,037)	([illegible]
Total comprehensive income						
Dividends on common stock			(9,965)			([illegible]
Contribution from parent company for reallocation of taxes		305				
Balance at December 31, 2005	$ 8,780	$ 23,760	$ 166,242	$ -	$ (2,323)	$ 1[illegible]
Net income			$ 10,723			$ [illegible]
Other comprehensive income, net of tax effect of ($1,011)						
Minimum pension liability adjustment					(767)	
Cash flow hedges				(741)		
Total comprehensive income						
Contribution from parent company for reallocation of taxes		523				
Adjustment due to SFAS No. 158 adoption					3,090	
Contribution from parent company for purchase of generating assets		140,061				1[illegible]
Balance at December 31, 2006	$ 8,780	$ 164,344	$ 176,965	$ (741)	$ -	$ 3[illegible]

See Notes to Financial Statements

DUKE ENERGY KENTUCKY
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2006	2005
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ 10,723	$ 14,645
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	37,750	20,625
(Gains) losses on sales of equity investments and other assets	(104)	51
Deferred income taxes	8,481	2,161
Regulatory asset/liability amortization	3,969	3,847
Accrued pension and postretirement benefit costs	4,113	2,718
Contribution to company sponsored pension plan	(2,330)	(1,861)
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	1,653	-
Receivables	4,684	(9,655)
Inventory	(1,556)	(2,267)
Other current assets	2,849	(4,215)
Increase (decrease) in:		
Accounts payable	(8,849)	14,757
Taxes accrued	(166)	7,340
Other current liabilities	2,545	2,191
Regulatory asset/liability deferrals	(4,016)	(5,459)
Other assets	8,466	1,957
Other liabilities	(6,804)	(2,578)
Net cash provided by operating activities	61,408	44,257
Cash Flows from Investing Activities		
Capital expenditures	(65,096)	(47,144)
Purchases of emission allowances	(23,289)	-
Sale of emission allowances	4,748	-
Net cash used in investing activities	(83,637)	(47,144)
Cash Flows from Financing Activities		
Issuance of long-term debt	193,728	-
Redemption of long-term debt	(76,939)	-
Notes payable and commercial paper	(93,454)	18,531
Dividends paid	-	(9,965)
Other	(4,389)	
Net cash provided by financing activities	18,946	8,566
Net (decrease) increase in cash and cash equivalents	(3,283)	5,679
Cash and cash equivalents at beginning of year	9,876	4,197
Cash and cash equivalents at end of year	$ 6,593	$ 9,876
Supplemental Disclosures		
Cash paid during the period for:		
Interest (net of amount capitalized)	$ 13,913	$ 6,581
Income taxes	$ 5,950	$ (2,689)
Non-cash financing and investing activities:		
Equity contribution from parent company for acquisition of net generating assets	$ 140,061	$ -

See Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Nature of Operations and Basis of Consolidation

Duke Energy Kentucky (formerly The Union Light, Heat and Power Company), 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, formerly The Cincinnati Gas & Electric Company, an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp., a Delaware corporation organized in 1993.

On April 3, 2006, in accordance with their previously announced merger agreement, 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. As a result of the merger transactions, each outstanding share of Cinergy common stock was converted into 1.56 shares of Duke Energy common stock, 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.

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.

Inventory

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

	December 31, 2006	December 31, 2005
	(in thousands)	
Inventory		
Fuel for use in electric production	$ 9,074	$ -
Other materials and supplies	8,940	417
Gas stored for current use	10,988	10,350
Total Inventory	$ 29,002	$ 10,767

Cost-Based Regulation

Duke Energy Kentucky uses the same accounting policies and practices for financial reporting purposes as non-regulated companies under GAAP. However, sometimes actions by its regulators, the Federal Energy Regulatory Commission (FERC) and the state utility commission, result in accounting treatment different from that used by non-regulated companies. When this occurs Duke Energy Kentucky applies the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "*Accounting for the Effect 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 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. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery. 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.

Accounting for Risk Management and Hedging Activities and Financial Instruments

Duke Energy Kentucky 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 Balance Sheets at their fair value. Cash inflows and outflows related to derivative instruments, except those that contain financing elements and those related to investing activities, are a component of operating cash flows in the accompanying 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 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 Statements of Cash Flows.

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 Statements of Operations.

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 is 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 it is 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 2006 and 3.4% for 2005.

When Duke Energy Kentucky retires its 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 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 FASB Interpretation No. 47, "*Accounting for Conditional Asset Retirement Obligations*" (FIN 47), for conditional ARO's in which the timing or method of settlement are conditional on a future event that may or may not be within the control of Duke Energy Kentucky. 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.

Long-Lived Asset Impairments

Duke Energy Kentucky evaluates whether long-lived assets, including intangible assets, have been impaired when circumstances indicate the carrying value of those assets may not be recoverable. For such long-lived assets, 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 would generally require management to re-assess the cash flows related to the long-lived assets.

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.

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 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

Revenues for electric and gas service are recorded when delivered to customers. Customers are billed throughout the month as both gas and electric meters are read. Duke Energy Kentucky recognizes revenues for retail energy sales that have not yet been billed, but where gas or electricity has been consumed. Given the use of these systems and the fact that customers are billed monthly, Duke Energy Kentucky believes it is unlikely that materially different results will occur in future periods when these amounts are subsequently billed.

Unbilled revenues for Duke Energy Kentucky at December 31, 2006 and 2005 were $22 million and $27 million, respectively.

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 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 for the year ended December 31, 2006 was $1.4 million. The total amount of AFUDC included in the Statements of Operations was $.8 million in 2005.

Accounting For Purchases and Sales of Emission Allowances

Duke Energy Kentucky recognizes emission allowances in earnings as they are consumed or sold. Gains or losses on sales of recoverable emission allowances are included in the rate structure 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 emission allowances. Emission allowances are recorded as *Intangible assets* on the Balance Sheet. 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, Duke Energy Kentucky entered into a tax sharing agreement with Duke Energy, where the separate return method is used to allocate benefits to the subsidiaries whose investments or results of operations provide these tax 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. 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.

Segment Reporting

As a result of the merger with Duke Energy, effective in the second quarter of 2006, Duke Energy Kentucky adopted new business segments, and the segment performance measure has been changed to earnings before interest and taxes (EBIT) from continuing operations. As a result, certain prior period amounts have been retroactively adjusted to conform to the new segment presentation and measures.

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 Kentucky's defined business segments. SFAS No. 131 also establishes standards and related disclosures about the way the operating segments were determined, 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 Kentucky'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.

Reclassifications and Revisions

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

New Accounting Standards

The following new accounting standards were 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:

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 Income (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 is required to initially recognize the funded status of its allocated portion of Cinergy's defined benefit pension and other postretirement plans and to provide the required additional disclosures as of December 31, 2006 (see Note 16). Retrospective application is not permitted. The adoption of SFAS No. 158 recognition and disclosure provisions resulted in 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 impact on Duke Energy Kentucky'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 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. The measurement date requirement is effective for the year ending December 31, 2008, and early application is encouraged. Duke Energy Kentucky intends to adopt 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 for the three-month period between September 30, 2006 and December 31, 2006 will be recognized, net of tax, as a separate adjustment of retained earnings as of January 1, 2007. Additionally, changes in plan assets and plan obligations between September 30, 2006 and December 31, 2006 not related to net periodic benefit cost will be recognized, net of tax, as an adjustment to OCI.

The following new accounting standards were adopted by Duke Energy Kentucky during the year ended December 31, 2005 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

FIN 47 "Accounting for Conditional Asset Retirement Obligations"). 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 Kentucky as of December 31, 2005, and the adoption of FIN 47 did not have a material impact on Duke Energy Kentucky'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 Kentucky as of December 31, 2006:

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. Duke Energy Kentucky does not anticipate the adoption of SFAS No. 155 will have any material impact on its 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, "*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. Duke Energy Kentucky does not anticipate the adoption of SFAS No. 156 will have any material impact on its consolidated results of operations, cash flows or financial position.

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 consolidated 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 consolidated 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.

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 its 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 will implement this new accounting standard effective January 1, 2007. The implementation will impact a variety of balance sheet line items, including Deferred income taxes, Taxes accrued, and Other Liabilities. Upon implementation of FIN 48, Duke Energy Kentucky will reflect interest expense related to taxes as interest expense, in Other Income and Expenses, net in the Statement of Operations. In addition, accounting for this standard after January 1, 2007 will involve 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 would impact income tax expense and interest expense in the Statement of Operations, with offsetting impacts to the balance sheet line items described above. Duke Energy Kentucky is still in the process of reviewing the impacts of this standard and expects the adjustment will be immaterial.

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 is effective for Duke Energy Kentucky as of January 1, 2007 and will be applied retrospectively for all financial statements presented. Duke Energy Kentucky does not anticipate the adoption of FSP No. AUG AIR-1 will have any material impact on its consolidated results of operations, cash flows or financial position.

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 is effective for Duke Energy Kentucky beginning January 1, 2007. Duke Energy Kentucky does not anticipate the adoption of EITF No. 06-3 will have any material impact on its results of operations, cash flows or financial position.

2. Duke Energy/Cinergy Merger

On April 3, 2006, the previously announced 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 combines the Duke Energy and Cinergy regulated franchises as well as deregulated generation in the Midwestern United States (Midwest). See Note 5 for discussion of regulatory impacts of the merger. In connection with the merger, Duke Energy issued 1.56 shares of Duke Energy common stock for each outstanding share of Cinergy common stock, which resulted in the issuance of approximately 313 million shares of Duke Energy common stock. 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 is valued at approximately $9.1 billion.

3. 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. The Kentucky Public Service Commission (KPSC) and the FERC had earlier issued orders approving aspects of the transaction. See Note 5 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

As part of this transaction, Duke Energy Ohio and Duke Energy Kentucky terminated the long-term wholesale power contract under which Duke Energy Ohio had previously supplied power to Duke Energy Kentucky. Further, Duke Energy Ohio also proposed to supply and Duke Energy Kentucky agreed to purchase back-up power from Duke Energy ~~Ohio for planned and unplanned~~ outages at the East Bend and Miami Fort plants through December 31, 2009 pursuant to a draft contract. The parties never executed ~~this draft contract and~~ Duke Energy Kentucky currently purchases back-up power, when needed, through the Midwest ISO energy markets. Under the proposed settlement in its electric rate case (see Note 5) , Duke Energy Kentucky will continue to use its best efforts to procure back-up power supply and to obtain FERC approval, if necessary, as soon as possible. The revenue increase in the proposed settlement recovers all demand charges for back-up power. Effective on and after January 1, 2007, Duke Energy Kentucky will recover energy charges for back-up power consistent with the KPSC's fuel adjustment cost regulations. Duke Energy Kentucky filed during the first quarter 2007, a least cost back-up supply plan with the KPSC. The KPSC issued an order approving the back up supply plan which eliminates risks of recovery limits that may have resulted under the terms of the back-up supply plan proposed with the transfer of these assets.

4. Business Segments

In conjunction with the merger with Duke Energy, effective with the second quarter of 2006, Duke Energy Kentucky adopted the new business segment that management believes properly aligns the various operations of Duke Energy Kentucky with how the chief operating decision maker views the business. Prior period segment information has been recast to conform to the new segment structure. Accordingly, Duke Energy Kentucky has the following reportable business segment:

- Franchised Electric and Gas consists of regulated electric generation and regulated electric and gas transmission and distribution systems

Duke Energy Kentucky's chief operating decision maker regularly reviews financial information about the business unit in deciding how to allocate resources and evaluate performance. The business unit is considered a reportable segment under SFAS No. 131. There is no aggregation within Duke Energy Kentucky's defined business segment.

Prior to the merger with Duke Energy, Duke Energy Kentucky operated a single business unit, Regulated, which was considered a reportable segment under SFAS No. 131:

- Regulated - consisted of Duke Energy Kentucky's regulated generation, transmission and distribution operations.

Franchised Electric and Gas plans, constructs, operates and maintains Duke Energy Kentucky's generation, transmission and distribution systems and delivers gas and electric energy to consumers.

The remainder of Duke Energy Kentucky's operations is presented as "Other." While it is not considered a business segment, Other primarily includes certain allocated corporate governance costs.

Management evaluates segment performance based on EBIT which represents all profits from continuing operations (both operating and non-operating) 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 segment EBIT.

Business Segment Data

	Unaffiliated Revenues	Segment EBIT/ Consolidated Income before Income Taxes	Depreciation and Amortization	Capital and Investment Expenditures	Segment Assets
		(in thousands)			
Year Ended December 31, 2006					
Franchised Electric	$ 404,452	$ 40,065	$ 37,749	$ 65,096	$ 980,131
Total reportable segment	404,452	40,065	37,749	65,096	980,131
Other	—	(8,742)	—	—	—
Interest expense	—	(16,602)	—	—	—
Interest income and other	—	3,192	—	—	—
Total consolidated	$ 404,452	$ 17,913	$ 37,749	$ 65,096	$ 980,131
Year Ended December 31, 2005					
Franchised Electric	$ 388,127	$ 34,132	$ 20,625	$ 47,144	$ 518,214
Total reportable segment	388,127	34,132	20,625	47,144	518,214
Other	—	(7,276)	—	—	—
Interest expense	—	(6,903)	—	—	—
Interest income and other	—	2,525	—	—	—
Total consolidated	$ 388,127	$ 22,478	$ 20,625	$ 47,144	$ 518,214

All of Duke Energy Kentucky's revenues are generated and its long-lived assets are invested domestically.

5. Regulatory Matters

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. (For further information see Note 1.)

Duke Energy Kentucky		**December 31, 2006**		**2005**
		(in thousands)		
Regulatory Assets				
Accrued Pension and Post Retirement	$	21,560	$	-
Merger Costs		4,453		1,453
Deferred Project Costs		1,312		611
Other		4,414		3,326
Total Regulatory Assets	$	31,739	$	5,390
Regulatory Liabilities				
Removal Costs	$	26,937	$	26,826
Amounts due from Customers – Income Taxes (1)		2,238		1,887
Other		257		325
Total Regulatory Liabilities	$	29,432	$	29,038
Authorized for Recovery (2)	$	6,906	$	1,770

(1) This amount is the net of amounts recorded in Regulatory Assets - Amounts due to Customers – Income Taxes and Regulatory Liabilities - Amounts due from Customers – Income Taxes

(2) As of December 31, 2006, these amounts are being recovered through rates charged to customers over periods ranging from 3-10 years.

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 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 Duke Energy Kentucky customers over five years, ending when new rates are established in the next rate case after January 1, 2008. As of December 31, 2006, Duke Energy Kentucky has returned $1 million to customers on this rate reduction.

In addition, the FERC approved the merger without conditions. In January 2006, Public Citizen's Energy Program, Citizens Action Coalition of Indiana, Inc., Ohio Partners for Affordable Energy and Southern Alliance for Clean Energy requested rehearing of the FERC approval. In February 2006, the FERC issued an order granting rehearing of FERC's order for further consideration. On February 5, 2007, after further consideration, the FERC issued an order dismissing the request for a rehearing.

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. At the present time, Duke Energy Kentucky cannot predict the timing or outcome of this litigation.

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. At this time, Duke Energy Kentucky cannot predict the outcome of this litigation.

Duke Energy Kentucky Electric Rate Case

In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates. The application, which sought an increase of approximately $67 million in revenue, or approximately 28 percent, was filed 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 December 2006, the KPSC approved a settlement agreement with all parties to this proceeding resolving all the issues raised. 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. In April 2007 the KPSC issued an order approving Duke Energy Kentucky's back-up supply plan.

Midwest ISO Revenue Sufficiency Guarantee (RSG)

In April 2006, the FERC issued an order on the Midwest ISO's revisions to its Transmission and Energy Markets Tariffs regarding its RSG. The FERC found that the Midwest ISO violated the tariffs when it did not charge RSG costs to virtual supply offers. The FERC, among other things, ordered the Midwest ISO to recalculate the rate and make refunds to customers, with interest, to reflect the correct allocation of RSG costs. Duke Energy Shared Services, on behalf of Duke Energy Kentucky, has filed a Request for Rehearing, and in October 2006, the FERC issued an order which, among other things, granted rehearing on the issue of refunds. The FERC stated that it would not require recalculation of the rates and, as such, refunds are no longer required. As a result, Duke Energy Kentucky does not believe that this issue will have a material effect on its financial position, cash flows or results of operations.

6. Joint Ownership of Generating Facilities

Duke Energy Kentucky and Dayton Power & Light jointly own an electric generating unit in Kentucky. As of December 31, 2006, Duke Energy Kentucky's share in the jointly-owned plant or facilities was as follows:

	Ownership Share	Property, Plant, and Equipment	Accumulated Depreciation	Construction Work in Progress
		(in thousands)		
Duke Energy Kentucky				
Production.				
East Bend Station[a]	69.0 %	$ 422,947	$ 216,900	$ 4,126

Duke Energy Kentucky's share of revenues and operating costs of the above jointly owned generating facilities are included within the corresponding line of the statement of operations.

7. Income Taxes

The following details the components of income tax expense from continuing operations:

	For Years Ended December 31, 2006	2005
	(in thousands)	
Current income taxes		
Federal	$ (292)	$ 5,811
State	(174)	681
Total current income taxes	(466)	6,492
Deferred income taxes		
Federal	$ 7,835	672
State	1,728	922
Total deferred income taxes	9,563	1,594
Investment tax credit amortization	(1,082)	(253)
Total income tax expense (benefit) presented in Consolidated Statements of Operations	$ 8,015	$ 7,833

Reconciliation of Income Tax Expense (Benefit) at the US Federal Statutory Tax Rate to the Actual Tax Expense (Benefit) from Continuing Operations (Statutory Rate Reconciliation)	For Years Ended December 31, 2006	2005
	(in thousands)	
Income tax expense (benefit), computed at the statutory rate of 35%	$ 6,558	$ 7,306
State income tax, net of federal income tax effect	1,010	$ 561
Depreciation & other PP&E related differences	(336)	(559)
ITC amortization	(812)	(253)
Other items, net	1,594	778
Total income tax expense (benefit) from continuing operations	$ 8,015	$ 7,833
Effective tax rate	42.8%	34.8%

During 2006 Duke Energy Kentucky recorded approximately $1.5 million of tax expense relating to certain deferred tax accounts. This adjustment is reflected in the Statutory Rate Reconciliation in the "Other items, net."

Net Deferred Income Tax Liability Components		**December 31, 2006**		**2005**
		(in thousands)		
Deferred credits and other liabilities	$	7,905	$	5,583
Other		1,614		1,790
Total deferred income tax assets		9,519		7,373
Investments and other assets		3,342		1,573
Accelerated depreciation rates		153,834		57,218
Regulatory assets and deferred debits		359		1,382
Total deferred income tax liabilities		157,535		60,173
Total net deferred income tax liabilities	$	(148,016)	$	(52,800)

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

Deferred Tax Liabilities		**December 31, 2006**		**2005**
		(in thousands)		
Current deferred tax assets, included in other current assets	$	1,000	$	-
Non-current deferred tax liabilities		(149,016)		(52,800)
Total net deferred income tax liabilities	$	(148,016)	$	(52,800)

Although the outcome of tax audits is uncertain, management believes that adequate provisions for income and other taxes have been made for potential liabilities resulting from such matters. Management is not aware of any issues for open tax years that upon final resolution are expected to have a material adverse effect on Duke Energy Kentucky's consolidated results of operations, cash flows or financial position.

As a result of the Duke Energy/Cinergy merger consummation, Cinergy and its subsidiaries entered into a new tax sharing agreement with Duke Energy, where the separate return method is used to allocate benefits to the subsidiaries whose investments or results of operations provide these tax benefits. This new agreement with Duke Energy supersedes the previous agreement between Cinergy and its subsidiaries.

8. Asset Retirement Obligations

Duke Energy Kentucky applies SFAS No. 143, which 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 property, plant and equipment increases.

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

Upon adoption of SFAS No. 143, Duke Energy Kentucky's regulated electric and regulated natural gas operations classified 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 on the Consolidated Balance Sheets was $27 million at both December 31, 2006 and 2005.

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.

As a result of the adoption of FIN 47 in 2005, net property, plant and equipment increased by approximately $1 million, regulatory liabilities decreased by approximately $5 million, and ARO liabilities increased by approximately $6 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.

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

	Years Ended December 31, 2006	2005
	(in thousands)	
Balance as of January 1,	$ 6,306	$ 0
Liabilities incurred due to new acquisitions	1,736	—
Accretion expense	481	—
Revisions in estimated cash flows	(257)	—
Adoption of FIN 47	—	6,306
Balance as of December 31,	$ 8,266	$ 6,306

9. Risk Management and Hedging Activities 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.

Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt and commercial paper. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposure to percentages of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters interest rate swaps to manage and mitigate interest rate risk exposure. Duke Energy Kentucky's interest rate derivative instruments and related ineffectiveness were not material to its results of operations, cash flows or financial position in 2006 and 2005.

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

10. Intangible Assets

The carrying amount and accumulated amortization of intangible assets are as follows:

	December 31, 2006	December 31, 2005
	(in thousands)	
Emission allowances	$ 12,470	$ -
Other	-	1,093
Total gross carrying amount	$ 12,470	$ 1,093

(a) Emission allowances do not have a contractual expiration date.

(b) Other represents intangible assets related to pensions which do not have a definitive life.

Emission allowances sold or consumed during the year ended December 31, 2006 was $11.3 million.

~~Amortization expense for intangible assets for Duke Energy Kentucky was immaterial for the years ended December 31, 2006 and 2005.~~

The table below shows the expected amortization expense for the next five years for intangible assets as of December 31, 2006. The expected amortization expense includes estimates of emission allowance 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, additional intangible asset acquisitions and other events.

2007	2008	2009	2010	2011
		(in thousands)		
$ 9,883	$1,275	$1,313	$0	$0

11. 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, 2006 and December 31, 2005 are as follows:

	December 31, 2006	December 31, 2005
	(in thousands)	
Accounts Receivable	$ 4,622	$ 6,567
Accounts Payable	$ 20,303	$ 26,815

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 for the twelve months ended December 31, 2006 and twelve months ended December 31, 2005 were as follows:

	December 31, 2006	December 31, 2005
	(in thousands)	
Corporate Governance and shared service expenses	**$ 51,072**	$ 30,700

12. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Kentucky sells certain of its accounts receivable and related collections through Cinergy Receivables Company, LLC (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, nearly all of their retail accounts receivable and related collections. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," (SFAS No. 140) and according Cinergy Corp. 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 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 Accounts Receivable in the accompanying Balance Sheets. In addition, Cinergy's investment in Cinergy Receivables constitutes a purchased beneficial interest (purchased right to receive specified cash flows, in our case residual cash flows), which is subordinate to the retained interests held by Duke Energy Kentucky.

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 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, 2006	Years Ended December 31, 2005
Anticipated credit loss rate	**1.0%**	1.1%
Discount rate on expected cash flows	**7.4%**	5.7%
Receivables turnover rate	**12.1%**	12.3%

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.

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

	Year Ended December 31, 2006		Year Ended December 31, 2005	
Receivables sold as of period end	$	51,748	$	71,613
Less: Retained interests		20,183		29,267
Net receivables sold as of period end	$	31,565	$	42,346
Sales during period				
Receivables sold	$	383,713	$	405,998
Loss recognized on sale		5,721		5,558
Cash flows during period				
Cash proceeds from sold receivables	$	387,040	$	391,729
Collection fees received		-		-
Return received on retained interests		2,784		2,172

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

13. Property, Plant and Equipment

	Estimated Useful Life	December 31, 2006	December 31, 2005
	(Years)	(in thousands)	
Land	-	$ 9,932	$ 4,636
Plant—Regulated			
Electric generation, distribution and transmission[a]	8-100	1,068,630	292,930
Natural gas transmission and distribution[a]	12-65	295,340	274,548
Other buildings and improvements[a]	15-45	3,919	8,352
Equipment	5-35	23,911	22,159
Construction in process	-	26,679	12,840
Other[a]	15	23,052	18,614
Total property, plant and equipment		1,451,463	634,079
Total accumulated depreciation—regulated[b]		(599,625)	(188,614)
Total net property, plant and equipment		$ 851,838	$ 445,465

(a) Includes capitalized leases: $17,857 for 2006 and $16,610 for 2005.
(b) Includes accumulated amortization of capitalized leases: $1,329 for 2006 and $1,009 for 2005.

14. *Debt and Credit Facilities*

Summary of Debt and Related Terms

	Weighted-Average Rate	Year Due	December 31, 2006	December 31, 2005
			(in thousands)	
Unsecured debt	6.0 %	2008-2036	$ 195,000	$ 95,000
Capital leases	5.3 %	2008-2015	13,513	12,327
Other debt[a]	3.9 %	2027	76,720	-
Money pool	5.4 %		42,603	29,777
Unamortized debt discount and premium, net			(723)	(591)
Total debt			327,113	136,513
Current maturities of long-term debt			(1,318)	(1,233)
Short-term notes payable			(42,603)	(29,777)
Total long-term debt			$ 283,192	$ 105,503

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

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 outstanding at Duke Energy Ohio. The Duke Energy Ohio debt was assumed by Duke Energy Kentucky as part of the recent transfer of generating assets from Duke Energy Ohio to Duke Energy Kentucky. Approximately $27 million of the floating rate debt was swapped to a fixed rate concurrent with closing.

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 Consolidated Balance Sheets. The amounts outstanding were $42,603 as of December 31, 2006 and $29,777 as of December 31, 2005. The change in the money pool from December 31, 2005 to December 31, 2006 is reflected as a $12,826 cash inflow in Notes payable and commercial paper within Net cash provided by (used in) financing activities on the Statement of Cash Flows.

	Annual Maturities as of December 31, 2006 (in thousands)
2007	$ 1,318
2008	21,463
2009	21,984
2010	1,118
2011	919
Thereafter	237,708
Total long-term debt (including current maturities)	$ 284,510

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

Duke Energy Kentucky receives support for its short-term borrowing needs from its parent entity, Cinergy, whose short-term borrowings consist primarily of unsecured revolving lines of credit and sale of commercial paper. During June 2006, Cinergy and its subsidiaries, including Duke Energy Kentucky, amended their multi-year syndicated $2.0 billion revolving credit facility to extend the expiration date from September 2010 to June 2011, to reduce costs, and to conform the terms to those found in the legacy Duke Energy facilities. In November 2006, the credit facility was decreased from $2.0 billion to $1.5 billion. This credit facility contains an option allowing borrowing up to the full amount of the facility on the day of initial expiration for up to one year and contains a covenant requiring the debt-to-total capitalization ratio to not exceed 65% for Cinergy and certain of its subsidiaries, including Duke Energy Kentucky. The credit facility also contains a $100 million borrowing sub limit for Duke Energy Kentucky.

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

Cinergy's credit agreement contains various financial and other covenants; however, Cinergy's credit agreement does not include material adverse change clauses or any covenants based on credit ratings. Failure to meet those covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of December 31, 2006, Cinergy 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 to 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.

15. 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

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 consolidated 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. 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, 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 (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 NOx and in 2010 for SO 2. Phase 2 begins in 2015 for both NOx 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 Kentucky 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 will have no material adverse effect on its consolidated results of operations, cash flows or financial position. Duke Energy Ohio 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 Current Liabilities and 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, 2006 and 2005. 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 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 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) Lawsuit

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 in June 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.

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.

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 understand 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.

Hurricane Katrina Lawsuit

On April 19, 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, is liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that the defendant's, 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 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.

16. Employee Benefit Obligations

Cinergy Retirement Plans

Duke Energy Kentucky participates in 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 Duke Energy changed from 5.50% to 6.00% in 2006.

Duke Energy Kentucky adopted the disclosure and recognition provisions of SFAS No. 158, effective December 31, 2006. The following table describes the total incremental effect of the adoption of SFAS No. 158 on individual line items in the Duke Energy Kentucky December 31, 2006 Consolidated Balance Sheet.

	Duke Energy Kentucky		
	Before Application of SFAS No. 158	**Adjustment**	**After Application of SFAS No. 158**
		(in thousands)	
Accrued pension and other post-retirement liabilities [a]	$(16,041)	$ (21,560)	$ (37,601)
Regulatory Assets	---	21,560	21,560
Total Recognized	$(16,041)	$ ---	$(16,041)

(a) Includes approximately $1 million related to pension benefits in Other Current Liabilities and approximately $.5 million related to other post-employment benefits in Other Liabilities on the Balance Sheets at December 31, 2006.

Qualified Pension Plans

Cinergy's qualified defined benefit pension plans cover substantially all United States employees meeting certain minimum age and service requirements. Cinergy's qualified defined benefit pension plans 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. 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 12 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. Cinergy uses a September 30 measurement date for its defined benefit retirement plans.

Duke Energy Kentucky's Qualified Pension Plan Pre-Tax Net Periodic Pension Benefit costs as allocated by Cinergy were approximately $2.9 million and $1.6 million for the years ended December 31, 2006 and 2005, respectively.

The fair value of Cinergy's plan assets was $1,302 million as of September 30, 2006 and $1,169 million as of September 30, 2005. The projected benefit obligation for the plans was $1,976 million as of September 30, 2006 and $1,751 million as of September 30, 2005. The accumulated benefit obligation for the plans was $1,688 million at September 30, 2006 and $1,535 million at September 30, 2005. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Consolidated Balance Sheets at December 31, 2006 and 2005 was approximately $24 million and $13 million, respectively.

Duke Energy Kentucky contributed approximately $2 million for both of the years ended December 31, 2006 and 2005 respectively, to the legacy Cinergy qualified pension plans.

The amount recognized in Regulatory assets was approximately $15 million as of December 31, 2006.

Assumptions used for Cinergy's pension benefits accounting were as follows:

	2006	2005
Benefit Obligations		
Discount rate	5.75	5.75
Salary increase	5.00	4.00
Net Periodic Benefit Cost		
Discount rate [a]	5.50-6.00	5.75
Salary increase	5.00	4.00

(a) Discount rate was 6.00% for the nine months ended December 31, 2006. Discount rate was 5.50% and 5.75% for the three months ended March 31, 2006 and the year ended December 31, 2005.

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 $114 million as of September 30, 2006 and $147 million as of September 30, 2005. The accumulated benefit obligation for the plans was $109 million at September 30, 2006 and $132 million at September 30, 2005. The accrued pension liability as allocated by Cinergy to Duke Energy Kentucky and recognized in Accrued pension and other postretirement benefit costs within the Consolidated Balance Sheets at December 31, 2006 and 2005 was $134 thousand and $109 thousand, respectively, and as recognized in Other Current Liabilities within the Consolidated Balance Sheet at December 31, 2006 was $11 thousand.

Duke Energy Kentucky's Non-Qualified Pension Plan pre-tax Net Periodic Pension Benefit Costs as allocated by Cinergy for the years ended December 31, 2006 and 2005 were $16,000 and $11,000, respectively.

Assumptions used for Cinergy's pension benefits accounting were as follows:

	2006	2005
Benefit Obligations		
Discount rate	5 75	5 75
Salary increase	5 00	4 00
Net Periodic Benefit Cost		
Discount rate [a]	5 50-6 00	5 75
Salary increase	5 00	4 00

(a) Discount rate was 6.00% for the nine months ended December 31, 2006. Discount rate was 5.50% and 5.75% for the three months ended March 31, 2006 and the year ended December 31, 2005.

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. There are no plan assets. The accumulated other post-retirement benefit obligation for the plans was $497 million as of September 30, 2006and $414 million as of September 30, 2005. 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 Consolidated Balance Sheets at December 31, 2006 and 2005 was $13 million and $7 million, respectively, and as recognized in Other Current Liabilities within the Consolidated Balance Sheet at December 31, 2006 was $1 million.

Duke Energy Kentucky's Other Post-Retirement Plan pre-tax Net Periodic Benefit costs as allocated by Cinergy for the years ended December 31, 2006 and 2005 were $1.2 million and $1.1 million, respectively.

The amount recognized in Regulatory assets was approximately $6 million as of December 31, 2006.

Assumptions used in Cinergy's other post-retirement benefits accounting were as follows:

	2006	2005
Benefit Obligations		
Discount rate	5 75	5 50
Net Periodic Benefit Cost		
Discount rate [a]	5 50-6 00	6 00

(a) Discount rate was 6.00% for the nine months ended December 31, 2006. Discount rate was 5.50% and 5.75% for the three months ended March 31, 2006 and the year ended December 31, 2005.

17. Other Income and Expenses, net

The components of Other Income and Expenses, net on the Statements of Operations for the years ended December 31, 2006 and the ended December 31, 2005 are as follows:

	Year Ended December 31, 2006	Year Ended December 31, 2005
	(in thousands)	
Income/(Expense)		
Interest income	**$ 3,192**	$ 2,525
AFUDC allowance	**626**	642
Other	**(1,609)**	(220)
Total	**$ 2,209**	$ 2,947