CINERGY.

Cinergy Corp.
139 East Fourth Street
Rm 25 AT II
P.O. Box 960
Cincinnati, OH 45201-0960
tel 513.287.3601
fax 513.287.3810
jfinnigan@cinergy.com

John J. Finnigan, Jr.
Senior Counsel

VIA OVERNIGHT MAIL

March 28, 2006

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: 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. 2005-00228

Dear Ms. O'Donnell:

The Commission's November 29, 2005 Order in the above-referenced case requires the filing with this Commission of the merger approvals received from the FERC, the Nuclear Regulatory Commission, the Federal Communications Commission, and all state regulatory commissions.

As you may know, the North Carolina Utilities Commission ("NCUC") issued an order approving the merger of Cinergy Corp. and Duke Energy Corporation on Friday, March 24, 2006. A copy of the order is enclosed with this letter.

ULH&P reports that the NCUC order does not trigger the Most Favored Nations provisions set forth in this Commission's order, because the rate mechanism approved in the NCUC case for sharing of merger savings with retail customers will not result in sharing a greater proportion of merger savings with retail customers served by Duke Power in North Carolina than the merger savings sharing mechanism approved by this Commission.

If you have questions or comments, please feel free to contact me at (513) 287-3601. Thank you.

Sincerely,

John J. Finnigan, Jr.
Senior Counsel

JJF/sew

cc: All Counsel of Record (with enclosure)

182676

STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. E-7, SUB 795

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of		
Application of Duke Energy Corporation for Authorization under G.S. 62-111 to Enter Into a Business Combination Transaction With Cinergy Corp. and for Approval of Affiliate Agreements under G.S. 62-153	)))))	ORDER APPROVING MERGER SUBJECT TO REGULATORY CONDITIONS AND CODE OF CONDUCT

HEARD: Commission Hearing Room 2115, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina, on Tuesday, December 6, 2005, at 9:30 a.m., Tuesday, December 13, 2005, at 1:00 p.m., Wednesday, December 14, 2005, at 9:30 a.m., Thursday, December 15, 2005, at 9:30 a.m., and Wednesday, January 18, 2006, at 9:30 a.m.

BEFORE: Chair Jo Anne Sanford, Presiding, and Commissioners Robert V. Owens, Jr., Sam J. Ervin, IV, Lorinzo L. Joyner, James Y. Kerr, II, and Howard N. Lee

APPEARANCES:

For Duke Energy Corporation:

Kodwo Ghartey-Tagoe, Chief Litigation Counsel, Lara S. Nichols, Associate General Counsel, and Lawrence B. Somers, Assistant General Counsel, Duke Energy Corporation, 422 South Church Street, Charlotte, North Carolina 28202

Robert W. Kaylor, Law Offices of Robert W. Kaylor, P.A., 225 Hillsborough Street, Suite 480, Raleigh, North Carolina 27603

For Carolina Industrial Group for Fair Utility Rates III:

Ralph McDonald, Bailey & Dixon, LLP, P.O. Box 1351, Raleigh, North Carolina 27602

For Carolina Utility Customers Association, Inc:

James West, West Law Offices, P.C., 434 Fayetteville Street Mall, Suite 1735, Raleigh, North Carolina 27601

For Environmental Defense:

Daniel Whittle, Senior Attorney, Environmental Defense, 2500 Blue Ridge Road, #330, Raleigh, North Carolina 27607

For North Carolina Sustainable Energy Association:

John Runkle, P.O. Box 3793, Chapel Hill, North Carolina 27515

For the Using and Consuming Public:

Antoinette R. Wike, Chief Counsel, and Gisele L. Rankin, Staff Attorney, Public Staff–North Carolina Utilities Commission, 4326 Mail Services Center, Raleigh, North Carolina 27699-4326

Leonard G. Green, Assistant Attorney General, North Carolina Department of Justice, P.O. Box 629, Raleigh, North Carolina 27602

BY THE COMMISSION: This matter arose upon the filing of an Application by Duke Energy Corporation (Duke Energy) on July 15, 2005, seeking authority pursuant to G.S. 62-111 to enter into a business combination (hereinafter referred to as "the Merger") with Cinergy Corp. (Cinergy) and approval pursuant to G.S. 62-153 of certain affiliate agreements. Exhibits filed with the Application included the Agreement and Plan of Merger (Merger Agreement) dated May 8, 2005, and amended as of July 11, 2005; a schematic diagram of transactions under the Merger Agreement; Annual Reports of Duke Energy and Cinergy; a Cost-Benefit Analysis; and a Market Power Analysis. Also included were four affiliate agreements: a Utility Service Agreement, an Operating Companies Service Agreement, an Operating Company/Non-Utility Companies Service Agreement, and a Utility Money Pool Agreement. A Tax Sharing Agreement was filed on August 1, 2005. On November 18, 2005, Duke Energy filed the Second Amendment to the Merger Agreement, dated October 3, 2005.

In response to the Application, the Commission issued an order on August 11, 2005, scheduling the matter for hearing on December 6, 2005, and requiring public notice. On November 17, 2005, the Commission issued an order scheduling the December 6 hearing for the sole purpose of receiving public witness testimony and rescheduling the evidentiary hearing for December 13, 2005.

Petitions to intervene were filed by Carolina Utility Customers Association, Inc. (CUCA); Carolina Industrial Group for Fair Utility Rates III (CIGFUR III); North Carolina

Sustainable Energy Association, Inc. (NCSEA); Environmental Defense; and the North Carolina Electric Membership Corporation (NCEMC). By various orders, the Commission granted the petitions to intervene. The Attorney General filed notice of intervention pursuant to G.S. 62-20. The intervention of the Public Staff was deemed recognized pursuant to Commission Rule R1-19(e).

On November 29 and 30, 2005, a Stipulation and Agreement (Stipulation) between Duke Energy and the Public Staff was filed by the Public Staff. Attached to the Stipulation were proposed Regulatory Conditions, a proposed Code of Conduct, and a revised exhibit showing the net merger savings proposed to be shared by Duke Energy with its North Carolina retail ratepayers.

The matter came on for hearing as scheduled. Dr. Edwin Cox, a licensed physician and former director of the cancer center database at the Duke Comprehensive Cancer Center, and Martin Lancaster, President of the North Carolina Community College System, testified as public witnesses.

Duke Energy presented the direct testimony of Ruth G. Shaw, President and Chief Executive Officer of Duke Power; James E. Rogers, Chairman and Chief Executive Officer of Cinergy; Myron L. Caldwell, Group Vice President and Chief Financial Officer of Duke Power; Thomas J. Flaherty, Senior Vice President in the Energy and Utilities practice of Booz Allen Hamilton; and Carol E. Shrum, Vice President of Financial Planning and Analysis for Duke Energy Business Services. The testimony of Dr. William Hieronymus, Vice President of CRA International, Inc. (formerly Charles River Associates), filed with the Application, was entered into the record by stipulation.

CIGFUR III presented the testimony of Nicholas Phillips, Jr., a consultant with the firm of Brubaker & Associates, Inc. CUCA presented the testimony of Kevin W. O'Donnell, President of Nova Energy Consultants, Inc. The Public Staff presented the joint testimony of Elise Cox, Assistant Director, Accounting Division; Thomas W. Farmer, Jr., Director, Economic Research Division; and James S. McLawhorn, Utilities Engineer, Electric Division. Environmental Defense presented the testimony of Michael Shore, Senior Air Policy Analyst.

Duke Energy presented the rebuttal testimony of Myron L. Caldwell, Thomas J. Flaherty, and Janice D. Hager, Vice President, Rates and Regulatory Affairs, for Duke Power. CUCA presented the rebuttal testimony of Kevin W. O'Donnell.

By order issued December 20, 2005, the Commission directed Duke Energy and the Public Staff to convene a conference of all parties to discuss and negotiate reasonable and appropriate post-hearing changes and modifications to the proposed Regulatory Conditions and Code of Conduct that were attached to the Stipulation. The parties were directed to prepare and file a matrix of contested, non-settled issues following the negotiations. The order also required Duke Energy to file a pro forma balance sheet setting forth the financial position of Duke Power Company, LLC,

immediately following the Merger and updated Cost-Benefit Analyses setting forth the total five-year and ten-year net merger savings expected to be realized from the Merger. The Public Staff was required to file a detailed assessment of the separate settlement proposals filed with or approved by each of the state and federal agencies that are required to rule on the Merger, with particular emphasis on the benefits granted to ratepayers and whether any of those benefits would invoke the provisions of the Most Favored Nation clause in the proposed Regulatory Conditions. Duke Energy was also requested to file copies of all state and federal orders ruling on the proposed Merger. By order issued December 29, 2005, the Commission reaffirmed the requirement of an informal conference and granted Duke Energy and the Public Staff's request for oral argument.

On December 22, 2005, Duke Energy filed copies of the following orders: Order Authorizing Merger issued December 20, 2005, by the Federal Energy Regulatory Commission (FERC) in Docket No. EC05-103-000; Order Approving Stipulations and Merger issued December 7, 2005, and Order Granting Clarification issued December 8, 2005, by the Public Service Commission of South Carolina in Docket No. 2005-210-E; Order issued November 29, 2005, by the Public Service Commission of Kentucky in Case No. 2005-00228; and Finding and Order issued December 21, 2005, by the Public Utilities Commission of Ohio in Case Nos. 05-732-EL-MER, 05-733-EL-AAM, and 05-794-GA-AAM.

On January 13, 2006, Duke Energy filed the pro forma balance sheet and updated Cost-Benefit Analyses required by the Commission.

On January 17, 2006, the Public Staff filed a matrix of contested, non-settled issues and the Revised Regulatory Conditions and Code of Conduct provisions proposed by Duke Energy and the Public Staff, and CUCA filed its proposed Revised Regulatory Conditions and Code of Conduct. An oral argument to consider relevant issues related to the proposed Regulatory Conditions and Code of Conduct was held as scheduled on January 18, 2006.

On January 25, 2006, Environmental Defense and NCSEA jointly filed a Partial Proposed Order.

On January 27, 2006, the Public Staff filed Further Revised Regulatory Conditions and Code of Conduct, a revised matrix of contested, non-settled issues, and its assessment of the settlement proposals and orders in other jurisdictions; the Attorney General filed his Brief; and the Commission issued an Order Granting Second Extension of Time to File Proposed Orders and Briefs.

On January 30, 2006, the Public Staff filed its Proposed Order and Brief, Duke Energy filed its Proposed Order, and Briefs were filed by CUCA and CIGFUR III. On February 1, 2006, CIGFUR III filed redacted pages omitted from its Brief filed on January 30, 2006.

On February 10, 2006, in response to the Commission's order of December 20, 2005, Duke Energy filed a copy of the Nuclear Regulatory Commission's Order Approving Application Regarding Proposed Corporate Restructuring and Approving Conforming Amendments, issued on February 7, 2006.

On February 14, 2006, Duke Energy filed its Revised Utility Money Pool Agreement.

On March 3, 2006, Duke Energy filed its Revised Tax Sharing Agreement and, in response to the Commission's order of December 20, 2005, the Entry on Rehearing issued by the Public Utilities Commission of Ohio on February 6, 2006.

On March 21, 2006, in response to the Commission's order of December 20, 2005, Duke Energy filed a copy of the Indiana Utility Regulatory Commission's March 15, 2006 order approving the Settlement Agreement and items related to the merger of Cinergy and Duke Energy Corporation.

On March 23, 2006, the Public Staff filed an Updated Assessment of Orders wherein it set forth its evaluation of the Indiana Utility Regulatory Commission's recent order approving the Settlement Agreement.

Based on the foregoing, the evidence presented at the hearing, and the entire record in this matter, the Commission now makes the following

FINDINGS OF FACT

1. Duke Energy is a corporation duly organized and existing under the laws of North Carolina and headquartered in Charlotte, North Carolina. Duke Power, a division of Duke Energy, is engaged in the business of generating, transmitting, distributing, and selling electricity to approximately 2.2 million retail customers in a service area that covers central and western North Carolina and western South Carolina.

2. Duke Energy owns and operates approximately 94,000 miles of distribution lines and 13,000 miles of transmission lines. It also sells electricity at wholesale to municipal, cooperative, and investor-owned electric utilities.

3. Duke Energy is a public utility subject to the jurisdiction of this Commission and the jurisdiction of the Public Service Commission of South Carolina. Duke Energy is also a public utility under the Federal Power Act (FPA) and is subject to the jurisdiction of the FERC.

4. Subsidiaries of Duke Energy are engaged in a broad range of energy and energy-related business activities in North and South America.

5. Cinergy is a corporation duly organized and existing under the laws of Delaware and headquartered in Cincinnati, Ohio. Its principal direct and indirect subsidiaries are PSI Energy, Inc. (PSI), a vertically-integrated electric utility serving a portion of Indiana; The Cincinnati Gas & Electric Company (CG&E), a utility engaged in the production, transmission, distribution, and sale of electricity and the transportation of natural gas in southwestern Ohio; and The Union Light, Heat and Power Company (ULH&P), a wholly-owned subsidiary of CG&E and a vertically-integrated utility providing retail electric and natural gas service in northern Kentucky. Collectively, PSI, CG&E, and ULH&P serve approximately 1.5 million retail electric customers and 500,000 retail natural gas customers. Cinergy is a registered holding company under the Public Utility Holding Company Act of 1935 (PUHCA 1935).

6. PSI is a public utility subject to the jurisdiction of the Indiana Utility Regulatory Commission, and ULH&P is a public utility subject to the jurisdiction of the Public Service Commission of Kentucky. The electric transmission and distribution functions and natural gas distribution functions of CG&E are subject to the jurisdiction of the Public Utilities Commission of Ohio. PSI, ULH&P, and CG&E are public utilities under the FPA and are subject to the jurisdiction of the FERC.

7. Subsidiaries of Cinergy are involved in wholesale power generation, energy marketing and trading, and other energy-related businesses.

8. Duke Energy is lawfully before the Commission pursuant to G.S. 62-111 and 62-153 with respect to the relief sought in its Application and is in compliance with the filing requirements established by the Order Requiring Filing of Analyses issued November 2, 2000, in Docket No. M-100, Sub 129, with respect to the Market Power and Cost-Benefit Analyses submitted with the Application.

9. The Merger Agreement provides that, through a series of mergers, conversions, and reorganizations, Duke Power, Duke Capital, LLC, Duke Energy Shared Services, LLC, and Cinergy will become wholly-owned subsidiaries of a new Delaware holding company to be named Duke Energy Corporation (sometimes referred to as "new Duke Energy").[1] The Merger will be accomplished through an all-stock transaction. Holders of Duke Energy common stock will receive new Duke Energy common stock on a one-for-one basis, and holders of Cinergy common stock will receive 1.56 shares of new Duke Energy common stock for each share of Cinergy stock held. After the Merger is completed, former Duke Energy shareholders will own approximately 76% and former Cinergy shareholders will own approximately 24% of the new Duke Energy holding company stock.

10. Pursuant to the Merger Agreement, Duke Energy will convert to a limited liability company to be called Duke Power Company, LLC (Duke Power), and Duke Power then will distribute its assets and liabilities associated with Duke Capital to

[1] For purposes of this order, the term "Duke Energy" will be used to refer to existing Duke Energy Corporation and to new Duke Energy Corporation, as appropriate.

new Duke Energy. Following the Merger, Duke Power will be a stand-alone public utility without extensive non-utility holdings.

11. Known and potential benefits of the Merger to Duke Energy include greater diversity and depth of resources, diversity of service areas, increased efficiency, and increased financial strength and flexibility. Known and potential benefits to North Carolina ratepayers in particular include economies of scale and scope that will enable Duke Power to offer lower rates than otherwise would have been possible, greater depth and diversity of human resources experience that will help Duke Power to continue its commitment to customer service, and access to best practices of other utilities in the Cinergy group.

12. Another significant, known and potential benefit of the Merger to ratepayers is the creation of a holding company, which will allow Duke Power to be maintained as a separate legal entity with its own debt issuances and its own capital structure and will also simplify the tracking of costs and revenues between utility and non-utility operations.

13. The primary quantifiable benefit of the Merger to ratepayers consists of the estimated net merger savings generated by combining certain corporate and utility functions after the Merger. Duke Power proposes to share 42% ($117,517,000) of the five-year estimated net merger savings amount of $279,841,000 assignable to its North Carolina retail customers. Pursuant to Finding of Fact No. 35, Duke Power will be required to implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of $117,517,000. The Commission makes no specific determination as to the reasonableness of Duke Energy's five-year estimated net merger savings amount of $279,841,000 assignable to its North Carolina retail customers, the propriety of the determination and apportionment thereof, or the validity and correctness of the Company's Cost-Benefit Analyses.

14. Known and potential costs and risks of the Merger to ratepayers include the possibility of preemption resulting from the creation of a holding company, the repeal of PUHCA 1935, and the enactment of the Energy Policy Act of 2005 (EPACT 2005). Other known and potential costs and risks include cost increases that could impact North Carolina retail rates, potential adverse impacts on Duke Power's cost of capital, potential adverse effects on Duke Power of transactions within the holding company family and the resulting need for increased regulatory oversight of such transactions, the potential for Duke Power to unreasonably favor its unregulated affiliates over non-affiliated suppliers of goods and services, the potential for Duke Power's quality of service to deteriorate because of increased management focus on diversification and growth, and the exposure of Duke Power's ratepayers to environmental compliance costs incurred by Cinergy subsidiaries. The Commission-approved Regulatory Conditions and Code of Conduct will protect Duke Power's North Carolina retail ratepayers to the extent reasonably possible from known and potential costs and risks of the Merger.

15. The Commission-approved Regulatory Conditions will effectively protect the Commission's jurisdiction from the probability of federal preemption.

16. The Commission-approved Regulatory Conditions will effectively address known and potential risks and concerns related to cost allocation and ratemaking arising from the Merger.

17. The Commission-approved Regulatory Conditions will impose appropriate and effective auditing and reporting requirements with respect to affiliate transactions and cost of service.

18. The Commission-approved Regulatory Conditions will effectively protect Duke Power's North Carolina retail customers from impacts of the Merger on cost of service for ratemaking purposes.

19. The Code of Conduct required by the Commission-approved Regulatory Conditions will effectively govern the relationships, activities, and transactions among Duke Power and other members of the Duke Energy holding company family following the Merger.

20. The Commission-approved Regulatory Conditions will effectively address known and potential risks and concerns related to finance and corporate governance issues arising from the Merger.

21. The Commission-approved Regulatory Conditions will effectively enable the Commission to exercise its jurisdiction over business combinations involving Duke Power or other members of the Duke Energy holding company family following the Merger.

22. The Commission-approved Regulatory Conditions will effectively address known and potential risks and concerns related to structure and organization arising from the Merger.

23. The Commission-approved Regulatory Conditions will provide appropriate and effective procedures for advance notices and other filings arising from the Merger.

24. The Commission-approved Regulatory Conditions will effectively ensure that Duke Energy and Duke Power maintain a commitment to customer service following the Merger.

25. The Commission-approved Regulatory Conditions will effectively ensure that Duke Power's North Carolina retail customers are protected from any adverse effects of a tax sharing agreement and receive an appropriate portion of income tax benefits associated with Duke Energy Shared Services.

26. The Commission-approved Regulatory Conditions will effectively preserve the benefits of Nantahala's historical hydroelectric resources and cost of service for Duke Power's Nantahala retail customers following the Merger.

27. The Commission-approved Regulatory Conditions will effectively ensure that the Commission and the Public Staff continue to have access to the books and records of Duke Power and members of the Duke Energy holding company family in accordance with North Carolina law following the Merger.

28. The Commission-approved Regulatory Conditions will appropriately recognize the continuing effect of prior Commission orders.

29. The Commission-approved Regulatory Conditions accurately describe their effect on the Commission's statutory authority and Duke Energy's rights under state and federal law.

30. The Commission-approved Regulatory Conditions do not impose legal obligations on entities in which Duke Energy does not have a controlling interest.

31. The Commission-approved Regulatory Conditions will appropriately allow requests for waivers of any aspect of the conditions under exigent circumstances.

32. The Commission-approved Regulatory Conditions will appropriately become effective only upon closing of the Merger.

33. The Commission-approved Regulatory Conditions will appropriately recognize the rights of parties to this docket with respect to participation in subsequent proceedings.

34. The Merger presents no known risk of adverse competitive effects within the jurisdiction of the Commission or concerns of increased market power within Duke Power's service territory.

35. Duke Power shall implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of $117,517,000. In addition, any fuel-related savings associated with the Merger shall be flowed through to Duke Power's North Carolina retail customers pursuant to G.S. 62-133.2.

36. Duke Power shall contribute $12,000,000 to various energy- and environmental-related and economic- and educationally-beneficial programs, said funds to be distributed as follows: $6,000,000 to Duke Power's Share the Warmth, Cooling Assistance, and Fan-Heat Relief programs; $2,000,000 for conservation and energy efficiency programs; $2,000,000 to the Community College Grant Fund; and $2,000,000 to NC GreenPower.

37. The Commission will, in 2007, initiate an investigation pursuant to G.S. 62-130(d), 62-133, and 62-136(a) to determine whether Duke Power's existing rates and charges are unjust and unreasonable and, as part of this investigation, will require Duke Power to either (a) file a general rate case (including prefiled testimony and exhibits) in North Carolina pursuant to G.S. 62-137 or (b) show cause in the form of prefiled testimony and exhibits why the Company's existing rates and charges should not be found unjust and unreasonable.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1 – 8

The evidence supporting these findings of fact is contained in the verified Application and in the testimony of Duke Energy witnesses Shaw and Rogers. These findings are essentially informational, procedural, and jurisdictional in nature and for the most part are not in dispute.

Pursuant to the order entered on November 2, 2000, in Docket No. M-100, Sub 129, applicants for merger approval pursuant to G.S. 62-111 are required, among other things, to file (1) a market power analysis employing the Herfindahl-Hirschman Index or other accepted measurement and (2) sensitivity analyses on the impact on market power of significant factors as discussed in that order. Applicants are also required to file a "comprehensive list of all material areas of expected benefit, detriment, cost, and savings over a specified period (e.g., three to five years) following consummation of the merger." The purpose of such analyses is to assist the Commission in determining whether or not a merger meets the statutory standard for approval. None of the parties in this case challenged the Market Power Analysis submitted with the Application or contended that the Merger raises market power issues. With respect to the Cost-Benefit Analysis, at the hearing some questioned the allocation of net merger savings and the proposed sharing mechanism as discussed below, but none took issue with the estimates themselves.

The Commission therefore finds and concludes that Duke Energy is lawfully before the Commission with respect to the relief sought in its Application and has fully met the merger filing requirements established in Docket No. M-100, Sub 129.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 9 AND 10

The evidence supporting these findings of fact is contained in the verified Application, including the Merger Agreement, and the testimony of Duke Energy witness Caldwell. These findings are essentially uncontroverted.

Through its Application and the testimony of witness Caldwell, Duke Energy described the mergers, conversions, and restructurings through which the Merger will be accomplished, including the creation of a new holding company to be named Duke Energy Corporation (new Duke Energy), and the conversion of the current Duke Energy Corporation into a limited liability company, Duke Power Company, LLC. Witness Caldwell testified that post-merger, Duke Power will be a separate, first-tier

subsidiary under new Duke Energy. He further explained that, as part of the overall merger transaction, Duke Power will distribute its ownership of Duke Capital to new Duke Energy and become a free-standing utility subsidiary without extensive non-utility holdings other than land held for future use.

Thus, following the Merger, Duke Power will be a stand-alone public utility without extensive non-utility holdings.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

The evidence supporting this finding of fact is contained in the verified Application and the testimony of Duke Energy witnesses Shaw, Rogers, and Flaherty.

Duke Energy witness Shaw testified that the Merger will benefit Duke Energy and its customers by creating greater diversity and depth of resources, as well as increasing the number and diversity of service areas and customers. She stated that the integration of the two companies will lead to increased efficiency and lower operating costs and increase the financial flexibility of the new company. Witness Shaw further testified that the Merger will allow the companies to reduce risk to regulated operations by adding diversity of service areas, climates, and economic and competitive conditions. Referring to witness Flaherty's testimony, she stated that the Merger will result in synergies that will lower the overall cost structure of the combined company and enable Duke Power to offer lower rates than would otherwise have been possible. She also stated that the Merger will enhance Duke Power's ability to serve its customers by providing greater depth and diversity of human resources experience and by allowing access to "best practices" among the operating companies.

Duke Energy witness Rogers testified that the anticipated cost savings and synergies, paired with the increased scale and scope of the combined company, will position new Duke Energy to serve its customers well in an era of rising costs.

Based on the conclusions reached hereinafter with respect to the effectiveness of the Commission-approved Regulatory Conditions, the Commission finds and concludes that known and potential benefits to North Carolina retail ratepayers in particular include economies of scale and scope that will enable Duke Power to offer lower rates than otherwise would have been possible, greater depth and diversity of human resources experience that will help Duke Power to continue its commitment to customer service, and access to best practices of other utilities in the Cinergy group.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 12

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witnesses Caldwell, Shrum, and Hager.

Duke Energy witness Caldwell testified that Duke Power will remain responsible for approximately $6 billion of debt securities issued at the Duke Energy level for which it is responsible today. These securities consist of approximately $4.5 billion of unsecured debt and $1.5 billion of first mortgage bonds.

He explained that the unsecured debt was issued for the benefit of Duke Power for the purpose of supporting its regulated operations and can only be used to support the electric operations within Duke Power, but, because Duke Power is a division of Duke Energy, this debt was issued in the legal name of Duke Energy. By virtue of the conversion of the existing Duke Energy into Duke Power, the holders of the securities would not have the ability to call on the assets of Duke Capital in the future, unless Duke Energy guaranteed them. As a result, new Duke Energy will guarantee the unsecured debt to maintain the current status of the debt holders and their ability to call on the assets of new Duke Energy, including Duke Capital. He further explained that Duke Power does not own or have financial encumbrances associated with Duke Capital operations.

Witness Caldwell testified that, as a separate subsidiary, Duke Power's credit risk will be rated separately from that of new Duke Energy and its other subsidiaries. The structure in place after the Merger will potentially improve the credit standing of Duke Power as a stand-alone company, as it will give Duke Power visibility and transparency for the rating agencies. Witness Caldwell further testified that each operating company, including Duke Power, will have its own distinct capital structure for both accounting and ratemaking purposes. Duke Power will issue its own debt and/or receive equity contributions from new Duke Energy as needed. Thus, the formation of the holding company and the presence of Duke Power as a stand-alone subsidiary will provide additional protection to insulate Duke Power from any potential risks associated with the unregulated businesses.

The Commission recognizes that the holding company is a common and accepted corporate structure for diversified business activities. Indeed, the Commission has considerable experience with this structure, having approved regulatory conditions, codes of conduct, cost allocation manuals, and a variety of affiliate agreements for the Carolina Power & Light Company, Dominion Resources, and SCANA holding companies. Moreover, as Duke Energy witnesses Shrum and Hager observed, the use of a service company is not a new concept to Duke Power or the Commission, inasmuch as many service company functions are currently being provided by Duke Energy Business Services (DEBS). Thus, while the number of transactions may increase, the costs will either be directly assigned or allocated in accordance with the cost allocation manual (CAM) just as they are today. There is no reason to conclude that the allocation process will be any more complex or that affiliate transactions will not be appropriately documented, reported, and audited as currently required. Contrary to the contentions of CIGFUR III and CUCA, the Commission believes that a holding company structure can actually simplify the tracking of costs and revenues between utility and non-utility operations, which can be expected to result in improved regulatory oversight, particularly with the Commission-approved Regulatory Conditions.

Furthermore, the Commission agrees with Duke Energy witness Caldwell that this structure should potentially improve Duke Power's credit standing, as Duke Power should be insulated from events that occur elsewhere in the holding company family. As discussed below, the Commission also concludes that with the "ring fencing" provisions of the approved Regulatory Conditions, Duke Power should be protected from any adverse affects that might result from its membership in a holding company system.

Based on the conclusions reached hereinafter with respect to the effectiveness of the Commission-approved Regulatory Conditions, the Commission finds and concludes that Duke Power's North Carolina retail ratepayers will benefit from the creation of a holding company as part of the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 13

The evidence supporting this finding of fact is contained in the verified Application, the testimony of Duke Energy witnesses Flaherty, Shrum, and Hager, the testimony of CIGFUR III witness Phillips, and the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

Duke Energy witness Flaherty testified that the Merger is expected to provide the potential for an estimated $2.1 billion in total gross cost savings to be realized for corporate, shared services, regulated, and non-regulated businesses over a five-year period following the close of the Merger. Witness Flaherty testified that $780 million of the total related to gross cost savings were directly attributable to the non-regulated business segment, whereas approximately $1.3 billion of gross savings were attributable to corporate, shared services, and utility-related services. He also stated that approximately $770 million in corporate, shared services, regulated, and non-regulated costs-to-achieve, and other offsets to the identified savings, had been estimated. These offsets consist of (1) approximately $61 million directly attributable to the non-regulated segment, (2) approximately $183 million in change-in-control payments that have been eliminated from consideration for purposes of calculating net merger savings for this proceeding, (3) approximately $513 million of costs-to-achieve related to corporate, shared services and utility segments, and (4) $10 million in pre-merger initiatives for cost savings that Cinergy had planned prior to the Merger.

Witness Flaherty testified that the net merger savings that relate to corporate, shared services, and the utility segments amount to approximately $807 million ($1.3 billion in gross savings less $513 million in costs-to-achieve and $10 million in pre-merger initiatives). He stated that the $1.3 billion in cost savings are in six major categories: corporate and headquarters staffing, utility support staffing, corporate and administrative programs, information technology, supply chain, and coal supply. He also stated that the $513 million in costs-to-achieve are in the following categories: separation, retention, relocation, directors' and officers' coverage, regulatory process, internal and external communication, transition costs, and transaction costs.

Witness Flaherty testified that the estimated cost savings were jointly developed by the management of Duke Energy and Cinergy with the assistance of Booz Allen Hamilton. According to witness Flaherty, the process utilized by Duke Energy and Cinergy was comprehensive and captured all significant sources of merger-related costs savings that are typically available.

Duke Energy witness Shrum testified that the estimated net savings were allocated to Duke Power and other companies of new Duke Energy using cost causation principles. For example, savings related to customer service were assigned using the number-of-customers ratio. When costs/savings could not be identified at the function level or data necessary for the calculation of a proposed new factor could not yet be identified, a general allocation method was used to assign costs/savings.

The Public Staff witnesses testified that estimated five-year net savings assignable to North Carolina retail customers should be $279,841,000, which is an increase from the $273,283,000 amount originally filed by Duke Power. The increase is attributable to changes in an affiliate allocation factor and a jurisdictional allocation factor assigning net savings to North Carolina retail operations. As shown on Attachment C of the Stipulation, Duke Energy and the Public Staff agreed that the amount of estimated five-year net savings assignable to North Carolina retail customers is $279,841,000.

Duke Energy witness Hager testified that the vast majority of the non-regulated savings were due to the consolidation of two trading floors to one trading floor for the Duke Energy North America (DENA) operations. She testified that, now that Duke Energy is divesting itself of the majority of its merchant generation and is no longer going to have a trading floor, those savings are no longer merger savings but are savings associated with discontinued operations.

CIGFUR III witness Phillips disagreed with the presentation or allocation of the net merger savings in Table 1 of witness Flaherty's testimony. Witness Phillips testified that the way the savings are structured, Duke Energy will keep the total unregulated savings, which he stated is more than 50% of the total, and Duke Energy will share 42% of the smaller regulated savings. According to witness Phillips' calculation, under this structure, Duke Energy will keep 84% of the total savings and will give only 16% of the total savings to regulated ratepayers.

The Commission, in conjunction with its ruling on Finding of Fact No. 35, concludes that Duke Power should be required to implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of $117,517,000. The Commission makes no specific finding or determination as to the reasonableness of Duke Energy's five-year estimated net merger savings amount of $279,841,000 assignable to its North Carolina retail customers, the propriety of the determination and apportionment thereof, or the validity and correctness of the Company's Cost-Benefit Analyses. Such a determination is unnecessary in view of the Commission's decision to accept Duke's offer to refund the amount of $117,517,000 to

the Company's North Carolina retail customers in a manner to be determined by the Commission.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 14

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn, CIGFUR III witness Phillips, CUCA witness O'Donnell, and Environmental Defense witness Shore.

The Public Staff witnesses testified that, because PUHCA 1935 has been repealed, the concerns about preemption by the Securities and Exchange Commission (SEC) that were addressed in earlier merger proceedings are no longer at issue. The witnesses further testified that they had been advised by counsel that the Merger creates other preemption risks and concerns given the enactment of various other parts of EPACT 2005, including the Public Utility Holding Company Act of 2005 (PUHCA 2005). In addition, they testified that they had been advised by counsel that the repeal of PUHCA 1935 removes a number of significant consumer protections on large holding company systems, such as limitations on non-utility diversification and investment in merchant and foreign generating plants.

The other potential costs and risks identified by the Public Staff include: (1) direct merger costs, indirect corporate costs, and other cost increases that could impact North Carolina retail rates, (2) potential adverse effects on Duke Power's cost of capital, (3) potential adverse effects resulting from transactions between and among Duke Power and its affiliates, (4) the potential for Duke Power to unreasonably favor its unregulated affiliates over non-affiliated suppliers of goods and services, and (5) the potential for Duke Power's quality of service to deteriorate for reasons such as an increased focus on diversification and growth in non-regulated businesses. The Public Staff further testified that all of these concerns have been addressed in the Regulatory Conditions and Code of Conduct stipulated to by the Public Staff and Duke Energy.

CIGFUR III witness Phillips suggested that the proposed Merger presents even greater regulatory challenges than those faced by the Commission in Docket No. E-7, Sub 694. In that case, Duke Power proposed to transfer employees who operate and maintain Duke Power's fossil, hydroelectric, and nuclear generating facilities to subsidiaries of a new affiliate, Duke Energy Generation Services, LLC (DEGS), which would then operate the facilities for Duke Power pursuant to affiliate agreements but would also perform services for an unregulated affiliate, DENA. CUCA witness O'Donnell also cited the DEGS case, noting that the Commission approved the proposed affiliate agreements subject to a number of conditions related to affiliate transactions and that Duke Power ultimately withdrew its request for approval.

The Commission notes that, while some of the conditions imposed in Docket No. E-7, Sub 694 were vacated after the request was withdrawn, most were retained and have been implemented without undue difficulty or fanfare. Moreover,

those conditions have been incorporated into the Regulatory Conditions approved in this case. The Commission further notes that one of the principal concerns in the DEGS case was not the complexity of the transactions but the fact that operating personnel were involved. There is no such proposal before the Commission in this case. Indeed, Duke Energy witness Shrum indicated that the utility shared services would be of a different nature and would include managerial support and other administrative-type services. Duke Power's generating facilities will continue to be operated by Duke Power employees as they are today.

Environmental Defense witness Shore testified with respect to financial risks due to future regulation of global warming pollution, especially the costs that Cinergy may be required to bear in order to meet federal standards. Witness Shore recommended that the Commission require an assessment of the financial risks of the transaction. He encouraged the Commission to consider requiring that all new electric generating resources acquired by Duke Energy be selected based on an imputed carbon dioxide cost. He further requested the Commission to consider ordering commencement of a new proceeding to evaluate opportunities for Duke Energy to develop a comprehensive global warming management plan to protect North Carolina ratepayers from the financial risks of future global warming reduction regulation.

Duke Energy witness Hager testified that witness Shore's recommendations are outside the scope of this proceeding. She added that Duke Energy looks forward to the opportunity to work with Environmental Defense and other stakeholders on these issues in the appropriate forums. The Commission agrees that such environmental issues are outside the scope of this specific merger docket. The Commission does note, however, that Commission-approved Regulatory Condition No. 30 holds Duke Power's North Carolina retail customers harmless from all current and prospective liabilities of Cinergy Corp. and its subsidiaries including matters such as, but not limited to, litigation involving manufactured gas plant sites, asbestos claims, and environmental compliance.

Based on the conclusions reached hereinafter with respect to the effectiveness of the Commission-approved Regulatory Conditions, the Commission finds and concludes that Duke Power's North Carolina retail ratepayers will be protected to the extent reasonably possible from known and potential costs and risks of the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 15

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witness Caldwell and Public Staff witnesses Cox, Farmer, and McLawhorn.

Duke Energy witness Caldwell testified that EPACT 2005 repealed PUHCA 1935 effective six months from August 8, 2005. He further testified that, as a result, the SEC will no longer have regulatory authority over a public utility holding company system like the proposed Duke Energy system and that the companies do not intend to file for SEC

approval of the Merger under PUHCA 1935. Nevertheless, new Duke Energy will be organized as a holding company and will have a services company, a money pool agreement, a tax sharing agreement, and several other structures that enable a more efficient and transparent operation – even though such arrangements are no longer required by federal law.

The Public Staff panel testified that, because PUHCA 1935 has been repealed, the concerns about preemption by the SEC that were addressed in earlier merger proceedings are no longer at issue. They further testified, however, that they had been advised by counsel that the proposed Merger creates other preemption risks and concerns given the enactment of various other parts of EPACT 2005, including PUHCA 2005.

The Public Staff panel further testified that Regulatory Condition Nos. 1 through 15 are designed to protect the Commission's authority from the risk of preemption with respect to affiliate transactions, wholesale contracts, resource adequacy, asset transfers and any proposed transfers of operational control of generating or transmission facilities, and financings.[2] They testified that they had been advised by counsel that these conditions are intended to address preemption concerns, including those raised by EPACT 2005, and that these conditions adequately protect the Commission's jurisdiction. The only exception to the protection from preemption is the right Duke Power has under Regulatory Condition No. 21 to exercise a limited opportunity under Section 1275(b) of PUHCA 2005 to request that the FERC review traditional service company costs and allocations under certain circumstances.

To address the fact that the FERC had not yet issued its order ruling on Duke Energy's and Cinergy's Merger Application, the Public Staff witnesses further testified that Regulatory Condition No. 16 provides that Duke Energy and the Public Staff will request that the Commission include a paragraph in any order approving the Merger that requires the Public Staff and Duke Power to meet promptly after the FERC issues its order to determine whether changes are needed in the conditions to maintain their intended protections.

Finally, the Public Staff panel testified that Regulatory Condition No. 17, as originally proposed by Duke Energy and the Public Staff, requires Duke Power to provide to the Public Staff on a quarterly basis a list and summary of (1) filings and submissions Duke Power and its affiliates make to the FERC and (2) orders issued by the FERC that are reasonably likely to have an effect on Duke Power's rates or service. The purpose of this condition is to ensure that the Public Staff will be aware of relevant

[2] The only conditions currently applicable to Duke Energy in North Carolina related to preemption are Condition (h) approved in Docket No. E-7, Sub 700, and Condition (q) in Docket No. E-7, Sub 596. These conditions simply provide that, if Duke Energy or its affiliates engage in acquisitions or other actions that create the possibility of Duke Energy becoming a registered holding company, Duke Energy will notify the Commission, will bear the full risk of any preemptive effects of the FPA or the PUHCA 1935, and will take all such actions as the Commission finds necessary and appropriate to hold North Carolina retail ratepayers harmless from such preemption.

filings and orders so that it can monitor them. This condition was revised after the hearing during the required negotiation process to require Duke Power to file the lists and summaries, but not to serve them.

No other witness filed testimony with respect to these conditions, although CUCA, through its revised conditions filed on January 17, 2006, proposed that a number of revisions be made to them. Most of the proposed revisions with respect to the anti-preemption conditions, however, are not challenges to the anti-preemption conditions themselves, but rather are directed at incorporating CUCA's proposed definitions of "Effect" and "Requesting Intervenor" and at amending Regulatory Condition No. 2 to subject new Duke Energy to G.S. 62-111 and securities regulation by the Commission. These and the other revisions proposed by CUCA will be addressed subsequently.

The Merger raises a number of issues with respect to potential preemption risks that are predominantly legal, rather than factual, in nature. The Commission has been faced with similar issues in prior cases, although they involved the potential for preemption by the SEC under PUHCA 1935. The Commission concluded in those proceedings that a utility becoming part of a registered holding company system created substantial risks that an appellate court would find that the Commission's jurisdiction was preempted, and the Commission therefore imposed a number of conditions designed to protect its jurisdiction in that regard.[3] Because PUHCA 1935 has now been repealed, the SEC's authority is no longer an issue. The risks of preemption created by the Merger now must be analyzed with respect to the authority of the FERC given the repeal of PUHCA 1935 and the additional grants of authority to the FERC under EPACT 2005.

The issues related to preemption risks under the FPA can be divided into the following four categories: (1) inter-affiliate transactions involving wholesale sales and the transmission of electricity in interstate commerce under the FPA, (2) inter-affiliate financings, (3) mergers and acquisitions under § 203 of the FPA, including amendments by EPACT 2005, and (4) inter-affiliate transactions involving non-power goods and services under PUHCA 2005. These four categories of issues are discussed separately below.

---

[3] See, e.g., Order Approving Merger and Issuance of Securities, 98 NCUC 187 (Docket No. E-2, Sub 760, August 22, 2000); Order Approving Application, 98 NCUC 259 (Docket No. E-2, Sub 753, May 17, 2000); Order Approving Merger and Issuance of Securities, 97 NCUC 384 (Docket No. G-5, Sub 400, December 7, 1999; Order Approving Merger and Issuance of Securities, 97 NCUC 306 (Docket No. E-22, Sub 380, October 18, 1999).

(1) Wholesale Sales and Transmission in Interstate Commerce

With regard to preemption issues raised by the creation of a holding company and its acquisition of one or more additional public utilities, the Commission dealt with such issues in the Carolina Power & Light Company/Florida Progress merger proceeding (Docket No. E-2, Sub 760) and in the native load priority cases (e.g., Docket Nos. E-100, Sub 85A, and E-2, Sub 820). These issues include: (a) wholesale sales of electricity generally; (b) market-based rates; (c) joint planning, coordination, and generation dispatch (i.e., a holding company system integration agreement); (d) native load priority; (e) Regional Transmission Organization (RTO) membership; and (f) FERC filings, such as Duke's Application to amend its Open Access Transmission Tariff (OATT) to include an Independent Entity and Independent Monitor (Docket No. ER05-1236-000) and the Duke/Cinergy FERC Merger Application (Docket No. EC05-103-000).

The majority of these issues were dealt with in the Stipulation filed by Duke Energy and the Public Staff by adapting conditions that had previously been approved by the Commission in other dockets. The remaining issues were handled by formulating new conditions or, in the case of Cinergy's ownership of a public utility (CG&E) that is subject to retail competition, by changes in other conditions (see, e.g., the definition of "Utility Affiliates" and Regulatory Condition No. 48) and by specific provisions in the Code of Conduct (see, e.g., the definition of "Utility Affiliates" and Sections III.D.3.(d) and III.D.5).

(a) Wholesale Sales Generally. In Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986) (Nantahala), and in Mississippi Power & Light v. Mississippi ex rel. Moore, 487 U.S. 354 (1988) (Mississippi Power), the Supreme Court reasoned that the FERC's approval of an inter-affiliate power sale agreement under § 205 of the FPA was the equivalent of a FERC order requiring the utility to buy the specified amount of power. Because the relevant state commissions, for ratemaking purposes, then treated the utility buyer as having the freedom to buy a different amount, the state decisions resulted in "trapped costs" and were preempted. The key fact in both Nantahala and Mississippi Power was that the purchasing utility's actions were ordered by the FERC either with respect to mandated allocations of power or the rate paid. Because the utility had no choice but to follow the FERC's decision, the Supreme Court reasoned that a state could not then treat the utility as if it were free to make a different purchase or pay a different rate. Nantahala, at pp. 966-67.

When a FERC-imposed obligation to make a specific purchase has not been involved, states have not been found to be preempted from making ratemaking adjustments to disallow imprudent choices among wholesale suppliers. Kentucky West Virginia Gas Co. v. Pennsylvania Public Utilities Commission, 837 F.2d 600 (3d Cir. 1988) (citing the "long-standing notion that a State Commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source"); Pike County Light & Power Co. v. Pennsylvania Public Utilities Commission, 465 A.2d 735 (1983) (similar

holding). In both of these cases, no trapped costs and no preemption were found because the buying utility was free to choose its seller and the state commission's disallowance was based on its judgment as to the wisdom of that choice. Thus, to protect the Commission's jurisdiction from preemption after the Merger, a condition must be imposed to ensure that contracts entered into by Duke Power for the purchase of electricity from affiliates are voluntary and do not obligate Duke Power to make any purchases. Regulatory Condition No. 1 explicitly requires this.

Regulatory Condition No. 1 prescribes procedures related to all contracts between Duke Power and any affiliate and between any affiliates of Duke Power if such contracts are reasonably likely to have an Effect on Duke Power's Rates or Service (as defined in the conditions). First, Duke Power must obtain the Commission's permission before engaging in such inter-affiliate transactions. Second, the contracts themselves must provide that Duke Power's participation in the agreement is voluntary, that Duke Power is not obligated to take or provide services or make any purchases or sales pursuant to the agreement, and that Duke Power may elect to discontinue its participation in the agreement at its election after giving any required notice. Third, the contracts must provide that Duke Power may not (a) make or incur a charge under the contract except in accordance with North Carolina law, or (b) seek to reflect in rates any cost incurred or revenue earned under the contract except as permitted by the Commission.

As a result of Regulatory Condition No. 1, Duke Power's obligation to make purchases pursuant to the inter-affiliate contract would be voluntary, and its obligation to pay charges under the contract would be limited to those charges determined by the Commission to be consistent with Duke Power's obligation under state law to charge just and reasonable rates. This approach responds directly to the "trapped cost" reasoning used in the Supreme Court decisions discussed above. If the FERC-jurisdictional contract (the "filed rate") itself provides that Duke Power's participation is voluntary and limits Duke Power's obligation to one that is consistent with state law and the amount allowed into rates, there can be no "trapped costs" and, therefore, no preemption.

Subsection (c) of Regulatory Condition No. 1 provides a mechanism for enforcing the foregoing by requiring Duke Power to file with the Commission any proposed affiliate contract or amendment 30 days prior to filing it with the FERC. This allows parties and the Commission an opportunity to determine if a proposed contract poses a risk of preemption and provides a process for handling objections.

Regulatory Condition No. 7 serves a number of purposes. Subsection (d) prohibits Duke Power from making a variety of constitutional arguments that could otherwise inhibit the Commission's authority with respect to wholesale contracts in which Duke Power is the seller. The first sentence of Regulatory Condition No. 7(d)(iv) is designed to protect the Commission's jurisdiction to make retail ratemaking decisions involving Duke Power's wholesale contracts from claims of federal preemption based upon the Commerce Clause. The second sentence of Regulatory Condition No. 7(d)(iv)

creates an exception that allows Duke to claim "that a specific exercise of authority by the Commission violates the Commerce Clause." At the January 18, 2006 oral argument in this docket, Duke and the Public Staff expressed different views as to the scope of Regulatory Condition No. 7(d)(iv). Duke stated that the exception would apply anytime "you had a Duke-specific case and you looked at a specific transaction and issued an order...." The Public Staff stated that the exception would only apply to a Commission order "that bore no relationship to the facts or evidence...it was irrational, capricious...it was a pretty egregious action." CUCA argues in its brief that the exception in the second sentence is too broad and should be eliminated altogether.

The Commission notes that Progress Energy Carolinas, Inc. (Progress), has a similar regulatory condition and that Progress' condition was discussed before the Commission at an August 30, 2004 conference in Docket No. E-2, Sub 844. At that conference, Progress and the Public Staff "stated that their intent was to bar Commerce Clause challenges globally and only allow them based on specific evidence of undue interference. Progress and the Public Staff agreed that 'what could not be done under this thing would be to say that any condition, period, constituted an implicit Commerce Clause violation, but that instead a showing would have to be made of...undue interference with interstate commerce on a case-by-case basis on the facts of that specific case.'" Order Revising Regulatory Conditions and Code of Conduct (Docket No. E-2, Sub 844, September 15, 2004). The Commission adopted this interpretation of the Progress condition and concluded that the Progress condition put the Commission in a position to protect retail ratepayers. "The primary tool for protecting ratepayers has always been the Commission's authority to set retail rates. That authority is recognized by the new condition and is protected from many challenges that Progress would otherwise be able to assert." Id.

The Commission believes that the interpretation and application of Duke Power's Regulatory Condition No. 7(d)(iv) should be consistent with the comparable regulatory condition of Progress since the two are similarly worded and are intended to address the same issue. In order to accomplish this result, the Commission has revised the proposed Regulatory Condition No. 7(d)(iv) by changing "general statutory authority of" in the first sentence to "exercise of authority by" (which is the wording of the Progress condition) and by adding "based upon specific evidence of undue interference with interstate commerce" at the end of the second sentence (which is the interpretation of the Progress condition adopted by the Commission in the September 15, 2004 order in Docket No. E-2, Sub 844).

(b) Market-Based Tariffs. Market-based rates present additional issues that need to be addressed by the conditions in order to protect the Commission's jurisdiction. The FERC approved, by order dated November 22, 2005, the market-based tariffs filed August 19, 2005, by Cinergy Services, Inc., on behalf of CG&E, PSI, ULH&P, and Cinergy's marketing affiliates. These FERC-approved tariffs establish the rate that will apply to affiliate sales. Cinergy's filing explicitly states that the market-based rate tariffs proposed therein will be further amended prior to the Merger closing to include appropriate affiliate safeguards with respect to any relevant new Duke Energy

affiliates. Regulatory Condition No. 4 is intended to protect the Commission's jurisdiction in this regard by prohibiting Duke Power from buying and selling electricity except as specifically provided in the condition. In addition, both Regulatory Condition No. 1 and Regulatory Condition No. 7 offer protection. Any proposed tariff revisions to include Duke Power will have to be pre-filed with the Commission pursuant to Regulatory Condition No. 1(c) 30 days in advance of their being filed with the FERC. The prohibitions against making various constitutional arguments in Regulatory Condition No. 7(d) are explicitly applicable to master and service agreements under Duke Power's market-based rate tariff.

The FERC's market-based tariff analysis also potentially raises preemption issues as to resource adequacy. Before allowing market-based pricing, the FERC has required a showing that there is direct head-to-head competition either in a formal solicitation or in an informal negotiation process that does not provide a preference to an affiliate.[4] The FERC has explicitly stated that this does not involve a determination that the buyer has evaluated all supply and demand-side options and prudently chosen from among them, noting that such a determination is primarily a state commission matter. However, an argument with respect to preemption could be made. While several of the conditions are relevant, Regulatory Condition No. 8 specifically prohibits Duke Power and its affiliates from asserting that approval by the FERC of market-based rates, transfers of generating facilities, or any matter that involves affiliates in any way preempts the Commission's authority to determine the reasonableness or prudence of Duke Power's decisions with respect to supply-side resources, demand-side management, or any other aspect of resource adequacy.

(c) The Potential for a Holding Company System Integration Agreement. Because Cinergy currently is a registered holding company with multiple public utilities that formerly operated pursuant to a FERC-approved integration agreement,[5] the Public Staff notes in its brief that additional attention was paid to the potential risk of preemption in this regard. Due to the repeal of PUHCA 1935, Duke no longer intends to enter into a formal integration agreement as initially proposed in its FERC Merger Application. Even without this requirement, however, there is a risk that an inter-affiliate agreement could be interpreted as such an agreement.

There is little question that the FERC has exclusive jurisdiction to approve the wholesale rates paid and received by, and to approve the allocations of power among, public utility members of a holding company system. As a result, Regulatory Condition No. 9 specifically provides that Duke Power cannot enter into an agreement, and no filing with the FERC can be made by it or on its behalf, that (a) commits Duke Power to, or involves it in, joint planning, coordination, or operation of generation, transmission, or distribution facilities with one or more affiliates, or (b) otherwise alters Duke Power's

---

[4] Boston Edison Co. Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382 (1991).

[5] Until January 1, 2006, CG&E and PSI operated pursuant to the Joint Generation Dispatch Agreement approved by the FERC on March 18, 2002, Cinergy Services, Inc., 98 FERC ¶ 61,306 (2002), and revised on March 25, 2005, Cinergy Services, Inc., Letter Order, ER05-640-000 (dated March 25, 2005).

obligations with respect to these Regulatory Conditions, absent explicit approval of the Commission.

In addition, Regulatory Condition Nos. 5 and 6 specifically impose a continuing obligation on Duke Power to pursue least cost integrated resource planning and remain responsible for its own resource adequacy subject to Commission oversight, and require that Duke Power's ratepayers receive priority with respect to the planning and dispatch of its system generation.

Regulatory Condition No. 10 provides added protection in this regard by requiring Duke Power and its affiliates to file notice with the Commission 30 days prior to filing with the FERC any agreement, tariff, or other document or any proposed amendments, modifications, or supplements to any such document having the potential to (a) affect Duke Power's cost of service for its pre-merger system power supply resources or transmission system; (b) be interpreted as involving Duke Power in joint planning, coordination, or operation of generation or transmission facilities with one or more affiliates; or (c) otherwise affect Duke Power's rates or service.

(d) Other Issues. Other potential preemption risks presented by the proposed Merger relate to (1) potential RTO membership, (2) Duke Power's Independent Entity (IE) Application at the FERC, (3) Duke and Cinergy's FERC Merger Application, and (4) currently pending rulemaking proceedings and potential future revisions of PUHCA 2005 that could affect the proposed conditions.

With respect to RTO membership (and any proposed transfer of control, operational responsibility, or ownership), Regulatory Condition No. 3 requires a 30-day notice and specific protective language in any contract and in any filing with the FERC with respect to the transfer by Duke Power of the control of, operational responsibility for, or ownership of any generation, transmission, or distribution assets (in excess of $10 million gross book value) used to provide retail service to its North Carolina retail customers. In addition, Regulatory Condition No. 11 specifically requires any contract or filing regarding Duke Power's membership in or withdrawal from an RTO or comparable entity to be contingent upon state regulatory approval.

With respect to Duke Power's IE Application at the FERC, Regulatory Condition No. 12 provides that, if the FERC (1) does not approve the specified sections of the OATT Attachment K and Duke Power's IE Agreement dated July 22, 2005, both of which were filed with the FERC in Docket No. ER05-1236-000 on July 22, 2005, or (2) makes any change that would make the IE a FERC-jurisdictional entity or otherwise affect the Commission's jurisdiction over the transmission component of Duke Power's retail service or rates, then Duke shall withdraw the filing and exercise its right to terminate the IE Agreement, absent an order from the Commission explicitly relieving Duke Power of this obligation. Subsequent to the filing of the stipulated conditions, the FERC approved the IE Application without condition; however, this condition should be retained to protect against any subsequent orders that may be issued by the FERC.

With respect to potential preemption risks posed by Duke and Cinergy's FERC Merger Application, the Commission notes that the FERC has approved the Application without imposing any conditions of concern. However, at least one rehearing petition has been filed, and the FERC has not yet acted on that petition. Therefore, Regulatory Condition No. 16 explicitly provides that upon a decision by the FERC on the petition for rehearing, Duke Power shall meet promptly with the Public Staff and negotiate in good faith whether and how these Regulatory Conditions might be or have been affected by such order, and whether changes are necessary to maintain their intended protections. In the event the parties are unable to reach agreement within a reasonable time, the unresolved issues shall be submitted to the Commission for resolution. Such resolution would be subject to appeal.

Finally, Regulatory Condition No. 15 provides for subsequent determinations as to whether any condition would need to be revised based upon currently pending rulemaking proceedings that could affect the proposed conditions, and upon the repeal or revision of PUHCA 2005.

Additional conditions have been included to provide additional, more generic protections against the risk of preemption. Specifically, Regulatory Condition No. 13 prohibits Duke Power and its affiliates from asserting in any forum that the Commission is in any way preempted from exercising any authority it has under North Carolina law, and prohibits Duke and its affiliates from supporting such arguments if any other entity were to make them. Regulatory Condition No. 14[6] requires Duke Power and its affiliates to bear the full risk of any preemptive effects of federal law and to take all actions as may be reasonably necessary and appropriate to hold North Carolina ratepayers harmless.

(2) Inter-Affiliate Financings

With respect to issues presented by inter-affiliate financings, the Commission is familiar with these from issues raised in the Carolina Power & Light Company (CP&L) holding company proceeding (Docket No. E-2, Sub 753). In this regard, the Commission notes that § 204(a) of the FPA, 16 U.S.C. § 824c(a), provides the FERC with authority comparable to that granted to the Commission in G.S. 62-161. With respect to preemption, however, § 204(f) provides that the FERC's authority does not extend to a public utility organized and operating in a state in which its security issuances are regulated by a state commission. Thus, the FERC's financing authority does not encompass a public utility organized and operating in North Carolina.

[6] The Commission has revised proposed Regulatory Condition Nos. 14 and 29 to add "Affiliates" to the list of entities subject to the specific provisions set forth therein. This change would ensure that the language of these Regulatory Conditions is consistent with other Regulatory Conditions, such as Nos. 8, 10, 13, 14, 20, 22, 24, 27, etc. which apply to Duke Power, Duke Energy Corporation, Affiliates, and Nonpublic Utility Operations.

While EPACT 2005 did not amend § 204, it did change the FERC's authority vis-à-vis the SEC. Section 318 of the FPA, 16 U.S.C. § 825q, provides that, with respect to the issuance, sale, or guaranty of a security or assumption of an obligation or liability in respect of a security, or the acquisition or disposition of any security, capital assets, facilities, or any other subject matter, if a person is subject to both PUHCA 1935 and the FPA, such person shall not be subject to the FPA with respect to the same subject matter. Section 1277(a) of EPACT 2005 repealed § 318. Thus, the FERC now has authority over the issuance of securities and the assumption of liabilities by public utilities that it previously could not have had. However, because § 204(f) has not been changed, the Commission concludes that this should have relatively little preemptive effect on the Commission's authority.

Although there appears to be relatively little risk of preemption with respect to the Commission's authority over financings, Regulatory Condition No. 2 provides that, with respect to any financing transaction involving Duke Power and its affiliates, any proposed contract must provide (1) that Duke Power may not enter into any such financing transaction except in accordance with North Carolina law and the Commission's rules, regulations, and orders and (2) that Duke Power may not include the effects of any capital structure or debt or equity costs associated with such financing transaction in its North Carolina retail cost of service or rates except as allowed by the Commission. Regulatory Condition Nos. 13 and 14 again would serve as catch-all provisions in the unlikely event the other conditions did not control a particular risk of preemption.

(3) Mergers and Acquisitions under § 203 of the FPA, including Amendments to § 203 by EPACT 2005

The following issues are presented by § 203 of the FPA and the amendments in EPACT 2005 to the FERC's § 203 authority: (a) the expansion of the FERC's § 203 authority to include certain generating facilities and certain holding company transactions and (b) the requirement for findings about cross-subsidization and pledging and encumbrances of utility assets.

(a) Generating Facilities and Holding Company Transactions. Prior to the EPACT 2005 amendments, the FERC's authority under § 203 of the FPA, 16 U.S.C. § 824b, did not extend to transactions involving the acquisition of generating facilities or to certain acquisitions by holding companies. Section 1289 of EPACT 2005, in relevant part, amends § 203 of the FPA to include these types of transactions.

Amended § 203(a)(1)(D) states that no public utility shall, without first having secured an order of the FERC authorizing it to do so, purchase, lease, or otherwise acquire an existing generation facility (i) that has a value in excess of $10 million and (ii) that is used for interstate wholesale sales and over which the FERC has jurisdiction for ratemaking purposes. In its order implementing the amendments,[7] the FERC adopted a

[7] Transactions Subject to FPA Section 203, Order No. 669, 113 FERC ¶ 61,315 (December 23, 2005) (Section 203 Final Rule).

rebuttable presumption that amended § 203(a) as it applies to the transfer of any existing (i.e., operational) generation facility unless the utility can demonstrate with substantial evidence that the generating facility is used exclusively for retail sales.

The FERC's Section 203 Final Rule generally recognizes that Congress did not intend any infringement on state jurisdiction. In addition, as stated before, the FERC's jurisdiction under § 203 has always been viewed as concurrent with state jurisdiction. In any event, Regulatory Condition Nos. 1, 3, 8 and 10 all protect the Commission's jurisdiction in this regard. As discussed earlier, Regulatory Condition No. 8 specifically prohibits Duke Power and its affiliates from asserting that approval of a transfer of generating facilities by the FERC in any way preempts the Commission's authority to determine the reasonableness or prudence of Duke Power's decisions with respect to supply-side resources, demand-side management, or any other aspect of resource adequacy. Regulatory Condition Nos. 13 and 14 again serve as catch-all provisions in the unlikely event the other conditions did not control a particular risk of preemption.

Section 203(a)(2) adds the entirely new requirement that no holding company in a holding company system that includes a transmitting utility or an electric utility shall (1) purchase, acquire, or take any security with a value in excess of $10 million or (2) by any means whatsoever, directly or indirectly, merge or consolidate with a transmitting utility, an electric utility company, or a holding company in a holding company system that includes a transmitting utility, or an electric utility company, with a value in excess of $10 million, without prior Commission authorization.[8]

The scope of amended § 203(a)(2) turns in large part upon the FERC's interpretation of the term "electric utility company," which, in turn, affects whether an entity is a holding company subject to § 203(a)(2). The FPA does not include a definition of "electric utility company," and the FERC concluded in its Section 203 Final Rule that the term, as used in amended § 203(a)(2), should have the same meaning as in PUHCA 2005, which is "any company that owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale." EPACT of 2005 at § 1262(5).

Because of concerns expressed by parties to the rulemaking, the FERC included the following language in its Section 203 Final Rule:

> Our core jurisdiction under Part II of the FPA continues to be transmission and sales for resale of electric energy in interstate commerce and we believe that a major impetus behind § 203(a)(2) was to clarify the Commission's jurisdiction over mergers of holding companies that own public utilities as defined in the FPA. However, the fact is that the language in § 203(a)(2) does more than address this issue, and we must implement the provision in a way that

[8] Section 203(a)(6), which is also new, provides that for purposes of this subsection, the terms "associate company," "holding company," and "holding company system" have the meaning given those terms in PUHCA 2005.

> recognizes the expansion of authority, yet retains our primary focus on interstate wholesale energy markets and does not interfere unduly with historical state jurisdiction.[9]

There appears to be relatively little risk of preemption as a result of this amendment to § 203. Nevertheless, to the extent there is any risk, Regulatory Condition Nos. 2, 13 and 14, as discussed above, apply.

(b) Cross-Subsidization. In its Section 203 Final Rule, the FERC required § 203 applicants to include an explanation of (1) how they are providing assurances that the proposed transaction will not result in cross-subsidization or improper pledges or encumbrances of utility assets or (2) if such results would occur, how those results are consistent with the public interest. With respect to the effect of this requirement on state jurisdiction, the FERC explicitly stated that any additional conditions imposed by it would complement, not nullify, those imposed by state commissions. The Commission therefore concludes that the conditions previously discussed in this section provide adequate protection from any risk of preemption.

(4) Inter-Affiliate Transactions Involving Non-Power Goods and Services under PUHCA 2005

The issues raised by PUHCA 2005 generally include the following: (a) federal access to books and records pursuant to § 1264; (b) the allocation of costs of non-power goods and services supplied to a public utility by an affiliated company, including the FERC's authority to review the recovery in jurisdictional rates, and whether cost allocation agreements have to be filed as agreements affecting jurisdictional rates; and (c) the potential for preemption pursuant to § 1275(b) at the request of a holding company system or a state commission.

Section 1261 et seq. of EPACT 2005, repeals PUHCA 1935 and enacts PUHCA 2005. As interpreted by the FERC in its implementing order,[10] PUHCA 2005 contains only two grants of new authority to the FERC: (1) the federal books and records access provision in § 1264 and (2) the non-power goods and services provision in § 1275(b), both of which supplement the FERC's existing authorities under the FPA (and the Natural Gas Act).

(a) Access to Books and Records. Sections 1264(a) and (b) of EPACT 2005 generally provide that each holding company and each associate company of a holding company, as well as each affiliate of a holding company or any subsidiary company of a holding company, shall maintain, and shall make available to the FERC, such books, accounts, memoranda, and other records (books and records) as the FERC determines are relevant to the costs incurred by a public utility and necessary or appropriate for the

---

[9] Section 203 Final Rule, ¶ 56.

[10] Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, Order No. 667, FERC Stats. & Regs. ¶ 31,197 (December 8, 2005) (PUHCA 2005 Final Rule).

protection of public utility customers with respect to jurisdictional rates. With respect to preemptive concerns, the FERC confirmed that its own access under § 1264 does not preempt rights to access information by state commissions under § 1265.[11]

(b) Section 1275: The Allocation of Costs of Non-Power Goods and Services. In its PUHCA 2005 Final Rule, the FERC stated that there are two circumstances in which the "at-cost" or "market" standard may arise in the context of its jurisdictional responsibilities under § 205 and § 206 of the FPA. First, the FERC has a responsibility to ensure that the costs of non-power goods and services provided by a traditional, centralized service company to public utilities within the holding company system are just, reasonable, and not unduly discriminatory or preferential for purposes of FERC-jurisdictional rates. The second context in which the "at-cost" or "market" standard is likely to arise is when a service company that is a special-purpose company within a holding company (e.g., a fuel supply company or construction company) provides non-power goods or services to one or more public utilities in the same holding company system.

The FERC concluded that traditional, centralized service companies currently using the SEC's "at-cost" standard would not be required to comply with the FERC's market standard for their sales of non-fuel, non-power goods and services to regulated affiliates. The FERC agreed with commenters that centralized provision of accounting, human resources, legal, tax, and other such services benefits ratepayers through increased efficiency and economies of scale. It, therefore, decided to apply a rebuttable presumption that costs incurred under "at cost" pricing of such services are reasonable, with the proviso that it would entertain complaints that "at cost" pricing for such services exceeds the market price.

With respect to non-power goods and services transactions between holding company affiliates other than traditional, centralized service companies (i.e., service companies that are non-regulated, special-purpose affiliates such as a fuel supply company or a construction company), the FERC concluded that it would continue its prior policy of requiring the service company to provide non-power goods and services at a price no higher than market. When a public utility is providing non-power goods and services, the price should be the higher of cost or market.

With respect to concerns that were expressed about the potential preemptive effect of FERC review of cost-allocation agreements, the FERC concluded that it would not mandate the blanket filing of cost-allocation agreements governing the costs of non-power goods and services purchased by jurisdictional public utilities from affiliated service companies under § 1275(b) of EPACT 2005.[12]

Based upon the foregoing, the Commission concludes that the provisions of PUHCA 2005 other than § 1275(b) do not present risks of preemption different from other aspects of the FERC's authority. As a result, the conditions previously discussed,

---

[11] Id., at ¶ 105.
[12] Id., at ¶ 151.

particularly Regulatory Condition Nos. 1, 9, and 10, apply to protect the Commission's jurisdiction from preemption, with Regulatory Condition Nos. 13 and 14 again serving as catch-all provisions.

(c) The Potential for Preemption Pursuant to § 1275(b). With respect to the preemptive effect, if any, of a FERC-approved service company cost allocation, the FERC's PUHCA 2005 Final Rule does not clearly answer the question.

Section 1275(b) provides as follows:

> In the case of non-power goods or administrative or management services provided by an associate company organized specifically for the purpose of providing such goods or services to any public utility in the same holding company system, at the election of the system or a State commission having jurisdiction over the public utility, the Commission [FERC], after the effective date of this subtitle, shall review and authorize the allocation of the costs for such goods and services to the extent relevant to that associate company.

In its comments in response to the FERC's Notice of Proposed Rulemaking, the Missouri Public Service Commission argued that an interpretation of § 1275(b) giving FERC-approved cost allocations preemptive effect would be contrary to the clear language contained within § 1275(c), which provides that "[n]othing in this section shall affect the authority of the Commission or a state commission under other applicable law." The Missouri Commission further argued that, since state commissions have state law authority to set retail rates, including authority to disallow purchase costs or sales prices deemed unreasonable or imprudent, § 1275(c) on its face protects the state commissions from any asserted preemptive effect of a FERC allocation under § 1275(b). A number of utilities argued (1) that the FERC would need to impose a specific methodology in a situation in which a multi-state holding company system finds that all state commissions do not approve a single allocation agreement and (2) that any FERC-approved cost allocations under § 1275 would necessarily preempt state determinations.

The FERC concluded as follows:

> In response to the requests for clarification of the preemptive effects of section 1264 and the Commission's regulations thereunder, we believe that issues related to preemption are more appropriately addressed on a case-by-case basis to give the Commission the opportunity to consider the potential preemptive effect of section 1264 in specific circumstances. However, we anticipate that such issues would arise only in unusual circumstances.[13]

[13] Id., at ¶ 180 (emphasis added).

Given the reference to § 1264, rather than § 1275(b), which was the section under discussion in the preceding paragraphs of the FERC order, the FERC's position with respect to the preemptive effect of § 1275(b) cannot be conclusively determined.

The Regulatory Conditions and Code of Conduct adopted herein impose fairly strict rules with respect to affiliate transactions, particularly with respect to those involving a service company, and the Commission maintains comprehensive oversight of Duke Power's affiliated transactions and cost allocations. For example, under Regulatory Condition No. 18, Duke Power cannot seek to recover from its retail customers any costs that exceed fair market value (as defined in the conditions) for any service provided to Duke Power by an affiliate, and Duke Power is required to seek out and buy all goods and services from the lowest cost qualified provider of comparable goods and services. Duke Power has the burden of proving that all goods and services procured from its affiliates have been procured on terms and conditions comparable to the most favorable terms and conditions reasonably available in the relevant market, which must include a showing that comparable goods or services could not have been procured at a lower price from qualified non-affiliate sources or that Duke Power could not have provided the services or goods itself on the same basis at a lower cost.

Under Regulatory Condition No. 20, Duke Power is required to re-file its proposed final forms of service agreements that authorize the provision and receipt of non-power goods or services between and among Duke Power and its affiliates, the lists of goods and services it intends to take from the proposed service company and other affiliates, the basis for the determination of such lists and election of such services, and appropriate cost allocation manuals (CAMs). The required CAMs must be updated annually, and neither the lists of goods and services nor the CAMs can be changed except upon the filing of a 15-day notice with the Commission.

Except to the limited extent to which Regulatory Condition No. 21 provides otherwise, no claims of preemption can be made with respect to the allocation of costs. In addition, Regulatory Condition No. 21 does not apply to the list of services a utility chooses to take from a service company, and, therefore, neither Duke Power nor Duke Energy can make any claims of preemption with respect to the services the Commission allows Duke Power to take. For example, under Regulatory Condition No. 18, Duke Power cannot take a service from a service company unless it has carried its burden of proving that it could not have procured the service at a lower price from qualified non-affiliate sources, that it could not have provided the service itself on the same basis at a lower cost, or that no comparable service is available. Requiring Duke Power to provide the service for itself or to take it from a non-affiliate is not subject to any preemptive effect that § 1275(b) may ultimately be determined to have.

In addition, the exception provided in Regulatory Condition No. 21 with respect to the other anti-preemption conditions is more limited than the provisions of §1275(b). This section allows the holding company system to request review by the FERC. Regulatory Condition No. 21 only allows Duke Power to make such a request. In addition, any such request is limited to "the extent the allocations adopted by the

Commission when compared to the allocations adopted by the other State commissions with ratemaking authority as to a Utility Affiliate of Duke Power result in significant trapped costs," which is considerably narrower than the language used in § 1275(b).

In conclusion, it is not clear that § 1275(b) will have any preemptive effect given the savings clauses in PUHCA 2005 and the FERC's interpretation in its PUHCA 2005 Final Rule (particularly if one assumes that the reference to § 1264 was inadvertent). If it does, it is further limited as described above. The Public Staff stated in its brief that it believes that allowing this potential narrow preemption risk was an appropriate trade off given the waiver of all the federal rights by Duke Power, Duke Energy, and other affiliates in the other conditions, and the Commission agrees.

In addition to the above discussion of the anti-preemption Regulatory Condition Nos. 1 through 17, the Commission must also address in more detail several specific arguments and proposed revisions made by CUCA.

CUCA's primary substantive attack on the effectiveness of the anti-preemption conditions is the argument that the conditions do not protect Duke Power's ratepayers from an assertion of preemption by third parties. The Commission concludes that many of the conditions do provide such protection. An excellent example is Regulatory Condition No. 1, which makes an affiliate contract unenforceable against Duke except to the extent the Commission approves the costs. Regulatory Condition No. 1 limits the utility's obligation to pay charges under the contract to those charges determined by the Commission to be consistent with the utility's obligation under state law to charge just and reasonable rates. As previously discussed, this approach responds directly to the "trapped cost" reasoning of the Supreme Court. If a FERC-jurisdictional contract itself provides that the utility's participation is voluntary and limits the utility's obligation to one that is consistent with state law, there would be no "trapped costs" and, therefore, no preemption. Regulatory Condition Nos. 2 and 3, which apply to financings and asset transfers, respectively, are very similar to Regulatory Condition No. 1. They also provide protection against challenges by third parties.

It is difficult to perceive how a third party would have standing to challenge Regulatory Condition Nos. 5 though 7 on preemption grounds. If a third party were found to have standing, it is difficult to perceive how it could successfully argue that the Commission's authority to require least cost planning, the dedication of Duke Power's generating facilities to retail native load customers (as defined in the conditions), and the Commission's ratemaking and other types of authority with respect to Duke Power's wholesale contracts as seller was preempted. The retail loads of the historically served wholesale customers are the only third parties that have any sort of claim on Duke Power's generating facilities, and they have been included in the protections provided by Regulatory Condition Nos. 5 though 7.

Regulatory Condition No. 10 requires the pre-filing of certain contracts that are required or intended to be filed at the FERC. Given the North Carolina appellate courts'

recent affirmations of the Commission's authority relating to the 20-day notice required by the Commission in Docket No. E-2, Sub 760 (appealed in Docket No. E-100, Sub 85A), a successful third-party challenge to this condition appears to be unlikely.

The provisions of Duke's OATT and IE Agreement referenced in and protected by Regulatory Condition No. 12 have already withstood numerous arguments before the FERC that they should be rejected. The FERC approved the OATT without change to the provisions protecting the ability of Duke to withdraw the OATT and terminate the IE Agreement if a negative effect on the Commission's jurisdiction were to occur.

Regulatory Condition No. 13 recognizes that another entity could make preemption arguments and prohibits Duke Power and its affiliates from supporting any such arguments. This condition is similar to several conditions imposed, without objection by CUCA, in various merger proceedings. See Docket Nos. E-2, Sub 753 (Condition Nos. 2, 7, and 12); E-2, Sub 760 (Condition No. 15); E-22, Sub 380 (Condition Nos. 31, 38, and 41); G-5, Sub 400 (Condition Nos. 2, 9, and 12); and E-2, Sub 844 (Condition Nos. 6, 9, and 11).

Finally, Regulatory Condition No. 14 provides the ultimate protection. It requires Duke Power and its affiliates to (1) bear the full risk of any preemptive effects of federal law with respect to any contract, transaction, or commitment entered into or made by Duke Power or which may otherwise affect Duke Power's operations, service, or rates and (2) take all actions as may be reasonably necessary and appropriate to hold North Carolina ratepayers harmless.

In conclusion, as demonstrated above, the anti-preemption conditions are not particularly susceptible to third-party challenges. In any event, they require Duke Power and its affiliates to bear any effects and hold Duke Power's ratepayers harmless from any preemption.

CUCA's other objections do not go to the effectiveness of the conditions as protection against preemption, but rather are specific proposals that object to the wording of the conditions.

During the hearing, counsel for CUCA cross-examined the Public Staff with respect to the meaning of "affect Duke Power's rates or service" and "have an effect on Duke Power's rates or service" in a number of conditions. In response, Duke and the Public Staff proposed to create a definition of "Effect on Duke Power's Rates or Service" and replace "affect Duke Power's rates or service" and "have an effect on Duke Power's rates or service" in the definition of "Affiliate Contract," and in Regulatory Condition Nos. 2(b), 10, 13, and 22. That definition is as follows:

> **Effect on Duke Power's Rates or Service**: When used with reference to the consequences to Duke Power of actions or transactions involving an Affiliate or Nonpublic Utility Operation, this phrase has the same meaning that it has when the Commission

interprets G.S. 62-3(23)(c) with respect to the affiliation covered therein.

The Public Staff explained at the oral argument that the purpose of this definition and its use in the specified conditions was to incorporate into the Regulatory Conditions the concept in G.S. 62-3(23)(c) with respect to the extent to which affiliation can cause an affiliate to be found to be a public utility.

In the revised conditions it filed on January 17, 2006, CUCA proposed to replace "affect Duke Power's rates or service" and "effect on Duke Power's rates or service" with a different defined term, "Effect." This defined term would be included in the definition of "Affiliate Contract," Regulatory Condition Nos. 2(a), 10, 13, 14, and 17, as well as in Regulatory Condition Nos. 20(d), 22, 23, 26,27, 28, 29, 32, 38, 55, and 57. CUCA would define the term "Effect" as follows:

> **Effect**: Any effect on Duke Power's rates and/or services to its North Carolina retail customers, including but not limited to an increase in fuel costs or fuel-related costs for which Duke Power seeks recovery pursuant to G.S. 62-133.2, a change of one (1) basis point (one-tenth of one percent) or more in Duke Power's quarterly or annual earnings in the ES-1 report, a ratings downgrade, a change of $100,000 or more in the net bulk power revenues ordered to be shared by the Commission in Docket No. E-7, Sub 751, an appreciable change in service quality perceptible by a reasonable person, asset transfers and sales, and change(s) in operation, efficiency, interchange, pooling, wholesale power sales agreements, and financing.

CUCA stated at the oral argument that more specificity was needed in the conditions, particularly with respect to establishing a floor to ensure that it was clear that a particular contract or action fell within a condition. Duke Energy and the Public Staff took the position that specifically defining a term can lead to unintended consequences over time and limit the Commission's ability to make appropriate case-by-case determinations based upon the facts at the time the determination is made. They also argued that attempting a specific definition could create confusion as to the meaning of the term in its broader application in Chapter 62. The Commission concludes that CUCA's proposed definition should be rejected. The terms "effect" and "affect" are used in Chapter 62 without definition, so the Commission has the ability to determine their meanings based upon the facts and circumstances of each case at the time the interpretation is made. It is the Commission's responsibility to decide in a particular case whether a transaction or action has the necessary effect. CUCA's proposed definition could be both too limiting and not limiting enough, depending upon the particular circumstances to which it is being applied.

In addition, CUCA proposed to insert "any adverse Effect to Duke Power's North Carolina retail ratepayers" into Regulatory Condition No. 2(b) and "Effect that is adverse

to the ratepayers' interest associated with or related to [such preemption]" into Regulatory Condition No. 14. The term "Effect," as defined by CUCA, already includes a substantial list of adverse effects. While CUCA explained this additional language at the oral argument as reflecting a desire to capture any positive effects, the Commission finds it to be an added complication that is unnecessary.

CUCA also proposed to revise Regulatory Condition No. 2(a) to deem new Duke Energy to be a public utility for purposes of the Commission's securities authority and G.S. 62-111 and to have waived all of its federal and constitutional challenges with respect to such authority. This is an expansion of the Commission's authority, rather than a protection of the Commission's authority from preemption. This would be more appropriately accomplished, if at all, with a revision to Regulatory Condition No. 41, and it is discussed in that section of this order.

CUCA further proposed to revise Regulatory Condition No. 3 to state that it applies to transfers that, either alone or collectively, have a gross book value in excess of $10,000,000 in any calendar year. Duke Energy and the Public Staff argued that the condition as written provides sufficient protection. The book value of $10,000,000 proposed in Duke Energy and the Public Staff's stipulated conditions would be a very small fraction of Duke Power's gross book value. Additionally, subjecting such a small amount to the condition would be an inefficient use of resources. Furthermore, it is illogical to approve a condition that could require Duke Power to provide notice, after having made transfers totaling $9,900,000, for a transfer of $101,000. The Commission concludes that CUCA's proposed revision should be rejected.

In addition, CUCA proposed to revise Regulatory Condition No. 4 to clarify its relationship to various sections of the Code of Conduct, to specify that the costs incurred are "total all-in" costs, and to delete the exception for emergency transactions. The Commission concludes that this condition should be revised to specify that the costs incurred are "total all-in costs, including, but not limited to, generation, transmission, ancillary costs, distribution, and delivery points costs," but that the exception for emergency transactions should be retained. This exception has been approved in other proceedings without objection or need for revision. See Docket No. E-2, Sub 760 (Condition No. 18) and Docket No. E-2, Sub 844 (Condition No. 54). As noted by the Commission during the oral argument, any such emergency transactions would be tracked, accounted for, and subject to review in both the required affiliate transaction report and in fuel clause proceedings. By their very nature, emergency transactions cannot be planned or subjected to rigid before-the-fact limitations. A utility must have some flexibility in the relatively few instances when the integrity of its transmission system, for example, requires unusual actions and transactions.

CUCA further proposed to revise Regulatory Condition No. 6 to delete "off-system" and to substitute "outside of its North Carolina and South Carolina retail franchised service territory or to any wholesale customer." This language would treat historically served wholesale customers as off-system sales, which is inconsistent with the protections intended by the condition. Duke Energy and the Public Staff took the

position that "off-system sales" should be deleted, but that it should be replaced with "sales to customers that are not Retail Native Load Customers." The Commission concludes that "off-system sales" should be replaced as proposed by Duke Energy and the Public Staff. CUCA's replacement language would exclude the historically served wholesale customers from protections intended to be granted to them in Regulatory Condition No. 7.

With respect to Regulatory Condition No. 7, CUCA proposed to delete subsection (a) in its entirety. This provision would allow Duke Power to grant its historically served wholesale customers native load priority, which would cause the retail native loads of those wholesale customers to be considered Retail Native Load Customers, as defined in the conditions, for purposes of Regulatory Condition Nos. 5 and 6. The Commission rejects CUCA's proposal to delete this provision for much the same reasons it found unpersuasive CUCA's opposition to including CP&L's historically served wholesale customers in a virtually identical condition approved by the Commission in Docket No. E-2, Sub 844. The Commission concludes that, given the interpretation of the condition as provided for in the Sub 844 proceeding and the benefits to all customer classes from such a condition, subsection (a) of Regulatory Condition No. 7 should not be deleted. CUCA's two additional proposed changes, to increase the notice period in Regulatory Condition No. 7(b) from 30 to 45 days and to delete the provision that exempts wholesale sales at less than native load priority from the notice provision, are also rejected.

CUCA also proposed to revise Regulatory Condition No. 17 to require Duke Power to provide the required lists and summaries to "the Public Staff and each Requesting Intervenor" and to provide, in addition to the lists and summaries already included in the condition, a list of each affiliate that has made one or more filings with the FERC and a summary of the content of each filing if the filing is made under seal. Duke Power and the Public Staff subsequently proposed revisions to Regulatory Condition No. 17 to require Duke Power to file with the Commission, but not serve, the required lists and summaries. The Commission concludes that Regulatory Condition No. 17 already requires Duke Power to compile and file with the Commission a substantial amount of information on a quarterly basis and that Duke Power should not be required to file the additional lists and summaries sought by CUCA. However, the Commission agrees with CUCA that all parties should receive copies of any information actually filed by Duke Power pursuant to Regulatory Condition No. 17, and the Commission will not include the phrase "but need not serve" in the condition. Duke Power, therefore, shall serve any information filed with the Commission pursuant to Regulatory Condition No. 17 on all parties, if any, to the applicable docket.

Finally, CUCA's proposal to define "Requesting Intervenor" and insert it into various conditions, including Regulatory Condition Nos. 1(a) and (c), 13, 15 and 17, is discussed and rejected later in this order.

In summary, based upon all of the foregoing, the Commission concludes that the Regulatory Conditions approved herein are comprehensive and do everything

reasonably possible to preserve the Commission's regulatory authority from the probability and risk of federal preemption. The mere risk of federal preemption as an abstract theory does not justify rejection of the proposed transaction. The slight risk that might remain, therefore, is entitled to very little weight in the balancing of the potential benefits and harms of the Merger identified in the record in this proceeding. Accordingly, based upon the conclusions of law discussed above with respect to the effectiveness and comprehensiveness of Regulatory Condition Nos. 1 through 17 approved herein, the Commission finds and concludes that Regulatory Condition Nos. 1 through 17 ensure that the Commission's jurisdiction is protected as much as possible from the probability of federal preemption and that Duke Power's ratepayers are insulated as much as reasonably possible from the probability of any preemptive consequences potentially resulting from the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 16

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witnesses Hager and Shrum and Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff testified that Regulatory Condition No. 18 provides that Duke Power will not seek to recover more than fair market value for the services and costs provided by affiliates and establishes principles that will govern the prices at which goods and services are exchanged between and among Duke Power and its affiliates. Regulatory Condition No. 19 requires that the accounting for the provision of good and services among Duke Power and its affiliates be consistent with the conditions and Code of Conduct.

Regulatory Condition No. 20 deals with service agreements, the filing of cost allocation manuals and the lists of services Duke Power intends to offer to and take from affiliates. While the Public Staff believes efficiencies and cost savings can be achieved by the combination of a number of corporate and utility support functions, the service agreements as filed raise a number of concerns. Therefore, Regulatory Condition No. 20 sets forth procedures for the re-filing of the service agreements and recommendations from the intervening parties. In this regard, the Public Staff noted that Regulatory Condition No. 20 requires Duke to re-file final forms of service agreements and the lists of goods and services it intends to take from and provide to its affiliates no later than 60 days prior to the expected close of the Merger. Within 30 days after such filing, the Public Staff is required to file its comments and recommendations concerning these agreements with the Commission. Therefore, the Public Staff recommended that the Commission address these agreements after Duke Power has made its filing pursuant to Regulatory Condition No. 20 and the Public Staff and other parties have filed their recommendations with the Commission.

Regulatory Condition No. 21 provides that, notwithstanding any of the provisions contained in the conditions, if allocations adopted by the Commission result in significant trapped costs related to non-power goods or administrative or management

services, Duke Power may request, pursuant to EPACT 2005, that the FERC review the allocation of costs for such goods and services.

On cross-examination, the Public Staff testified that the purpose of the periodic market studies in Regulatory Condition No. 18 was to establish the reasonableness of the prices paid and the prudence of choosing to purchase from and sell to affiliates. When questioned about the frequency of the market studies and the reliance on Duke to perform the market studies, the Public Staff testified that how often market studies should be performed depends on the type of goods and services procured or provided and that Duke should be required to conduct the studies, rather than another entity, because it is in the market of purchasing goods and services. The Public Staff further stated that it would review the market studies and, because other utilities are subject to the same requirement, it can compare Duke's studies with other studies to determine their reasonableness.

Another issue raised on cross-examination of the Public Staff panel regarding Regulatory Condition No. 18(d) was the definition of, and exception for, items that are not commercially available. The Public Staff defined "not commercially available" as there being no equivalent service available in the market place, with the example of executive management as something specific or unique to Duke. When questioned by the Commission about the exception to transfer pricing for providing services from the service company to affiliates at fully distributed cost, Duke Energy witness Shrum stated that the conditions require that Duke be able to demonstrate on a periodic basis that costs coming from the shared services organization are comparable or better than market to show that Duke is not being charged more than it could secure those services elsewhere. She testified that, in Duke's current ongoing operations, it does comparisons to market on an annual basis for certain types of costs.

CUCA proposed that the market studies required by Regulatory Condition No. 18 be conducted by an independent auditor and that market studies be required every two years. Additionally, CUCA proposed to eliminate the "not commercially available" exception to the market study requirement.

After careful consideration, the Commission concludes that Duke Power should be responsible for conducting market price studies and that the frequency with which market price studies should be performed should not be set at two years, but rather the frequency should be determined based upon the nature of the goods and services being procured. Similar conditions have been approved without objection in other proceedings. (See Docket Nos. E-2, Sub 753 (Condition 21), E-2, Sub 380 (Condition 19) and E-2, Sub 844 (Condition 17).) In addition, the Commission concludes that it is appropriate to make an exception to Regulatory Condition No. 18 for goods or services that are not commercially available. The exception was included to recognize that market studies are unnecessary for goods or services that are not commercially available. This language is consistent with Duke's current Code of Conduct and with other Codes of Conduct approved by the Commission.

With respect to CUCA's concern about Regulatory Condition No. 20, on cross-examination, Duke witness Shrum was asked why Duke could not file the cost allocation manual prior to filing the service agreements and prior to asking for approval. She testified that the services agreements would tell the Commission how Duke plans to allocate the service company costs and that more time was needed to comply with the requirement.

The Public Staff panel testified that Duke Power is required to file the list of services that it intends to take from the service company and provide the basis for the election of services to be taken. Additionally, Regulatory Condition No. 20 requires Duke to file a revised CAM a month after the Merger closes, an annual update of the CAM, and a review of the allocation factors every two years.

CUCA proposed that CAM revisions should be filed prior to Duke Power undertaking the affiliate transactions and that the allocation factors in the CAM should be approved by the Commission and audited by a third-party independent auditor to ensure appropriate allocations.

After careful consideration, the Commission concludes that Regulatory Condition No. 20, as approved herein, is appropriate. Moreover, as discussed below, these conditions are intended to establish much broader and more detailed requirements related to pricing between and among affiliates and Duke Power's nonpublic utility operations than currently are in effect for Duke pursuant to orders in Docket No. E-7, Subs 694 and 596.

CUCA also proposed revising Regulatory Condition No. 21 to more specifically define "trapped cost" for purposes of Duke Power's ability to avail itself of the provisions of § 1275(b) of PUHCA 2005. As discussed earlier, Regulatory Condition No. 21 represents an appropriate balancing of interests and would not be improved by the revisions proposed by CUCA. Accordingly, its proposed revisions are rejected.

Based upon all of the foregoing, the Commission finds and concludes that Commission-approved Regulatory Condition Nos. 18 through 21 will effectively address known and potential risks and concerns related to cost allocation and ratemaking issues arising from the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn, CUCA witness O'Donnell, and Duke Energy witness Shrum.

The Public Staff witnesses testified that proposed Regulatory Condition No. 22 provides that affiliated transactions that are likely to have a significant effect on Duke Power's rates or service shall be reviewed annually by Duke Energy's internal auditors. The witnesses further testified that proposed Regulatory Condition No. 31

continues the current requirement that Duke Power file an annual report of affiliated transactions, and proposed Regulatory Condition No. 32 provides for the filing of third-party independent audit reports. With respect to cost of service, Further Revised Regulatory Condition No. 33 requires the filing of revisions to Duke Power's electric cost of service manual to reflect any changes to the cost of service resulting from the Merger.

Commission-approved Regulatory Condition No. 22 provides that transactions between Duke Power and other members of the Duke Energy holding company family that are reasonably likely to have a significant Effect on Duke Power's Rates or Service must be reviewed at least annually by Duke Energy's internal auditors. Moreover, the audits and all workpapers related to internal audits and all other internal audit workpapers related to affiliate transactions must be made available to and for review by the Public Staff and the Commission. Finally, Duke Energy will not oppose requests by the Public Staff or the Commission to review external audit workpapers.

CUCA's proposed Regulatory Condition No. 22 would apply to transactions that "either alone or collectively, will have or are reasonably likely to have an Effect [a defined term discussed elsewhere in this order]" and would place each Requesting Intervenor [another proposed defined term discussed elsewhere] along side the Public Staff.

With respect to applicability of this condition, the Commission believes CUCA's proposed change is unnecessary, as the consideration of whether affiliate transactions have a significant effect can take into account the interdependencies of affiliate transactions. The Commission also rejects CUCA's proposal that "each Requesting Intervenor" have the same right of access to audit reports and workpapers as the Commission and the Public Staff for the reasons given elsewhere in this order.

Regulatory Condition No. 31 provides that Duke Power shall file an annual report of affiliate transactions in the format prescribed by the Commission in Docket No. E-7, Sub 694. Changes may be made as necessary to the reporting requirements and submitted to the Commission for approval. None of the parties took issue with Regulatory Condition No. 31.

There was extensive testimony concerning third-party independent audits of affiliate transactions. Regulatory Condition No. 32, as originally proposed, required Duke Power to provide to the Public Staff and the Commission the third-party independent audit reports that were agreed to be submitted to the Kentucky Commission and the Attorney General in the stipulation in Case Number 2005-00228. Public Staff witness Cox testified that an independent audit would be conducted of affiliate transactions and that, to the extent that Duke Power participated in affiliate transactions related to the Service Agreements, such audit would cover those affiliate transactions. Witness Cox explained that it would be beneficial for there to be coordination between the states concerning the audit process. CUCA witness

O'Donnell testified that he would be more satisfied if this Commission required an independent audit specific to North Carolina as opposed to the Kentucky audit.

Proposed Regulatory Condition No. 32, as further revised by Duke Power and the Public Staff in their filing of January 27, 2006, provides that comprehensive third-party independent audits of affiliate transactions undertaken pursuant to the affiliate agreements filed in this docket will be conducted no less often than every two years and that the independent auditor will have sufficient access to the books and records of Duke Energy to perform the audits. Duke Power is required to identify one or more proposed independent auditors with the selection subject to Commission approval. Other parties may comment and propose additional auditors. Duke Power will provide the funds for the audit and will record the appropriate allocation of the cost of the audit in utility accounts, subject to review in a subsequent ratemaking proceeding. The auditor's reports will be filed with the Commission. Duke Power may request a change to the frequency of the audits in future years, subject to Commission approval. Duke Energy will endeavor to coordinate the affiliate transaction audits in the various states. To the extent separate independent audits continue to be performed in any of the states, Duke Power will provide the audit reports to the Public Staff and the Commission.

CUCA's proposed Regulatory Condition No. 32 would require comprehensive third-party independent audits of all affiliate transactions to which Duke Power is a party and all affiliate transactions that "have an Effect or are reasonably likely to have an Effect." The auditor would have sufficient access to the books and records to perform the audits. The audit reports would be provided to the Public Staff and each Requesting Intervenor. The independent auditor would be selected by the Commission, in cooperation with regulatory agencies in other states, from a list nominated by the Requesting Intervenors. The independent auditor would not be a governmental agency or a division of such an agency. The auditor's fees would be paid by Duke Energy to the Commission, which would be responsible for retaining the auditor and remitting the payments to the auditor.

After careful consideration, the Commission concludes that Regulatory Condition No. 32 should be modified to read as follows:

> Periodic comprehensive third-party independent audits of the affiliate transactions undertaken pursuant to the affiliate agreements filed in this docket (as subsequently re-filed in accordance with Regulatory Condition No. 20 and allowed to go into effect by the Commission) shall be conducted no less often than every two years. The independent auditor shall have sufficient access to the books and records of Duke Power, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations to perform the audits. The scope of the audits shall include Duke Energy Corporation's and Duke Power's compliance with all conditions ordered herein concerning affiliate company transactions, including the propriety of the transfer pricing of goods and

services between and/or among Duke Power and its affiliates, that is, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations. Duke Power and the Public Staff shall confer and jointly identify one or more proposed independent auditors. Other parties shall have an opportunity to comment and propose additional auditors. Selection of the independent auditor shall be made by the Commission. The independent auditor shall be supervised in its duties by the Public Staff. Not later than 60 days after consummation of the Merger, the Public Staff shall file a recommendation with the Commission as to how and when the first independent audit should be commenced. Duke Energy Corporation shall bear the cost of the audits, and all such costs shall be excluded from Duke Power's utility accounts, except to the extent that reasonable assignments or allocations of such audit costs may be included in the transfer prices charged to Duke Power for goods and services provided to it by Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations; provided however, that such transfer prices, individually, shall not exceed prices determined in strict compliance with all other Regulatory Conditions and the Code of Conduct as prescribed herein. The appropriateness of the assignment or allocation of the cost of the audits to utility accounts in the manner described above, if any, shall be subject to review in subsequent ratemaking proceedings. The auditor's reports shall be filed with the Commission. Duke Power may request a change in the frequency of the audit reports in future years, subject to approval by the Commission. Duke Energy Corporation shall endeavor to coordinate the various state affiliate transaction audits. To the extent separate third-party independent audits continue to be performed in the other states, Duke Power shall provide the reports of those audits to the Public Staff and the Commission.

The additional changes and modifications adopted and required by the Commission with respect to Regulatory Condition No. 32 significantly strengthen the consumer protections afforded to North Carolina retail ratepayers which such Condition is designed to provide. These changes guarantee that the independent auditor will have access to all records necessary to ensure the integrity, completeness, and scope of the audit process. In addition, the Public Staff, fulfilling its statutory duty to represent the interests of North Carolina retail consumers, has been designated by the Commission to play a crucial and integral role in the audit process as supervisor of the independent auditor.

Appropriate provisions for the assignment and allocation of audit costs have also been adopted to ensure that North Carolina retail ratepayers of Duke Power are not improperly, unduly, and/or unfairly burdened by such costs. In particular, the Commission has done so as it is of the opinion that it would be unfair and unreasonable to indiscriminately saddle ratepayers with costs incurred to protect them from the potential abuse that arises from the creation of a holding company arrangement, particularly in consideration of the fact that such an arrangement was requested by

Duke Energy. Strict and extensive affiliate transfer pricing rules and other conditions have been adopted herein to protect ratepayers against that potential holding company abuse. The independent audit is crucial to determining whether those rules have been appropriately implemented and whether they are being exactingly followed. Therefore, inasmuch as the audit, including its attendant cost, is made necessary by virtue of creation of the holding company arrangement, as requested by Duke Energy, the Commission is of the view that such cost should not be borne by the North Carolina retail ratepayers of Duke Power, except to the extent, if any, as discussed below.

In reaching this decision regarding the cost of the audit, the Commission has been mindful of the fact that efficiencies and cost savings may be realized by Duke Power and its ratepayers as a result of the holding company arrangement. Therefore, the Commission has included provisions in this regard that would allow audit cost to be passed through to ratepayers as a component of the transfer prices charged for goods and services provided by Duke Energy Corporation, other affiliates, and Nonpublic Utility Operations to Duke Power, provided however, that such transfer prices are determined in strict compliance with other Regulatory Conditions and the Code of Conduct as prescribed herein. [14]

---

[14] For example, with regard to transfer pricing, the Code of Conduct required by the Commission-approved Regulatory Conditions as adopted herein, among other things, in pertinent part, provides as follows:

> Part III, Section D(3)(b): Except as otherwise provided for in this Section D, for goods and services provided, directly or indirectly, by Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation to Duke Power, the transfer price(s) charged by Duke Energy Corporation, the Affiliate, and the Nonpublic Utility Operation to Duke Power shall be set at the lower of Market Value or Duke Energy Corporation's, the Affiliate's or the Nonpublic Utility Operation's Fully Distributed Cost(s) . . . .

Therefore, with certain noted exceptions, the present provision effectively places a ceiling on the transfer prices that may be charged to Duke Power by an affiliate for goods and services provided by the affiliate to Duke Power. The ceiling price is the lower of "market value" or the affiliate's "fully distributed cost." Thus, in determining the transfer price(s) to be charged for goods and services subject to this pricing provision of the Code of Conduct, the "market values" and "fully distributed costs" of such goods and services must be determined. In determining "fully distributed cost," under the Commission's instant ruling, it would be entirely proper to include an appropriate proportional share of the audit cost in the "fully distributed cost" of each good or service. If "fully distributed cost," including an appropriate share of audit cost, was the same as or less than "market value," then and in that event such audit cost would be properly chargeable to Duke Power's regulated electric utility operations. However, if "fully distributed cost" exceeded "market value," the transfer price would be limited to "market value" and the audit cost, either in whole or in part, would not be chargeable to or recoverable from Duke Power's North Carolina retail ratepayers.

To the extent audit cost is included in determining the appropriateness of transfer prices and/or is otherwise included in assessments of the net benefit(s) of the instant affiliate relationships, the Commission is of the opinion, and so concludes, that the audit cost should be appropriately assigned or allocated, at a minimum, to all goods and services of all affiliates engaged both directly and indirectly in providing goods and services to Duke Power. Further, to the extent the cost of an audit is deferred for potential recovery from Duke Power's North Carolina retail ratepayers, such cost shall not be eligible for recovery for a period any longer than 24 months from the date the audit report is filed with the Commission.

The provisions of Regulatory Condition No. 32 have been reinforced by the Commission to ensure, to the maximum extent possible, that the Merger will have no adverse impact on the rates charged and the services provided to Duke Power's North Carolina retail ratepayers and that ratepayers are sufficiently protected and insulated from potential costs and risks resulting from the Merger.

Furthermore, in so ruling, the Commission has declined to adopt CUCA's proposal to require an independent audit of all affiliate transactions to which Duke Power is a party and other affiliate transactions that have an effect on Duke Power's rates or service, as defined by CUCA. The Commission believes it is sufficient for purposes of this proceeding to require an independent audit only of transactions pursuant to the affiliate agreements filed in connection with the proposed Merger. The Commission has ample authority to require an audit by the Public Staff or an independent third party of other affiliate transactions should such an audit appear warranted in the future.

The Commission, therefore, finds and concludes that the Commission-approved Regulatory Conditions as discussed hereinabove will impose appropriate and effective auditing and reporting requirements with respect to affiliate transactions and cost of service.

Additionally, as an added measure to further protect North Carolina retail ratepayers from future potential negative consequences that may arise from the Merger, if any, the Commission is of the opinion that the following Regulatory Condition requiring Duke Power to track its actual net merger savings should be added to those proposed by Duke Energy and the Public Staff:

> 32a. Duke Power shall track its actual net merger savings for the five-year period beginning immediately subsequent to consummation of the Merger and submit quarterly reports delineating the actual net benefits derived therefrom with respect to its North Carolina retail operations. Said reports shall include explanations of the methodologies, assumptions, judgments, and estimates, if any, on which the reports are based. Copies of the workpapers setting forth the calculations of the net merger savings shall also be provided. These reports shall be verified by either the Chief Executive Officer, a senior-level financial officer, or the responsible accounting officer of Duke Power and shall be provided in conjunction with Duke Power's quarterly NCUC ES-1 Reports. The Public Staff is hereby requested to investigate, verify, and assess the reports required in this regard and submit an annual report to the Commission setting forth its findings and recommendations. It is further requested that the Public Staff's annual report be submitted on or before June 1st with respect to Duke Power's quarterly reports for the preceding calendar year.

This Regulatory Condition, which requires Duke Power to track the actual benefits and costs of the Merger, should provide the Commission with additional meaningful information that will allow it to monitor the actual effect that the Merger is having on North Carolina retail ratepayers, thereby helping to ensure that such ratepayers are, in fact, appropriately and fully protected from adverse consequences, if any, that may arise from the Merger. The Commission, therefore, finds and concludes that Regulatory Condition No. 32a should be adopted for purposes of this proceeding.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witness Hager and Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff witnesses testified that proposed Regulatory Condition No. 23 states that costs and credits associated with the Catawba agreements will result in no harm to North Carolina retail customers. This condition provides that the assignment or allocation of costs to the North Carolina retail jurisdiction will not be adversely affected by virtue of the agreements between Duke Power and the Catawba Joint Owners.

CUCA's proposed Regulatory Condition No. 23 replaces "be adversely affected by the manner and amount of recovery of electric system costs from the Catawba Joint Owners as a result of the agreements between Duke Power and the Catawba Joint Owners" with "result in an Effect [as defined by CUCA] adverse to the interest of Duke Power's Carolina retail ratepayers due to the manner and amount of recovery of electric system costs from the Catawba Joint Owners as a result of the agreements between Duke Power and the Catawba Joint Owners."

Having rejected use of the term "Effect," as defined by CUCA, in the Regulatory Conditions, the Commission concludes that Regulatory Condition No. 23 is already clear and rejects CUCA's proposed revision.

The Public Staff witnesses also testified that proposed Regulatory Condition Nos. 25 through 27 protect North Carolina retail ratepayers from potential negative effects of the merger by ensuring that direct merger costs and any costs associated with commitments made by Duke Power or imposed on Duke Power are not flowed through to Duke Power's cost of service for ratemaking purposes.

Regulatory Condition No. 25 proposed by Duke Energy and the Public Staff excludes direct expenses associated with costs to achieve the Merger from Duke Power's retail cost of service for ratemaking purposes and provides that any capital costs must be shown by Duke Power to benefit North Carolina retail customers before they may be included. This condition also provides that, if a one-year rate decrement is approved, Duke Power may spread the impact evenly over five years, but must note the amount expensed as a footnote to its ES-1 Reports.

CUCA's proposed Regulatory Condition No. 25 provides that the impact of the rate decrement may be evenly spread over "the savings period upon which the decrement was based."

After careful consideration, the Commission concludes that Regulatory Condition No. 25 should be modified to include the following additional language:

> If the merger is not consummated, neither the cost of any termination payment nor the receipt of a termination payment between Duke Energy and Cinergy shall be allocated to Duke Power's books. Nor shall Duke Power's North Carolina retail customers otherwise bear any direct expenses or costs associated with a failed merger.

The modification adopted and required by the Commission with respect to Regulatory Condition No. 25 ensures that there will be no adverse impact on the rates charged to Duke Power's North Carolina retail ratepayers and that the ratepayers are sufficiently protected from potential costs that may result if the Merger fails to be consummated.

Furthermore, as discussed below, the Commission has adopted Duke Energy's offer of a one-year rate decrement in the amount of $117,517,000, and the Commission also finds it reasonable and appropriate to adopt Duke Energy's proposal to allow the Company to spread the impact evenly over five years for NCUC ES-1 reporting purposes. Accordingly, CUCA's proposed revision to Regulatory Condition No. 25 is rejected.

Proposed Regulatory Condition Nos. 26 and 27 ensure that any commitments to Duke Power's wholesale customers in connection with the Merger will not decrease the bulk power revenues to be shared in Docket No. E-7, Sub 751, or increase North Carolina retail fuel costs or cost of service.

CUCA's proposed Regulatory Condition No. 26 provides that if "one or more" commitments to Duke Power's wholesale customers "have an Effect that is adverse to the interest of Duke Power's North Carolina retail customers," including but not limited to the effects listed, those effects shall not be recognized for North Carolina retail cost of service or ratemaking purposes.

Having rejected use of the term "Effect," as defined by CUCA, in the Regulatory Conditions, the Commission concludes that Regulatory Condition No. 26 is already clear and rejects CUCA's proposed revision. The Commission further concludes that the addition of "one or more" is equally unnecessary, as "commitments" is already plural.

As explained by the Public Staff witnesses, proposed Regulatory Condition No. 28 provides that any acquisition adjustment that results from the merger will be

excluded from Duke Power's utility accounts and will not affect Duke Power's North Carolina retail electric rates and charges. CUCA's proposed revision would replace "affect Duke Power's North Carolina retail rates and charges" with "have an Effect that is adverse to the interests of Duke Power's North Carolina retail ratepayers," but the proposed revision is rejected.

The Public Staff witnesses testified that proposed Regulatory Condition Nos. 29 and 30 provide that Duke Energy and its affiliates will take all steps reasonably necessary to hold Duke Power's North Carolina retail ratepayers harmless from any effects of the merger and that North Carolina retail ratepayers will be protected from current and prospective liabilities of Cinergy.

CUCA's proposed revision to Regulatory Condition No. 29 would replace "effects of the Merger, including" with "each and every Effect of the Merger that is adverse to Duke Power's North Carolina retail ratepayers, including but not limited to." This revision is rejected for the reasons given above with respect to other conditions.

None of the parties took issue with Regulatory Condition No. 30. The Commission notes, however, that this condition effectively addresses the concern expressed by Environmental Defense with respect to the impact of Cinergy's environmental compliance costs on North Carolina retail ratepayers.

The Commission, therefore, finds and concludes that the Commission-approved Regulatory Conditions will effectively protect Duke Power's North Carolina retail customers from other impacts of the Merger on cost of service for ratemaking purposes.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 19

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witness Hager and Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff testified that Regulatory Condition No. 34 provides that Duke Power and its affiliates and nonpublic utility operations would be bound by the Code of Conduct approved in this proceeding. Other than several specific revisions proposed by CUCA, no party took exception to the Code of Conduct.

The Commission notes that approval of this condition by the Commission would impose a Code of Conduct on Duke Power that is significantly broader and more restrictive than the Code approved in Docket No. E-7, Sub 694. The most substantive revisions are the expansions of the Code of Conduct to explicitly incorporate certain standards, or revised to provide more specific instructions, with respect to (a) nonpublic utility operations, (b) separation of Duke Power operations from affiliate operation, (c) disclosure of Confidential Systems Operation Information, (d) joint marketing and the use of Duke Power's name or logo in non-utility advertising, (e) intangible benefits compensation, if appropriate, (f) shared services, (g) disclosure of Customer Information to affiliates and non-affiliates, (h) exchange of goods and services

between Duke Power and the other Utility Affiliates of new Duke Energy, (i) joint coal purchases between Duke Power, PSI, and ULH&P, and (j) demonstration of the reasonableness and prudence of any permitted acquisition of natural gas, other fuel, or purchased power by Duke Power from an affiliate or nonpublic utility operation.

The specific revisions proposed by CUCA to the Code of Conduct include the following: (1) substantial revisions to the definition of Fully Distributed Cost, (2) the explicit exclusion of goods and services that are subject to sale or purchase at market based rates from Section III.D.3.(c), and (3) the inclusion in Section III.E.3 of a requirement that a competitive bidding process be used.

The Public Staff and Duke Energy also proposed an amendment to the definition of Fully Distributed Cost and proposed that the definitions in the Conditions and the Code be the same. The definition they proposed in the Attachment A filed with their proposed orders is as follows:

> **Fully Distributed Cost:** All direct and indirect costs, including overheads and an appropriate cost of capital, incurred in providing goods or services to another business entity; provided, however, that (1) the return on common equity utilized in determining such cost of capital for each good and service supplied by or from Duke Power shall equal the return on common equity authorized by the Commission in Duke Power's most recent general rate case proceeding, and (2) the cost of capital for each good and service supplied to Duke Power shall not exceed the overall cost of capital authorized by the Commission in Duke Power's most recent general rate case proceeding.

The definition proposed by CUCA would require the cost of capital for each good and service supplied by or from Duke Power to equal the overall cost of capital, which would not allow current debt costs to be used. The Commission concludes that CUCA's definition unduly complicates the matter, particularly considering that the cross-subsidization concern upon which CUCA's revisions are based is prohibited by the Code of Conduct.

With respect to CUCA's proposed revision of Section III.D.3.(c), the Commission concludes that the proposed change is unnecessary. "Customer," as defined in the Code, is any Duke Power retail customer, which means the provision is only applicable to retail tariffs. Similarly, CUCA's proposed change to Section III.E.3 is unnecessary. Similar provisions which have been approved by the Commission for other utilities have not required that competitive bidding be used. Finally, CUCA's proposed changes to reflect its defined terms "Effect" and "Requesting Intervenor" have been discussed and rejected elsewhere in this order.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 20

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witness Caldwell and Public Staff witnesses Cox, Farmer, and McLawhorn.

Duke witness Caldwell testified that, based upon estimates as to income, assets, and market capitalization, the new Duke Energy would be one of the top five electric businesses in the United States if the Merger is approved. He further testified that Duke Power would benefit from new Duke Energy's financial strength and access to financial markets and that Duke Power would itself retain the ability and financial strength to obtain financing on its own, subject to any needed regulatory approvals.

He further testified that, historically, Duke Energy's Duke Power division has had strong cash flow and financial stability and the Merger will have no adverse impact on this position. Post-Merger, Duke Power will be a separate first-tier subsidiary under new Duke Energy. As a separate subsidiary, Duke Power's credit risk will be rated separately from that of new Duke Energy and its other subsidiaries, with the structure in place after the Merger potentially improving the credit standing of Duke Power as a stand-alone company. The financial ability of new Duke Energy and Duke Power, he testified, would support Duke Power's ability to provide reliable service to its North Carolina ratepayers.

Witness Caldwell further testified that each operating company, including Duke Power, would have its own distinct capital structure for both accounting and ratemaking purposes, with Duke Power issuing its own debt and/or receiving equity contributions from new Duke Energy as needed. He also testified that the operating companies' dividend payout amounts would be consistent with each operating company maintaining an adequate cash position and that all debt issued by new Duke Energy and its other subsidiaries would be non-recourse to Duke Power.

The Public Staff's testimony described the general finance conditions as follows: Regulatory Condition Nos. 35 through 37 provide for the tracking of cost of capital details so that the Public Staff may evaluate and propose various capital structure components and cost rates for regulatory purposes. Regulatory Condition No. 38 provides a means for adjusting long-term debt cost if Duke Power's long-term debt is adversely affected by the Merger. Regulatory Condition No. 39 addresses the redemption of Duke Energy preferred stock. Regulatory Condition Nos. 40 and 41 require Duke Power's long-term debt securities to be associated with its utility operations and capital requirements and contain procedural and informational requirements for Duke Power's and Duke Energy's financings. Regulatory Condition No. 42 clarifies that other conditions do not restrict the Commission's right to adjust Duke Power's cost of capital for securities associated with the Merger. Finally, because Merger-related risks could affect Duke's cost of debt or common stock, Regulatory Condition No. 53 makes all of the cost of capital conditions in the stipulated conditions applicable to, and prevents any Merger risks from affecting, Duke Power's

determination of the maximum allowable AFUDC rate, the rate of return applied to any deferred accounts, and the other purposes listed in the condition.

With respect to Regulatory Condition Nos. 43 through 52, the Public Staff testified that they are intended to address the loss of PUHCA 1935 protections by providing some protections to Duke Power and its ratepayers from any financial risks caused by the creation of a holding company and affiliated dealings. To this end, Regulatory Condition No. 43 establishes as a target an investment grade debt rating for Duke Power and requires prompt notice and action if Duke Power's debt rating falls to the lowest level considered investment grade. Regulatory Condition No. 44 (originally No. 47) provides that both Duke Power and new Duke Energy are obligated to ensure that Duke Power's operations are adequately funded. Regulatory Condition No. 45 (originally No. 44) and No. 46 (originally No. 45) set parameters for distributions from Duke Power to Duke Energy and for Duke Power's investment in non-regulated assets, respectively.

The Public Staff further testified that the annual report required in Regulatory Condition No. 47 (originally No. 46) will provide some perspective concerning Duke Energy's investments in Exempt Wholesale Generators and generation assets in foreign countries. Requirements related to short-term and long-term debt financings are set out in Regulatory Condition No. 48. The composition of Duke Energy's Board of Directors is addressed in Regulatory Condition No. 49. Condition No. 50 sets forth notification requirements for Duke Power if it makes certain regulated or non-regulated investments. Regulatory Condition No. 51 requires notification in the event of a default of an obligation or a bankruptcy that is material to Duke Energy. Finally, an annual report is required in Regulatory Condition No. 52 to provide information on Duke Power, Duke Energy, and certain significant affiliates, including current organization, non-regulated investments, risk assessments, capital structure, market capitalization, protective measures, and shared personnel.

With respect to Duke Energy's proposed Utility Money Pool Agreement (Utility MPA), as shown in Exhibit 2 to witness Caldwell's testimony, the Public Staff stated that it was concerned that it includes participants that currently or potentially prospectively are not utility companies. Tri-State Improvement Company is a development company for CG&E and should be excluded from the Utility MPA. Because the generation assets of CG&E may become completely unregulated after 2008, the Public Staff recommended that Duke Power should be required to obtain Commission approval to continue to participate in the Utility MPA if CG&E is still a participant. These concerns were addressed in Regulatory Condition No. 48. The Public Staff recommended that Duke Power be required to re-file the Utility MPA in accordance with Regulatory Condition No. 48.[15] To address the reporting requirements in G.S. 62-169, the Public Staff recommended that Duke Power file monthly reports for months that it initiates a transaction under the Utility MPA. Such reports should include the following for each transaction: date of transaction, borrowing or lending activity, counterparty,

[15] Duke Energy filed its revised Utility Money Pool Agreement on February 14, 2006.

amount, date of maturity, interest rate, brief explanation for interest rate, and associated expenses.

Neither CUCA witness O'Donnell nor CIGFUR III witness Phillips specifically addressed Regulatory Condition Nos. 35 through 42 and No. 53, although CIGFUR III witness Phillips did offer some comments on the ring-fencing conditions, which are summarized below.

On rebuttal, Duke witness Caldwell testified that, with the exit of Duke Energy from substantially all of the DENA business, any risk to Duke Power from unregulated operations would be substantially reduced. The formation of the holding company and the presence of Duke Power as a stand-alone subsidiary will provide additional protection to insulate Duke Power from any potential risks associated with the unregulated businesses. He also noted that, as part of the Stipulation, Duke Energy has committed to Regulatory Condition Nos. 35 through 53, which specify new Duke Energy's obligations with regard to finance and corporate governance and include an annual report requirement that will include, among other things, an assessment of the risk associated with significant affiliates of Duke Power. He also pointed out that the Commission is able to protect customers from risk through its statutory authority with regard to ratemaking. In his opinion, there are no additional significant risks to customers from the unregulated operations of new Duke Energy and any potential risks are more than offset by the existing regulatory framework and the settlement and conditions with the Public Staff.

In response to a question from the Commission with respect to whether any of the conditions would make it difficult for Duke Power to operate in the manner that he thought necessary, witness Caldwell testified that he was comfortable with all of the conditions associated with the financings (Regulatory Condition Nos. 35 through 53). In addition, witness Caldwell stated that, if the Commission approved the proposed Merger, what North Carolina would have with Duke Power would be nothing but a utility, except for ancillary things like holding property for future utility use.

For purposes of discussion, this order divides Regulatory Condition Nos. 35 through 53 into two groups based upon their purpose: (1) Regulatory Condition Nos. 35 through 42 and Condition No. 53, which provide the usual kinds of protections the Commission has approved in the past to protect a utility's ratepayers from adverse financial impacts of a proposed Merger, and (2) Regulatory Condition Nos. 43 through 52, which are "ring-fencing" measures designed to replace the loss of PUHCA protections.

(1) General Financial Protections

With respect to the more general financial protections provided by Regulatory Condition Nos. 35 through 42 and No. 53, the Commission concludes, based upon the foregoing, that they will effectively insulate Duke Power's ratepayers from any increases in cost of capital and other risks related to the Merger. Specifically, Regulatory

Condition No. 36 requires Duke Energy and Duke Power to keep their respective accounting books and records in a manner that will allow all capital structure components and cost rates of the cost of capital to be identified easily and clearly for each entity on a separate basis. The purpose of this condition is to ensure that the components of the cost of capital can be isolated so that ratepayers can be held harmless from the effect of any Merger-related risks in this regard. Similarly Regulatory Condition No. 38 protects ratepayers from the possibility of higher borrowing costs if the Merger were to have a negative impact on Duke Power's credit rating. It provides that to the extent that debt ratings are adversely affected by a downgrade due to the Merger, a replacement cost rate will be utilized to prevent Duke Power's ratepayers from paying any increased costs.

Regulatory Condition No. 39 is solely a reporting requirement allowing the Commission to track the source of the funds used to execute the redemption of current Duke Energy preferred stock.

The first part of Regulatory Condition No. 42 ensures that no prior orders of the Commission with respect to Duke Energy issuances are affected by the conditions. The second part continues the Commission's long-standing expressed right to review and adjust a utility's cost of capital for ratemaking purposes to account for the effects of the securities-related transactions associated with the Merger.

Finally, because Merger-related risks could affect Duke's cost of debt or common stock, Regulatory Condition No. 53 makes all of the cost of capital conditions in the stipulated conditions applicable to, and prevents any Merger risks from affecting, Duke Power's determination of the maximum allowable AFUDC rate, the rate of return applied to any deferred accounts, and the other purposes listed in the condition.

Most of the foregoing conditions have been approved in numerous prior merger proceedings and have not been controversial. Other than Regulatory Condition No. 41, CUCA's specific proposed revisions to the foregoing conditions are solely to include the defined terms "Requesting Intervenor" and "Effect" and to add "adverse to the interests of Duke Power ratepayers." These proposed revisions have been rejected previously in this order and are rejected with respect to these conditions for the same reasons.

CUCA proposed to delete Regulatory Condition No. 41 as unnecessary because its proposed amendments to Regulatory Condition No. 2 provide that Duke Energy (the holding company) shall be deemed a public utility for purposes of Article 8 of Chapter 62 and G.S. 62-111 and that it waives all federal and constitutional challenges, thus making Regulatory Condition No. 41 unnecessary.

Under Regulatory Condition No. 41, new Duke Energy is required to file an annual financing plan, including details about the types of security, an estimate of cost rates, the amount of the proceeds, a brief description of the purpose for the issue, and the amount of proceeds, if any, that might flow to Duke Power. This condition further provides that Duke Energy may proceed with equity issuances upon the filing of the

plan, but cannot issue debt until 30 days after the plan has been filed. Specifics as to procedures by which the Commission can determine if any debt issuance requires approval pursuant to Chapter 62 also are provided.

The Commission notes that this condition does not remove any Commission authority. It merely facilitates review by the Commission of new Duke Energy's financing plans. The Commission retains the authority to treat new Duke Energy as a public utility by virtue of G.S. 62-3(23)(c) if it makes the necessary finding that new Duke Energy's affiliation with Duke Power, with regard to a proposed equity issuance, affects Duke Power's rates or service.

More importantly, the Commission does not need absolute authority with respect to equity issuances by new Duke Energy. The Commission's major concern in this regard with a holding company is that it will become too highly leveraged and its worsened financial state will have a negative impact upon the utility. The ability to determine without challenge whether proposed debt issuances will affect Duke Power and to take appropriate action, again without challenge, if the Commission finds that they do is sufficient authority in this regard. In addition, as discussed more fully below, if the Commission were concerned that Duke Power had become overly leveraged, it could require new Duke Energy to take action, such as infusing equity into Duke Power, pursuant to Regulatory Condition No. 44 (originally filed as No. 47). Finally, the Commission does not need to control new Duke Energy's equity issuances for purposes of determining Duke Power's capital structure for ratemaking purposes because the Commission has full authority to determine the appropriate capital structure for such purposes.

The Commission concludes that the revisions proposed by CUCA should be rejected. The protections provided by the Commission-approved conditions in conjunction with the insulating effects of the legal separation of the holding company and the utility operations that will occur as a result of the Merger will effectively protect Duke Power's ratepayers.

(2) Ring-Fencing Conditions

As described by the Public Staff in its testimony, Regulatory Condition Nos. 43 through 52, the so-called ring-fencing conditions, are intended to address the loss of PUHCA 1935 protections by providing some protections to Duke Power and its ratepayers from any financial risks caused by the creation of a holding company. On cross-examination, the Public Staff testified that Regulatory Condition Nos. 43 and 47 (No. 47 is now No. 44) are sufficient to protect Duke Power in the event of a problem with the parent.

CIGFUR III witness Phillips testified that the conditions are not adequate to protect the utility against the parent company leaning on it during times of stress. In response to questions from the Commission, witness Phillips referenced a case involving the financial difficulties of CMS Energy (CMS) resulting from investments in

other countries. He testified that, despite its pledge not to let those activities affect its regulated subsidiary, he believed that the Michigan Commission ended up having to grant a rate increase to the regulated subsidiary of CMS because of concerns about bankruptcy.

The repeal of PUHCA 1935 presents numerous issues because of the loss of its consumer protections. It was designed to control holding companies and prevent abusive affiliated transactions; cost misallocations; financial abuse, such as draining the utility of cash and using it for collateral; and diversification into non-core, risky businesses. With the repeal of PUHCA 1935, none of these federal limitations and protections remain in effect.

Section 7 of PUHCA 1935, 15 U.S.C. § 79g, provided for extensive regulation of the use of securities by holding companies and their subsidiaries. In addition, § 12 of PUHCA 1935, 15 U.S.C. § 79l, prohibited holding companies and their subsidiaries from borrowing and from receiving an extension of credit, or an indemnification, from a public utility in the same holding company system. By virtue of PUHCA 1935, using a utility's assets or revenue streams as collateral for holding company or affiliate loans, using the utility as a "cash cow" to make excessive dividend payments, thereby depriving the utility of working capital, and diversifying by investing in unrelated businesses and increasing the riskiness of the utility were all prohibited. These types of restrictions, along with limitations on future acquisitions and mergers, typically are called ring-fencing measures. Such measures tend to be a major topic of discussion at the state level and within NARUC given the repeal of PUHCA 1935 effective February 8, 2006.

Ring-fencing can be defined as the legal walling off of certain assets or liabilities within a corporate family, including the creation of a new subsidiary to protect (i.e., ring-fence) specific assets from creditors.[16] Ring-fencing measures are used to insulate a regulated utility from the potentially riskier activities of unregulated affiliates. From a debt rating agency perspective, ring-fencing mechanisms are techniques used to isolate the credit risks of one company from the risks of affiliate companies. Concurrent use of numerous ring-fencing measures, including regulatory, financial, structural, and operational restrictions, is considered to be the most effective way to separate risk.[17]

According to Fitch Ratings, the holding company structure itself aids in the construction of a strong ring fence.[18] Thus, Duke's proposed separation of its regulated utility operations into a separate company, rather than continuing to operate the utility as a division of the parent company, is an effective ring-fencing measure separate and apart from the other measures discussed subsequently herein.

---

[16] Commission Staff Analysis of Ring-Fencing Measures for Investor-Owned Electric and Gas Utilities, Maryland Public Service Commission Staff, February 18, 2005.

[17] Bonelli, Sharon and Lapson, Ellen, Ratings Linkage within U.S. Utility Groups, Fitch Ratings Global Power/North America Special Report, April 9, 2003.

[18] Id., at p. 3.

The Sarbanes-Oxley Act of 2002 is viewed as protection for a utility's captive customers in that it requires audit committee independence, chief executive officer and chief financial officer certification of the accuracy and truth of financial filings, enhanced financial disclosure, and criminal fraud accountability. These requirements, when coupled with appropriate ring-fencing measures, should provide for a transparent environment that will enable the Commission and others to monitor the activities of Duke Power, new Duke Energy, and its unregulated subsidiaries.

Generally speaking, a key difficulty in establishing ring-fencing measures is fashioning a response that meets all of the goals but does not unnecessarily inhibit the operations of the utility and its relationships within a holding company structure. Possible solutions include (a) capital structure requirements (often a minimum percentage of equity), (b) dividend restrictions, (c) restrictions on unregulated investments, including some control over future acquisitions and mergers, whether unregulated or not, (d) prohibitions or at least control of utility asset sales, (e) collateralization requirements, (f) working capital restrictions, (g) prohibitions on inter-family loans, (h) maintenance of stand-alone bonds, (i) independence of board members, (j) bankruptcy protection, and (k) credit rating separation. These possible solutions are discussed separately below.

(a) Capital structure requirements. Conditions related to capital structure requirements can be couched in terms of a minimum percentage of equity being maintained. The Oregon Public Utility Commission, when it approved the acquisition of Portland General Electric (PGE) by Enron Corporation in Order No. 97-196 on June 4, 1997, required that PGE maintain a 48% equity ratio. Kentucky's stipulation and order approving the present Merger require that ULH&P maintain a capital structure with a minimum of 35% equity.

Prescribing a specific equity ratio is problematic for a number of reasons. A relatively high minimum equity ratio increases the cost of financing ongoing business operations. Debt is generally less expensive, within leverage limits, because debt usually has a significantly lower cost than equity. In addition, a utility with a higher equity ratio than its parent or unregulated affiliates creates the potential for the parent and affiliates to benefit from the utility's higher equity ratio by increasing their debt levels while maintaining the same debt rating. On the other hand, an equity minimum that is too low can also cause higher costs to be incurred because a more highly leveraged company is a higher risk. The optimal solution is for the equity ratio to be high enough for the utility to maintain a solid investment grade debt rating, but no higher.

Regulatory Condition No. 44 (originally proposed as No. 47) addresses these concerns. This condition provides that new Duke Energy and Duke Power shall ensure that Duke Power has sufficient access to equity and debt capital to enable Duke Power to adequately fund and maintain its current and future generation, transmission, and distribution systems and otherwise meet the service needs of its customers at a reasonable cost. This condition imposes on new Duke Energy both the obligation to

infuse sufficient equity and debt capital into Duke Power to adequately fund its current and future operations and the obligation that such funding be at a reasonable cost. This allows the ratio of equity to debt to fluctuate from time to time depending upon industry trends and issues, but it requires that the costs to ratepayers always be reasonable.

The protections afforded by this condition are further enhanced by the requirement in Regulatory Condition No. 43 that Duke Power operate its business with the intention of maintaining an investment grade rating and a requirement that, in the event its debt rating falls to the lowest investment grade level, it provide immediate notice to the Commission and the filing of a plan 45 days later regarding the steps it intends to take to maintain and improve its debt rating.

Finally, part 4 of the report required by Regulatory Condition No. 52 requires Duke Power to provide a description of the actual capital structure of Duke Power and each "Significant Affiliate" and to describe new Duke Energy's and Duke Power's goals for Duke Power's capital structure and plans for achieving those goals.

(b) Dividend restrictions. Conditions related to dividend restrictions need to strike a balance between not discouraging investors while preventing the siphoning off of utility funds to the detriment of the utility. Regulatory Condition No. 45 (formerly No. 44) requires cumulative distributions paid by Duke Power to new Duke Energy subsequent to the Merger to be limited to (i) the amount of Retained Earnings on the day prior to the closure of the Merger, plus (ii) any future earnings recorded by Duke Power subsequent to the Merger. This is very similar to the provision in the Kentucky stipulation and order that provides that ULH&P will pay dividends only out of retained earnings.

(c) Restrictions on unregulated investments. Significant investments in unregulated assets can obviously create greater risks for the parent and its subsidiaries. Six of the conditions are designed to ameliorate these risks. One of these, Regulatory Condition No. 46 (formerly No. 45), prohibits Duke Power from investing in a non-regulated utility asset or any non-utility business venture exceeding $50 million dollars in purchase price or gross book value to Duke Power (except for land held for future franchise use) until after it has provided 30 days' advance notice to the Commission.

Regulatory Condition No. 50 requires new Duke Energy to notify the Commission of any intended investment in a regulated or non-regulated business representing five percent or more of new Duke Energy's market capitalization. Because investments in exempt wholesale generators (EWGs) and foreign utility companies (FUCOs) are generally considered to be riskier than many other types of investments, Regulatory Condition No. 47 (formerly No. 46) requires new Duke Energy to provide an annual report summarizing its investments in EWGs and FUCOs.

While not included in the "Finance/Corporate Governance" section of the conditions, Regulatory Condition Nos. 41 and 54 can be considered to be ring-fencing measures. Regulatory Condition No. 41 requires that an annual financing plan be filed,

including descriptions of all financings that new Duke Energy reasonably believes may occur during the calendar year. This enables the Commission to determine if any proposed debt financings could affect Duke Power sufficiently for approval under North Carolina law to be required. Similarly, Regulatory Condition No. 54 provides a mechanism by which the Commission can determine if a merger or acquisition proposed by new Duke Energy is likely to affect Duke Power, thereby necessitating the filing of an application for approval.

Finally, the annual report required by Regulatory Condition No. 52 requires Duke Power to (1) identify all "Significant Affiliates" that are considered to constitute non-regulated investments and provide each company's total capitalization, the percentage it represents of new Duke Energy's total non-regulated investment, and the percentage it represents of new Duke Energy's total investments, and (2) provide an assessment of the risks that each unregulated "Significant Affiliate" could pose to Duke Power based upon the current business activities of those affiliates and any contemplated significant changes to those activities.

(d) Prohibitions on utility asset sales. As previously discussed in this order, Regulatory Condition No. 3 applies to the transfer by Duke Power to any entity, affiliated or not, of the control of, operational responsibility for, or ownership of utility assets with a gross book value in excess of $10 million. It requires that notice be given and that any contract effectuating the proposed transfer contain language protecting the Commission's authority. In addition, Regulatory Condition No. 9 prohibits any agreement and all filings with the FERC that alter Duke Power's obligations with respect to the conditions, absent explicit approval of the Commission. Finally, Regulatory Condition No. 10 requires notice to the Commission 30 days prior to any filing with the FERC of any agreement, tariff, or other document or any proposed changes, amendments, modifications, or supplements to any such document that have the potential to affect Duke Power's cost of service or otherwise affect its rates or service.

(e) Collateralization restrictions. Chapter 62 regulates the extent to which a utility can guarantee or be used as collateral for affiliate debt. G.S. 62-160 prohibits a public utility from pledging its faith, credit, moneys, or property for the benefit of any holder of its stocks or bonds or any other business interest with which it may be affiliated without making application to the Commission and obtaining its permission by order. G.S. 62-161 prohibits a public utility from assuming any liability or obligation as lessor, lessee, guarantor, indorser, surety or otherwise with respect to any other person unless and until the Commission, after investigation, authorizes by order such issue or assumption. Because explicit written approval is required, conditions prohibiting utility guarantees and requiring parent company debt to be non-recourse to the utility are not necessary.

(f) Working capital restrictions. As discussed above, Regulatory Condition No. 44 (formerly No. 47) imposes on new Duke Energy the obligation to infuse sufficient equity and debt capital into Duke Power to adequately fund its current and future operations,

and Regulatory Condition No. 45 (formerly No. 44) imposes limits on the amount of cumulative distributions that can be paid by Duke Power to Duke Energy.

(g) Prohibitions on inter-family loans. Regulatory Condition No. 48 requires Duke Power to borrow short-term funds through the financial markets or through the Utility Money Pool Agreement (Utility MPA) approved by the Commission, which prohibits loans through the Utility MPA being made to, and borrowings through the Utility MPA being made by, new Duke Energy and Cinergy Corp. In addition, it requires Duke Power to acquire its long-term debt funds through the financial markets and prohibits its borrowing from, and lending to, on a long-term basis, new Duke Energy or any of its other affiliates.

(h) Maintenance of stand-alone bonds. Regulatory Condition No. 40 requires Duke Power to identify as clearly as possible long-term debt (of more than one year duration) that it issues in connection with its regulated utility operations and capital requirements or to replace existing debt. In addition, Regulatory Condition No. 48 requires that Duke Power acquire its long-term debt funds through the financial markets, and have all of the debt it acquires through the financial markets rated under its own name, to the extent it is feasible to obtain a debt rating.

(i) Independence of board members. Regulatory Condition No. 49 requires new Duke Energy to comply with the New York Stock Exchange Listing Standards with respect to the composition of its Board of Directors. These standards require listed companies to have a majority of independent directors on their boards of directors, which increases the quality of board oversight and lessens the possibility of conflicts of interest. See Corporate Governance Standard 303A.01.

(j) Bankruptcy protection. Regulatory Condition No. 51 requires Duke Power to notify the Commission of a default if (1) an affiliate of Duke Power experiences a default of an obligation that is material to Duke Energy or (2) files for bankruptcy, and such bankruptcy is material to new Duke Energy. This notification must be made in advance, if possible, or as soon as possible, but not later than ten days, from the default. In addition, part 5 of the annual report required by Regulatory Condition No. 52 requires Duke Power to provide a complete description of all protective measures (other than those provided for by the conditions adopted in this case) in effect between Duke Power and any of its affiliates and a description of how each measure operates, including the mitigation of Duke Power's exposure in the event of a bankruptcy proceeding of any affiliates.

(k) Credit rating separation. To the extent ring-fencing measures are viewed as effective or enforceable, credit rating agencies may not consolidate a utility subsidiary with its parent for debt rating purposes. Regulatory Condition Nos. 35 through 52, as a package, should be sufficient to justify a separate credit rating for Duke Power.

With respect to CIGFUR III witness Phillips' use of a CMS case in Michigan to criticize the proposed ring-fencing conditions, a review of the Michigan Commission's

order in Case No. U-13730, dated October 14, 2004, reveals that the "pledge" apparently made by CMS was in filings made pursuant to § 33(a)(2) of PUHCA 1935, 15 U.S.C. 79z-5b, with respect to investments in FUCOs, and that the "pledge" was a representation that the investments would not have a detrimental effect on the regulated utility. Interestingly, in this regard, the Michigan Commission initiated a show cause proceeding in 2003 (Case No. U-13860) because CMS had not filed the application required by PUHCA 1935 before investing in a FUCO.

In neither of these cases does it appear that the Michigan Commission had previously imposed significant conditions or taken other official actions, particularly with respect to specific limits on the payment of dividends and the imposition on the parent of a specific, enforceable obligation to provide adequate funds at a reasonable cost to the utility. As a result, this situation does not cast doubt on the adequacy of the ring-fencing conditions proposed in this proceeding. Similar conditions did not fail in the CMS situation; there were very few, if any, comparable conditions. In addition, the witness for CIGFUR III acknowledged on cross-examination that he did not know if Duke Power would have to get permission from the Commission to loan money to an affiliate and conceded that the conditions make progress.

CUCA's specific proposed revisions to these conditions include (1) adding the defined term "Requesting Intervenor," (2) adding "alone or collectively in a calendar year" to Regulatory Condition Nos. 45 and 50, and (3) changing "shall" to "may" in Regulatory Condition No. 48. The Commission has rejected the first two with respect to other conditions and again rejects these revisions. With respect to Regulatory Condition No. 48, the Commission notes that the purpose of the term "shall" was to prohibit Duke Power from borrowing short-term funds from affiliates. If "shall" were changed to "may," further revisions to the condition would be necessary to prohibit Duke Power from borrowing short-term funds from new Duke Energy or other affiliates. This proposed revision also is rejected.

The foregoing conditions as a group provide very comprehensive ring fencing protections. In addition, a comprehensive report is required by Regulatory Condition No. 52 to allow the Commission to gather relevant information into one report, which will allow the Commission to act more promptly if it becomes necessary to take measures to protect Duke Power. Nevertheless, the Commission is of the opinion that two supplemental conditions need to be added in the general area of financial requirements.

The first of these conditions concerns the appropriate capital structure for use by Duke Power in preparing its quarterly NCUC ES-1 Reports to the Commission. This condition, which has been memorialized as Regulatory Condition No. 37a, in essence, provides that Duke Power shall, following consummation of the Merger, begin transitioning to its actual capital structure for purposes of calculating and reporting its actual North Carolina retail jurisdictional earnings to the Commission. In particular, this condition sets forth general guidelines for Duke Power to follow in the phase-in process and establishes a time certain by which Duke Power shall have transitioned to exclusive use of its actual capital structure for purposes of its quarterly NCUC ES-1 Reports.

Regulatory Condition No. 37a also contains certain informational reporting requirements. The Commission has determined that this condition is needed in consideration of the change in the organizational structure of the regulated corporate entity, including the change in its actual capital structure, which will result upon consummation of the Merger, and in consideration of the overall objective associated with the Commission's ES-1 reporting requirement.[19]

The second supplemental condition concerns the carry-forward, without adjustments, of certain Duke Energy balance sheet account balances to Duke Power's balance sheet following the Merger, that is, in particular, account balances of the following nature: regulatory liability; deferred credit, including deferred income tax; reserve; valuation; and over-accrued liability accounts, if any, applicable and/or reasonably attributable to Duke Energy's regulated electric utility operations which existed prior to consummation of the Merger. This condition also contains provisions which are intended to help ensure that funds, if any, distributed to Duke Energy after consummation of the Merger that are attributable to payments and distributions made by its regulated electric utility operations prior to the Merger are, where appropriate, promptly distributed to Duke Power. This condition has been memorialized as Regulatory Condition No. 53a.

The Commission is of the opinion that Regulatory Condition No. 53a is needed in consideration of certain aspects of modern-day accounting theory, including certain generally-accepted principles, practices, and procedures through which it is implemented. The art of accounting, and in particular the periodic reporting of net income and/or operating income, inherently involves the use of estimates, assumptions, and judgments. Estimates are most often not realized in an absolute sense and assumptions and judgments do not always turn out to be entirely correct, notwithstanding their having been made with the best of intentions and employing state-of-the-art techniques. Thus, it is not at all unusual for a level of cost recorded in one period to be adjusted in a subsequent period, and such adjustments may, in certain instances, be of material consequence.

In consideration of the foregoing and generally speaking, the primary purpose of Regulatory Condition No. 53a is this: to the extent, if any, certain regulated electric utility accounts have been overstated prior to the Merger, this provision is intended to help ensure that adjustment for such overstatement will be made to, and reflected in, regulated electric utility accounts following the Merger. Thus, in consideration of (a) the foregoing, (b) the change in the corporate ownership of the regulated electric utility following the Merger, and (c) the need to ensure that Duke Power's North Carolina retail customers are not disadvantaged in any way by the Merger, the Commission has

[19] Generally speaking, with regard to jurisdictional utilities who are subject to rate base, rate-of-return regulation, the purpose of the ES-1 reporting requirement is to allow the Commission to obtain meaningful information on an ongoing basis which will allow the Commission to monitor the financial viability of the reporting companies, including assessment of certain standard measures of their profitability and consequently, in certain respects, thereby allowing the Commission to gain insight into the appropriateness of their existing rates and charges.

determined that the present condition is warranted and that it should be implemented as a regulatory condition in addition to those proposed by Duke Energy and the Public Staff.

The Commission, therefore, finds and concludes that Commission-approved Regulatory Condition Nos. 35 through 53a will effectively address known and potential risks and concerns related to finance, corporate governance, and certain other matters of a financial nature arising from the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 21

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff witnesses testified that proposed Regulatory Condition No. 54 provides for Commission approval of future proposed mergers by Duke Power and notification of further proposed mergers involving Duke Energy or other affiliates.

Regulatory Condition No. 54, as proposed by Duke Energy and the Public Staff, addresses both business combinations involving Duke Power and those involving other entities within the Duke Energy holding company family. With respect to Duke Power, this condition provides that an application for approval pursuant to G.S. 62-111(a) will be filed at least 180 days before the closing of the proposed transaction. With respect to the other entities, it establishes a procedure to enable the Commission to determine, before the fact, whether a proposed transaction is reasonably likely to affect Duke Power so as to require approval pursuant to the statute.

In considering whether to approve the Regulatory Conditions proposed by Duke Energy and the Public Staff, the Commission is influenced by regulatory conditions approved in other dockets, most recently those approved for Progress by order issued October 27, 2004, in Docket No. E-2, Sub 844, as well as by factors specific to this case. The Commission notes that Regulatory Condition No. 33 approved in Docket No. E-2, Sub 844, requires the filing of advance notification of a proposed transaction and the filing of an application for approval of a transaction believed to have an effect on utilities 180 days prior to the closing date. Progress' condition further provides for a "demonstration of no effect" on utilities, a 45-day comment period, and a ruling by the Commission as promptly as possible. If the Commission does not agree with the demonstration, closing is prohibited until the transaction has been approved. Thus, Progress' condition recognizes that not all business combinations within the holding company family will implicate G.S. 62-111(a).

Regulatory Condition No. 54(b), as proposed by Duke Energy and the Public Staff, takes the same general approach as Progress' condition. Unlike Progress' condition, however, the advance notification requirement in Regulatory Condition No. 54(b) is proposed to be limited to business combinations with a transaction value exceeding five percent of the market capitalization of new

Duke Energy. In addition, unlike Progress' condition, Regulatory Condition No. 54(b) explicitly provides that the entity in question may proceed with the transaction if no order has been issued at the end of the notice period, although it will be subject to any fully adjudicated Commission order on the matter, including a requirement to file an application and potential ultimate denial of approval to enter into the proposed transaction.

The Commission raised questions during oral argument concerning the use of the defined term "Effect on Duke Power's Rates or Service" in proposed Regulatory Condition 54(b), suggesting that the condition be revised to conform to the language in G.S. 62-111(a), which reads "affecting any public utility." A question was also raised as to whether subsection (d) should be revised to clarify that the 180-day notice requirement in subsection (a) does not also apply if the Commission determines that approval is required pursuant to the statute. The Further Revised Regulatory Conditions proposed by Duke Energy and the Public Staff attempted to address these concerns.

CUCA initially proposed to revise Regulatory Condition No. 54 to require Duke Energy to file an application for approval pursuant to G.S. 62-111(a) of any business combination involving a member of the holding company family, whether or not the transaction has been determined to affect Duke Power. In Exhibit 1 attached to its brief, CUCA subsequently argued that Regulatory Condition No. 54 "should be deleted in virtually its entirety because it appears to unduly limit the Commission's merger jurisdiction." CUCA further argued "that the application of a 5% threshold to a $60 billion company such as [new Duke Energy] would allow a merger of up to $3 billion without regulatory scrutiny."

After careful consideration, the Commission is of the opinion that the general framework set forth in Regulatory Condition No. 54, as proposed by Duke Energy and the Public Staff, is a reasonable and appropriate way of enabling the Commission to exercise its authority and responsibility under G.S. 62-111(a) while recognizing Duke Energy's right to assert in a timely manner that jurisdiction does not lie in a specific case. Regulatory Condition No. 54(a) is clarified, however, to require Duke Power to file in advance an application pursuant to G.S. 62-111(a) for approval of any proposed transaction "by or affecting" Duke Power. Thus, Duke Power shall proceed to file an application for any transaction that it concedes is subject to the jurisdiction of the Commission pursuant to G.S. 62-111(a). To require the filing of an application in each and every case, as advocated by CUCA, would not only burden the Commission's docket unnecessarily but also attempt to impermissibly expand the Commission's statutory authority under G.S. 62-111(a) to include approval of proposed business combinations not affecting Duke Power. Regulatory Condition No. 54(b) is revised to incorporate as subsections the applicable procedures proposed by Duke Energy and the Public Staff in sections 54(c) through 54(e). Under Regulatory Condition No. 54(b), Duke Energy is only required to provide 90-day advance notice to the Commission of transactions involving Duke Energy, other affiliates, or the nonpublic utility operations which (1) Duke Energy believes do not affect Duke Power

and would not, therefore, be subject to the Commission's jurisdiction pursuant to G.S. 62-111(a) and (2) exceed a threshold transaction value. The Commission agrees with CUCA, however, that the threshold proposed by Duke Energy and the Public Staff is too high, and shall require Duke Energy to file advance notice pursuant to Regulatory Condition No. 54(b) of any transaction which involves Duke Energy, other affiliates, or the nonpublic utility operations and which has a transaction value exceeding $1 billion.

The Commission, therefore, finds and concludes that the Regulatory Conditions, as modified and approved herein, will effectively enable the Commission to exercise its jurisdiction over business combinations involving Duke Power or other members of the Duke Energy holding company family following the Merger. The Commission reserves the right to act on its own motion with regard to any advance notice filed by Duke Power regardless of whether objections are filed by any other party.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 22

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff testified that Regulatory Condition Nos. 55 through 57 address (1) notice requirements before Duke Power transfers functions or employees, (2) continuing Commission review of the holding company structure, and (3) discussions between Duke Power and the Public Staff about significant changes and developments affecting Duke Power or new Duke Energy. Regulatory Condition No. 58 addresses filing requirements for the Tax Sharing Agreement as well as any plans to consolidate employee benefits plans and other similar agreements.

Regulatory Condition No. 55 requires Duke Power to file notice with the Commission 30 days prior to the initial transfer or any subsequent transfer of any services, functions, departments, employees, rights, obligations, assets, or liabilities from Duke Power to an affiliate to the extent such transfers potentially would have a significant effect on Duke Power's public utility operations. Regulatory Condition No. 56 provides that the benefits, costs, and associated risks of the Merger and the operation of Duke Power under a holding company structure shall continue to be subject to Commission review and subject to the Commission's authority to order lawful modifications to the structure or operations of Duke Energy and Duke Power's other affiliates. Finally, Regulatory Condition No. 57 requires Duke Power to meet and consult with, and provide requested relevant data to, the Public Staff, at least semiannually through 2010, unless there is agreement that no meeting is necessary, regarding plans for significant changes in Duke Power's or new Duke Energy's organization, structure, and activities; the expected or potential impact of such changes on Duke Power's retail rates, operations, and service; and proposals for assuring that such plans do not adversely affect Duke Power's North Carolina retail electric customers.

CUCA proposed several specific revisions with respect to these conditions. With respect to Regulatory Condition No. 55, CUCA proposed to increase the required advance notice from 30 to 75 days. The Commission concludes that this proposal should be rejected. The provision, as proposed by Duke Energy and the Public Staff, represents a reasonable balance between allowing Duke Power to operate its business and providing sufficient time for parties to raise concerns. CUCA also proposed to revise Regulatory Condition No. 55 to state that it would be deemed applicable to a transfer or a series of transfers involving more than 50 employees in a calendar year. The Commission rejects this proposed change also. Again, the condition, as proposed by Duke Energy and the Public Staff, represents a reasonable balance between allowing Duke Power to operate its business and providing sufficient time for parties to raise concerns. Additionally, the transfer of 50 employees may be too few or too many, depending upon what functions are involved. The other changes proposed by CUCA to these four conditions have already been rejected in other parts of this order.

The Commission, therefore, finds and concludes that Commission-approved Regulatory Condition Nos. 55 through 58 will effectively address known and potential risks and concerns related to structure and organization arising from the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 23

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff testified that Regulatory Condition No. 59 describes the procedures to be followed for advance notices with respect to the various conditions. As revised, it clearly sets forth the procedures that are to be followed with respect to all filings that are required pursuant to the Regulatory Conditions. Parties to this docket may file a request in Docket No. E-7, Sub 795A within 30 days of the date of this order to be made parties to that docket and to be served with copies of any filings made pursuant to Regulatory Condition No. 59(a)(i) that do not involve advance notices.

CUCA proposed that Regulatory Condition No. 59(a)(ii) be revised to require Duke Power to "state prominently on the first page of such advance notice that it is filed 'pursuant to Condition 59 of the Regulatory Conditions set forth in Docket No. E-7, Sub 795.'" The Commission rejects this proposal because this subsection already requires sufficient identifying information to be provided in the cover sheet for an advance notice.

CUCA also proposed to revise Regulatory Condition No. 59(b)(ix) to provide that, as a general rule, Duke Power shall bear the burden of proof in proceedings pursuant to Regulatory Condition No. 59. The Commission rejects this proposed revision because it is inconsistent with the conclusion reached by the Commission in its September 11, 2002 order in Docket No. E-2, Sub 753A. In that order, the Commission rejected the Public Staff's argument that the party protesting the subject of the advance

notice should be required to show sufficient grounds for a hearing, but that the burden of proof on the merits should be borne by the utility. The Commission concluded that the party filing the objection should bear the burden of proof if the Commission schedules a hearing on the objection. This same procedure is set forth in Regulatory Condition No. 59, as filed by the Public Staff and Duke Energy.

However, the Commission will require that Regulatory Condition No. 59(b)(viii) be revised to add a new second sentence which reads as follows: "The Commission reserves the right to extend an advance notice period by order should the Commission need additional time to deliberate or investigate any issue." Under the procedures set forth in Regulatory Condition No. 59, when Duke Power files a 30-day advance notice, the Public Staff or any other party has 15 days within which to file an objection. The Public Staff then has two weeks to place the matter on a Commission Staff Conference Agenda. Finally, if the Commission has not issued an order at the end of the advance notice period, Duke Power may proceed with the activity to be undertaken, but shall be subject to any fully-adjudicated Commission order on the matter. Since the procedure under Regulatory Condition No. 59 could take almost the entire advance notice period, leaving the Commission with little or no time to investigate the matter which is the subject of the advance notice, the Commission shall require that Regulatory Condition No. 59 be further revised, as specifically described herein, to prevent Duke Power from proceeding with any activity to be undertaken until the Commission reaches a decision. Furthermore, the Commission reserves the right to act on its own motion with regard to any advance notice filed by Duke Power regardless of whether objections are filed by any other party.

The Commission concludes that Regulatory Condition No. 59, as approved herein, will provide appropriate and effective procedures for advance notices and other filings arising from the Merger or this order.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 24

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witnesses Shaw and Rogers and Public Staff witnesses Cox, Farmer, and McLawhorn.

Witness Shaw testified that the proposed Merger will directly enhance Duke Power's ability to serve its customers by providing even greater depth of human resources experience to customer service. For example, the broader employee base will provide all retail customers access to greater resources in the event of severe weather or emergency outages. Witness Shaw stated that quality of service should also improve by giving Duke Power access to the best practices of well-run utilities in the Cinergy group. In addition, Duke Power customers will continue to have the same local presence of, and access to, the utility that they have come to expect.

Witness Rogers testified that, like Duke Power, Cinergy's operating utilities share a commitment to service and satisfaction, commitments that are reflected in recent rankings and awards such as those given by J.D. Powers and Associates.

Regulatory Condition No. 60 proposed by Duke Energy and the Public Staff provides that Duke Power will continue to implement and further its commitment to providing superior utility service, will make every effort to incorporate best practices of utilities in the Cinergy group in Duke Power's operations, and will work with the Public Staff to monitor service quality. This condition further commits Duke Power to advise the Commission at least annually for a period of five years on the adoption and implementation of best practices following the Merger. In addition, Further Revised Regulatory Condition No. 44 requires both Duke Energy and Duke Power to ensure that Duke Power has sufficient access to capital to be able to maintain its facilities and otherwise meet the service needs of its customers.

The Commission rejects the suggestion of CIGFUR III that the term "superior" in Regulatory Condition No. 60 might be defined to strengthen the condition. As noted by Duke Energy and the Public Staff, this term has been used in similar conditions, without objection, in various proceedings. As the term appears to be well understood and accepted, the Commission believes no definition is necessary.

The Commission also rejects CUCA's proposal that Duke Power be required to work with "each Requesting Intervenor" in addition to the Public Staff to monitor service quality; however, the Commission expects Duke Power to work with all of its customers to monitor and improve service quality to them individually.

The Commission, therefore, finds and concludes that the Commission-approved Regulatory Conditions will effectively ensure that Duke Energy and Duke Power maintain a commitment to customer service following the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 25

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff testified that Regulatory Condition Nos. 61 and 62 provide that Duke Power, under any tax sharing agreement, will not seek to recover any tax cost that exceeds Duke Power's tax liability calculated on a stand-alone basis and that Duke Power shall share in appropriate tax benefits associated with Duke Energy Shared Services. Additionally, the Public Staff testified that it had discussed the Tax Sharing Agreement with Duke Energy and recommended that the agreement be re-filed clarifying certain terms and allocation methodologies.[20]

None of the parties took issue with Regulatory Condition Nos. 61 and 62. The Commission concludes that the approved conditions will effectively ensure that

[20] Duke Energy filed its revised Tax Sharing Agreement on March 3, 2006.

Duke Power's North Carolina retail customers are protected from any adverse effects of a tax sharing agreement and that they will receive an appropriate portion of income tax benefits associated with Duke Energy Shared Services.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 26

The evidence supporting this finding of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff witnesses testified that proposed Regulatory Condition Nos. 63 and 64 address the continuation of the current ratemaking treatment of Nantahala's hydroelectric generation resources as well Nantahala's separate rates and financial information.

Regulatory Condition No. 63 provides that retail customers in Duke Power's Nantahala area will continue to receive the benefits of Nantahala's historical hydroelectric generating resources. Regulatory Condition 64 provides that, until the Commission orders otherwise, the rates charged Nantahala's retail customers will continue to be based on Nantahala's own cost of service, Nantahala's purchased power costs will continue to be determined in accordance with the Duke – Nantahala Interconnection Agreement, and stand-alone Duke Power and Nantahala financial information will continue to be provided.

None of the parties took issue with Regulatory Condition Nos. 63 and 64. The Commission finds and concludes that the Commission-approved Regulatory Conditions will effectively preserve the benefits of Nantahala's historical hydroelectric resources and cost of service for Nantahala's retail customers following the Merger.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 27 - 32

The evidence supporting these findings of fact is contained in the testimony of Public Staff witnesses Cox, Farmer, and McLawhorn.

The Public Staff witnesses testified that Regulatory Condition Nos. 65 through 71 proposed by Duke Energy and the Public Staff address miscellaneous matters such as continued access to books and records of Duke Energy, applicability of prior Commission orders, the Commission's statutory authority, and the ability of Duke Power and its affiliates to request waivers from the conditions.

Regulatory Condition No. 65 provides that the Commission will continue to have access to the books and records of Duke Power and other members of the Duke Energy holding company family, in accordance with North Carolina law. Regulatory Condition No. 66 ensures that all Duke Power books and records will be made available in Charlotte, North Carolina.

None of the parties took issue with Regulatory Condition Nos. 65 and 66. The Commission finds and concludes that these Commission-approved Regulatory Conditions will effectively ensure that the Commission and the Public Staff continue to have access to the books and records of Duke Power and members of the Duke Energy holding company family in accordance with North Carolina law.

Regulatory Condition No. 67 provides that all prior orders of the Commission applicable to Duke Energy, Duke Power, and Nantahala will remain applicable to Duke Power after the Merger unless superseded by Commission order. To enable the Commission to determine which of the regulatory conditions previously approved remain in effect, this condition requires Duke Energy to file for comment a list of conditions imposed in Docket Nos. E-7, Subs 557, 596, 694, and 700, which have not been superseded by the Regulatory Conditions.

None of the parties took issue with Regulatory Condition No. 67. The Commission finds and concludes that the Commission-approved Regulatory Conditions will appropriately recognize the continuing effect of prior Commission orders.

Regulatory Condition No. 68, as proposed by Duke Energy and the Public Staff, provides as follows:

> These Regulatory Conditions are based on the general power and authority granted to the Commission in Chapter 62 of the North Carolina General Statutes to control and supervise the public utilities of the State. The Regulatory Conditions either (a) constitute specific exercises of the Commission's authority, (b) provide mechanisms that enable the Commission to determine in advance the extent of its authority and jurisdiction over proposed activities of and transactions involving Duke Power, Duke Energy Corporation, other Affiliates or Nonpublic Utility Operations, or (c) protect the Commission's jurisdiction from federal preemption and its effects. Pursuant to these conditions, Duke Power, Duke Energy Corporation, and other Affiliates waive certain of their federal rights as specified in these Regulatory Conditions, but do not otherwise agree that the Commission has authority other than as provided for in Chapter 62. Other than as provided for, or explicitly prohibited, in these conditions, Duke Energy Corporation, Duke Power, and its Affiliates retain the right to challenge the lawfulness of any Commission order issued pursuant to or relating to these Regulatory Conditions on the basis that such order exceeds the Commission's statutory authority under North Carolina law or the other grounds listed in G.S. 62-94(b).

CUCA proposed certain changes to Regulatory Condition No. 68 in order to prevent such Condition from "undermining the efficacy of all other conditions."

The Commission finds good cause to approve Regulatory Condition No. 68 as filed and to deny CUCA's proposed changes for the reason that such changes are

unnecessary. Regulatory Condition No. 68 does not, in any way, undermine the efficacy of any of the other Commission-approved Regulatory Conditions. This Regulatory Condition does not restrict or detract from the Commission's statutory authority or otherwise subtract from the benefits and protections offered by the other Regulatory Conditions. Therefore, the Commission finds and concludes that the Commission-approved Regulatory Conditions clearly and accurately describe their effect on the Commission's statutory authority and Duke Energy's rights under state and federal law.

Regulatory Condition No. 69 provides that these Regulatory Conditions are not intended to and do not purport to impose legal obligations on entities in which Duke Energy does not directly or indirectly have a controlling voting interest.

None of the parties took issue with Regulatory Condition No. 69. The Commission finds and concludes that the Commission-approved Regulatory Conditions will appropriately clarify that there is no intent to impose legal obligations on entities not subject to control by new Duke Energy.

Regulatory Condition No. 70 proposed by Duke Energy and the Public Staff provides that entities subject to the conditions may request waivers if exigent circumstances in a particular case justify such. CUCA's proposed Regulatory Conditions omit this provision, and the record indicates that CUCA believes relief should be sought pursuant to G.S. 62-80 rather than through a waiver request.

G.S. 62-80 authorizes the Commission upon notice and opportunity to be heard to rescind, alter, or amend an order or decision made by it. While the language of the statute is quite broad, it allows the Commission to reconsider or rehear a matter when, for example, it appears that a decision was based on a misapprehension of the facts. In the Commission's experience, circumstances that may justify a waiver of a regulatory condition are not such as to require reconsideration of the condition in its entirety. Rather, a waiver procedure simply recognizes the impossibility of anticipating and addressing all circumstances where the letter of a condition may apply but the spirit of the condition would warrant an exception. The Commission, therefore, finds and concludes that the Commission-approved Regulatory Conditions will appropriately allow requests for waivers of any aspect of the conditions under exigent circumstances.

Regulatory Condition No. 71 provides that the Regulatory Conditions will become effective only upon the closing of the Merger. The Commission finds and concludes that the Commission-approved Regulatory Conditions will appropriately become effective only upon closing of the Merger. The Commission notes, however, that if the Merger is not approved, Duke Energy will continue to be subject to conditions and code of conduct provisions approved in previous dockets and many of the protections and benefits secured by the Commission-approved Regulatory Conditions will not be realized until another day.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 33

The Revised Regulatory Conditions proposed by Duke Energy and the Public Staff include a new condition which makes it clear that the conditions are not intended to affect the rights of parties to this docket with respect to participation in subsequent proceedings. The Commission believes that this new Regulatory Condition No. 72 is sufficient to protect the legitimate rights and interests of intervenors with respect to all of the other conditions on an ongoing basis.

In its proposed conditions, CUCA included the following defined term:

> **Requesting Intervenor**: An intervenor in this proceeding, provided that the intervenor signs a confidentiality agreement to protect the confidentiality of any proprietary information of Duke Energy Corporation, Duke Power, or any Affiliate, to the extent the disclosing company reasonably deems a confidentiality agreement to be necessary.

CUCA proposed to insert this term in a number of the Regulatory Conditions proposed by Duke Energy and the Public Staff. While the proposed definition would appear to include the Public Staff, some of CUCA's proposed Regulatory Conditions refer to "the Public Staff and each Requesting Intervenor," and the Commission therefore assumes that the Public Staff is not included.

The Commission finds and concludes that the Commission-approved Regulatory Conditions appropriately recognize the effect of the Regulatory Conditions on the rights of parties to this docket with respect to participation in subsequent proceedings, that the definition of the term "Requesting Intervenor" proposed by CUCA is not necessary, and that adopting CUCA's proposal might, in fact, introduce unneeded confusion into the operation of the Regulatory Conditions.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 34

The evidence supporting this finding of fact is contained in the testimony of Duke Energy witness Hieronymus. This finding of fact is uncontroverted.

Witness Hieronymus presented and explained a detailed market power analysis that he conducted, and from which he concluded that the proposed merger will have no adverse effect on competition in the markets in which Duke Energy and Cinergy conduct business. There was no cross-examination or rebuttal of witness Hieronymus' study or conclusions, nor did any other witness address the effect of the Merger on competition or market power.

The Commission, therefore, finds and concludes that the Merger presents no known risk of adverse competitive effects within the jurisdiction of the Commission or concerns of increased market power within Duke Power's service territory.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 35 - 37

The evidence supporting these findings of fact is contained in the testimony of Duke Energy witnesses Flaherty and Hager, CIGFUR III witness Phillips, CUCA witness O'Donnell, and Public Staff witnesses Cox, Farmer, and McLawhorn.

Regulatory Condition No. 73[21] as proposed by Duke Energy and the Public Staff provides that Duke Power would share $117,517,000 or 42% of the net merger savings assignable to North Carolina with its retail customers. This sharing is in addition to any fuel-related savings associated with the Merger that will flow through the annual fuel charge adjustment.

CIGFUR III witness Phillips testified that Duke Energy's proposal to keep all of the unregulated savings and share 42% of the regulated savings amounts to keeping 86% and giving up only 14% of total savings related to the Merger. With respect to the sharing of net merger savings, witness Phillips recommended a base rate reduction of $78.8 million annually based on normalized net savings during the third year, excluding one-time costs. He further recommended that the reduction be allocated 45% to residential customers, 45% to industrial customers, and 10% to commercial customers based on the differences between Duke Power's rates in North Carolina and South Carolina.

CUCA witness O'Donnell initially testified that a proxy for the risk to ratepayers of accounting misrepresentations involving affiliate transactions would be the average annual pre-tax effect of accounting irregularities that occurred in 1998, 1999, and 2000 as identified in the 2002 Grant Thornton report or approximately $41,300,000 a year. In order to compensate ratepayers for the larger risks related to the Merger, Duke Energy should share 50% of the ten-year estimated net merger savings. In his rebuttal testimony, witness O'Donnell recommended that the $112,517,000 one-time rate reduction recommended by the Public Staff, if approved, be allocated exclusively to manufacturers in Duke Power's North Carolina territory.

Duke Energy witness Flaherty testified that the use of a ten-year view of cost savings realization to determine the level of savings to be distributed to customers would be inappropriate because it introduces a level of uncertainty and additional complexity into determination of the level of sharing. He stated that it is not the predictability in saving estimation that should determine the time period over which savings should be viewed. Rather, it is the ability to adequately determine the financial and operating position of the merged companies that defines the time frame to be utilized. Witness Flaherty further testified that adopting a period longer than five years would be difficult to accept without providing for adequate protection against the possibility of adverse events which have been prone to occur given the nature, degree, and pace of change with this industry. He stated that the use of a longer time period

[21] The number for this Regulatory Condition changed from 72 to 73 based on the revisions filed by the Public Staff on January 27, 2006. The corresponding Commission-approved Regulatory Condition is also numbered 73.

would imply that there will be no subsequent opportunities for the Commission to revisit the level of savings sharing in a future rate proceeding when better information is available about ongoing costs, financial performance and other external influences that can affect required rate levels. Furthermore, he testified that, in his experience, a shorter time period is typically used where an up-front savings sharing will be determined.

The Commission does not find good cause to base the decision in this case on ten-year cost savings projections as advocated by CUCA.[22] As noted above, the Commission's merger filing requirements call for estimates of savings "over a specified period (e.g., three to five years) following consummation of the merger. . ."[23] Accordingly, the Commission finds good cause to deny CUCA's proposed revisions to Regulatory Condition Nos. 25, 72, and 73 to utilize ten-year estimated savings in furtherance of its position. With respect to Condition No. 72, however, the Commission agrees in concept with CUCA's proposed revision to include language used in South Carolina, but believes that the language proposed by Duke Energy and the Public Staff is more appropriate. The Commission notes that Regulatory Condition No. 24 provides that any party may, without objection, seek the inclusion of cost savings that may be realized as a result of the Merger in future rate proceedings.

The Commission agrees with Duke Energy witness Hager that the reliance of CIGFUR III on rate disparities between North and South Carolina, standing alone,[24] is contrary to North Carolina law. See State ex rel. Corporation Comm'n v. Cannon Mfg. Co., 185 N.C. 17, 28, 116 S.E. 178, 185 (1923): "[T]he Corporation Commission [now Utilities Commission] in this State is empowered and directed to make reasonable and just rates as applied to the distribution and sale of power in this State and not otherwise, and such power cannot be directly controlled or weakened by conditions existent in other states, either from the action or nonaction of official bodies there, or the dealings between private parties. To hold otherwise would, in its practical operation, be to withdraw or nullify the powers that the statute professes to confer and should not for a moment be entertained." See also State ex rel. Utilities Comm'n v. Lee Tel. Co., 263 N.C. 702, 709, 140 S.E.2d 319, 325 (1965): "When a company operates in two or more states, the operations are treated as separate businesses for the purpose of rate regulation."

Moreover, the Commission rejects CUCA's argument that the ratepayers are somehow at risk in amounts exceeding $400 million over the next ten years because of potential accounting misrepresentations involving affiliate transactions. The Commission addressed the basis for this argument in 2002 by approving a Settlement Agreement between Duke Energy and the Commission Staff and the Staff of the

[22] Nor has the Commission made a finding regarding the validity and correctness of the Company's five-year Cost-Benefit Analysis. See footnote 21.

[23] See Order Requiring Filing of Analyses entered in Docket No. M-100, Sub 129 on November 2, 2000 (Decretal Paragraph 2.a).

[24] Evidence comparing the rates of different utilities "is not competent or proper in the absence of evidence showing the comparative costs and conditions under which the respective companies operate." State ex rel. Utilities Comm'n v. Gas Co., 254 N.C. 734, 740 (1961).

Public Service Commission of South Carolina in an order that withstood challenge on appeal. State ex rel. Utilities Comm'n v. Carolina Utility Customers Association, Inc., 163 N.C. App. 1, 592 S.E.2d 277 (2004). The Settlement Agreement provides that the Staffs "desire to formally and positively resolve all matters within the scope of the accounting review without further controversy" and that "[h]aving reached resolution of this matter, it is the intention of the parties to move forward in a positive fashion without further controversy." This was the Commission's desire and intent as well. The Commission also rejects as unreasonable and inappropriate the specific rate reduction proposals advocated by CIGFUR III and CUCA, including the testimony regarding those proposals offered by their respective witnesses. The Commission-approved one-year rate decrement in the amount of $117,517,000 is based on a careful consideration of the totality of the facts in this case, including all of the other Commission-approved Regulatory Conditions. It is not unreasonable or unfair to Duke Power since it is the level of rate reduction in dollars offered by the Company as a principal part of its proposal to gain approval of the Merger. It is also generally consistent with the position taken by the Public Staff as to the appropriate amount of the one-year rate decrement in total dollars which should accrue to the benefit of Duke Power's North Carolina retail customers. In sum, $117,517,000 is a fair and reasonable amount by which to reduce rates by a rate decrement in this case, considering in particular the totality of the Conditions imposed by the Commission on the Merger.

Duke Power proposes to share 42% ($117,517,000) of the five-year estimated net merger savings amount of $279,841,000 assignable to its North Carolina retail customers. Public witness Lancaster requested additional funding for economic development and educational programs established through the sharing of net revenues from bulk power sales that was approved by the Commission in Docket No. E-7, Sub 751. The Public Staff witnesses recommended a one-year across-the-board decrement to Duke Power's rates in the amount of $112,517,000, with the remainder distributed as follows: $2,000,000 for Duke Power's Share the Warmth, Cooling Assistance, and Fan-Heat Relief programs; $2,000,000 for conservation and energy efficiency programs (to be submitted to the Commission for approval); and $1,000,000 for NC GreenPower. The Public Staff witnesses further stated, however, that if the Commission wished to direct a portion of the savings to worker training through the Community College Grant Fund, the Public Staff would have no objection and would recommend that the $2,000,000 for conservation and energy efficiency programs be reduced accordingly. Duke Energy took no position on this issue.

After careful consideration, the Commission concludes that the Merger should be approved subject to the following conditions as set forth in Commission-approved Regulatory Condition Nos. 73 through 76:

(1) Duke Power shall implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of $117,517,000, rather than $112,517,000 as advocated by the Public Staff.[25] This

[25] In so ruling, the Commission has made no finding or determination as to either the reasonableness of Duke's specific proposal to share 42% of the Company's five-year estimated net merger savings amount

decision is literally consistent with the proposed language of Regulatory Condition No. 73, which provides, in pertinent part, that "Duke Power shall share with its North Carolina retail customers $117,517,000 . . . in a manner to be determined by the Commission." If customers receive a one-year rate reduction of only $112,517,000, with the remaining $5,000,000 being allocated to other uses, Duke Power's North Carolina retail customers will not in fact receive the full benefit of the exact "sharing" required by the Duke Energy and Public Staff proposed Regulatory Condition No. 73, i.e., $117,517,000. Furthermore, the Commission rejects as unreasonable CUCA's suggestion that any rate reduction be limited to a single class of customers. All customers will bear the risks associated with the Merger, and it only follows that all customers should share in the quantifiable benefits.

(2) Any fuel-related savings associated with the Merger shall be flowed through to Duke Power's North Carolina retail customers pursuant to G.S. 62-133.2.

(3) Duke Power shall contribute $12,000,000 to various energy- and environmental-related and economic- and educationally-beneficial programs, said funds to be distributed as follows: $6,000,000 to Duke Power's Share the Warmth, Cooling Assistance, and Fan-Heat Relief programs; $2,000,000 for conservation and energy efficiency programs (to be submitted to the Commission for approval)[26]; $2,000,000 to the Community College Grant Fund; and $2,000,000 to NC GreenPower. These contributions shall be made by Duke Power on or before June 30, 2006. Such contributions shall not be charged to Duke Power's regulated utility operations, but shall be borne by the Company's shareholders.

(4) The Commission will, in 2007, initiate an investigation[27] pursuant to G.S. 62-130(d), 62-133, and 62-136(a) to determine whether Duke Power's existing rates and charges are unjust and unreasonable and, as part of this investigation, will require Duke Power to either (a) file a general rate case (including prefiled testimony and exhibits) in North Carolina pursuant to G.S. 62-137 or (b) show cause in the form of prefiled testimony and exhibits why the Company's existing rates and charges should not be found unjust and unreasonable.[28] The Merger at issue in this docket and the

---

of $279,841,000 assignable to its North Carolina retail customers, the propriety of the determination and apportionment thereof, or the validity and correctness of the Company's Cost-Benefit Analyses. Thus, the Commission's decision to accept Duke's offer to implement a one-year rate reduction in the amount of $117,517,000 should not be viewed as a precedent in future merger cases, particularly on issues related to the reasonableness of the percentage of net merger savings proposed to be shared with consumers or the validity of the Cost-Benefit Analysis employed by the utility to estimate net merger savings.

[26] Duke Power, the Public Staff, and the Attorney General shall confer and jointly develop a list of appropriate and effective conservation and energy efficiency programs and shall submit their recommendations to the Commission for approval not later than 45 days from the date of this Order.

[27] This investigation will be undertaken as a condition to regulatory approval of the Merger and has been memorialized as Regulatory Condition No. 76.

[28] The test period for this proceeding will be the twelve-month period ending December 31, 2006, with appropriate adjustments. Duke Power will be required to make its filing, including a Rate Case Information Report - NCUC Form E-1, not later than June 1, 2007. Any rate changes proposed by Duke Power should be proposed to become effective on January 1, 2008. To the extent the $117,517,000 one-year rate decrement flowed through by Duke Power to its North Carolina retail customers is deferred, with

Commission-approved Regulatory Conditions adopted herein are extremely complex and will have significant impact on the post-merger operations and regulation, including surveillance, of Duke Power. Upon consummation of the Merger, the organizational structure of Duke Power will be substantially altered; Duke Power will become, for the first time, a stand-alone operating company and a first-tier subsidiary within a holding company structure. Therefore, consummation of the Merger will constitute a compelling and very specific factor that warrants a general rate investigation for Duke Power so that the Commission can ensure that (a) the ongoing rates charged by Duke Power are in fact just and reasonable and (b) customers receive the actual, achieved benefits of Duke Power's post-merger operations to the maximum extent possible.[29] Nevertheless, in so ruling, the Commission notes that it has made no determination that the rates currently being charged by Duke Power are in fact unjust and unreasonable. To the contrary, that is why the Commission will allow Duke Power, in the first instance, to either file a general rate case (including prefiled testimony and exhibits) in North Carolina pursuant to G.S. 62-137 or show cause why the Company's existing rates and charges are not unjust and unreasonable.

Regulatory Condition No. 74 provides that Duke Power's North Carolina retail customers will receive the benefit of "Most Favored Nation" status with regard to the percentage sharing of net merger savings among the states of Kentucky, Ohio, South Carolina, and Indiana.

The Commission has reviewed the orders of other state commissions filed by Duke Energy and the assessment of those orders/settlement proposals filed by the Public Staff. Based on this review, the Commission concludes that none of the sharing arrangements agreed to and/or approved in other states invokes the "Most Favored Nation" provision in Regulatory Condition No. 74.[30] That provision, which is identical to the "Most Favored Nation" provisions in the other states, is limited to the percentage of net merger savings that will be shared with retail ratepayers. It does not include other benefits and commitments, which may or may not be quantifiable and may or may not

---

plans or provisions for amortization over future periods pursuant to Regulatory Condition No. 25, no portion of such amount, including amortization thereof, will be eligible for recovery as a component of Duke Power's North Carolina retail rates set prospectively following consummation of the Merger. In particular, no allowance for same will be included in the test-year cost of service developed for purposes of the general rate case proceeding to be instituted pursuant to this Regulatory Condition; nor will any portion of such amount be recoverable from Duke Power's North Carolina retail ratepayers by means of a rate rider or otherwise. Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. This investigation will be consolidated with the investigation and hearing the Commission is required to undertake for Duke Power pursuant to G.S. 62-133.6(d) and (f) to review the Company's environmental compliance costs.

[29] Indeed, the Commission views this provision as integral to the safeguards implemented herein to ensure that Duke Power's North Carolina retail ratepayers are protected to the maximum extent possible from potential negative consequences, if any, which may arise from approval of the Merger.

[30] Pursuant to the order entered in this docket on December 20, 2005, parties have until Monday, April 3, 2006, to file comments on the report filed by Public Staff on March 23, 2006, wherein the Public Staff set forth its evaluation of the Indiana Utility Regulatory Commission's recent order approving the Settlement Agreement. If any comments are filed, the Commission will take appropriate action.

be relevant to North Carolina. Likewise, none of the Regulatory Conditions imposed by the Commission in this case will trigger any of the "Most Favored Nation" provisions in the other states and the Commission has been careful to adopt no Condition which will trigger any of those provisions.[31]

Furthermore, the Commission is satisfied that the benefits of the Merger to be received by Duke Power's North Carolina retail ratepayers are at least equal to those to be received by retail ratepayers in the other states and in many respects are superior. To the Commission's knowledge, no other state commission has imposed specific conditions giving it the same opportunity to determine in advance the extent of its statutory jurisdiction over activities of utility affiliates or the protections against federal preemption set forth in the Commission-approved Regulatory Conditions.

The Commission, therefore, finds and concludes that the Commission-approved Regulatory Conditions and Code of Conduct will effectively ensure that Duke Power's North Carolina retail customers will receive an appropriate share of the benefits resulting from the Merger.

CONCLUSIONS OF LAW

The Commission concludes that (1) the Commission-approved Regulatory Conditions and Code of Conduct, (2) the one-year across-the-board decrement to rates for the benefit of Duke Power's North Carolina retail customers in the amount of $117,517,000[32], (3) the $12,000,000 contribution to various energy- and environmental-related programs to be made by Duke Power, and (4) the Commission-initiated 2007 Duke Power rate investigation are sufficient to ensure that the Merger will have no adverse impact on the rates and service of Duke Power's North Carolina retail ratepayers; that Duke Power's retail ratepayers are protected as much as possible from potential costs and risks resulting from the Merger; that there are sufficient benefits from the Merger to offset the potential costs and risks; and that the proposed business combination between Duke Energy and Cinergy is justified by the public convenience and necessity.

Accordingly, the Commission finds good cause to approve Duke Energy's application to enter into a business combination with Cinergy, provided that Duke Energy shall file a statement in this docket notifying the Commission that the Company accepts and agrees to all of the terms, conditions, and provisions of this order +and the Commission-approved Regulatory Conditions and Code of Conduct.

---

[31] This conclusion is supported by representations by Duke Power's counsel at the January 18, 2006 oral argument (Tr. pp. 74-80). The Commission notes that the one-year rate decrement in the amount of $117,517,000 ordered by the Commission is equivalent and equal to the exact dollar amount offered by Duke Power based upon its proposal to share 42% of the Company's five-year estimated net merger savings amount assignable to its North Carolina retail ratepayers.

[32] Duke Power shall, not later than Friday, April 7, 2006, make an appropriate filing to implement this rate decrement in conjunction with its pending fuel adjustment proceeding in Docket No. E-7, Sub 805.

IT IS, THEREFORE, ORDERED as follows:

1. That Duke Energy's Application to enter into a business combination with Cinergy is approved, provided that Duke Energy shall, not later than Friday, March 31, 2006, file a statement in this docket notifying the Commission that the Company accepts and agrees to all of the terms, conditions, and provisions of this order and the Commission-approved Regulatory Conditions and Code of Conduct attached hereto as Attachments A and B, respectively, and incorporated herein;

2. That the Commission will take further action, if necessary, as contemplated by Regulatory Condition No. 16 following the issuance of a FERC decision on rehearing with respect to FERC Docket No. EC05-103-000; however, notwithstanding anything in this paragraph, unless changed by a subsequent Commission order, this order constitutes final approval of the Application in this docket;

3. That, consistent with the provisions of this order, Duke Power, the Public Staff, and the Attorney General shall confer and jointly develop a list of appropriate and effective conservation and energy efficiency programs and shall submit their recommendations to the Commission for approval not later than 45 days from the date hereof; and

4. That parties to this docket may file a request in Docket No. E-7, Sub 795A within 30 days of the date of this order to be made parties to that docket and to be served with copies of any filings made pursuant to Regulatory Condition No. 59(a)(i) that do not involve advance notices.

ISSUED BY ORDER OF THE COMMISSION.

This the 24th day of March, 2006.

NORTH CAROLINA UTILITIES COMMISSION

Geneva S. Thigpen

Geneva S. Thigpen, Chief Clerk

Bb032406.01

ATTACHMENT A

REGULATORY CONDITIONS
DOCKET NO. E-7, SUB 795

A. DEFINITIONS

For the purposes of these Regulatory Conditions, the terms listed below shall have the following definitions:

Affiliate: Duke Energy Corporation and any business entity, other than Duke Power, of which ten percent (10%) or more is owned or controlled, directly or indirectly, by Duke Energy Corporation. For purposes of these Regulatory Conditions, Duke Energy Corporation and any business entity so controlled by it are considered to be Affiliates of Duke Power.

Affiliate Contract: Any contract or agreement (a) between and among any of the Affiliates if such contracts are reasonably likely to have an Effect on Duke Power's Rates or Service, or (b) to which both Duke Power and any Affiliate are parties. Such contracts and agreements include, but are not limited to, service, operating, interchange, pooling, and wholesale power sales agreements and agreements involving financings and asset transfers and sales.

Catawba Joint Owners: The North Carolina Electric Membership Corporation, North Carolina Municipal Power Agency No. 1, Piedmont Municipal Power Agency, and Saluda River Electric Cooperative, Inc. For purposes of these Regulatory Conditions, Duke Power is not included in the definition of Catawba Joint Owners.

Commission: The North Carolina Utilities Commission.

Customer: Any retail electric customer of Duke Power, including those served under the Commission-approved rates for Nantahala Power and Light.

Duke Energy Corporation: The current holding company parent of Duke Power and any successor company.

Duke Energy Shared Services: Duke Energy Shared Services, LLC, and its successors, which is a service company Affiliate that provides Shared Services to Duke Power, Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations of Duke Power, singly or in any combination.

Duke Power: Duke Power Company, LLC, the business entity, wholly owned by Duke Energy Corporation, that holds the franchises granted by the Commission to provide Electric Services within the North Carolina service territories of Duke Power and

Nantahala Power and Light, and that engages in public utility operations, as defined in G.S. 62-3(23), within the State of North Carolina.

Effect on Duke Power's Rates or Service: When used with reference to the consequences to Duke Power of actions or transactions involving an Affiliate or Nonpublic Utility Operation, this phrase has the same meaning that it has when the Commission interprets G.S. 62-3(23)(c) with respect to the affiliation covered therein.

Electric Services: Commission-regulated electric power generation, transmission, distribution, delivery, or sales, and other related services, including, but not limited to, administration of Customer accounts and rate schedules, metering, billing, and standby service.

FERC: The Federal Energy Regulatory Commission.

Fully Distributed Cost: All direct and indirect costs, including overheads and an appropriate cost of capital, incurred in providing goods or services to another business entity; provided, however, that (1) the return on common equity utilized in determining such cost of capital for each good and service supplied by or from Duke Power shall equal the return on common equity authorized by the Commission in Duke Power's most recent general rate case proceeding, and (2) the cost of capital for each good and service supplied to Duke Power shall not exceed the overall cost of capital authorized by the Commission in Duke Power's most recent general rate case proceeding.

Market Value: The price at which property, goods, and services would change hands in an arm's length transaction between a buyer and a seller without any compulsion to engage in a transaction, and both having reasonable knowledge of the relevant facts.

Merger: The mergers, the conversion of Duke Energy Corporation into a limited liability company, the restructuring transactions, and all other transactions contemplated by the Agreement and Plan of Merger between Duke Energy Corporation and Cinergy Corp.

Nonpublic Utility Operations: All business operations engaged in by Duke Power involving activities (including the sales of goods or services) that are not regulated by the Commission, nor otherwise subject to public utility regulation at the state or federal level.

PUHCA 2005: The Public Utility Holding Company Act of 2005.

Regulatory Conditions: The conditions imposed by the Commission in connection with or related to the Merger.

Retail Native Load Customers: The captive retail Customers for which Duke Power has an obligation under North Carolina law to engage in long-term planning and to supply all Electric Services, including installing or contracting for capacity, if needed, to reliably meet their electricity needs.

Retained Earnings: The retained earnings currently required to be listed on page 112, line 11, of the pre-Merger Duke Energy Corporation FERC Form 1.

Shared Services: The services that meet the requirements of these Regulatory Conditions and that the Commission has explicitly authorized Duke Power to take from Duke Energy Shared Services pursuant to a service agreement (a) filed with the Commission pursuant to G.S. 62-153(b), thus requiring acceptance and authorization by the Commission, and (b) subject to all other applicable provisions of North Carolina law, the rules and orders of the Commission, and the Regulatory Conditions, including, but not limited to, Regulatory Condition No. 20.

Utility Affiliates: The public utility operations of any Affiliate of Duke Power, including the public utility operations of PSI Energy, Inc., the public utility operations of Union Light, Heat and Power Company, and the transmission and distribution operations of The Cincinnati Gas and Electric Company.

B. PROTECTION FROM PREEMPTION

1. With respect to transactions between Duke Power and its Affiliates and to Affiliate Contracts, the following requirements and procedures shall apply:

   (a) Duke Power shall not engage in any such transactions without first filing the proposed Affiliate Contract with the Commission that memorializes any such dealings and taking such actions and obtaining from the Commission such decisions as are required under North Carolina law. Duke Power shall submit each proposed Affiliate Contract to the Public Staff for informal review at least ten days before filing it with the Commission. No additional advance notice is required for agreements that Duke Power intends to file pursuant to G.S. 62-153 unless the agreements are to be filed with the FERC, in which case subsection (c) applies.

   (b) All Affiliate Contracts to which Duke Power is a party shall provide the following:
      (i) Duke Power's participation in the agreement is voluntary, Duke Power is not obligated to take or provide services or make any purchases or sales pursuant the agreement, and Duke Power may elect to discontinue its participation in the agreement at its election after giving any required notice;
      (ii) Duke Power may not make or incur a charge under the agreement except in accordance with North Carolina law and the rules, regulations and orders of the Commission promulgated thereunder;
      (iii) Duke Power may not seek to reflect in rates any (A) costs incurred under the agreement exceeding the amount allowed by the Commission or (B) revenue level earned under the agreement less than the amount imputed by the Commission; and

(iv) Duke Power will not assert in any forum that the Commission's authority to assign, allocate, make pro-forma adjustments to or disallow revenues and costs for retail ratemaking and regulatory accounting and reporting purposes is preempted and will bear the full risk of any preemptive effects of federal law with respect to the agreement.

(c) The following shall apply to all proposed Affiliate Contracts and any proposed amendments to existing Affiliate Contracts to which Duke Power is a party or which involve costs that will be assigned or allocated to Duke Power that are required or intended to be filed with the FERC:

(i) In order to enable the Commission to determine if it has jurisdiction over the proposed Affiliate Contract or amendment and how it will exercise its jurisdiction, Duke Power shall file a notice and a copy of the proposed Affiliate Contract or amendment with the Commission 30 days prior to a filing covered by this condition being made with the FERC. A copy shall be provided to the Public Staff at the time of the filing.

(ii) If an objection to Duke Power proceeding with the filing with the FERC is filed pursuant to the procedures set out in Regulatory Condition No. 59(b), the proposed filing shall not be made with the FERC until the Commission issues an order resolving the objection.

(iii) Filings of advance notices and copies of Affiliate Contracts and amendments to existing Affiliate Contracts pursuant to this subsection shall be in addition to filings required by G.S. 62-153, and the burden of proof as to those filings shall be as provided by statute.

(d) Duke Power shall certify that neither Duke Power, Duke Energy Corporation, any Affiliate, nor any Nonpublic Utility Operation has made any filing with the FERC or any other federal regulatory agency inconsistent with the foregoing. Such certification shall be repeated annually on the anniversary of the first certification.

2. With respect to any financing transaction involving Duke Power, Duke Energy Corporation or any of its Affiliates, the following shall apply:

(a) With respect to any financing transaction between Duke Power and Duke Energy Corporation or any one or more of its other Affiliates, any contract memorializing such transaction shall provide that Duke Power may not enter into any such financing transaction except in accordance with North Carolina law and the rules, regulations and orders of the Commission promulgated thereunder; and

(b) With respect to any financing transaction (i) between and among any of the Affiliates if such contracts are reasonably likely to have an Effect on

Duke Power's Rates or Service, or (ii) between Duke Power and any Affiliate, any contract memorializing such transaction shall provide that Duke Power may not include the effects of any capital structure or debt or equity costs associated with such financing transaction in its North Carolina retail cost of service or rates except as allowed by the Commission.

3. At the time the Merger is closed, Duke Power shall own and control all assets or portions thereof used for the generation, transmission, and distribution of electric power to its North Carolina retail customers (with the exception of assets used to provide power purchased by Duke Power at wholesale). With respect to the transfer by Duke Power to any entity, affiliated or not, of the control of, operational responsibility for, or ownership of such assets with a gross book value in excess of ten million dollars ($10 million), the following shall apply:

   (a) Duke Power shall provide notice with the Commission pursuant to Regulatory Condition No. 59(b) at least 30 days in advance of the proposed transfer;

   (b) Any contract memorializing such a transfer shall provide the following:
      (i) Duke Power may not commit to or carry out the transfer except in accordance with all applicable law, and the rules, regulations and orders of the Commission promulgated thereunder; and
      (ii) Duke Power may not include in its North Carolina cost of service or rates the value of the transfer, whether or not subject to federal law, except as allowed by the Commission in accordance with North Carolina law; and

   (c) Any filing with the FERC in connection with any transfer of control, operational responsibility or ownership that involves or otherwise affects Duke Power shall include the commitments in (b)(i) and (ii), above, and shall request that the FERC include language in its approval order(s) to the effect that its approval of the application in no way affects the right of the North Carolina Commission to review and determine the value of such asset transfer and establishing the value of the asset transfer for purposes of determining the rates for services rendered to Duke Power's North Carolina retail customers.

4. Subject to additional restrictions set forth in the Code of Conduct approved by this Commission, Duke Power shall not purchase electricity (or related ancillary services) from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation under circumstances where the total all-in costs, including, but not limited to, generation, transmission, ancillary costs, distribution, and delivery point costs, incurred (whether directly or through allocation) exceed fair Market Value for comparable service, nor shall it sell electricity (or related ancillary services) to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility

Operation for less than fair Market Value; provided, however, that such restrictions shall not apply to emergency transactions.

5. Duke Power shall retain the obligation to pursue least cost integrated resource planning for its Retail Native Load Customers and remain responsible for its own resource adequacy subject to Commission oversight in accordance with North Carolina law. Duke Power shall determine the appropriate self-built or purchased power resources to be used to provide future generating capacity and energy to its Retail Native Load Customers, including the siting considered appropriate for such resources, on the basis of the benefits and costs of such siting and resources specifically to Duke Power's Retail Native Load Customers.

6. The planning and dispatch of Duke Power system generation and purchased power resources subsequent to the Merger shall ensure that Duke Power's Retail Native Load Customers receive the benefits of those resources, including priority of service, to meet their electricity needs. Duke Power shall continue to serve its Retail Native Load Customers in North Carolina with the lowest-cost power it can reasonably generate or purchase from other sources before making power available for sales to customers that are not Retail Native Load Customers.

7. The following provisions shall apply to Duke Power's participation in the wholesale market subsequent to the issuance of the Commission's Order in Docket No. E-7, Sub 795:

   (a) To the extent that Duke Power proposes to enter into wholesale power contracts that grant native load priority to the following historically served customers: Schedule 10A Customers, Town of Highlands, WCU, the electric membership cooperatives (EMCs) within Duke's control area, North Carolina Municipal Power Agency No. 1, Piedmont Municipal Power Agency, and Saluda River Electric Cooperative, Inc., Duke Power is not required to file an advance notice with the Commission or receive its approval. Subject to the conditions set out in subsection (d) below, the retail native loads of these historically served wholesale customers shall be considered Duke Power's Retail Native Load Customers for purposes of Regulatory Condition Nos. 5 and 6; provided, however, that this subsection applies only to the same types of supplemental load and backstand requirements services that were historically provided to the Catawba Joint Owners under the Catawba Interconnection Agreements between Duke Power and the Catawba Joint Owners prior to 2001, which, for the North Carolina Electric Membership Corporation, only includes the EMCs within Duke Power's control area.

   (b) Before granting native load priority to a wholesale customer other than as provided for in subsection (a) above or to other companies' retail customers, Duke Power must provide 30 days' advance notice of its intent to grant native load priority and to treat the retail native load of a proposed

wholesale customer as if it were Duke Power's retail native load pursuant to Regulatory Condition Nos. 5 and 6. The advance notice provisions of Regulatory Condition No. 59(b) apply.

(c) To the extent that Duke Power's proposed wholesale power contracts or other sales of energy and capacity are at less than native load priority, then no advance notice is required and no approval by the Commission is needed. For purposes of this condition, "native load priority" is defined as power supply service being provided or electricity otherwise being sold with a priority of service equivalent to that planned for and provided by Duke Power to its Retail Native Load Customers.

(d) The following conditions apply to all wholesale contracts (including master and service agreements under Duke Power's market-based rate tariff) that are entered into by Duke Power, as seller, subsequent to the date of the Commission's order approving the Merger in this docket:

(i) The Commission retains the right to assign, allocate, and make pro-forma adjustments with respect to the revenues and costs associated with Duke Power's wholesale contracts for both retail ratemaking and regulatory accounting and reporting purposes.

(ii) Entry into wholesale contracts that grant native load priority or otherwise obligate Duke Power to construct generating facilities or make commitments to purchase capacity and energy to meet those contractual commitments constitutes acceptance by Duke Power, Duke Energy Corporation, and any Affiliates or Nonpublic Utility Operations thereof of the risks that investments in generating facilities or commitments to purchase capacity and energy to meet such contractual commitments and maintain an adequate reserve margin throughout the term of such contracts may become uneconomic sunk costs that are not recoverable from Duke Power's retail ratepayers. In a future Commission retail proceeding in which cost recovery is at issue, Duke Power shall (1) not claim that it does not bear this risk, and (2) acknowledge that the Commission retains full authority under Chapter 62 to disallow such costs as not used and useful and to allocate or assign such costs away from retail customers. For purposes of this condition, capacity will be considered used and useful and not excess capacity to the extent the Commission determines such capacity is needed by Duke Power to meet the expected peak load of Duke Power's Retail Native Load Customers in the near term future plus a reserve margin comparable to that currently being used or otherwise considered appropriate by the Commission.

(iii) Duke Power shall not assert before the FERC or any federal or state court that (1) transactions entered into pursuant to Duke Power's cost- or market-based rate authority or (2) the filing with, or acceptance for filing by, the FERC of any wholesale power contract

imply a cost allocation methodology that is binding on the Commission, require the pass-through of any costs or revenues under the filed rate doctrine, or preempt the Commission's authority to assign, allocate, make pro-forma adjustments to, or disallow the revenues and costs associated with, Duke Power's wholesale contracts for both retail ratemaking and regulatory accounting and reporting purposes.

(iv) Duke Power shall not assert before any federal or state court that the exercise of authority by the Commission to assign, allocate, make pro forma adjustments to, or disallow the costs and revenues associated with Duke Power's wholesale contracts for retail ratemaking and regulatory accounting and reporting purposes in itself constitutes an undue burden on interstate commerce or otherwise violates the Commerce Clause of the United States Constitution. However, Duke Power retains the right to argue that a specific exercise of authority by the Commission violates the Commerce Clause based upon specific evidence of undue interference with interstate commerce.

(v) Except as provided in the foregoing conditions, Duke Power retains the right to challenge the lawfulness of any Commission order issued in connection with the assignment, allocation, pro-forma adjustments to, or disallowances of the revenues and costs associated with Duke Power's wholesale contracts for retail ratemaking and regulatory accounting and reporting purposes on any other grounds, including but not limited to the right outlined in G.S. 62-94(b).

8. Neither Duke Power, Duke Energy Corporation, another Affiliate, nor a Nonpublic Utility Operation shall assert that approval by the FERC of market-based rates, transfers of generating facilities, or any matter that involves Affiliates in any way preempts the Commission's authority to determine the reasonableness or prudence of Duke Power's decisions with respect to supply-side resources, demand-side management, or any other aspect of resource adequacy.

9. No agreement shall be entered into, nor shall any filing be made with the FERC, by or on behalf of Duke Power, that (a) commits Duke Power to, or involves it in, joint planning, coordination, or operation of generation, transmission, or distribution facilities with one or more Affiliates, or (b) otherwise alters Duke Power's obligations with respect to these Regulatory Conditions, absent explicit approval of the Commission.

10. Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall file notice with the Commission 30 days prior to filing with the FERC any agreement, tariff, or other document or any proposed amendments, modifications, or supplements to any such document having the potential to (a) affect Duke Power's cost of service for its pre-merger system power supply resources or transmission system; (b) be interpreted as involving Duke Power in joint planning, coordination or operation of generation or

transmission facilities with one or more Affiliates; or (c) otherwise affect Duke Power's rates or service. The advance notice provisions of Regulatory Condition No. 59(b) apply; provided, however, that, to the extent the filing with the FERC is not to be made by Duke Power, the advance notice procedures shall be for the purpose of a Commission determination as to whether the filing is reasonably likely to have an Effect on Duke Power's Rates or Service.

11. Any contract or filing regarding Duke Power's membership in or withdrawal from an RTO or comparable entity must be contingent upon state regulatory approval.

12. If the FERC does not approve Section 3.2 of the OATT Attachment K and Section 4.5 in Duke Power's Independent Entity Agreement (IE Agreement) dated July 22, 2005, both of which were filed in FERC Docket No. ER05-1236-000 on July 22, 2005, or makes any change that would make the Independent Entity a FERC-jurisdictional entity or otherwise affect the Commission's jurisdiction over the transmission component of Duke Power's retail service or rates, then Duke shall withdraw the filing and exercise its right to terminate the IE Agreement, absent an order from the Commission explicitly relieving Duke Power of this obligation.

13. Neither Duke Power, Duke Energy Corporation, another Affiliate, nor a Nonpublic Utility Operation shall assert in any forum, with respect to any contract or transaction in which Duke Power is involved or any contract or transaction involving Duke Energy Corporation, any other Affiliate, or any Nonpublic Utility Operation that may have an Effect on Duke Power's Rates or Service, that the Commission is in any way preempted from exercising any authority it has under North Carolina law as to:

    (a) reviewing the reasonableness of any Affiliate commitment entered into by Duke Power, or from disallowing the costs of, or imputing revenues related to such commitment to, Duke Power;

    (b) exercising its authority over financings or from setting rates based on the capital structure, corporate structure, debt costs, or equity costs that it finds to be appropriate for ratemaking purposes;

    (c) reviewing the reasonableness of any commitment entered into by Duke Power to transfer an asset, mandating, approving or otherwise regulating a transfer of assets, or scrutinizing and establishing the value of the asset transfers for purposes of determining the rates for services rendered to Duke Power's retail customers; or

    (d) otherwise exercising any lawful authority it may have.

Should any other entity so assert, neither Duke Power, Duke Energy Corporation, the other Affiliates, nor the Nonpublic Utility Operations shall support any such assertion and shall, upon learning of such assertion, so advise and consult with the Commission and the Public Staff regarding such assertion.

14. Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall (a) bear the full risk of any preemptive effects of federal law with respect to any contract, transaction, or commitment entered into or made by Duke Power or which may otherwise affect Duke Power's operations, service, or rates and (b) shall take all actions as may be reasonably necessary and appropriate to hold North Carolina ratepayers harmless from rate increases, foregone opportunities for rate decreases or any other effects of such preemption. Such actions include, but are not limited to, filing with and making reasonable efforts to obtain approval from the FERC or other applicable federal entity of such commitments as the Commission deems reasonably necessary to prevent such preemptive effects.

15. The following provisions shall apply:

    (a) Whenever the FERC issues rules regarding PUHCA 2005 or other rules reasonably likely to affect these Regulatory Conditions, Duke Power shall meet promptly with the Public Staff and negotiate in good faith whether and how these Regulatory Conditions might be or have been affected by such rules, and whether changes are necessary to maintain their intended protections. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time after the issuance of final rules, the unresolved issues shall be submitted to the Commission for resolution. Any proposed changes to these Regulatory Conditions must be approved by the Commission.

    (b) If PUHCA 2005 is amended, revised, or replaced by future legislation, Duke Power shall meet with the Public Staff promptly after the passage of such legislation and negotiate in good faith whether and how these conditions have been affected by such legislation, and whether changes are necessary to maintain their intended protections. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time after passage of such legislation, the unresolved issues shall be submitted to the Commission for resolution. Any proposed changes to these Regulatory Conditions must be approved by the Commission.

16. Upon a decision by FERC on the petition for rehearing pending in Docket No. EC05-103-000, Duke Power shall meet promptly with the Public Staff and negotiate in good faith whether and how these Regulatory Conditions might be or have been affected by such order, and whether changes are necessary to maintain their intended protections. In the event the parties are unable to reach

agreement within a reasonable time, the unresolved issues shall be submitted to the Commission for resolution.

17. In addition to the filing requirements of Commission Rule R8-27 and all other applicable statutes and Commission Rules, Duke Power shall, on a quarterly basis, file with the Commission the following: (a) a list of all applications, reports, contracts, rate schedules, and other documents (including the docket number(s) and a summary of each item listed) filed with or submitted to the FERC or other federal regulatory agency (or their staffs) by Duke Power, Duke Energy Corporation, Duke Energy Shared Services, other Affiliates, or the Nonpublic Utility Operations, to the extent such filings and submissions are reasonably likely to have a significant Effect on Duke Power's rates or service to its North Carolina retail customers, and (b) a list of all orders issued by FERC or any other federal regulatory agency (including docket number(s) and a summary of each order listed) in dockets to which Duke Power, Duke Energy Corporation, any other Affiliate, or any Nonpublic Utility Operation is a party, to the extent such orders are reasonably likely to have a significant Effect on Duke Power's rates or service to its North Carolina retail customers.

C. COST ALLOCATIONS AND RATEMAKING

18. Subject to additional provisions set forth in the Code of Conduct approved by this Commission, Duke Power shall take the following actions in connection with procuring goods and services for its utility operations from Affiliates or Nonpublic Utility Operations and providing goods and services to its Affiliates or Nonpublic Utility Operations:

(a) Duke Power shall not seek to recover from its retail customers any costs that exceed fair Market Value for any service provided to Duke Power from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation.

(b) Duke Power shall seek out and buy all goods and services from the lowest cost qualified provider of comparable goods and services, and shall have the burden of proving that all goods and services procured from its Affiliates or Nonpublic Utility Operations have been procured on terms and conditions comparable to the most favorable terms and conditions reasonably available in the relevant market, which shall include a showing that comparable goods or services could not have been procured at a lower price from qualified non-Affiliate sources or that Duke Power could not have provided the services or goods itself on the same basis at a lower cost. To this end, Duke Power must conduct periodic market price studies for goods and services it receives from Duke Energy Corporation, Duke Energy Shared Services, another Affiliate, or a Nonpublic Utility Operation.

(c) Duke Power shall have the burden of proving that all goods and services provided to Duke Energy Shared Services, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation have been provided on the terms and conditions comparable to the most favorable terms and conditions reasonably available in the market, which shall include a showing that such goods or services have been provided at the higher of cost or market price. To this end, Duke Power shall conduct periodic market price studies for goods and services provided to Duke Energy Corporation, Duke Energy Shared Services, another Affiliate, or a Nonpublic Utility Operation.

(d) The evaluation of providers of goods and services and the comparison of goods and services to Market Value required by the Regulatory Condition may take into consideration qualitative as well as quantitative factors. To the extent that comparable goods or services provided to Duke Power or by Duke Power are not commercially available, this Regulatory Condition shall not apply.

19. For the purposes of North Carolina retail accounting, reporting, and ratemaking, the Commission may, after appropriate notice and hearing or other appropriate opportunity for Duke Power to be heard, issue future orders relating to Duke Power's cost of service as the Commission may determine is necessary to ensure that Duke Power's operations and transactions with its Affiliates and Nonpublic Utility Operations are consistent with the Regulatory Conditions and Code of Conduct approved by the Commission, and with any other applicable decision of the Commission.

20. With regard to goods and services provided by Duke Power to Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, and to goods and services, including Shared Services, provided to Duke Power by Duke Energy Shared Services, Duke Energy Corporation (should Duke Energy Corporation be allowed to provide any such goods or services), any other Affiliate, or any Nonpublic Utility Operation, the following conditions shall apply:

(a) No later than 60 days prior to the expected close of the Merger, Duke Power shall file pursuant to G.S. 62-153 final forms of service agreements that authorize the provision and receipt of non-power goods or services between and among Duke Power, its Affiliates or Nonpublic Utility Operations, the list(s) of goods and services it intends to take from Duke Energy Shared Services, and the basis for the determination of such list(s) and election of such services. All such lists that involve payment of fees or other compensation by Duke Power shall require acceptance and authorization by the Commission, and shall be subject to any other Commission action required or authorized by North Carolina law and the Rules and orders of the Commission.

(b) No later than 30 days after such filing, the Public Staff shall file its response to Duke Power's filing, which shall include a recommendation as to how the Commission should proceed. If no Commission order is issued by the close of the Merger, Duke Power may operate on an interim basis, subject to ongoing Commission review, pursuant to the agreements as filed and make payments, subject to refund, as provided for therein.

(c) The services rendered by Duke Power to its Affiliates and Nonpublic Utility Operations and the services received by Duke Power from its Affiliates and Nonpublic Utility Operations pursuant to these agreements, the costs and benefits assigned or allocated in connection with such services, and the determination or calculation of the bases and factors utilized to assign or allocate such costs and benefits, as well as Duke Power's compliance with its Commission approved-Code of Conduct and all Regulatory Conditions placed upon it by the Commission, shall remain subject to ongoing review. These agreements shall be subject to any Commission action required or authorized by North Carolina law and the Rules and orders of the Commission.

(d) No later than one month after the closing date of the Merger, Duke Power shall file with the Commission all newly-created cost allocation manuals (CAMs) and revisions to existing CAMs, including CAMs related to Shared Services provided by Duke Energy Shared Services. The CAMs referred to herein are those intended to govern the assignment and allocation of direct, indirect, and other costs associated with goods and services (i) provided by Duke Power to Duke Energy Corporation, Duke Energy Shared Services, other Affiliates, and the Nonpublic Utility Operations, or (ii) by those entities to Duke Power and to each other (to the extent they may affect Duke Power's cost of service to its North Carolina retail electric Customers) and shall include a full description thereof, including a detailed review of common costs to be allocated and allocation factors to be used. The following additional provisions shall apply:

(i) The CAM(s) shall be updated annually, and the revised CAM(s) shall be filed with the Commission no later than March 31 of the year that the CAM(s) are to be in effect. Duke Power shall review allocation factors every two years, and the result of such review shall be filed with the Commission; and

(ii) Interim changes shall be made to the CAM(s), if and when necessary, and shall be filed with the Commission. No changes shall be made to the cost allocations, cost allocation methodologies, or related accounting entries associated with goods and services (including Shared Services provided by Duke Energy Shared Services) provided to or by Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations until Duke Power has given 15 days notice to the Commission of the proposed changes.

(e) No later than 30 days after the closing date of the Merger, Duke Power shall file with the Commission pursuant to G.S. 62-153 the list(s) of goods and services (1) it intends to offer to Duke Energy Corporation, Duke Energy Shared Services, other Affiliates, and the Nonpublic Utility Operations, and (2) it intends to take from Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations (excluding Shared Services provided by Duke Energy Shared Services, which are required to be filed pursuant to subsection (a) above), and the basis for the determination of such list(s) and election of such services. All such lists that involve payment of fees or other compensation by Duke Power shall require acceptance and authorization by the Commission, and shall be subject to any other Commission action required or authorized by North Carolina law and the Rules and orders of the Commission. The following additional provisions shall apply:

(i) The list(s) of goods and services, including the list required by subsection (a) above, shall be updated annually, and the revised list(s) shall be filed with the Commission no later than March 31 of the year that they are to be in effect; and

(ii) Interim changes shall be made to the list(s) of goods and services, if and when necessary, and shall be filed with the Commission. No changes shall be made to the list(s) of goods and services until Duke Power has given 15 days notice to the Commission of the proposed changes.

(f) With respect to interim changes to the CAM(s) or the list(s) of goods and services, for which 15 days notice to the Commission is required, the following procedures shall apply: Before the end of the notice period, the Public Staff shall file a response and make a recommendation as to how the Commission should proceed. If the Commission has not issued an order within 30 days of the end of the notice period, Duke Power may proceed with the changes but shall be subject to any fully adjudicated Commission order on the matter.

(g) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this condition.

(h) The Service Agreements, the CAM(s) and the assignments and allocations of costs pursuant thereto, the biannual allocation factor reviews, the list(s) and the goods and services provided pursuant thereto, and the changes to these documents shall be subject to ongoing Commission review, and Commission action if appropriate.

21. Notwithstanding any of the provisions contained in these Regulatory Conditions, to the extent the allocations adopted by the Commission when compared to the allocations adopted by the other State commissions with ratemaking authority as to a Utility Affiliate of Duke Power result in significant trapped costs related to

"non-power goods or administrative or management services provided by an associate company organized specifically for the purpose of providing such goods or services to any public utility in the same holding company system," including Duke Power, Duke Power may, after the effective date of the Energy Policy Act of 2005 (PUHCA 2005), request pursuant to Section 1275(b) of Subtitle F in Title XII of PUHCA 2005 that the FERC "review and authorize the allocation of the costs for such goods and services to the extent relevant to that associate company." Such review and authorization shall have whatever effect it is determined to have under the law. The quoted language in this condition is taken directly from Section 1275(b) of Subtitle F in Title XII of PUHCA 2005. The terms "associate company" and "holding company system" are defined in Sections 1262(2) and 1262(9), respectively, of Subtitle F in Title XII of PUHCA 2005 and have the same meanings for purposes of this condition.

22. Transactions between Duke Power and Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, and other transactions among Affiliates if such transactions are reasonably likely to have a significant Effect on Duke Power's Rates or Service, shall be reviewed at least annually by Duke Energy Corporation's internal auditors. To the extent external audits of the transactions are conducted, Duke Power shall make available such audits for review by the Public Staff and the Commission. Duke Power shall make available for review by the Public Staff and the Commission all workpapers relating to internal audits and all other internal audit workpapers, if any, related to affiliate transactions, and shall not oppose Public Staff and Commission requests to review relevant external audit workpapers.

23. For North Carolina retail electric cost of service/ratemaking purposes, Duke Power electric system costs shall be assigned or allocated among retail and wholesale jurisdictions based on reasonable and appropriate cost causation principles. Assignment or allocation of costs to the North Carolina retail jurisdiction shall not be adversely affected by the manner and amount of recovery of electric system costs from the Catawba Joint Owners as a result of agreements between Duke Power and the Catawba Joint Owners. For cost of service/ratemaking purposes, North Carolina retail ratepayers will be held harmless from any cost assignment or allocation of costs resulting from the agreements between Duke Power and the Catawba Joint Owners.

24. Neither Duke Power, Duke Energy Corporation, any other Affiliate, nor a Nonpublic Utility Operation shall assert that any interested party is prohibited from seeking the inclusion in future rate proceedings of cost savings that may be realized as a result of the Merger.

25. Direct expenses associated with costs to achieve the Merger shall be excluded from retail cost of service for ratemaking purposes. Duke Power shall bear the burden of proof to demonstrate in its first rate case after closing of the Merger that any capital costs, such as system integration costs, associated with costs to

achieve the merger that Duke seeks to recover from the North Carolina retail customers are to the benefit of North Carolina retail customers. The North Carolina portion of costs to achieve merger savings shall be reflected in Duke Power's North Carolina ES-1 report as recorded on its books and records under generally accepted accounting principles. To the extent a one-year rate decrement is approved, the rate decrement's impact may be spread evenly over five years in the ES-1 report, commencing with the date the rate decrement is implemented. However, Duke Power shall include as a footnote in the ES-1 report the merger related costs to achieve that were expensed during the relevant period. If the merger is not consummated, neither the cost of any termination payment nor the receipt of a termination payment between Duke Energy and Cinergy shall be allocated to Duke Power's books. Nor shall Duke Power's North Carolina retail customers otherwise bear any direct expenses or costs associated with a failed merger.

26. The revenues from certain Duke Power electric utility wholesale transactions are (a) assigned or allocated in part to Duke Power's North Carolina retail operations and (b) treated in part as a credit to jurisdictional fuel expenses in Duke Power's annual North Carolina retail fuel proceedings. To the extent commitments to Duke Power's wholesale customers relating to the Merger are made by or imposed upon Duke Power, the effects of which serve to (a) decrease the net bulk power revenues ordered to be shared by the Commission in Docket No. E-7, Sub 751, (b) increase the North Carolina retail cost of service, or (c) increase North Carolina retail fuel costs under reasonable cost assignment and allocation practices approved or allowed by the Commission, those effects shall not be recognized for North Carolina retail cost of service or ratemaking purposes.

27. To the extent that other such commitments are made by or imposed upon Duke Power, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation relating to the Merger, either through an offer, a settlement, or as a result of a regulatory order, the effects of which serve to increase the North Carolina retail cost of service or North Carolina retail fuel costs under reasonable cost allocation practices, the effects of these commitments shall not be recognized for North Carolina retail ratemaking purposes.

28. Any acquisition adjustment that results from the Merger shall be excluded from Duke Power's utility accounts and treated for regulatory accounting, reporting, and ratemaking purposes so that it does not affect Duke Power's North Carolina retail electric rates and charges.

29. Duke Power, Duke Energy Corporation, the other Affiliates, and all of the Nonpublic Utility Operations shall take all such actions as may be reasonably necessary and appropriate to hold North Carolina retail ratepayers harmless from effects of the Merger, including rate increases or foregone opportunities for rate decreases, and other effects otherwise adversely impacting North Carolina retail customers.

30. Duke Power's North Carolina retail customers shall be held harmless from all current and prospective liabilities of Cinergy Corp. and its subsidiaries including, but not limited to, the litigation involving manufactured gas plant sites, asbestos claims, environmental compliance, pensions and other employee benefits, and taxes.

31. Duke Power shall file an annual report of affiliated transactions with the Commission in the format prescribed by the Commission in Docket No. E-7, Sub 694. The report shall be filed on or before May 30 of each year, for activity through December 31 of the preceding year. Changes may be made, if and when deemed necessary, to the required affiliated transaction reporting requirements and submitted to the Commission for approval.

32. Periodic comprehensive third-party independent audits of the affiliate transactions undertaken pursuant to the affiliate agreements filed in this docket (as subsequently re-filed in accordance with Regulatory Condition No. 20 and allowed to go into effect by the Commission) shall be conducted no less often than every two years. The independent auditor shall have sufficient access to the books and records of Duke Power, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations to perform the audits. The scope of the audits shall include Duke Energy Corporation's and Duke Power's compliance with all conditions ordered herein concerning affiliate company transactions, including the propriety of the transfer pricing of goods and services between and/or among Duke Power and its affiliates, that is, Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations. Duke Power and the Public Staff shall confer and jointly identify one or more proposed independent auditors. Other parties shall have an opportunity to comment and propose additional auditors. Selection of the independent auditor shall be made by the Commission. The independent auditor shall be supervised in its duties by the Public Staff. Not later than 60 days after consummation of the Merger, the Public Staff shall file a recommendation with the Commission as to how and when the first independent audit should be commenced. Duke Energy Corporation shall bear the cost of the audits, and all such costs shall be excluded from Duke Power's utility accounts, except to the extent that reasonable assignments or allocations of such audit costs may be included in the transfer prices charged to Duke Power for goods and services provided to it by Duke Energy Corporation, other Affiliates, and all of the Nonpublic Utility Operations; provided however, that such transfer prices, individually, shall not exceed prices determined in strict compliance with all other Regulatory Conditions and the Code of Conduct as prescribed herein. The appropriateness of the assignment or allocation of the cost of the audits to utility accounts in the manner described above, if any, shall be subject to review in subsequent ratemaking proceedings. The auditor's reports shall be filed with the Commission. Duke Power may request a change in the frequency of the audit reports in future years, subject to approval by the Commission. Duke Energy Corporation shall endeavor to coordinate the various state affiliate transaction audits. To the extent separate third-party independent audits continue to be

performed in the other states, Duke Power shall provide the reports of those audits to the Public Staff and the Commission.

32a. Duke Power shall track its actual net merger savings for the five-year period beginning immediately subsequent to consummation of the Merger and submit quarterly reports delineating the actual net benefits derived therefrom with respect to its North Carolina retail operations. Said reports shall include explanations of the methodologies, assumptions, judgments, and estimates, if any, on which the reports are based. Copies of the workpapers setting forth the calculations of the net merger savings shall also be provided. These reports shall be verified by either the Chief Executive Officer, a senior-level financial officer, or the responsible accounting officer of Duke Power and shall be provided in conjunction with Duke Power's quarterly NCUC ES-1 Reports. The Public Staff is hereby requested to investigate, verify, and assess the reports required in this regard and submit an annual report to the Commission setting forth its findings and recommendations. It is further requested that the Public Staff's annual report be submitted on or before June 1st with respect to Duke Power's quarterly reports for the preceding calendar year.

33. Within six months after the closing date of the Merger, Duke Power shall file with the Commission revisions to its electric cost of service manual to reflect any changes to the cost of service determination process made necessary by the Merger, any subsequent alterations in the organizational structure of Duke Power, Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, or other circumstances that necessitate such changes.

D. CODE OF CONDUCT

34. Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall be bound by the Code of Conduct approved by the Commission in Docket No. E-7, Sub 795, and as it may subsequently be amended.

E. FINANCE/CORPORATE GOVERNANCE

35. Duke Energy Corporation shall maintain its books and records so that any net equity investment in Cinergy Corp. or its subsidiaries (or their successors) by Duke Energy Corporation or any of its Affiliates can be identified and made available on an ongoing basis. This information shall be provided to the Public Staff upon its request.

36. Duke Energy Corporation and Duke Power shall keep their respective accounting books and records in a manner that will allow all capital structure components and cost rates of the cost of capital to be identified easily and clearly for each entity on a separate basis. This information shall be provided to the Public Staff upon its request.

37. Duke Power shall keep its books and records so that the amount of Duke Energy Corporation's equity investment and member's equity in Duke Power can be identified and made available upon request on an ongoing basis. This information shall be provided to the Public Staff upon request.

37a. Effective upon consummation of the merger and beginning with the quarterly report due for the first 12-month reporting period beginning concurrent therewith or subsequent thereto, whichever shall first occur, Duke Power shall begin transitioning to its actual capital structure for purposes of calculating and reporting its quarterly North Carolina retail jurisdictional earnings in its NCUC ES-1 Reports to the Commission. Said transition shall be accomplished by use of a consistent, uniform, systematic approach applied on a quarterly basis such that exclusive use of the Company's actual capital structure will be fully phased in and reflected in the Company's NCUC ES-1 Report for the 12-month period ending June 30, 2007.[1] Once fully phased in, the information to be submitted as part and parcel of, or in conjunction with, the NCUC ES-1 Reports shall include, among other things, a calculation of the 13-month average actual capital structure utilized in such reports, with the individual capital components (long-term debt, member's and/or common equity, etc.) on a total-company basis shown separately and in total. NCUC ES-1 Reports filed by Duke Power during the phase-in shall clearly disclose and reflect the methodology employed by Duke Power in calculating the 13-month average capital structure utilized therein. In recognition of the change in its organizational structure that will result upon consummation of the merger, Duke Power shall, following the merger, continue to provide to the Commission and/or the Public Staff all financial and operational information which is currently being provided on an ongoing basis by Duke Energy Corporation. Duke Power shall base such reports primarily on the corporate entity Duke Power.

As part of its NCUC ES-1 Reports, Duke Power shall also include a schedule of any capital contribution(s) received from Duke Energy Corporation in the applicable calendar quarter. The same requirements set forth above shall also apply to NCUC ES-1 Quarterly reports filed for Nantahala Power & Light Company subsequent to consummation of the merger.

38. To the extent the cost rates of any of Duke Power's long-term debt (more than one year) or short-term debt (one year or less) are or have been adversely affected, through a ratings downgrade or otherwise, by the Merger, a replacement cost rate to remove the effect shall be used for all purposes affecting any of Duke Power's retail rates and charges. This replacement cost rate shall be applicable to all financings, refundings, and refinancings taking place following the change in ratings. This procedure shall be effective through

[1] This phase-in requirement is not, and should not be construed to be, a precedent or otherwise determinative with respect to the capital structure appropriate for use in determining the test-year cost of service for purposes of setting rates prospectively in the context of any future general rate case proceeding for Duke Power.

Duke Power's next general rate case. As part of Duke Power's next general rate case, any future procedure relating to a replacement cost calculation will be determined. This condition does not indicate a preference for a specific debt rating for Duke Power within the intended investment grade range provided for in Regulatory Condition No. 43 on current or prospective bases.

39. Within 90 days from the date of redemption of current Duke Energy Corporation's preferred stock, announced via a press release dated November 14, 2005, Duke Energy Corporation or Duke Power shall file a report with the Commission identifying the source(s) of funds used to execute the redemption and describing all costs, fees, etc., that are associated with the redemption.

40. Duke Power shall identify as clearly as possible long-term debt (of more than one year's duration) that it issues in connection with its regulated utility operations and capital requirements or to replace existing debt.

41. With respect to all proposed financing transactions, the following shall apply:

(a) For all types of financings for which Duke Power (or its subsidiaries, if any) are the issuers of the respective securities, Duke Power (or its subsidiaries, if any) shall request approval from the Commission to the extent required by G.S. 62-160 through G.S. 62-169 and Commission Rule R1-16. Generally, the format of these filings should be consistent with past practices. A "shelf registration" approach (similar to Docket No. E-7, Sub 727) may be requested.

(b) For all types of financings by Duke Energy Corporation, other than short-term debt as described in G.S. 62-167, the following shall apply:

(i) On or before January 15 of each year, Duke Energy Corporation shall file with the Commission and serve on the Public Staff an advance confidential plan of all securities issuances that are anticipated to occur during that calendar year. For 2006, an advance confidential plan shall be filed as soon as possible after the merger is consummated. The annual confidential plan shall include a description of all financings that Duke Energy Corporation reasonably believes may occur during the applicable calendar year. A description for each financing shall include the best estimates of the following: type of security; estimate of cost rate (e.g., interest rate for debt); amount of proceeds; brief description of the purpose/reason for issue; and amount of proceeds, if any, that may flow to Duke Power.

(ii) If at any time material changes to the financing plans included in the filed plan appear likely, Duke Energy Corporation shall file a revised 30-day advance confidential plan that specifically addresses such changes with the Commission and serve such notice on the Public Staff.

(iii) At the time of the confidential plan filings identified above, Duke Energy Corporation shall also file a non-confidential notice that states that a confidential plan has been filed in compliance with Regulatory Condition No. 41.

(iv) Duke Energy Corporation may proceed with equity issuances upon the filing of the confidential plan. However, actual debt issuances shall not occur until 30 days after the advance confidential plan or revised plans are filed. In the event it is not feasible for Duke Energy Corporation to file a revised advance confidential plan for a material change 30 days in advance, such plan shall be filed by a date that allows adequate time for review or a debt issuance shall be delayed to allow such review.

(v) Within 15 days after the filing of an advance confidential plan or revised plan, the Public Staff shall file a confidential report with the Commission with respect to whether any debt issuances require approval pursuant to G.S. 62-160 through G.S. 62-169 and Commission Rule R1-16 and shall recommend that the Commission issue an order deciding how to proceed. Duke Energy Corporation shall have seven days in which to respond to the report. If the Commission determines that any debt issuance requires approval, the Commission shall issue an order requiring the filing of an application and no issuance shall occur until the Commission approves the application. If the Commission determines that no debt issuance requires approval, the Commission shall issue an order so ruling. At the end of the notice period, Duke Energy Corporation may proceed with the debt issuance, but shall be subject to any fully adjudicated Commission order on the matter; provided, however, that nothing herein shall affect the applicability of G.S. 62-170 or other similar provision to such securities or obligations.

(vi) On or before April 15 of each year, Duke Energy Corporation shall file with the Commission a report on all financings that were executed for the previous calendar year. The actual reports should include the same information as required above for the advance plans plus the actual issuance costs.

(c) If a filing with the Securities and Exchange Commission or other federal agency will be made in connection with a securities issuance, the notice shall describe such filing(s) and indicate the approximate date on which it would occur.

(d) All securities issuances or financings that are associated with a merger, acquisition, or other business combination shall be filed in conjunction with the information requirements and deadlines stated in Regulatory Condition No. 54.

(e) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this condition.

42. These conditions do not supersede any orders or directives of the Commission regarding the issuance of specific securities by Duke Power or Duke Energy Corporation. The approval of the Merger by the Commission does not restrict the Commission's right to review, and by order to adjust, Duke Power's cost of capital for ratemaking purposes for the effect(s) of the securities-related transactions associated with the Merger.

43. Duke Power shall manage its business with the intention of maintaining an investment grade debt rating on all of its rated debt issuances with all of its debt rating agencies. If Duke Power's debt rating falls to the lowest level still considered investment grade at the time, Duke Power shall provide notice to the Commission and Public Staff within five (5) days of such change and an explanation as to why the downgrade occurred. Within 45 days of such notice, Duke Power shall meet with the Commission and the Public Staff and provide information regarding the steps it intends to take to maintain and improve its debt rating. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.

44. Duke Energy Corporation and Duke Power shall ensure that Duke Power has sufficient access to equity and debt capital to enable Duke Power to adequately fund and maintain its current and future generation, transmission, and distribution systems and otherwise meet the service needs of its customers at a reasonable cost.

45. Duke Power shall limit cumulative distributions paid to Duke Energy Corporation subsequent to the Merger to (i) the amount of Retained Earnings on the day prior to the closure of the Merger, plus (ii) any future earnings recorded by Duke Power subsequent to the Merger.

46. Duke Power shall not invest in a non-regulated utility asset or any non-utility business venture exceeding $50 million dollars in purchase price or gross book value to Duke Power unless it provides 30 days' advance notice, to which the advance notice provisions of Regulatory Condition No. 59(b) shall apply. Purchases of assets, including land, that will be held with a definite plan for future use in providing Electric Services in Duke Power's franchise area shall be excluded from this advance notice requirement.

47. By April 15 of each year, Duke Energy Corporation shall provide to the Commission and the Public Staff a report summarizing Duke Energy Corporation's investment in exempt wholesale generators (EWGs) and foreign utility companies (FUCOs) in relation to its level of consolidated retained earnings and consolidated total capitalization at the end of the preceding year. Exempt wholesale generator and foreign utility company are defined in Section

1262(6) of Subtitle F in Title XII of PUHCA 2005 and have the same meanings for purposes of this condition.

48. Duke Power shall borrow short-term funds in the financial markets or through the "Utility Money Pool Agreement" (Utility MPA), provided that the Utility MPA (a) is modified to exclude Tri-State Improvement Company; and (b) continues to provide that no loans through the Utility Money Pool will be made to, and no borrowings through the Utility Money Pool will be made by, Duke Energy Corporation and Cinergy Corporation. If, after December 31, 2008, certain of The Cincinnati Gas & Electric Company's generation assets are not dedicated to serving retail load in its service territory and are not subject to the rate stabilization plan (as approved in Case 03-93-ATA) or traditional regulation, then Duke Power shall obtain Commission approval to continue to participate in the Utility MPA. Duke Power shall acquire its long-term debt funds through the financial markets, and shall neither borrow from nor lend to, on a long-term basis, Duke Energy Corporation or any of its other Affiliates. To the extent that Duke Power borrows on short-term or long-term bases in the financial markets and it is feasible to obtain a debt rating, its debt shall be rated under its own name.

49. Duke Energy Corporation shall comply with New York Stock Exchange Listing Standards with respect to the composition of its Board of Directors.

50. Duke Energy Corporation shall notify the Commission subsequent to Board approval and as soon as practicable following any public announcement of any investment in a regulated or non-regulated business representing five (5) percent or more of Duke Energy Corporation's market capitalization. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.

51. If an Affiliate of Duke Power experiences a default on an obligation that is material to Duke Energy Corporation or files for bankruptcy, and such bankruptcy is material to Duke Energy Corporation, Duke Power shall notify the Commission in advance, if possible, or as soon as possible, but not later than ten days from such event. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.

52. By March 31 of the first calendar year following the close of the Merger and each March 31 thereafter, Duke Power shall file an annual report in the format provided hereinafter. Duke Power and the Public Staff shall meet and reach agreement as to the list of Affiliates for purposes of this Annual Report that constitute Significant Affiliates and Duke Power shall file this list with the Commission. In the event the Public Staff and Duke Power are unable to reach agreement within a reasonable time, both shall file their proposed lists and submit the unresolved issues to the Commission for resolution. Thereafter, the list shall be updated as appropriate on an annual basis.

ANNUAL REPORT ON CORPORATE
GOVERNANCE AND FINANCE

Report for Duke Power Company, LLC,
Year Ending December 31, ____

1. Provide a complete, detailed organizational chart that identifies Duke Power and each Significant Affiliate, including major groups and departments. State the business purpose of each company and each major group and each department within each company. Changes from the report for the immediately preceding year shall be summarized at the beginning of the report.

2. Identify all Significant Affiliates that are considered to constitute non-regulated investments and provide each company's total capitalization, the percentage it represents of Duke Energy Corporation's total non-regulated investments, and the percentage it represents of Duke Energy Corporation's total investments. Changes from the report for the immediately preceding year shall be summarized at the beginning of the report.

3. Provide an assessment of the risks that each unregulated Significant Affiliate could pose to Duke Power based upon current business activities of those affiliates and any contemplated significant changes to those activities.

4. Provide a description of Duke Power's and each Significant Affiliate's actual capital structure. In addition, describe Duke Energy Corporation's and Duke Power's goals for Duke Power's capital structure and plans for achieving such goals.

5. Provide a complete description of all protective measures (other than those provided for by the Regulatory Conditions adopted in Docket No. E-7, Sub 795) in effect between Duke Power and any of its Affiliates and a description of how each measure operates. This should include, but not be limited to, mitigation of Duke Power's exposure in the event of a bankruptcy proceeding involving any affiliate(s).

6. Provide a list of corporate officers and other key personnel that are shared between Duke Power and any Affiliate, along with a description of each person's position(s) with, and duties and responsibilities to each entity.

7. Provide a calculation of Duke Energy Corporation's total market capitalization as of December 31 of the preceding year for common equity, preferred stock, and debt.

53. The cost of capital conditions included herein shall also apply to Duke Power's determination of its maximum allowable AFUDC rate, the rate of return applied to any of Duke Power's deferral accounts and regulatory assets and liabilities that accrue a return, and any other component of Duke Power's cost of service impacted by the cost of debt.

53a. Duke Power shall carry forward to its post-merger balance sheet, among other things, the balances, without adjustment(s), in all accounts of the following nature: regulatory liability; deferred credit, including deferred income tax; reserve; valuation; and over-accrued liability accounts, if any, applicable and/or reasonably attributable to Duke Energy's regulated electric utility operations which existed prior to consummation of the merger. Further, Duke Energy shall promptly, where appropriate, distribute to Duke Power any and all payments, refunds, dividends, other distributions, etc., received by Duke Energy subsequent to the merger that have arisen from and/or are attributable to payments, distributions, etc., having been made by its regulated electric utility operations prior to the merger, including such funds received as a result of retrospective and/or other insurance plans.

F. FUTURE PROPOSED MERGERS

54. For all proposed mergers, acquisitions, or other business combinations involving Duke Energy Corporation, Duke Power, other Affiliates, or the Nonpublic Utility Operations, the following conditions shall apply:

(a) For any proposed merger, acquisition, or other business combination by or affecting Duke Power, Duke Power shall file an application for approval pursuant to G.S. 62-111(a) at least 180 days before the proposed closing date for such merger, acquisition, or other business combination.

(b) For any proposed merger, acquisition, or other business combination that is believed not to affect Duke Power but which involves Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations and which has a transaction value exceeding $1 billion:

(i) Advance notification shall be filed with the Commission at least 90 days prior to the proposed closing date for such proposed merger, acquisition or other business combination. The advance notification is intended to provide the Commission an opportunity to determine whether the proposed merger, acquisition, or other business combination is reasonably likely to affect Duke Power so as to require approval pursuant to G.S. 62-111(a). The notification shall contain sufficient information to enable the Commission to make such a determination. If the Commission determines that such

approval is required, the 180-day advance filing requirement in subsection (a), above, shall not apply.

(ii) Any interested party may file comments within 45 days of the filing of the advance notification.

(iii) If timely comments are filed, the Public Staff shall place the matter on a Commission Staff Conference agenda as soon as possible, but in no event later than 15 days after the comments are filed, and shall recommend that the Commission issue an order deciding how to proceed. If the Commission determines that the merger, acquisition, or other business combination requires approval pursuant to G.S. 62-111(a), the Commission shall issue an order requiring the filing of an application, and no closing can occur until and unless the Commission approves the proposed merger, acquisition, or business combination. If the Commission determines that the merger, acquisition, or other business combination does not require approval pursuant to G.S. 62-111(a), the Commission shall issue an order so ruling. At the end of the notice period, if no order has been issued, Duke Energy Corporation, any other Affiliate, or the Nonpublic Utility Operation may proceed with the merger, acquisition, or other business combination but shall be subject to any fully-adjudicated Commission order on the matter.

(iv) The advance notice provisions of Regulatory Condition No. 59(b) do not apply to any of the filings made pursuant to this Condition.

G. STRUCTURE/ORGANIZATION

55. Duke Power shall file notice with the Commission 30 days prior to the initial transfer or any subsequent transfer of any services, functions, departments, employees, rights, obligations, assets, or liabilities from Duke Power to Duke Energy Shared Services, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation that potentially would have a significant effect on Duke Power's public utility operations. The advance notice provisions of Regulatory Condition No. 59(b) apply to this Condition.

56. The benefits, costs, and associated risks of the Merger and the operation of Duke Power under a holding company structure shall continue to be subject to Commission review. To the extent the Commission has authority under North Carolina law, it may order lawful modifications to the structure or operations of Duke Energy Corporation, Duke Energy Shared Services, another Affiliate, or a Nonpublic Utility Operation, and to take whatever action the Commission deems necessary to protect Duke Power's North Carolina retail customers, including, but not limited to, modifications necessary to address changes in the electric industry.

57. Duke Power shall meet and consult with, and provide requested relevant data to, the Public Staff, at least semiannually through 2010, unless there is agreement

between Duke Power and the Public Staff that no meeting is necessary, regarding plans for significant changes in Duke Power's or Duke Energy Corporation's organization, structure (including RTO developments), and activities; the expected or potential impact of such changes on Duke Power's retail rates, operations and service; and proposals for assuring that such plans do not adversely affect Duke Power's North Carolina retail electric customers. To the extent that proposed significant changes are planned for any Affiliate's or Nonpublic Utility Operation's organization, structure, or activities, then Duke Power's plans and proposals for assuring that those plans do not adversely affect its customers must be included in these meetings. Duke Power or the Public Staff may initiate meetings more frequently if significant events or other changes require. Duke Power shall inform the Public Staff promptly of any such events and changes.

58. Duke Power shall provide to the Public Staff, 30 days prior to finalization, the Tax Sharing Agreement, any plans to consolidate Duke Energy Corporation's and Cinergy Corp.'s employee benefit plans, and any other similar agreements and plans.

H. PROCEDURES

59. Except to the extent a condition, Commission order, rule, or statute specifically provides otherwise, the following procedures shall apply with respect to all filings made pursuant to these Regulatory Conditions:

(a) All filings pursuant to the Regulatory Conditions shall be made as follows:

(i) Regulatory Condition filings that do not involve advance notices shall be made in Docket No. E-7, Sub 795A.

(ii) Each filing for which the Regulatory Conditions require an advance notice shall be assigned a new, separate Sub docket. Such a filing shall state what condition and notice period are involved and whether other regulatory approvals are required and shall be in the format of a pleading, with a caption, a title, allegations of the activities to be undertaken, and a verification. Advance notices may be filed under seal if necessary.

(b) The following additional procedures shall apply to all advance notices filed pursuant to Condition Nos. 1, 3, 7(b), 10, 46, and 55:

(i) Advance notices of activities to be undertaken shall not be filed until sufficient details have been decided upon to allow for meaningful discovery as to the proposed activities.

(ii) The Chief Clerk shall distribute a copy of advance notice filings to each Commissioner and to appropriate members of the Commission Staff and Public Staff.

(iii) Duke Power shall serve such advance notices on each party to Docket No. E-7, Sub 795, that has filed a request to receive them with the Commission within 30 days of the issuance of an order approving the Merger in this docket. These parties may participate in the advance notice proceedings without petitioning to intervene. Other interested persons shall be required to follow the Commission's usual intervention procedures.

(iv) To effectuate this Regulatory Condition, Duke Power shall serve pertinent information on all parties at the time it serves the advance notice. No later than 90 days after the closing date of the Merger, Duke shall have solicited input from the parties to Docket No. E-7, Sub 795, and shall have developed and circulated to those parties lists of pertinent information to be provided in each type of advance notice proceeding. Should Duke and any party not agree as to the adequacy of these lists, they shall take the matter to the Commission for resolution. During the advance notice period, a free exchange of information is encouraged, and parties may request additional relevant information. If Duke Power objects to a discovery request, Duke Power and the requesting party shall try to resolve the matter. If the parties are unable to resolve the matter, Duke Power may file a motion for a protective order with the Commission.

(v) The Public Staff shall investigate and file a response with the Commission no later than 15 days before the notice period expires. Any other interested party may also file a response within the notice period. Duke Power may file a reply to the response(s).

(vi) The basis for any objection to the activities to be undertaken shall be stated with specificity. The objection shall allege grounds for a hearing, if such is desired.

(vii) If neither the Public Staff nor any other party files an objection to the activities, no Commission order shall be issued, and the Sub docket in which the advance notice was filed may be closed.

(viii) If the Public Staff or any other party files a timely objection to the activities to be undertaken by Duke Power, the Public Staff shall place the matter on a Commission Staff Conference agenda as soon as possible, but in no event later than two weeks after the objection is filed, and shall recommend that the Commission issue an order deciding how to proceed as to the objection. The Commission reserves the right to extend an advance notice period by order should the Commission need additional time to deliberate or investigate any issue. At the end of the notice period, if no

order, whether procedural or substantive, has been issued, Duke Power, Duke Energy Corporation, any other Affiliate, or the Nonpublic Utility Operation may proceed with the activity to be undertaken, but shall be subject to any fully-adjudicated Commission order on the matter.

(ix) If the Commission schedules a hearing on an objection, the party filing the objection shall bear the burden of proof at the hearing.

(x) The precedential effect of advance notice proceedings, like most issues of *res judicata*, will be decided on a fact-specific basis.

(xi) If some other Commission filing or Commission approval is required by statute, notice pursuant to a Regulatory Condition alone does not satisfy the statutory requirement.

(xii) Duke Power, the Public Staff, or any party may move for a waiver if exigent circumstances in a particular case justify such.

I. SERVICE QUALITY

60. Duke Power shall continue to take steps to implement and further its commitment to providing superior public utility service. To the extent the quality of service practices of Cinergy Corp. or its utility subsidiaries are found to be superior to Duke Power's, Duke Power shall make every reasonable effort to incorporate those practices into its own practices to the extent practicable. Duke Power shall work with the Public Staff (a) to continue to monitor and improve service quality, and (b) to ensure the service quality indices (e.g., SAIDI, SAIFI) are appropriate and to revise them if and when such revisions are necessary. Duke Power commits that for a period of five years following the Merger, that it shall advise the Commission at least annually on the adoption and implementation of best practices at Duke Power following the completion of the Merger between Cinergy and Duke Energy.

J. TAX

61. Under any tax sharing agreement, Duke Power shall not seek to recover from its North Carolina retail ratepayers any tax costs that exceed Duke Power's tax liability calculated as if it were a stand-alone, taxable entity for tax purposes.

62. The appropriate portion of any income tax benefits associated with Duke Energy Shared Services shall accrue to North Carolina retail operations for regulatory accounting, reporting, and ratemaking purposes.

K. NANTAHALA

63. Until otherwise ordered by the Commission, Nantahala's retail customers shall continue to receive the benefits of Nantahala's historic hydroelectric generating resources.

64. Until otherwise ordered by the Commission, Nantahala's retail customers shall continue to be charged rates based on Nantahala's own cost of service, separate from that relating to the non-Nantahala Duke Power service area, Nantahala's purchased power costs shall continue to be determined in accordance with the Duke-Nantahala Interconnection Agreement, and stand-alone Duke Power and Nantahala financial information shall continue to be provided as it has been prior to the Merger.

L. GENERAL

65. In accordance with North Carolina law, the Commission and the Public Staff shall continue to have access to the books and records of Duke Power, Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations.

66. Duke Energy Corporation shall make available in Charlotte, North Carolina, all Duke Power financial books and records.

67. All previously issued Commission orders applicable prior to the Merger to Duke Energy Corporation, to Duke Power as a division of Duke Energy Corporation, to Nantahala as an area or division of Duke Power, or to Nantahala Power and Light Company shall remain applicable to Duke Power after the Merger, unless superseded by Commission order. Within 30 days of the Commission's Order approving the Merger, Duke Energy shall file a list of the conditions imposed by the Commission in Docket Nos. E-7, Subs 557, 596, 694, and 700, as well as in other dockets, that have not been superceded by these Regulatory Conditions. The Public Staff and other parties shall have 30 days to file responses. The Commission will then determine which of the previously approved conditions remain in effect. The advance notice provisions of Regulatory Condition No. 59(b) do not apply to this Condition.

68. These Regulatory Conditions are based on the general power and authority granted to the Commission in Chapter 62 of the North Carolina General Statutes to control and supervise the public utilities of the State. The Regulatory Conditions either (a) constitute specific exercises of the Commission's authority, (b) provide mechanisms that enable the Commission to determine in advance the extent of its authority and jurisdiction over proposed activities of and transactions involving Duke Power, Duke Energy Corporation, other Affiliates or Nonpublic Utility Operations, or (c) protect the Commission's jurisdiction from federal preemption and its effects. Pursuant to these conditions, Duke Power, Duke Energy Corporation, and other Affiliates waive certain of their federal rights as

specified in these Regulatory Conditions, but do not otherwise agree that the Commission has authority other than as provided for in Chapter 62. Other than as provided for, or explicitly prohibited, in these conditions, Duke Energy Corporation, Duke Power, and its Affiliates retain the right to challenge the lawfulness of any Commission order issued pursuant to or relating to these Regulatory Conditions on the basis that such order exceeds the Commission's statutory authority under North Carolina law or the other grounds listed in G.S. 62-94(b).

69. These Regulatory Conditions are not intended to and do not purport to impose legal obligations on entities in which Duke Energy Corporation does not directly or indirectly have a controlling voting interest.

70. Duke Power, Duke Energy Corporation and its Affiliates may request a waiver of any aspect of these Regulatory Conditions if exigent circumstances in a particular case justify such by filing a request for waiver with the Commission for approval.

71. These Regulatory Conditions shall become effective only upon closing of the Merger.

72. These Regulatory Conditions are not intended to and do not purport to affect any rights of the parties to Docket No. E-7, Sub 795, with respect to participation in subsequent proceedings.

M. RATE REDUCTION, MOST FAVORED NATION CLAUSE, CONTRIBUTION TO ENERGY- AND ENVIRONMENTAL-RELATED PROGRAMS, AND RATE INVESTIGATION

73. Duke Power shall implement a one-year across-the-board decrement to rates for the benefit of its North Carolina retail customers in the amount of $117,517,000. In addition, any fuel-related savings associated with the Merger shall be flowed through to Duke Power's North Carolina retail customers pursuant to G.S. 62-133.2.

74. Following the approval of the Merger by the state commissions of Kentucky, Ohio, and South Carolina and approval of the affiliate agreements filed with the Indiana Utility Regulatory Commission in connection with the Merger, any sharing mechanisms pursuant to which Merger savings are shared with retail customers in each of these states will be reviewed to identify the utility whose electric retail customers will receive the largest percentage of the net merger savings to be achieved over the first five years after closing of the Merger allocated to that utility. If the application of that percentage to the net savings allocable to North Carolina retail would result in a greater savings sharing than that which has been allocated to North Carolina customers, then the rate reduction described in Regulatory Condition No. 73 for North Carolina retail customers will be increased

to match the application of that percentage to the net savings allocable to North Carolina retail customers. Application of this methodology is intended to ensure that North Carolina retail customers receive the benefit of a "Most Favored Nation" status with regard to the sharing of net merger savings among the states named above. In no event will the application of the methodology cause North Carolina retail customers' share of net merger savings to be reduced.

75. Duke Power shall, as a condition to approval of the Merger, contribute $12,000,000 to various energy- and environmental-related and economic- and educationally-beneficial programs, said funds to be distributed as follows: $6,000,000 to Duke Power's Share the Warmth, Cooling Assistance, and Fan-Heat Relief programs; $2,000,000 for conservation and energy efficiency programs (to be submitted to the Commission for approval); $2,000,000 to the Community College Grant Fund; and $2,000,000 to NC GreenPower. These contributions shall be made by Duke Power on or before June 30, 2006. Such contributions shall not be charged to Duke Power's regulated utility operations, but shall be borne by the Company's shareholders.

76. As a condition to approval of the Merger, the North Carolina Utilities Commission shall in 2007, initiate an investigation pursuant to G.S. 62-130(d), 62-133, and 62-136(a) to determine whether Duke Power's existing rates and charges are unjust and unreasonable and, as part of this investigation, shall require Duke Power to either (1) file a general rate case (including prefiled testimony and exhibits) in North Carolina pursuant to G.S. 62-137 or (2) show cause in the form of prefiled testimony and exhibits why the Company's existing rates and charges should not be found unjust and unreasonable. The test period for this proceeding shall be the twelve-month period ending December 31, 2006, with appropriate adjustments. Duke Power shall make its filing, including a Rate Case Information Report - NCUC Form E-1, not later than June 1, 2007. Any rate changes proposed by Duke Power shall be proposed to become effective on January 1, 2008. To the extent the $117,517,000 one-year rate decrement flowed through by Duke Power to its North Carolina retail customers is deferred, with plans or provisions for amortization over future periods pursuant to Regulatory Condition No. 25, no portion of such amount, including amortization thereof, will be eligible for recovery as a component of Duke Power's North Carolina retail rates set prospectively following consummation of the Merger. In particular, no allowance for same will be included in the test-year cost of service developed for purposes of the general rate case proceeding to be instituted pursuant to this Regulatory Condition; nor will any portion of such amount be recoverable from Duke Power's North Carolina retail ratepayers by means of a rate rider or otherwise. Nor will any portion of the net merger savings attributed to shareholders by Duke Energy be eligible for recovery from North Carolina retail ratepayers in base rates, rate riders, or other cost recovery mechanisms set prospectively subsequent to consummation of the Merger. This investigation shall be consolidated with the investigation and hearing the Commission is required to undertake for Duke

Power pursuant to G.S. 62-133.6(d) and (f) to review the Company's environmental compliance costs.

ATTACHMENT B

DOCKET NO. E-7, SUB 795

CODE OF CONDUCT
GOVERNING THE RELATIONSHIPS, ACTIVITIES, AND TRANSACTIONS BETWEEN AND AMONG THE PUBLIC UTILITY OPERATIONS OF DUKE POWER, DUKE ENERGY CORPORATION, THE AFFILIATES OF DUKE POWER, AND THE NONPUBLIC UTILITY OPERATIONS OF DUKE POWER

I. DEFINITIONS

For the purposes of this Code of Conduct, the terms listed below shall have the following definitions:

Affiliate: Duke Energy Corporation and any business entity, other than Duke Power, of which ten percent (10%) or more is owned or controlled, directly or indirectly, by Duke Energy Corporation. For purposes of this Code of Conduct, Duke Energy Corporation and any business entity so controlled by it are considered to be Affiliates of Duke Power.

Commission: The North Carolina Utilities Commission.

Confidential Systems Operation Information: Nonpublic information that pertains to Electric Services provided by Duke Power, including but not limited to information concerning electric generation, transmission, distribution, or sales.

Customer: Any retail electric customer of Duke Power, including those served under the Commission-approved rates for Nantahala Power and Light.

Customer Information: Non-public information or data specific to a Customer or a group of Customers, including, but not limited to, electricity consumption, load profile, billing history, or credit history that is or has been obtained or compiled by Duke Power in connection with the supplying of Electric Services to that Customer or group of Customers.

Duke Energy Corporation: The current holding company parent of Duke Power and any successor company.

Duke Energy Shared Services: Duke Energy Shared Services, LLC, a service company Affiliate that provides Shared Services to Duke Power, Duke Energy

Corporation, other Affiliates, or the Nonpublic Utility Operations of Duke Power, singly or in any combination.

Duke Power: Duke Power Company, LLC, the business entity, wholly owned by Duke Energy Corporation, that holds the franchises granted by the Commission to provide Electric Services within the North Carolina service territories of Duke Power and Nantahala Power and Light, and that engages in public utility operations, as defined in G.S. 62-3(23), within the State of North Carolina.

Electric Services: Commission-regulated electric power generation, transmission, distribution, delivery, and sales, and other related services, including, but not limited to, administration of Customer accounts and rate schedules, metering, billing, standby service, backups, and changeovers of service to other suppliers.

Fuel and Purchased Power Supply Services: All fuel for generating electric power and purchased power obtained by Duke Power from sources other than Duke Power for the purpose of providing Electric Services.

Fully Distributed Cost: All direct and indirect costs, including overheads and an appropriate cost of capital, incurred in providing goods or services to another business entity; provided, however, that (1) the return on common equity utilized in determining such cost of capital for each good and service supplied by or from Duke Power shall equal the return on common equity authorized by the Commission in Duke Power's most recent general rate case proceeding, and (2) the cost of capital for each good and service supplied to Duke Power shall not exceed the overall cost of capital authorized by the Commission in Duke Power's most recent general rate case proceeding.

Market Value: The price at which property, goods, and services would change hands in an arm's length transaction between a buyer and a seller without any compulsion to engage in a transaction, and both having reasonable knowledge of the relevant facts.

Merger: The mergers, the conversion of Duke Energy Corporation into a limited liability company, the restructuring transactions, and all other transactions contemplated by the Agreement and Plan of Merger between Duke Energy Corporation and Cinergy Corp.

Natural Gas Services: Natural gas sales and natural gas transportation, and other related services, including, but not limited to, metering and billing.

Nonpublic Utility Operations: All business operations engaged in by Duke Power involving activities (including the sales of goods or services) that are not regulated by the Commission, nor otherwise subject to public utility regulation at the state or federal level. This Code does not address whether or not this term includes joint or shared utility/non-utility operations such as a network for power line communications.

Personnel: An employee or other representative of Duke Power, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, who is involved in fulfilling the business purpose of that entity.

Regulatory Conditions: The conditions imposed by the Commission in connection with or related to the Merger.

Shared Services: The services that meet the requirements of the Regulatory Conditions approved in Docket No. E-7, Sub 795, or subsequent orders of the Commission and that the Commission has explicitly authorized Duke Power to take from Duke Energy Shared Services pursuant to a service agreement (a) filed with the Commission pursuant to G.S. 62-153(b), thus requiring acceptance and authorization by the Commission, and (b) subject to all other applicable provisions of North Carolina law, the rules and orders of the Commission, and the Regulatory Conditions, including, but not limited to, Regulatory Condition No. 20 approved in Docket No. E-7, Sub 795.

Similarly Situated: Possessing comparable characteristics, such as, with regard to Electric Services, time of use, manner of use, customer class, load factor, and relevant Standard Industrial Classification.

Utility Affiliates: The public utility operations of any Affiliate of Duke Power, including the public utility operations of PSI Energy, Inc., the public utility operations of Union Light, Heat and Power Company, and the transmission and distribution operations of The Cincinnati Gas and Electric Company.

II. GENERAL

This Code of Conduct, while not wholly inclusive or totally encompassing, establishes the minimum guidelines and rules that apply to the relationships between and among, and activities and transactions involving Duke Power and (a) Duke Energy Corporation, (b) the other Affiliates of Duke Power, or (c) Duke Power's Nonpublic Utility Operations, to the extent such relationships, activities, and transactions affect the operations or costs of utility service experienced by the public utility operations of Duke Power in its Duke Power or Nantahala Power and Light service areas. This Code of Conduct will become applicable on the date that it is approved by the Commission. This Code of Conduct is subject to such modification by the Commission as the public interest may require, including, but not limited to, changes necessitated by a change in the organizational structure of Duke Power, Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations; changes in the structure of the electric industry; or other changes that warrant modification of this Code.

Duke Power may request a waiver of any aspect of this Code of Conduct if exigent circumstances in a particular case justify such by filing a request for waiver with the Commission for approval.

III. STANDARDS OF CONDUCT

A. Independence and Information Sharing

1. Separation – Duke Power, Duke Energy Corporation, and the other Affiliates shall operate independently of each other and in physically separate locations to the maximum extent practicable. Duke Power, Duke Energy Corporation, and each of the other Affiliates shall maintain separate books and records. Each of Duke Power's Nonpublic Utility Operations shall maintain separate records from those of Duke Power's public utility operations to ensure appropriate cost allocations and any arm's-length-transaction requirements.

2. Disclosure of Customer Information:

   (a) Upon request, and subject to the restrictions and conditions contained herein, Duke Power may provide Customer Information to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation under the same terms and conditions that such information is provided to non-Affiliates.

   (b) Except as provided in Section III.A.2.(f) below, Customer Information shall not be disclosed to any person or company, without the Customer's consent, and then only to the extent specified by the Customer. Consent to disclosure of Customer Information to Affiliates or Nonpublic Utility Operations may be obtained by means of written authorization, electronic authorization or recorded verbal authorization upon providing the Customer with the information set forth in Attachment A; provided, however, that Duke Power retains such authorization for verification purposes for as long as the authorization remains in effect.

   (c) If the Customer allows or directs Duke Power to provide Customer Information to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, then Duke Power shall ask the Customer if he, she, or it would like the Customer Information to be provided to one or more non-Affiliates. If the Customer directs Duke Power to provide Customer Information to one or more non-Affiliates, the Customer Information shall be disclosed to all entities designated by the Customer contemporaneously and in the same manner.

   (d) Sections III.A.2.(a), 2.(b), and 2.(c) herein shall be permanently posted on Duke Power's website.

   (e) No Duke Power employee who is transferred to Duke Energy Corporation or another Affiliate will be permitted to copy or otherwise compile any Customer Information for use by such entity except pursuant to written permission from the Customer, as reflected by a signed Data Disclosure

Authorization. Duke Power shall not transfer any employee to Duke Energy Corporation or another Affiliate for the purpose of disclosing or providing Customer Information to such entity.

(f) Notwithstanding the prohibitions established by this Section III.A.2, Duke Power may disclose Customer Information to Duke Energy Shared Services, any other Affiliate, a Nonpublic Utility Operation or a non-affiliated third party without customer consent, but only to the extent necessary for the Affiliate, Nonpublic Utility Operation or non-affiliated third party to provide goods or services to Duke Power and upon their explicit agreement to protect the confidentiality of such Customer Information.

(g) Duke Power shall take appropriate steps to store Customer Information in such a manner as to limit access to only those persons permitted to receive it and shall require all persons with access to such information to protect its confidentiality.

(h) Duke Power shall establish guidelines for its employees and representatives to follow with regard to complying with this Section III.A.2.

3. The disclosure of Confidential Systems Operation Information of Duke Power (referred to hereinafter as "Information") shall be governed as follows:

(a) Such Information shall not be disclosed by Duke Power to an Affiliate or a Nonpublic Utility Operation unless it is disclosed to all competing non-Affiliates contemporaneously and in the same manner. Disclosure to non-Affiliates is not required when disclosure to Affiliates or Nonpublic Utility Operations meets one of the following exceptions:

(i) A state or federal regulatory agency or court having jurisdiction over the disclosure of such Information requires the disclosure;

(ii) The Information is provided to employees of Duke Energy Shared Services pursuant to a service agreement filed with the Commission pursuant to G.S. 62-153;

(iii) The Information is provided to employees of Duke Power's Utility Affiliates for the purpose of sharing best practices and otherwise improving the provision of regulated utility service;

(iv) The Information is provided to an Affiliate pursuant to an agreement filed with the Commission pursuant to G.S. 62-153, provided that the agreement specifically describes the types of Information to be disclosed;

(v) Disclosure is otherwise essential to enable Duke Power to provide Electric Services to its Customers; or

(vi) Disclosure of the Information is necessary for compliance with the Sarbanes-Oxley Act of 2002.

(b) Any Information disclosed pursuant to the exceptions in Section III.A.3.(a), above, shall be disclosed only to employees that need the information for the purposes covered by those exceptions and in as limited a manner as possible. The employees receiving such Information must be prohibited from acting as conduits to pass the Information to any Affiliate(s) and must have explicitly agreed to protect the confidentiality of such Information.

(c) For disclosures pursuant to exceptions (v) and (vi) in Section III.A.3.(a), above, Duke Power shall include in its annual affiliated transaction report required by Regulatory Condition No. 31 approved in Docket No. E-7, Sub 795, the following information:

(i) The types of Information disclosed and the name(s) of the Affiliate(s) to which it is being, or has been, disclosed;

(ii) The reasons for the disclosure; and

(iii) Whether the disclosure is intended to be a one-time occurrence or an ongoing process.

To the extent a disclosure subject to the reporting requirement is intended to be ongoing, only the initial disclosure and a description of any processes governing subsequent disclosures need to be reported.

B. Nondiscrimination

1. Duke Power employees and representatives will not unduly discriminate against non-Affiliated entities.

2. Duke Power shall not provide any preference to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, nor to any customers of such an entity, as compared to non-Affiliates or their customers, in responding to requests for Electric Services or in providing Electric Services. Moreover, neither Duke Power, Duke Energy Corporation, nor any of the other Affiliates will represent to any person or entity that Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation will receive any such preference.

3. Duke Power shall apply the provisions of its tariffs equally to Duke Energy Corporation, the other Affiliates, the Nonpublic Utility Operations, and non-Affiliates.

4. Duke Power shall process all similar requests for Electric Services in the same timely manner, whether requested on behalf of Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated entity.

5. No personnel or representatives of Duke Power, Duke Energy Corporation, or another Affiliate shall indicate, represent, or otherwise give the appearance to another party that Duke Energy Corporation or another Affiliate speaks on behalf of Duke Power; provided however, that this prohibition does not apply to

employees of Duke Energy Shared Services providing Shared Services or to employees of another Affiliate to the extent explicitly provided for in an affiliate agreement that has been accepted by the Commission. In addition, no personnel or representatives of a Nonpublic Utility Operation shall indicate, represent, or otherwise give the appearance to another party that they speak on behalf of Duke Power's regulated public utility operations.

6. No personnel or representatives of Duke Power, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation shall indicate, represent, or otherwise give the appearance to another party that any advantage to that party with regard to Electric Services exists as the result of that party dealing with Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, as compared with a non-Affiliate.

7. Duke Power shall not condition or otherwise tie the provision or terms of any Electric Services to the purchasing of any goods or services from, or the engagement in business of any kind with, Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation.

8. When any employee or representative of Duke Power receives a request for information from or provides information to a Customer about goods or services available from Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation, the employee or representative must advise the Customer that such goods or services may also be available from non-Affiliated suppliers.

9. Disclosure of Customer Information to Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated entity shall be governed by Section III.A.2 of this Code of Conduct.

C. Marketing

1. The public utility operations of Duke Power may engage in joint sales, joint sales calls, joint proposals, or joint advertising (a joint marketing arrangement) with its Utility Affiliates and with its Nonpublic Utility Operations, subject to compliance with other provisions of this Code of Conduct and any conditions or restrictions that the Commission may hereafter establish. Duke Power may not otherwise engage in such joint activities with Affiliates without making such opportunities available to comparable third parties.

2. Neither Duke Energy Corporation nor any of the other Affiliates may use Duke Power's name or logo(s) in any communications unless a disclaimer is included that states the following:

   (a) "[Duke Energy Corporation/Affiliate] is not the same company as Duke Power, and [Duke Energy Corporation/Affiliate] has separate management and separate employees";

(b) "[Duke Energy Corporation/Affiliate] is not regulated by the North Carolina Utilities Commission or in any way sanctioned by the Commission";

(c) "Purchasers of products or services from [Duke Energy Corporation/Affiliate] will receive no preference or special treatment from Duke Power"; and

(d) "A customer does not have to buy products or services from [Duke Energy Corporation/Affiliate] in order to continue to receive the same safe and reliable electric service from Duke Power."

Nonpublic Utility Operations may not use Duke Power's name or logo(s) in any communications unless a disclaimer is included that states the following:

(a) "[Nonpublic Utility Operation] is not part of the regulated services offered by Duke Power and is not in any way sanctioned by the North Carolina Utilities Commission";

(b) "Purchasers of products or services from [Nonpublic Utility Operation] will receive no preference or special treatment from Duke Power"; and

(c) "A customer does not have to buy products or services from [Nonpublic Utility Operation] in order to continue to receive the same safe and reliable electric service from Duke Power."

The required disclaimer must be sized and displayed in a way that is commensurate with the name and logo so that the disclaimer is at least the larger of one-half the size of the type that first displays the name and logo or the predominant type used in the communication.

D. Transfers of Goods and Services, Transfer Pricing, and Cost Allocation

1. Cross-subsidies involving Duke Power, on the one hand, and Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations, on the other, are prohibited.

2. All costs incurred by Duke Power personnel or representatives for or on behalf of Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations shall be charged to the entity responsible for the costs.

3. As a general guideline, with regard to the transfer prices charged for goods and services, including the use or transfer of personnel, exchanged between and among Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations, to the extent such prices affect Duke Power's operations or costs of utility service, the following conditions shall apply:

(a) Except as otherwise provided for in this Section III.D, for untariffed goods and services provided by Duke Power to Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation, the transfer price paid to Duke Power shall be set at the higher of Market Value or Duke Power's Fully Distributed Cost.

(b) Except as otherwise provided for in this Section III.D, for goods and services provided, directly or indirectly, by Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation to Duke Power, the transfer price(s) charged by Duke Energy Corporation, the Affiliate, and the Nonpublic Utility Operation to Duke Power shall be set at the lower of Market Value or Duke Energy Corporation's, the Affiliate's, or the Nonpublic Utility Operation's Fully Distributed Cost(s). If Duke Power does not engage in competitive solicitation and instead obtains the goods or services from Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation, Duke Power shall implement adequate processes to comply with this condition and ensure that in each case Duke Power's Customers receive service at the lowest reasonable cost.

(c) Tariffed goods and services provided by Duke Power to Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation shall be provided at the same prices and terms that are made available to Similarly Situated Customers under the applicable tariff.

(d) Subject to and in compliance with all conditions placed upon Duke Power by the Commission, including the Regulatory Conditions imposed in Docket No. E-7, Sub 795, and subject to a case-by-case acceptance by the Commission of an affiliate agreement, untariffed non-power, non-generation, or non-fuel goods and services provided by Duke Power to its Utility Affiliates or by the Utility Affiliates to Duke Power, which for a single item or a single transaction amount to $100,000 or less, shall be transferred at the supplier's Fully Distributed Cost, if cost-beneficial to the recipient. Fully Distributed Cost pricing for items/transactions pursuant to this paragraph shall be limited to an aggregate annual amount of $7,500,000. Transfers above either the single item/transaction limit or the aggregate annual limit shall be priced according to Sections III.D.3.(a) and III.D.3.(b) of this Code of Conduct.

4. To the extent that Duke Power, Duke Energy Corporation, other Affiliates, or the Nonpublic Utility Operations receive Shared Services from Duke Energy Shared Services, these Shared Services may be jointly provided to Duke Power, Duke Energy Corporation, the Affiliates, or the Nonpublic Utility Operations on a fully distributed cost basis, provided that the taking of such Shared Services by Duke Power is cost beneficial on a service-by-service (e.g., accounting management, human resources management, legal services, tax administration, public affairs) basis to Duke Power and is undertaken pursuant to the provisions of Regulatory

Condition No. 18 approved by the Commission in Docket E-7, Sub 795. Charges for such Shared Services shall be allocated in accordance with the cost allocation manual(s) filed with the Commission pursuant to Regulatory Condition No. 20, subject to any revisions or other adjustments that may be found appropriate by the Commission on an ongoing basis.

5. Duke Power and its Affiliates may capture economies-of-scale in joint purchases of goods and services (excluding the purchase of natural gas, coal, and electricity or ancillary services intended for resale) if such joint purchases result in cost savings to Duke Power's Customers. Duke Power, PSI Energy, Inc., and Union Light, Heat and Power Company may capture economies-of-scale in joint purchases of coal, if such joint purchases result in cost savings to Duke Power's Customers. Notwithstanding the foregoing, if any of the coal jointly purchased by Duke Power, PSI Energy, Inc., and Union Light, Heat and Power Company is transferred to or utilized by another Affiliate within 12 months of the joint purchase, Duke Power will file a notification of such with the Commission.

   All joint purchases entered into pursuant to this section shall be priced in a manner that permits clear identification of each participant's portion of the purchases and shall be reported in Duke Power's affiliated transaction reports filed with the Commission.

6. All permitted transactions between Duke Power, Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations shall be recorded and accounted for in accordance with the cost allocation manuals required to be filed with the Commission pursuant to Regulatory Condition No. 20 and with affiliate agreements accepted by the Commission or otherwise processed in accordance with North Carolina law, the rules and orders of the Commission, and the Regulatory Conditions.

7. Costs that Duke Power incurs in assembling, compiling, preparing, or furnishing requested Customer Information or Confidential Systems Operation Information for or to Duke Energy Corporation, other Affiliates, Nonpublic Utility Operations, or non-Affiliates shall be recovered from the requesting party pursuant to Section III.D.3 of this Code of Conduct.

8. Any technology or trade secrets developed, obtained, or held by Duke Power in the conduct of regulated operations will not be transferred to Duke Energy Corporation, another Affiliate, or a Nonpublic Utility Operation without just compensation and 60-days prior notification to the Commission; provided however, that Duke Power may request a waiver of this requirement from the Commission if circumstances warrant. In no case, however, shall the notice period requested be less than 20 business days.

9. Duke Power shall receive compensation from Duke Energy Corporation, other Affiliates, and the Nonpublic Utility Operations for intangible benefits, if appropriate.

E. Regulatory Oversight

1. The State's existing requirements regarding affiliate transactions, as set forth in G.S. 62-153, shall continue to apply to all transactions between Duke Power, Duke Energy Corporation, and the other Affiliates.

2. The books and records of Duke Power, Duke Energy Corporation, the other Affiliates, and the Nonpublic Utility Operations shall be open for examination by the Commission, its staff, and the Public Staff as provided in G.S. 62-34, 62-37, and 62-51.

3. To the extent North Carolina law, the orders and rules of the Commission, and the Regulatory Conditions permit Duke Energy Corporation, an Affiliate, or a Nonpublic Utility Operation to supply Duke Power with Natural Gas Services or other Fuel and Purchased Power Supply Services used by Duke Power to supply electricity, and to the extent such Natural Gas Services or other Fuel and Purchased Power Supply Services are so supplied, Duke Power shall demonstrate in its annual fuel adjustment clause proceeding that each such acquisition was prudent and the price was reasonable.

F. Utility Billing Format

1. To the extent any bill issued by Duke Power, Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated third party includes any charges to Customers for Electric Services and non-Electric Services from Duke Energy Corporation, another Affiliate, a Nonpublic Utility Operation, or a non-Affiliated third party, the charges for the Electric Services shall be separated from the charges for any other services included on the bill. Each such bill shall contain language stating that the Customer's Electric Services will not be terminated for failure to pay for any other services billed.

G. Complaint Procedure

1. Duke Power shall establish complaint procedures to resolve potential complaints that arise due to the relationship of Duke Power with Duke Energy Corporation, its other Affiliates, and its Nonpublic Utility Operations. The complaint procedures shall provide for the following:

   (a) Verbal and written complaints shall be referred to a designated representative of Duke Power.

(b) The designated representative shall provide written notification to the complainant within 15 days that the complaint has been received.

(c) Duke Power shall investigate the complaint and communicate the results or status of the investigation to the complainant within 60 days of receiving the complaint.

(d) Duke Power shall maintain a log of complaints and related records and permit inspection of documents (other than those protected by the attorney/client privilege) by the Commission, its staff, or the Public Staff.

2. Notwithstanding the provisions of Section III.G.1, any complaints received through Duke Energy Corporation's EthicsLine (or successor), which is a confidential mechanism available to the employees of the Duke Energy Corporation holding company system, shall be handled in accordance with procedures established for EthicsLine.

3. These complaint procedures do not affect a complainant's right to file a formal complaint or otherwise address questions to the Commission.

CODE OF CONDUCT

ATTACHMENT A

DUKE POWER CUSTOMER INFORMATION DISCLOSURE AUTHORIZATION

For Disclosure to Affiliates:

Duke Power's Affiliates offer products and services that are separate from the regulated services provided by Duke Power. These services are not regulated by the North Carolina Utilities Commission or the Public Service Commission of South Carolina. These products and services may be available from other competitive sources.

The Customer authorizes Duke Power to provide any data associated with the Customer account(s) residing in any Duke Power files, systems or databases **[or specify specific types of data]** to the following Affiliate(s) _____ _____. Duke Power will provide this data on a non-discriminatory basis to any other person or entity upon the Customer's authorization.

For Disclosure to Nonpublic Utility Operations:

Duke Power offers optional, market-based products and services that are separate from the regulated services provided by Duke Power. These services are not regulated by the North Carolina Utilities Commission or the Public Service Commission of South Carolina. These products and services may be available from other competitive sources.

The Customer authorizes Duke Power to use any data associated with the Customer account(s) residing in any Duke Power files, systems or databases **[or specify types of data]** for the purpose of offering and providing energy-related products or services to the Customer. Duke Power will provide this data on a non-discriminatory basis to any other person or entity upon the Customer's authorization.